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Trade, Labor and EU Law Perspectives

An Indian Perspective on the Unrelenting Law Prohibiting Export Subsidies: A Disadvantage to Developing Countries

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In a recent US WTO challenge, the Panel decided that certain Indian export incentive schemes were prohibited export subsidies. The Panel Report demands that these schemes be phased out, despite the fact that it will adversely affect exporters and India's large current account deficit.[1]

Developing nations, like India, resort to export subsidies to stimulate industrial exports, resolve balance of payment problems, and diversify the economy. Export subsidies may be desirable if they create value through incentives to producers. Such incentives include duty free import entitlements, export grants to production, export duties only on raw materials (and not on the processed and manufactured goods they are used in), and others.[2]

Developing economies often rely on indirect forms of support because export subsidies are internationally frowned upon. They are condemned because they reduce import prices and consequently demand, inflicting harm on domestic production.[3] A few trade theorists believe that arguments against export subsidisation ignore existing externalities and imperfect competition that drive the economic forces.[4] If developing countries need export subsidies as a tool to drive development, is there room in the WTO regime – in particular the Agreement on Subsidies and Countervailing Measures (ASCM) – to accommodate them?

The issues that arose in India – Export Related Measures highlight a few shortcomings in the ASCM:

1. The graduation of Annex VII(b) countries implies that they have attained economic strength equal to that of other developing countries under Article 27.2(b). In keeping with the objective of fostering economic development, India as an Annex VII country, is entitled to an eight-year relaxation period (just as other developing countries were accorded in 1995) to phase out export subsidies. Therefore, a literal interpretation of Article 27.2(b) adopted by the Panel, would render Annex VII(b) superfluous and inconsistent with the object and purpose of the ASCM,[5] and would also lead to a result, contrary to the obligations under the Vienna Convention on the Law of Treaties, that is manifestly absurd and unreasonable.[6]
2. The United States did not complain any trade distortive attributes of the Indian subsidies, unlike its approach in addressing the EC's complaint regarding the US subsidies to aircraft producers, in which it identified adverse effects in the form of threat of significant price suppression.[7] Although a complaining member need not address trade distortions, the WTO should discourage this practice.[8]
3. A measure is not deemed a subsidy if it qualifies as a remission or drawback of import charges,

not exceeding the actual charges, on imported inputs that are “consumed” in the production of the exported product.[9] The US argument that the imported inputs were unconsumed delivered a major blow to India’s schemes, leading the Panel to find the conditions (expressed in footnotes 1 and 61) required to be drawback or remission unmet. India argued that the capital goods aspect (a significant input in the export schemes) are an indispensable part of the production process because they are effectively consumed even if not physically incorporated into the exported item. A few commentators,[10] and the Panel in *EU – PET (Pakistan)*, have found that the inputs ‘used’ in the creation of the product subsequently exported shall not be subsidies,[11] implying that the physical incorporation of inputs is not mandatory. The IMF also supports the proposition that capital goods are inputs because they contribute to the final cost of the product just like other intermediate inputs, and are ‘used-up’ in the production process. [12] This issue is therefore ripe to be addressed: the WTO must provide further clarity on the definition of ‘consumption’ to avoid misinterpretations of the definition of ‘inputs.’

Developing countries need to maintain what should be treated as harmless export supportive policies to develop their economy. One example is a policy supporting production that results in an increase in exports, a policy that is considered but should not be export subsidisation. The dilemma cries out for a distinction between export promotion and export subsidy. An angle of attack is to consider the concept of ‘export contingency.’[13] To rely on the test of contingency dooms measures involving legitimate subsidies that only incidentally relate to exports.[14] ‘Export contingency’ is an indivisible component of an export subsidy, and an attempt to remove export contingency would be equal to vanquishing the subsidy itself.[15] Undoubtedly, the Indian export incentive schemes rely on export but that alone is not enough; a legitimate subsidy or an incentive/support that is inevitably connected to export should be permitted, unless it adversely affects international trade. This reform of the ASCM is sorely needed by developing nations to balance trade rules and development goals.

[1] Panel Report, *India – Export Related Measures*, WT/DS541/R, 31 October 2019. Modern Diplomacy, *India’s Foreign Exchange Reserves* (16 April 2020) available at <https://modern diplomacy.eu/2020/04/16/indias-foreign-exchange-reserves> last accessed on 3 May 2020.

[2] Luc De Wulf, *Fiscal Incentives for Industrial Exports in Developing Countries* 31(1) National Tax Journal 45, 45 (1978).

[3] Jan Michalek, *Subsidies in the Context of World Trade Organization* 43(1) Dans *Reflets Et Perspectives De La Vie Économique* 25, 31 (2004).

[4] Warren Schwartz and Eugene Harper Jr., *Regulation of Subsidies Affecting International Trade* 70 Michigan Law Review 831,833-834 (1972).

[5] Panel Report, *India – Export Related Measures*, WT/DS541/R, 31 October 2019, paragraph 7.46.

[6] Vienna Convention on Law of Treaties, Article 32(b).

[7] Appellate Body Report, *United States – Measures Affecting Trade in Large Civil Aircraft* (Second Complaint)

- [8] Panel Report, Canada–Measures Affecting the Export of Civilian Aircraft (“Canada–Aircraft”), WT/DS70/R, adopted 20 August 1999, paragraph 5.137.
- [9] Panel Report, EU – PET (Pakistan), WT/DS486/11, 25 May 2018, paragraph 7.36
- [10] Frank Biermann and Rainer Brohm, *Implementing the Kyoto Protocol without the USA: the strategic role of energy tax adjustments at the border*, 4 *Climate Policy* 295, 289 (2005); *See also* Hoerner and Muller, *Compatibility Of Offsets With International Trade Rules*, 235 (Ökologisch orientierte Steuerreformen: Die fiskal- und außenwirtschaftspolitischen Aspekte. Haupt, Bern 1997);
- [11] EU – PET (Pakistan) (n 19) paragraph 7.37
- [12] Export Financing and Duty Drawbacks, Note on Issues Raised by Developing Countries in the Doha Round, WT/TF/COH/15, 14 February 2003, 10, paragraph 40.
- [13] Agreement on Subsidies and Countervailing Measures, Article 3.1.
- [14] Andrew Green and Michael Trebilcock, *Enforcing WTO Obligations: What Can We Learn From Export Subsidies* 10(3) *Journal of International Economic Law* 653, 665 (2007).
- [15] Tsai-yu-Lin, *Remedies for Export Subsidies in the Context Of Article 4 Of The SCM Agreement: Rethinking Some Persistent Issues* 3(1) *Asian Journal of WTO and International Health Law and Policy* 21, 30 (2008).

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