Regulating for Globalization

Trade, Labor and EU Law Perspectives

Developing Countries and Export Subsidies: WTO Panel's report in DS541

James J. Nedumpara (Centre for Trade and Investment Law, New Delhi) and Sparsha Janardhan (Senior Research Fellow, Centre for Trade and Investment Law, New Delhi) · Friday, November 15th, 2019

Introduction

The recent WTO Panel report in *India-Export Related Measures* (DS541) has significant implications for various export promotion schemes implemented by WTO Members. In this case, the United States challenged certain schemes implemented by India under the Foreign Trade Policy. These included the Export Oriented Unit (EOU) Scheme and Sector-Specific Schemes, Merchandise Exports from India (MEIS) Scheme and Export Promotion Capital Goods (EPCG) Scheme. In addition, the United States also challenged some of the benefits under the Duty-Free Imports for Exporters Scheme (DFIS) and the Special Economic Zones (SEZ) Act. In this post, we discuss the two fundamental issues that formed the crux of the dispute.

Findings of the Panel

Under the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement), Members are prohibited from granting or maintaining export subsidies, except in limited circumstances. Export subsidies are subsidies that are contingent upon export performance, i.e., the granting of a subsidy is legally or in fact tied to actual or anticipated exportation. The SCM Agreement provides for an accelerated dispute procedure in the case of export subsidies when compared to normal dispute settlement timelines.

Part VIII of the SCM Agreement provides certain flexibilities in relation to export subsidies provided by developing countries. Within Part VIII, a group of Least-Developed Countries and low-income developing countries, whose GNP per capita is less than $1000 per annum can maintain such subsidies, pursuant to Annex VII of the SCM Agreement. Once these developing countries exceed the per capita GNP threshold, they will have to phase-out their export subsidies. The key issue in this dispute was whether these countries will have to phase-out their export subsidies immediately upon graduation or if they will get an eight-year phase-out period. The language of the phase-out period is less than clear. For instance, Annex VII countries that may achieve export competitiveness in a product are entitled to an eight-year transition period to phase-out the export subsidies on such product under Article 27.5 of the SCM Agreement.

India argued that, on graduation from Annex VII, it should be allowed an eight-year phase-out period starting from 2017, so as to arrive at a coherent meaning of these provisions. The Panel, surprisingly, did not agree with India's argument. The Panel resorted to principles of treaty interpretation in arriving at its finding but did not look at the negotiating history in this process. According to the Panel, the language of Article 27 did not provide an additional flexibility to India as the content of the provision was clear, i.e., a period of eight years from the date of entry into force of the WTO Agreement. The consequence of this finding is that India is no longer permitted to provide export subsidies for industrial goods.

Regarding the specific challenged schemes, India's argument was that these schemes were conceived and implemented under the 'destination principle' which is well recognized under the WTO. Under the destination principle, WTO Members are allowed to provide an exemption or remission of duties and taxes of an exported product in amounts not in excess of those which have been accrued. Based on this, India contended that the challenged schemes, apart from the SEZ scheme, were not "subsidies" pursuant to footnote 1 of the SCM Agreement.

A measure under footnote 1 is subject to certain other conditions in the SCM Agreement, which describe the activities in the export process and the applicable duties to which such exemption or remission may apply. For instance, item (g) of Annex I of the SCM Agreement, allows a country to provide for exemption or remission of indirect taxes in respect of the production and distribution of the exported product. Further, such a measure would also have to ensure that there is no excess remission for which Annex II of the SCM Agreement provides guidance. India's argument was that the excess remission would have to be identified in individual circumstances in order to characterize the alleged benefits as subsidies. The Panel however proceeded to examine India's schemes against the legal standard explained above and made the following observations:

- *EOU Scheme*: The Panel was not convinced that capital goods and certain other goods, which may be imported duty free can be classified as "inputs consumed in the production of the exported process," which was one of the requirements India had to satisfy.
- *EPCG Scheme*: Similar to the findings in the EOU Scheme, the Panel found that capital goods are not "inputs consumed in the production of the exported product" and thus fell outside the ambit of footnote 1 of the SCM Agreement.
- *MEIS Scheme*: According to the Panel, the 'duty credit scrips' provided by India was a direct transfer of funds and not in the nature of remission or refund of indirect taxes for export of products, thus amounting to a 'subsidy'.
- *DFIS Scheme*: The Panel distinguished between the nature of goods falling under different line items and the applicable Conditions in the Scheme and identified the link between the duties exempted and the production of exported products. Consequently, the Panel ruled partially in favour of India by stating that certain Conditions in the DFIS Scheme fulfilled the requirements of footnote 1.
- *SEZ Scheme*: The Panel observed that the exemption from customs duty, IGST and deduction from corporate income tax amounted to India forgoing revenue that was otherwise due, resulting in it being a financial contribution under the SCM Agreement.

In addition to the above findings, the Panel held that these Schemes were subsidies contingent on export performance, resulting in an inconsistency with Article 3 of the SCM Agreement. The Panel has recommended the withdrawal of these subsidies within a 90-180 day period, depending on whether it requires an amendment to the Foreign Trade Policy or the relevant legislations.

Conclusion

This was a major dispute for India involving certain key export oriented schemes. The decision comes at a time when special and differential treatment for developing countries at the WTO is being unfairly targeted. This is the first dispute to address the issue of graduation of developing countries under the SCM Agreement and is of great importance for other developing countries facing graduation in the future.

To make sure you do not miss out on regular updates from the Kluwer Regulating for Globalization Blog, please subscribe here.

This entry was posted on Friday, November 15th, 2019 at 3:00 pm and is filed under India, Trade Law, USA, WTO
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.