EXPORT PROMOTION AND THE WTO

A BRIEF GUIDE

International Trade Centre

EXPORT IMPACT FOR GOOD

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Study looking at export promotion schemes which are consistent with international rules on subsidies, and are most frequently used by developing countries – examines the rules contained in the WTO Agreement on Subsidies and Countervailing Measures (ASCM), covering manufactured goods; highlights rules in the WTO Agreement on Agriculture (AoA) on subsidies, covering certain primary or agricultural products; outlines tools such as duty drawback, export credits and export guarantees, which are at the disposal of countries wishing to promote exports; presents and analyses examples of schemes in place in selected countries in Asia, Africa and Latin America.

Descriptors: **Export Promotion, Subsidies, Agreement on Subsidies and Countervailing Measures, Agreement on Agriculture, WTO, Case Studies.**

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Foreword

Export promotion schemes can play an important part in the development strategies of countries, especially of developing countries that seek to make exports an engine for economic growth. Membership in the World Trade Organization (WTO) is a critical tool for participation in the multilateral trading system. It requires opening domestic markets to international trade – where exceptions and flexibilities have not been not negotiated – but also provides huge market opportunities for domestic producers.

To design successful export development strategies, it is fundamental that governments and private exporters have a clear understanding of the applicable WTO rules and their implications for their specific individual characteristics.

The rules are complex. This book highlights the relevant rules contained in the WTO Agreement on Subsidies and Countervailing Measures (ASCM), covering manufactured goods, and the WTO Agreement on Agriculture (AoA).

Through it, ITC aims to respond to questions which governments and private exporters frequently confront when designing and implementing export promotion schemes. What is an export subsidy? What kinds of financial support can developing country governments provide to companies and businesses? Special dispensations have been negotiated for developing and least developed countries. Under which circumstances can they be used?

The study outlines the various tools, such as duty drawback, export credits and export guarantees, which are at the disposal of countries wishing to promote exports. To illustrate this, experiences from developing and least developed countries are analyzed to serve as case studies for others.

These examples should not be interpreted as an authoritative judgement on whether the schemes are in compliance with WTO rules. This timely book makes an effort to peel back some of the complexities, and helps developing countries identify policies and approaches that may assist them in their efforts to grow their economies through exports.

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Unless otherwise specified, all references to dollars ($) are to United States dollars, and all references to tons are to metric tons.

The following abbreviations are used:

ADA	Anti-Dumping Agreement
AoA	Agreement on Agriculture
ASCM	Agreement on Subsidies and Countervailing Measures
GATT	General Agreement on Tariffs and Trade
ITC	International Trade Centre
LDC	Least developed country
WTO	World Trade Organization

List of cases cited

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Brazil – *Aircraft* (Article 21.5 – Canada II)	Appellate Body Report, *Brazil – Export Financing Programme for Aircraft, Second Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW/2, adopted 23 August 2001
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Introduction

Starting with the General Agreement on Tariffs and Trade (GATT) in 1947, successive rounds of multilateral negotiations have brought increasing trade liberalization, mainly by lowering tariff levels around the world. Domestic industries that were previously protected by high tariffs face growing international competition and the struggle for foreign markets has intensified. In an increasingly competitive world, it is crucial, particularly for developing countries, to know what types of instruments to encourage exports are available, or might be available, under existing international trade rules.

Since subsidies can distort international free trade, they are regulated by World Trade Organization (WTO) agreements and are only permitted under very limited and strict conditions. Rules on subsidies were first laid down in the GATT and then further developed for industrial goods in the Agreement on Subsidies and Countervailing Measures ("ASCM") and for agricultural products in the Agreement on Agriculture ("AoA"). Both agreements, which are part of treaties setting up the WTO in 1995, provide some specific rules applicable only to developing countries. The latter are known as special and differential treatment.

The purpose of this book is to examine the export promotion schemes that are consistent with international rules on subsidies, and which developing countries use or may use. We will examine the rules included in the ASCM on subsidies for non-primary or industrial products, and those in the AoA covering certain primary or agricultural products. We will then look at the types of export promotion schemes that are most frequently used, and analyze concrete examples of schemes in place in certain developing countries. ***Nothing in this book should be construed as an authoritative interpretation of the WTO Agreements.***

Chapter 1

The WTO Agreement on Subsidies and Countervailing Measures

Coverage and main rules

The ASCM applies only to *subsidies* (as defined in Article 1 of the ASCM) that are *specific* (as defined in Article 2 of the ASCM). Programmes granting incentives to domestic producers which do not meet one or more of the elements included in those two provisions are *not* subject to the disciplines of the ASCM. Hence, WTO members can grant those subsidies. By contrast, programmes meeting the elements included in Articles 1 and 2 are subject to the disciplines of the ASCM, which will be described below.

Definition of a subsidy

Under Article 1 of the ASCM, a subsidy exists if the following two conditions are *both* fulfilled: A government (or a public body within the territory of a WTO member) is providing either a financial contribution or income support, and this confers a benefit on a specific recipient.

A financial contribution or income support by a government

The notion of 'government' must not be interpreted narrowly. Indeed, this notion covers not only the government and government agencies, but also any body that is directly or indirectly controlled by the state, such as the central bank or state-owned enterprises.

The notion of 'financial contribution' is broad. In fact, there are a large number of instances in which a financial contribution is granted by a government:

- If the government or any public body gives a grant or provides a loan guarantee to a private company, then there is a financial contribution.
- There is a financial contribution if a government revenue otherwise due is foregone or not collected. A typical instance of revenue foregone occurs when a company benefits from exemption from corporate income tax, or from tax credits.
- There is also a financial contribution when a government provides goods or services other than general infrastructure, or purchases goods.

Financial contributions may be indirect. If a government or any public body entrusts or directs a private party to carry out one or more of the functions that would give rise to a financial contribution if it had been carried out by the government or any public body itself, then this, too, amounts to a financial contribution under ASCM rules. For example, the government may ask a *private* bank to provide a loan at a preferential rate to a private steel producer.

In order to constitute an *indirect* financial contribution, the action of the government must contain a notion of delegation (in the case of entrustment) or command (in the case of direction) that necessarily carry with them the following three elements: (i) an explicit and affirmative action, be it delegation or command; (ii) addressed to a particular party; and (iii) the object of which action is a particular task or duty.[1]

Box 1.1 Example of a government action that is not an indirect financial contribution

Let us assume that a government imposes extremely high tariffs on imports of coal. It follows that the price of imported coal in the domestic market would increase and the supply thereof would perhaps decrease. Domestic downstream users of coal, such as steel producers, would probably find it more economical to purchase coal from domestic producers, who would thus see an increase in their sales volumes and would be likely to secure better terms of sale as well. A government action – the imposition of high tariffs on coal – would have benefited producers of coal by causing downstream users of coal to make a greater proportion of purchases from domestic producers vis-à-vis foreign producers as compared to the situation prior to the imposition of such tariffs. Surely this cannot be considered to be a situation where a government "entrusts or directs" a private body (users of coal) to purchase goods within the meaning of subparagraph (iii) – or "entrusts or directs" a private body (producers of coal) to provide goods within the meaning of subparagraph (iii) – and hence to constitute a financial contribution….

Source: *Panel Report, US – Export restraints, para. 8.37.*

Finally, income or price support measures – in the sense of Article XVI of the GATT – also constitute financial contributions. These are measures that affect primary products, i.e., any farm, forest or fishery product, or any mineral.[2]

Since the ASCM applies to only some types of financial contribution, developing countries wishing to develop export promotion schemes could set up measures falling outside the scope of the ASCM.

A government could, for example, decide to suspend import duties on certain items. As this applies "*erga omnes*", or "to all", and does not benefit anybody in particular, then the measure would not constitute a subsidy under ASCM rules.

Another type of action that would be authorized under the ASCM would be a loan provided by a partially state-owned bank, provided that the state's stake is relatively small (up to 25% of the bank's shares), the bank is subject to the same legislative rules as any other private bank and it is managed like any other private bank. Unless the government entrusts or directs the bank to give loans, any loans granted by the bank should not be considered to constitute a financial contribution, because they are loans between private parties. Hence, these loans should not be subject to the provisions of the ASCM.

1 Panel Report, *US – Export restraints*, para. 8.29.

2 *Ad note* to Article XVI of the GATT.

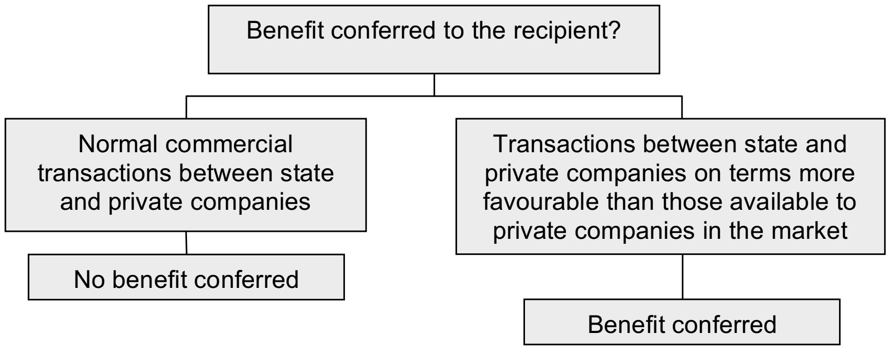
A benefit must be conferred

The second condition for the existence of a 'subsidy' is that a benefit is conferred as a result of one of the actions described above.

A benefit is conferred when the recipient is better off than would otherwise have been the case in the absence of a contribution. In general terms, a benefit will exist when the action considered provides more favourable conditions than would have been available on the market place.

This analysis is explained graphically as follows:

Figure 1.1 What is a benefit



In some cases, the determination of whether a financial contribution confers a benefit will be straightforward. For instance, if a private company receives a grant from the government or from a public body, the financial contribution will necessarily confer a benefit to the recipient.

In other cases, and actually in most cases, the existence of a benefit is more difficult to establish. For instance, the existence of a benefit when a company receives a loan from a state bank depends on the conditions (in particular, the interest rate) that the company would obtain from commercial banks for a similar loan. There will be a benefit only if the interest rate available from commercial banks is higher than the interest rate charged by the state bank.

How can we determine whether a benefit is conferred? The rules contained in Article 14 of the ASCM that deals with the calculation of the amount of a subsidy in a countervailing investigation provide useful guidelines to determine whether a given financial contribution confers a benefit. In fact, these guidelines clarify under which circumstances equity investments, loans, loan guarantees, the provision of goods or services by a government and the purchase of goods by a government can be regarded as conferring a benefit to its recipient. For instance, it provides that "a loan by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the loan pays on the government loan and the amount the firm would pay on a comparable commercial loan which the firm could actually obtain on the market. In this case the benefit shall be the difference between these two amounts.

Specificity

Subsidies will only fall under the rules of the ASCM if they are 'specific' within the meaning of Article 2 of the ASCM. Subsidies generally available are therefore not subject to the rules in the ASCM.

A subsidy is specific when it is expressly limited to certain enterprises[3]

The principle is that "where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific."[4]

Thus, when a subsidy is explicitly limited to:

- One enterprise (for instance the subsidy is limited to Company A), or;
- To certain enterprises (for instance it is limited to companies A, B and C), or;
- To one industry (for instance it is limited to the steel industry), or;
- To certain domestic industries (for instance it is limited to the steel and to the textile industries only), or;
- To certain enterprises located within a designated region(s) in the jurisdiction of a guaranteeing authority (for instance companies located in region Z).

Then that subsidy is considered to be specific.

Importantly, if a subsidy is not limited *in law* but there are reasons to believe that the subsidy is *in fact* limited to one or certain enterprises, or to one or certain domestic industries, or to certain enterprises located within a designated region(s), then additional factors may be analyzed including:[5]

- [The] use of a subsidy programme by a limited number of certain enterprises;
- Predominant use by certain enterprises;
- The granting of disproportionately large amounts of subsidy to certain enterprises; and
- The manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.

Thus, even where a programme is not explicitly limited, if it is found that only a limited number of certain enterprises have used the subsidy, or if it is determined that disproportionately large amounts of subsidy are granted to certain enterprises/domestic industries, then that subsidy may be found to be specific.

3 Articles 2.1 and 2.2 of the ASCM.

4 Article 2.1(a) of the ASCM.

5 Article 2.1(c) of the ASCM.

This does not mean however that *all* subsidy programmes not generally available are regarded as specific. Article 2.1(b) of the ASCM expressly states that if a subsidy programme is granted adhering to generally applicable neutral criteria (e.g., number of employees), the eligibility is automatic, and such criteria and conditions are strictly adhered to, that programme should be considered non-specific and thus outside the coverage of the ASCM.

Types and treatment of specific subsidies under the ASCM

The ASCM today distinguishes between two types of subsidies: prohibited subsidies and actionable subsidies.[6] Prohibited subsidies are defined in Article 3 of the ASCM. Other types of subsidies are not prohibited outright, and they can be set-up or maintained provided they do not cause "adverse effects" to the interests of other WTO members.

Prohibited subsidies

Article 3 of the ASCM prohibits outright any subsidy that is made contingent either on export performance or on the use of domestic rather than imported products. Prohibited subsidies are considered to be specific *per se.*

Subsidies contingent upon the use of domestic over imported goods

The ASCM prohibits subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

These are also known as import-substitution subsidies, because their intended purpose is to promote domestically produced goods. This type of subsidy was very popular for stimulating the development of certain industries, such as auto-making. Thus, assembly lines were offered subsidies provided that they used domestic parts.

The prohibition applies to subsidies that are contingent both, in law or in fact, upon the use of domestic over imported goods.

The prohibition applies to all countries. No special and differential treatment is provided to any country or group of countries.

Subsidies contingent upon export performance (export subsidies)

Export subsidies are subsidies that are contingent, in law or in fact, upon export performance, including those listed in Annex I of the ASCM.

6 A third type of subsidies, namely, non-actionable subsidies that were an integral part of the ASCM (under Article 8), no longer exist.

Illustrative list of export subsidies: Annex I of the ASCM

Annex I contains the "Illustrative list of prohibited export subsidies". As the title indicates, this list is not exhaustive, but merely illustrative. Therefore, subsidy programmes not contained in the list but that are contingent upon export performance, are, in principle, prohibited.

This list contains 12 items. Certain frequently used export schemes listed under Annex I will be addressed in Chapter 4 below. For now it is essential to note that, according to established WTO case-law, a subsidy coming under the purview of Annex I is *ipso facto* prohibited, i.e., once it is established that an export scheme falls within one of the 12 items listed under Annex I, there is no additional need to demonstrate that the threshold embedded in Article 3 of the ASCM has been met.[7]

Subsidies that are contingent, in law or in fact, upon export performance

Export subsidies include not only subsidies that are contingent "in law" upon export performance (*de jure*) but also those that are contingent "in fact" upon export performance (*de facto*).

De jure export contingency is, in principle, easy to discern as it is usually based on written statutes. Subsidies contingent in law usually involve legislation or regulation that tie the receipt of a subsidy to the exporting activity. For example, a government regulation that allows reimbursement of 20% of the sales revenue generated through exports of a particular product. As a result, in order to prove a *de jur*e export subsidy, it is usually sufficient to simply refer to the relevant piece of legislation or legal instrument concerned.

De facto export contingency is more complex to establish. The prohibition on granting subsidies that are *de facto* export contingent essentially operates as an anti-circumvention provision against attempts to link benefits to exports without explicitly stating in the law that this is the case. Proving a *de facto* export contingency is a much more difficult task because, quite often, there is no single (public) document demonstrating that a subsidy is *de facto* export contingent. In these cases, the existence of an export contingency must be inferred from the total configuration of the facts surrounding the granting of the subsidy, none of which is likely to be decisive on its own in any given case. Footnote 4 to Article 3 of the ASCM, dealing with *de facto* export subsidies, requires proof that the granting of a subsidy, when not legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings.

7 Appellate Body report, *Brazil – Aircraft (Article 21.5 – Canada II)*, paras. 5.272-5.275.

What can determine whether a subsidy programme is a de facto export subsidy?

The following are some of the factors that a WTO disputes' panel took into consideration in its examination of the Technology Partnership Canada (TPC) programme used to support, among others, aircraft manufacturer Bombardier, and which Brazil alleged to be an export subsidy:[8]

- TPC's statement of its overall objectives;
- Types of information called for in applications for TPC funding;
- The considerations, or eligibility criteria, employed by TPC in deciding whether to grant assistance;
- Factors to be identified by TPC officials in making recommendations about applications for funding;
- TPC's record of funding in the export field, generally, and in the aerospace and defense sector, in particular;
- The nearness-to-the-export-market of the projects funded;
- The importance of projected export sales by applicants to TPC's funding decisions;
- The export orientation of the firms or the industry supported.

In *Australia – Automotive Leather,*[9] the WTO panel took into account the following factors to conclude that a grant contract with Australian Leather Holdings (ALH) and Howe, a wholly owned subsidiary of ALH's Australian Leather Upholstery Pty Ltd, constituted a *de facto* export subsidy:

- The grant contract provided for an aggregate sales performance target and conditions the receipt of part of the grant on achieving those targets;
- The grant was provided to the Australian producer after it ceased to receive incentives under certain programmes which were export contingent (the grant compensated for the loss of the incentives under those programmes);
- At the time the grant contract was concluded, Howe exported a significant portion of its production, and the Australian Government was aware of this;

8 Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft (WT/DS70/R)*. The dispute concerned various Canadian Government measures alleged by Brazil to be export subsidies. Among the measures being challenged, there was the TPC Program, i.e. funds provided to the civil aircraft industry by the Technology Partnership Canada (TPC) programme and predecessor programmes.

9 Panel Report, Australia – Subsidies Provided to Producers and Exporters of Automotive Leather (WT/DS126/R) The Australia – Automotive Leather dispute concerned certain government assistance provided by the Australian Government to Howe, a wholly owned subsidiary of Australian Leather Upholstery Pty. Ltd., which is owned by Australian Leather Holdings, Limited (ALH). Howe is the only dedicated producer and exporter of automotive leather in Australia. On 9 March 1997, the Australian Government signed two contracts with ALH and Howe: a loan contract and a grant contract providing for funding for an assistance package. The grant contract provided for a series of three grant payments totalling up to a maximum of $A 30 million. The loan contract provided for a fifteen-year loan of $A 25 million by the Australian Government to ALH/Howe. These two contracts were examined by the Panel which had to determine whether they constituted export subsidies within the meaning of the ASCM.

- The Australian market for automotive leather was too small to absorb Howe's production, much less any expanded production that could result from the financial benefits accruing from the grant payments. According to the panel, in order to expand its sales in a manner that would enable it to reach the sales performance targets (interim targets and the aggregate target) set out in the grant contract, Howe would, of necessity, have to continue and probably increase exports.

The same panel examined whether a loan contract extended by the Australian Government to the leather producer was *de facto* contingent upon export performance. In reaching a negative answer, it examined the following factors:

- The source of funding to repay the loan was not necessarily export sales as the mother company had other businesses and produces other products from which it could generate the funds to repay the loan;
- The loan was secured by a lien on the assets and undertakings of the mother company, which was itself responsible for repayment of the loan;
- There was nothing in the terms of the loan contract itself which suggested a specific link to actual or anticipated exportation or export earnings.

What determines whether a loan is an export subsidy?

A loan that is granted at a preferential rate may be regarded as an export subsidy or not, depending on the facts of the case, in particular the following facts:

- The type of information sought by the bank from any companies requesting a loan can be a factor. If the bank were to ask for information regarding export volumes/values, whether past or future, or similar information, a WTO panel may view this as an indication that the loan constitutes an export subsidy. The same comment applies to the eligibility criteria used by the bank, and considerations in deciding whether to grant assistance.
- Similarly, the text of the loan contract between the bank and any companies receiving the loans may be taken into account. If the contract sets forth a requirement to export all or part of the production of the new products, or a requirement not to sell all or part of the production domestically, then a WTO panel may consider that this fact points towards a conclusion that the loan constitutes an export subsidy.
- Sales performance targets set forth in the loan contract or other documents could be an indication. This factor may be seen in the light of the size of the market for the new products, which would likely be limited or inexistent. Thus, if a panel determines that the market for new products in the territory is non-existent or small, then the sales' performance target may be considered a hidden export performance target.

Lines of 'attack' against prohibited subsidies

WTO members have two possible courses of action open to them when they believe other members are using prohibited subsidies. Firstly, they can opt for the multilateral track and challenge the subsidies before the WTO's Dispute Settlement Body (DSB). If the DSB finds in favour of the plaintiff, it will ask the country concerned to remove the prohibited subsidy. Alternatively, a country can take the unilateral track and carry out a national investigation after which it can levy countervailing duties where the subsidized products are being imported into its territory.

Actionable subsidies

Subsidies covered by the ASCM, and which do not fall under the category of prohibited subsidies, may still be challenged if they have "adverse effects" on the interests of other WTO members, as defined by Article 5 of the agreement.10 The article states:

"No WTO member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1 of the agreement, adverse effects to the interests of other members." For example, subsidies should not cause "injury to the domestic industry of another member."

As with prohibited subsidies, WTO members who believe that their interests are being harmed can take action either through the multilateral or the unilateral track. The relevant rules for WTO dispute settlement proceedings are contained in Articles 6 and 7 of the ASCM.[11]

In the case of developing countries, Articles 27.7-27.9 of the ASCM contain special and differential treatment provisions for developing countries, which will be discussed further below.

Non-actionable subsidies

Article 8 of the ASCM initially defined some subsidies as "non-actionable" if they were intended for environmental protection, to make up for regional inequalities within a state or to promote research and development. But the provision lapsed in 1999.[12]

Special and differential treatment for developing country members

Subsidies may play an important role in the economic development programmes of developing countries. Article 27 of the ASCM thus provides for specific rules and disciplines for developing country members that are less strict than the general rules and conditions applied to developed countries.

Exemption from the prohibition on export subsidies

The prohibition on establishing or maintaining "export subsidies"13 does not apply to:

- Least developed countries (LDCs) designated as such by the United Nations [Annex VII (a)].
- Certain members identified in Annex VII (b) of the ASCM until such time as their GNP per capita has reached US$ 1,000 per year in constant 1990

10 Should there be special rules in the AoA, those would apply rather than Article 5 *et seq* of the ASCM.

11 It is recalled that the presumption of Article 6.1 does not apply anymore.

12 However, legislations of some WTO Members continue to incorporate the content of Article 8 of the ASCM. Thus, for instance, Article 4 of the EC's Anti-subsidy Regulation sets forth that certain subsidies for research activities, to disadvantaged regions and to promote adaptation of existing facilities to new environmental requirements, provided that they meet certain requirements, are not countervailable. This provision continues to be applicable in EC countervail investigations in spite of the expiry of Article 8 of the ASCM.

13 Article 3(a)(1). d.

dollars for three consecutive years. So far, only the Dominican Republic, Guatemala and Morocco have been removed from the original list. Additionally, it is provided that a Member shall not leave Annex VII(b) so long its GNP per capita in current dollars has not reached US$ 1,000.[14]

- Other developing country members were initially granted an exemption until 2002. An extension to this provision was subsequently agreed, but only for specific programmes, as is explained more fully below.

Thus, at the time of writing, the prohibition on export subsidies under Article 3 of the ASCM does not apply to the following countries:

Table 1.1 Exempt countries

Based on Annex VII para. (a): Least developed countries members of the WTO	Based on Annex VII para. (b): Certain developing country members
Angola	Bolivia
Bangladesh	Cameroon
Benin	Congo
Burkina Faso	Côte d'Ivoire
Burundi	Egypt
Cambodia	Ghana
Central African Republic	Guyana
Chad	Honduras
Congo, Democratic Republic of the	India
Djibouti	Indonesia
Gambia	Kenya
Guinea	Nicaragua
Guinea Bissau	Nigeria
Haiti	Pakistan
Lesotho	Philippines
Madagascar	Senegal
Malawi	Sri Lanka
Maldives	Zimbabwe
Mali	
Mauritania	
Mozambique	
Myanmar	
Nepal	
Niger	

14 WTO Ministerial Conference, Doha 9 to 14 November 2001. Decision on implementation – Related Issues and Concerns, Paragraph 10.1.

Table 1.1 Exempt countries (cont'd)

Based on Annex VII para. (a): Least developed countries members of the WTO	Based on Annex VII para. (b): Certain developing country members
Rwanda	
Senegal	
Sierra Leone	
Solomon Islands	
Tanzania, United Republic of	
Togo	
Uganda	
Zambia	

Source: http://www.wto.org/english/thewto_e/whatis_e/tif_e/org7_e.htm.

Note: The WTO recognizes as least developed countries (LDCs) those countries which have been designated as such by the United Nations. There are currently 49 least developed countries on the United Nations list, 32 of which to date have become WTO members (listed in the table). LDCs not yet members of the WTO are not subject to the rules in the WTO Agreements and hence they can establish or maintain subsidies as they deem appropriate, including export subsidies. As stated above, three countries have been dropped from the list in para. (b) of Annex VII, and one country, Senegal, appears on both lists as its status changed to LDC later. Thus, 48 WTO members – out of a total of 153 – are exempted from the application of the prohibition to establish or maintain export subsidies. This exemption is not subject to any temporal deadline.

As stated above, three countries have been dropped from the list in para. (b) of Annex VII, and one country, Senegal, appears on both lists as its status changed to LDC later. Thus, 48 WTO members – out of a total of 153 – are exempted from the application of the prohibition to establish or maintain export subsidies. This exemption is not subject to any temporal deadline.

The third category of members, namely the other developing country members, benefited from the exemption for eight years from the date of entry into force of the WTO agreement, although they had to comply with certain obligations established in Article 27.4 of the ASCM. However, the same article provides a mechanism for extensions to be granted for certain specific programmes. A total of 22 developing countries applied for extensions under the article, of which 21 were granted by the WTO.[15] In July 2007, the WTO's executive General Council approved a recommendation of the Subsidies and Countervailing Measures Committee to continue the extension until the end of 2013.[16] This extension applies only to certain programmes from certain developing country members, as the table below shows:

15 WTO Ministerial Conference, Doha 9-14 November 2001. Pursuant to decision on Implementation Related Issues and Concerns. Paragraph 10.6.

16 WT/L/691. Beneficiary countries will have until end of 2015 (there is a two-year phasing out period) to dismantle – or bring into conformity with the ASCM – the programmes containing export subsidies and for which the extension was granted.

Table 1.2 WTO Members with programme extensions

Member	Programmes covered by the extension
Antigua and Barbuda	Fiscal Incentive Act Cap 172 (December 1975) (G/SCM/50/Add.4) Trade and Processing Zone Act No. 12 of 1994 (G/SCM/51/Add.4)
Barbados	Fiscal Incentive Programme (G/SCM/52/Add.4) Export Allowance (G/SCM/53/Add.4) Research and Development Allowance (G/SCM/54/Add.4) International Business Incentives (G/SCM/55/Add.4) Societies With Restricted Liability (G/SCM/56/Add.4)
Belize	Fiscal Incentives Act (G/SCM/57/Add.4) Export Processing Zone Act (G/SCM/58/Add. 4) Commercial Free Zone Act (G/SCM/59/Add.4) Conditional Duty Exemptions Facility under Treaty of Chaguaramas (G/SCM/60/Add.4)
Costa Rica	Free Zone Regime (G/SCM/61/Add.4) Inward Processing Regime (G/SCM/62/Add.4)
Dominica	Fiscal Incentives Programme (G/SCM/63/Add.4)
Dominican Republic	Law No. 8-90 to «Promote the Establishment of New Free Zones and Expand Existing Ones» (G/SCM/64/Add.4)
El Salvador	Export Processing Zones and Marketing Act, as amended (G/SCM/65/Add.4)
Fiji	Short-Term Export Profit Deduction (G/SCM/66/Add.4) Export Processing Factories/Export Processing Zones Scheme (G/SCM/67/Add.4) The Income Tax Act (Film Making and Audio Visual Incentive Amendment Decree 2000) (G/SCM/68/Add.4)
Grenada	Fiscal Incentives Act No. 41 of 1974 (G/SCM/69/Add.4) Statutory Rules and Orders No. 37 of 1999 (G/SCM/70/Add.4) Qualified Enterprises Act No. 18 of 1978 (G/SCM/71/Add.4)
Guatemala	Exemption from Company Tax, Customs Duties and Other Import Taxes for Companies under Special Customs Regimes (G/SCM/72/Add.4) Exemption from Company Tax, Customs Duties and Other Import Taxes for the Production Process Relating to Activities of Managers and Users of Free Zones (G/SCM/73/Add.4) Exemption from Company Tax, Customs Duties and Other Import Taxes for the Production Process of Commercial and Industrial Enterprises Operating in the Industrial and Free Trade Zone (G/SCM/74/Add.4)
Jamaica	Export Industry Encouragement Act (G/SCM/75/Add.4) Jamaica Export Free Zone Act (G/SCM/76/Add.4) Foreign Sales Corporation Act (G/SCM/77/Add.4) Industrial Incentives (Factory Construction) Act (G/SCM/78/Add.4)
Jordan	Partial or Total Exemption from Income Tax of Profits Generated from Exports under Law No. 57 of 1985, as amended (G/SCM/79/Add.4)
Mauritius	Export Enterprise Scheme (G/SCM/80/Add.4) Pioneer Status Enterprise Scheme (G/SCM/81/Add.4) Export Promotion (G/SCM/82/Add.4) Freeport Scheme (G/SCM/83/Add.4)
Panama	Official Industry Register (G/SCM/84/Add.4 Export Processing Zones (G/SCM/85/Add.4)
Papua New Guinea	Section 45 of the Income Tax (G/SCM/86/Add.4)

Table 1.2 WTO Members with programme extensions (cont'd)

Member	Programmes covered by the extension
St. Kitts and Nevis	Fiscal Incentives Act No. 17 of 1974 (G/SCM/90/Add.4)
St. Lucia	Fiscal Incentives Act No. 15 of 1974 (G/SCM/87/Add.4) Free Zone Act, No. 10 of 1999 (G/SCM/88/Add.4) Micro and Small Scale Business Enterprises Act, No. 19 of 1998 (G/SCM/89/Add.4)
St. Vincent and the Grenadines	Fiscal Incentives Act No. 5 of 1982, as amended (G/SCM/91/Add.4)
Uruguay	Automotive Industry Export Promotion Regime (G/SCM/92/Add.4)

In addition to the stand still and transparency obligations, the above members are required to submit an action plan for eliminating export subsidies under the above programmes as part of the annual updating notifications submitted for a review to be conducted in 2010.[17]

Special procedural rules concerning actions against subsidies provided by developing countries

Articles 27.7-27.9 of the ASCM lay down more stringent procedural rules on dispute settlement actions ("multilateral track") against subsidies provided by developing countries. Essentially these raise the bar for any action to be brought at the WTO, with the complaining party, and rules out certain kinds of challenges.

First, Article 4 which provides for procedures for seeking remedies against prohibited subsidies is not applicable in the case of export subsidies which are granted in accordance with the provisions of special and differential treatment of developing country members. (Article 27). These export subsidies can only be challenged through the procedure provided for actionable subsidies in Article 7.

Second, the presumption of serious prejudice of Article 6.1 does not apply to developing countries. Any finding of serious prejudice must be based on positive evidence.

Third, for actionable subsidies other than the subsidies referred to in Article 6.1, action may not be authorized or taken under Article 7 unless nullification or impairment of tariff concessions or other obligations under the GATT 1994 is found to exist as a result of that subsidy in such a way as to displace or impede imports of a like product of another Member into the market of the developing country or unless injury to the domestic industry in the importing country market occurs.

17 The action plan must indicate how the Member intends to eliminate export subsidies under the programme not later than the end of the final two-year phase-out period provided for in the last sentence of SCM Article 27.4, i.e. 2015, including information as to legislative changes, administrative amendments and/or other procedures as may be necessary, and whether any of these actions have been undertaken or are in the process of being undertaken, including how the individual beneficiaries of those subsidy programmes have been notified.

Developing countries also benefit from the so-called *de minimis* provision. This means that with regard to countervailing measures, developing country exporters are entitled to more favourable treatment with respect to investigations whenever the level of subsidization, or volume of imports, is small, as described below:

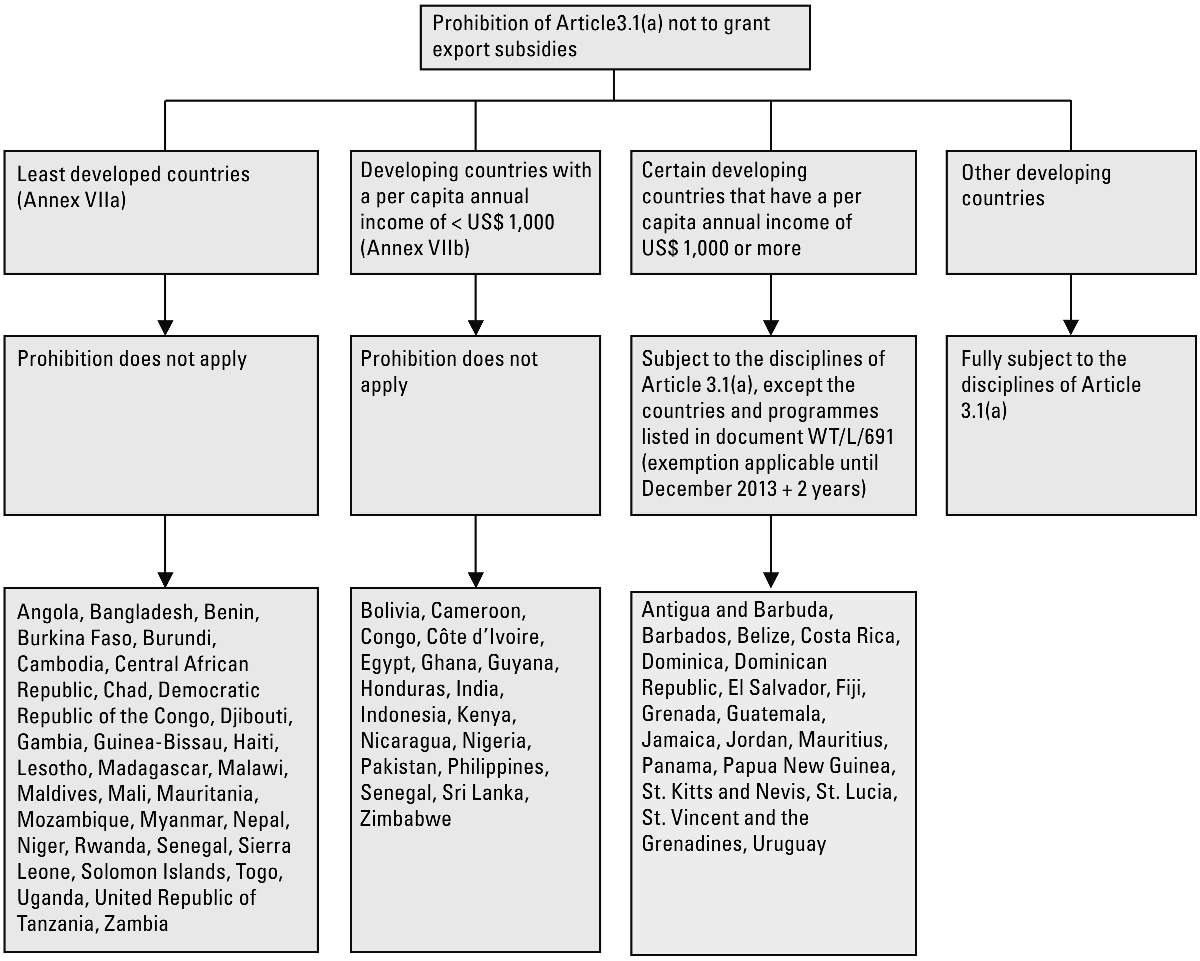
Under Article 27.10, "Any countervailing duty investigation of a product originating in a developing country member shall be terminated as soon as the authorities concerned determine that:

- "The overall level of subsidies granted upon the product in question does not exceed 2% of its value calculated on a per unit basis; or
- The volume of the subsidized imports represents less than 4% of the total imports of the like product in the importing member, unless imports from the developing country members, whose individual shares of total imports represent less than 4% collectively, account for more than 9% of the total imports of the like product in the importing member."

Figure 2.2 summarizes the situation in 2009 with respect to developing country members' ability to establish or maintain export subsidies.[18]

18 Developing countries, including LDCs, not members of the WTO are not subject to the rules contained in the ASCM.

Figure 1.2 Developing countries and export subsidies



Chapter 2

The agreement on agriculture

Introduction

Agriculture is a highly sensitive topic in virtually every country. In general, agricultural products are easily exported, hence the potential for trade is vast. Every country seeks to maximize economic advantages for its own agricultural sector for social, economic and political reasons. Thus, agriculture trade has been a topic of almost continuous negotiations, and was singled out for special treatment even during the GATT 1947 years.

The current Agreement on Agriculture ("AoA") has the long-term objective of establishing a fair market-oriented agricultural trading system through a progressive reduction of agricultural support and protection.[19] The AoA takes into consideration the particular needs of developing countries in agricultural trade by incorporating special and differential treatment provisions.[20]

The following section explains the current regime on export subsidies with regard to agricultural products, including a separate section dealing with the special and differential treatment for developing countries.

Coverage and main rules

The general disciplines enshrined in the AoA cover market access (i.e. tariff reductions for primary products), restrictions on the use of domestic subsidies for primary products and restrictions on the use of export subsidies for primary products.

Questions on market access and domestic support are not dealt with in this book. The following paragraphs will examine the obligations assumed by WTO members with regard to the use of export subsidies for products that fall within the scope of the AoA.

The AoA only covers the "agricultural products" that are listed in Annex I of the Agreement.

19 Preamble of the AoA.

20 Article 15.2 of the AoA. The special regime for developing and least developed countries is explained below under the respective section of this study.

Export promotion schemes under the AoA

What is an export subsidy?

Export subsidies are subsidies contingent upon export performance, including the export subsidies listed in Article 9 of the AoA.[21]

Export subsidies and schedules of commitments

For industrial goods, there is a set of rules on subsidies that applies equally to all products and all WTO members, albeit with special and differential treatment for developing countries. But for agricultural goods, the commitments made with respect to subsidies are specific to each member and are included in each member's schedule of concessions (part IV of the schedule). Each WTO member has a schedule of concessions, which is either annexed to the GATT 1994, or to a protocol of accession.

Under Article 3.3 of the AoA,[22] WTO members have made the following commitments:

- ❑ For those products or groups of products specified in section II of part IV of its schedule, a member has committed not to provide export subsidies listed in paragraph 1 of Article 9 "in excess of the budgetary outlay and quantity commitment levels specified therein".
- ❑ For all products not specified in that section of its schedule, a member has committed not to provide any export subsidies listed in paragraph 1 of Article 9 at all.

List of export subsidies

Article 9 lists the export subsidies that are prevalent in the agricultural sector. These listed export subsidies are subject to reduction commitments expressed in terms of both the volume of subsidized exports and the budgetary outlays for these subsidies. The export subsidies listed in Article 9.1 are the following:

Direct export subsidies contingent on export performance;

- ❑ Sales of non-commercial stocks of agricultural products for export at prices lower than comparable prices for such goods on the domestic market;
- ❑ Producer-financed subsidies such as government programmes which require a levy on all production which is then used to subsidize the export of a certain portion of that production;
- ❑ Cost reduction measures such as subsidies to reduce the cost of marketing goods for export: this can include upgrading and handling costs and the costs of international freight for instance;

21 Article 1(e) of the AoA.

22 Appellate Body report, *US – FSC*, paras. 145-146.

- Internal transport subsidies applying to exports only, such as those designed to bring exportable products to one central point for shipping;
- Subsidies on incorporated products, i.e. subsidies on agricultural products, such as wheat, contingent on their incorporation in export products, such as pasta.

Disciplines applicable to export subsidies

Export subsidies listed in Article 9.1

Scheduled products

Members are *not* allowed to grant subsidies to scheduled agricultural products that are in excess of the budgetary outlay reduction commitment level specified in part IV of each member's schedule, nor are they allowed to grant subsidies to such products that are in excess of the quantity reduction commitment level specified in the same schedule.

Unscheduled products

Regarding unscheduled products, members are not allowed to grant the export subsidies listed in Article 9.1 at all.

Export subsidies that are not listed in Article 9.1

Article 10 establishes an anti-circumvention obligation with respect to subsidies that are not listed under Article 9.1. Article 10.1 provides that the export subsidies that are not listed in Article 9.1 "shall not be applied in a manner which results in, or threatens to lead to, circumvention of export subsidy commitments".

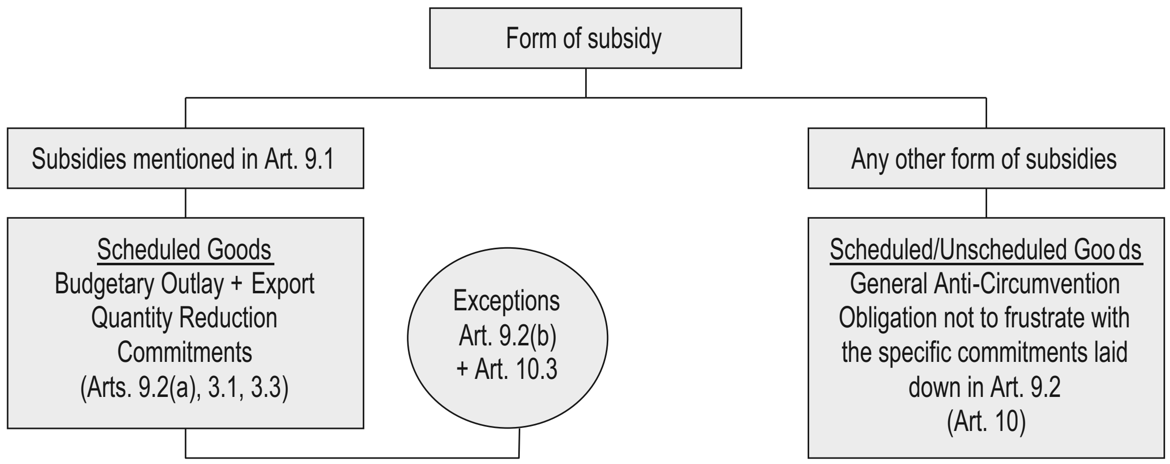
The standard of actual circumvention imposed by Article 10.1 on non-listed export subsidies is the same as the reduction commitments standard imposed on the export subsidies listed in Article 9.1. It means that WTO Members are not allowed to grant any subsidy whatsoever to export of unscheduled products and of scheduled products above their reduction commitment level.

However, non-listed export subsidies are even disciplined more stringently than the listed ones given that Article 10.1 includes an additional prohibition of "threat of circumvention". In other words, if unlisted export subsidies merely threaten to circumvent export subsidy commitments, it is sufficient to find an inconsistency with Article 10.1.[23]

Graphically, the disciplines in the AoA can be resumed as follows:

23 Appellate Body Report, US - Cotton Subsidies, paras. 704, 710 and 713.

Figure 2.1 Disciplines on subsidies



Special and differential treatment for developing country members

As already pointed out, the AoA takes note of the special needs of developing and least developed countries and establishes certain special provisions for them.

Article 9.4 initially provided that, during the implementation period, developing country members were not obliged to undertake reduction commitments with respect to export subsidies that are listed under Items (d) and (e) of Article 9, provided they are not applied in a manner that would circumvent reduction commitments. The implementation period has now ended. However, Members agreed at the ministerial meeting in Hong Kong in December 2005 that the provision should once again be made available once the WTO's Doha Round of free trade negotiations is completed. Developing country Members are likely to benefit from this provision until the end of 2021.

Secondly, Article 15 provides that developing country members have the flexibility to implement reduction commitments over a period of up to 10 years and that LDCs are not be required to undertake reduction commitments at all.

Conclusion

After having examined the regime applicable to export subsidies granted to agricultural products within the context of the AoA, we can see that the right to use export subsidies today exists in the following cases:

Firstly, export subsidies subject to product-specific reduction commitments within the limits specified in the schedule of the WTO member concerned.

Secondly – but only on the conclusion of the Doha Round – export subsidies envisaged under Article 9.4 of the AoA. This provision is proposed to expire at the end of 2021.[24]

24 WTO Ministerial Declaration adopted at Hong Kong on 18 December 2005 (WT/MIN(05)/DEC) read with Revised Draft Modalities for Agriculture contained in TN/AG/W/4 Rev.4 dated 6 December 2008.

Chapter 3

Analysis of certain types of frequently used export promotion schemes

Introduction

The following contains an overview of some of the most frequently used tools for export promotion schemes. In light of WTO and multilateral trade rules, an examination is also required as to the parameters within which these schemes can be legally used.

In particular, the following examines:

- Duty drawback schemes;
- Schemes involving the non-collection of government revenues that would otherwise be due;
- Export credits;
- Export guarantees;
- Free Trade Zones; and
- Other schemes.

Duty drawback schemes

Annex II of the ASCM defines duty drawback as those schemes that:

> Allow for the *remission* or *drawback* of import charges levied on inputs that are consumed in the production of the exported product (making normal allowance for waste).

Duty drawback schemes are in place in most countries and constitute an important tool to promote exports. In countries with high import tariffs, these schemes are extremely important because – if implemented in compliance with the provisions of the ASCM – they remove the impact of high import duties on inputs used in the production of goods for export.

In order for drawback or remission of import charges to be lawful or legal, the strict conditions laid down in the ASCM must be complied with:

To start with, footnote 1 of the ASCM provides that exempting exported product from duties or taxes borne by the like product when destined for domestic consumption or remitting such duties or taxes in amounts not in excess of those which have accrued shall not be deemed to be a subsidy.

It is to be noted that the content of this footnote in fact pre-existed the ASCM. Indeed, an Ad Note to Article XVI of the GATT 1947 already set forth that the exemption/remission of certain duties or taxes must not be deemed to constitute a subsidy.

As a corollary, Annex I to the ASCM entitled "Illustrative list of export subsidies" lists situations that are considered to constitute subsidies contingent upon export performance and, either expressly or by implication, certain situations that will not be considered as such. Items (g) (h) (i) respectively identify the remission or exemption of (g) indirect taxes with respect to the production or distribution of exported products or (h) indirect taxes on goods or services used in the production of exported goods or (i) import charges on imported inputs consumed in the production of exported goods in excess of the taxes or charges levied as illustrations of export contingency. Thus, items (g) (h) and (i) provide the legal justification for various programs in many countries that provide for the exemption or remission of duties or taxes on products when they are exported. For instance, VAT exemption/remission on products that are exported are perfectly WTO consistent as long as the exemption or remission does not exceed the taxes levied in respect of the like products sold for domestic consumption.

Item (i) deals specifically with duty drawback schemes and substitution drawback systems for which specific Guidelines are included respectively in Annex II and III of the ASCM.

> First, it must concern import charges *levied on inputs that are consumed in the production of exported products*. "Input consumed in the production of exported products" are defined as "inputs physically incorporated, energy, fuels and oil used in the production process and catalysts which are consumed in the course of their use to obtain the exported product."[25] The categories of inputs considered is thus, based on a closed list.

Second, remission or drawback of import charges cannot be in excess of those actually levied on inputs that are consumed in the production of the exported product.

Third, there must be in place, and applied, a system or procedure to confirm which inputs are consumed in the production of the exported product and in what amounts and such systems or procedures must be reasonable, effective for the purpose intended, and based on generally accepted commercial practices in the country of export.

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25 Footnote 61 to paragraph 3 of Annex II adds as follows: "Investigating authorities should treat inputs as physically incorporated if such inputs are used in the production process and are physically present in the product exported. The Members note that an input need not be present in the final product in the same form in which it entered the production process."

Substitution drawback systems

In real commercial situations, a producer may manufacture goods for sale on the home market and on the export market using domestic and imported merchandise. Substitution drawback systems can still allow refund of duties paid on designated imported merchandise, which is consumed in the production process of another product even in cases where it is the product with the domestic inputs that ends up being exported. In other words, the exported product may not physically contain the imported merchandise, which instead gets physically incorporated in the product sold on the domestic market.

The main requirement for substitution drawback systems to be authorized is that the home market inputs substituted for imported inputs in the production of a product for export must be equal in quantity to, and have the same quality and characteristics as, the imported inputs being substituted.

For example: An entrepreneur produces PET chips using terephthalic acid (PTA) and ethylene glycol (EG). PTA and EG are procured domestically as well as imported. PET chips are sold both on the domestic market as well as on the export market. It so happens that PET chips manufactured by using domestically procured PTA and EG are sold on the export market whereas the PET chips manufactured by using imported PTA and EG are sold on the domestic market. The entrepreneur can still claim refund of duties paid on imported PET and EG under the substitution drawback system under the following conditions:

i. The imported goods being substituted should normally be these two chemical substances (“same quality and characteristics”).
ii. The domestic inputs must be used in equal quantities to the imported inputs that are being substituted.

In addition, there must be a verification system, or procedure, that is reasonable and effective for the purpose intended, and based on generally accepted commercial practices in the country of export.

Duty drawback schemes, whether covered by Annex II or III, are implemented in different manners by different members.

In developed countries

In developed countries, it is normally easy to establish clear linkages between the imported inputs, for which exemption or remission of import charges is sought, and the exported product. New technologies can often facilitate these procedures.

In developing countries

By contrast, in developing countries, it may not be quite so easy, for various reasons.

Some developing countries have argued that having in place and implementing developed-countries procedures would be “impracticable” and “places an onerous burden due to the prevalence of a large number of small and medium enterprises”.[26] These countries argue that “[T]he administrative machinery

26 See TN/RL/W/120.

required for such verification of inputs would be prohibitive in terms of costs".[27] Some developing countries have developed and apply standard input-output norms (SION), or similar averaging procedures, for determining the average amount of various inputs required for the manufacture of one unit of the final product. SIONs are used to determine the amount payable to the exporter on account of remission of indirect taxes or import duties.

Box 3.1 Example of SIONs: the Duty Entitlement Passbook Scheme in India

The Duty Entitlement Passbook Scheme (DEPB) of India, which is regulated in the EXIM Policy 2004-2009, enables exporting companies to earn import duty exemptions in the form of duty credits. All exporters are eligible to earn DEPB credits on a post-export basis, provided that the Government of India has established a standard input/output norm (SION) for the exported product. DEPB credits can be used for raw materials, intermediates, components, parts, packaging material, etc. DEPB credits are valid for 24 months and are transferable.

The investigating authorities in the European Community and the United States, among others, have not agreed to treat the DEPB as either a duty drawback scheme of Annex II, or a substitution drawback scheme under Annex III.

For instance, the EC in the context of the PET film anti-subsidy investigation, concluded that it does not conform with the rules included either in Annex II or in Annex III of the ASCM since "an exporter is under no obligation to actually consume the goods imported free of duty in the production process and the amount of credit is not calculated in relation to actual inputs used" and that "moreover, there is no system or procedure in place to confirm which inputs are consumed in the production process of the exported product or whether an excess payment of import duties occurred" and lastly that "an exporter is eligible for the DEPB benefits regardless of whether it imports any inputs at all".

Source:
http://eur-lex.europa.eu/lex/LexUriServ/site/en/oj/2006/l_068/l_06820060308en00150036.pdf.

Schemes in the form of condoning or not collecting government revenues otherwise due

According to Article 1.1(a)(1)(ii), a government revenue constitutes a "financial contribution", if it is foregone or not collected while that government revenue is otherwise due.

Because normally these financial contributions confer a benefit, and provided that they are specific, they become subject to the application of the rules contained in the ASCM, as discussed above.

It is important to clarify that a financial contribution does not arise simply because a government decides not to raise revenue which it could have raised. As the Appellate Body clarified in *US – FSC*, "a Member, in principle, has

27 *Ibid.*

the sovereign authority to tax any particular categories of revenue it wishes. It is also free *not* to tax any particular categories of revenues. Members of the WTO are *not* obliged, by WTO rules, to tax *any* categories of income, whether foreign- or domestic-source income."[28]

The terms "otherwise due", …impl[y] a comparison with a 'defined, normative benchmark'. The purpose of this comparison is to distinguish between situations where revenue foregone *is* 'otherwise due' and situations where such revenue is *not* 'otherwise due'. As Members, in principle, have the sovereign authority to determine their own rules of taxation, the comparison under Article 1.1(a)(1)(ii) of the *SCM Agreement* must necessarily be between the rules of taxation contained in the contested measure and other rules of taxation of the Member in question. Such a comparison enables panels and the Appellate Body to reach an objective conclusion, on the basis of the rules of taxation established by a Member, by its own choice, as to whether the contested measure involves the foregoing of revenue that would be due in some other situation or, in the words of the *SCM Agreement*, 'otherwise due'."[29]

These schemes are quite popular among developing countries. The reason given for this is that developing countries cannot afford to grant subsidies that require disbursements – such as direct transfers of funds. Thus, to attract foreign investment, developing countries traditionally tended to offer tax holidays and similar schemes.

Options open to a developing country

The options available to a developing country depend on its status:

1. If the country is an LDC or one of those countries listed in Annex VII (b) of the ASCM, it could introduce or maintain grants and schemes foregoing or not collecting certain government revenue contingent upon export performance:

   - It could forego, in part or totally, the customs duties payable on imports of capital goods used for the production of existing or new export products, such as banana and mango chips.
   - It could forego, partially or totally, company tax payable with respect to profits obtained through the export business of agro-industrial companies producing in that country.
   - Other more specific schemes would include special deductions – such as double deductions – for certain activities that the authorities consider would promote exports. These could involve double deductions for all foreign advertising activities, or for attending trade fairs in exporting countries, for example.

   Nevertheless, because these are subsidies contingent upon export performance, they could be subject to countervailing measures by the domestic industries of importing members, if they can show that they cause injury. This applies even to LDC subsidies, although LDCs could get some protection from the *de minimis* clause (see *Special Dispute Settlement Rules*, page 20). These programmes are very frequently targeted in countervailing investigations carried out by Australia, Canada, the EC and the United States. They can also be challenged through the multilateral track (US – FSC is just one example). The country

28 Appellate Body Report on *US – FSC*, paras. 90 and 98.

29 Appellate Body Report on *US – FSC (Article 21.5 – EC)*, para. 89.

concerned should therefore carefully weigh the risks entailed by these schemes when devising and implementing them.

2. Regardless of its status, a country could develop programmes not contingent upon export performance. These programmes could be similar to those under option 1, but the export contingency requirement would be removed. The effect of these schemes would be felt across a company's entire production and would, therefore, impact its exported goods only in part. These would therefore constitute *indirect* export promotion measures.
3. The country concerned may devise schemes that do not fall under the scope of the ASCM. It could do this either by ensuring that they do not fall under any of the financial contribution categories set out in Article 1.1, or by making any scheme non-specific.

Export credits

What are export credits?

Export credits arise whenever a buyer or a supplier of exported goods or services is allowed to defer payment for a certain period of time. The types of export credits that involve a certain degree of official support are mainly granted in order to finance the export of capital goods and the related services.

How official support is granted varies from country to country. In most countries such support is given to the banking sector either directly or through a specialized intermediary. In other countries the funds necessary for the granting of export credits are provided directly by government agencies.

Export credits can take the form either of a supplier or a buyer credit. Supplier credits are extended by the exporting company, which then arranges refinancing. In the case of the buyer credit, the exporter's bank, or another financial institution, lends funds to the buyer in the importing market. Export credits can be medium-term (two to five years) or long term (at least five years). The objective in either case is the same: the promotion of exported goods and services in foreign markets.

Permitted Export Credits

The following rules concerning export credits are included in item (k) of the illustrative list of Annex I of the ASCM.

Grants by governments below certain interest rates, or payments by governments of at least part of the costs incurred by exporters, or financial institutions, in obtaining credits used to secure a material advantage concerning export credit terms, are considered as prohibited export subsidies.

However, as a matter of exception, subsidies granted in the form of export credits that are consistent with the terms and conditions set out in the *OECD Arrangement on Guidelines for Officially Supported Export Credits (hereinafter 'the OECD Arrangement")* are not be prohibited under the ASCM. It is essential to note at this point that pursuant to established WTO case-law, it is not sufficient to selectively comply merely with certain terms enshrined in the *OECD Arrangement*, e.g. the established interest rate. On the contrary, WTO members have to comply with all the criteria set out in the arrangement.

The *OECD Arrangement* sets out permitted interest rates and maturities, which vary according to the classification of the recipient in question.[30] For instance, higher interest rates and shorter maturities apply to developed countries than to developing countries. However, the minimum rates of all categories are lower than those prevailing in most capital markets. Furthermore, the *OECD Arrangement* promotes transparency by requiring its participants to notify any export credit granted and establish consultation procedures for each intended grant.[31] Any WTO member seeking to grant export credits in excess of the terms permitted under the Arrangement, e.g. at lower interest rates or with a longer maturity, must notify this intention to all fellow members accompanied by a detailed explanation of the reasons for such a deviation.[32] Participants are further required to regularly review the *OECD Arrangement* as well as the related provisions thereto, e.g. provisions on minimum rates or premium rates and related issues.[33]

Export credit guarantees

Export credit guarantee programmes are instruments that cover the risks of export credits, such as default by a borrower. The risks covered are of both political and commercial nature. Political risks are basically risks created by government practices in the importing country, such as sequestrations, expropriations and payment regulations. But they also include such risks as unpredictable war situations or natural disasters. Commercial risks are higher for an exporter than for a domestic supplier due to greater distances, different languages, lack of information sources in the importing country, different legal systems, and a possible hostile environment towards foreigners.

One common feature to all export credit financing systems is the government's direct or indirect assumption of the bulk of the credit risk through specialized official institutions or specialized institutions acting in the state's name. These institutions are members of the *International Union of Credit and Investment Insurers* (hereinafter '*the Berne Union*'). The *Berne Union* was established 1934 under the initiative of the *Export Credits Guarantee Department* (the British official institution of export credit insurance) and the other European export credit insurance institutions. The main reason for the establishment of the *Berne Union* was undoubtedly the desire to create an international framework for cooperation in the field of export credit guarantees. The main objectives of the *Berne Union* are the exchange of confidential creditworthiness information and the harmonization of policies on credit and investment insurance.

30 Articles 10-13 of the *Arrangement on Officially Supported Export Credits*, Revision 2005, effective as of 1 December 2005, available at *http://www.oecd.org.*

31 *Id.*, Articles 43-46.

32 *Id.*, Article 50.

33 *Id.*, Articles 64-66.

Prohibition of Item 'J' on the Illustrative List

Item (j) of the Illustrative List of Export Subsidies in Annex I of the ASCM prohibits the use of export guarantees that are granted at premium rates that are insufficient to cover their long-term operating costs and losses.

In order to determine the sufficiency of the premiums in this context, two factors are decisive in WTO case-law:

- ❑ Whether the premiums have been set with a view to covering the operating costs and losses of the programme at hand, and
- ❑ Whether the premiums paid constitute the revenues for the total cover of costs and losses of the programme at hand.

The above criteria are of particular importance for two reasons. Firstly, because the eventual purpose of Item (j) is to discern the net costs to the government, and secondly, because Item (j) does not mention any other source of revenues that must be sufficient to cover the costs and losses of the programme other than the premiums paid by the applicant exporter.

The following example taken from the dispute *US – Cotton Subsidies* reflects the foregoing assessment test:

> In this case, the WTO panel had to evaluate whether certain export credits extended by the United States Government were granted at adequate premiums within the context of Item (j). The panel found that the three export credit guarantee programmes at issue fell within the scope of Item (j) and thus were inconsistent with WTO law. One of the most decisive factors for the panel's finding was the fact that the US did not review its premium system over time in order to make it more risk-reflecting in accordance with the real cost of each export credit guarantee programme. The panel therefore concluded that the premiums of the programme were by no means proportionate to, reflective of, or geared towards, covering long-term operating costs and losses.

An important question regarding export credit guarantees (and actually also export credits) is the legal status of those that do not fall within the scope of the list of prohibited export subsidies. In other words, the issue is whether an export credit guarantee that is granted at premium rates that are adequate to cover the long-term operating costs and losses of the programmes are ipso facto not "prohibited" subsidies.

So far, WTO panels have suggested that export credit guarantees that do not fall within Item (j) of Annex I can still be found inconsistent with the ASCM by virtue of Articles 3 or 5. The Appellate Body has not ruled on this issue since all export credit programmes that have been challenged were programmes granted at inadequate rates.

Export credits constitute a very popular form of export promotion scheme in WTO Members. This is the reason why WTO Members would normally not challenge programmes that have been granted at adequate premium rates.

Free trade zones and other schemes

For many countries, providing trade liberalization on a national scale is not possible in both the short and medium term. Instead, they often opt for an intermediary step and pursue liberalization of trade and investment in geographically delineated economic areas, such as export processing zones, special industrial zones, or free trade zones. Governments using, or considering using, these Special Economic Zones (SEZ) (also known Export Promotion Zones – EPZ), must, however, abide by WTO rules, particularly those regarding subsidies, as well as give careful consideration to their economic feasibility. The following section gives a snapshot of benefits that enterprises established in SEZs receive.

A free trade zone, or free zone, may be defined as follows:

> An area within a country (a seaport, airport, warehouse or any designated area) regarded as being outside its customs territory. Importers may, therefore, bring goods of foreign origin into such an area without paying customs duties and taxes, pending their eventual processing, transshipment or re-exportation. (...) Free zones may also be known as "free ports," "free warehouses," "free trade zones" and "foreign trade zones."[34]

The common feature of these schemes is that they all offer a range of benefits to the companies making use of them. These benefits vary from country to country and even within the same country, from one free zone to another.[35]

While each country defines its own objectives for such schemes, they quite often involve the following:

- Increase exports;
- Attract foreign capital, achieve accrued capital;
- Introduce new technology, especially in the industrial field;
- Provide employment opportunities, generate a substantial skill surge."[36]

Free zones, and similar schemes, have therefore become popular tools to promote exports, especially in developing countries. This is particularly the case for countries in which import tariffs are, or have been, high. Companies operating

34 *http://www.asycuda.org*. In the EC, the following is considered to be a free zone:

Free zones are special areas within the customs territory of the Community. Goods placed within these areas are free of import duties, VAT and other import charges.

Free zone treatment applies to both *non-Community and Community goods*. Non-Community goods stored in the zone are considered as not yet imported to the Customs territory of the Community whereas certain Community goods stored in free zones can be considered as already exported.

On importation, free zones are mainly for storage of non-Community goods until they are released for free circulation. No import declaration has to be lodged as long as the goods are stored in the free zone. Import and export declarations have only to be lodged when the goods leave the free zone. In addition, there may be special reliefs available in free zones from other taxes, excises or local duties. These will differ from one zone to another.

The free zones are mainly a service for traders to facilitate trading procedures by allowing fewer customs formalities."

(*http://ec.europa.eu/taxation_customs/customs/procedural_aspects/imports/free_zones/index_en.htm*).

35 Even if there may be differences in terms of conditions to be met in order to benefit from each of these schemes, and of rights granted to the companies operating under them, for the purpose of this section of this book these schemes are all referred to as "free zones". Below the rights and obligations of some of these schemes will be examined separately.

36 Objectives as cited in the website of the Ministry of Trade and Industry of Egypt, available at *http://www.tpegypt.gov.eg/FreeZone.aspx*.

under these schemes have traditionally been exempt from paying customs duties on imports of raw materials, and often capital goods, used for the production of exported goods.

Unlike the other schemes that have been examined earlier on in this chapter, free zones typically provide a package of advantages that can range from tax holidays to up-todate infrastructure and simplified import/export procedures, etc. Many of these advantages are subsidies in the context of ASCM. They tend to promote the establishment of related industries to form clusters and, as they grow, they tend to attract new companies operating in the specific field in which the free zone specializes.

The following section provides examples of benefits granted by some countries in their FTZ. These are just examples that seek to illustrate benefits that developing countries grant in their FTZ. However, we do not draw any conclusion regarding their consistency with WTO rules.[37]

Table 3.1 Free zone advantages: types and examples

Type of advantage	Example of advantages
Provision of goods and other services	– Land; – Advisory services; – transport; – etc.
Construct appropriate infrastructure:	– Roads; – Sewage; – Energy grid; – Airports; – Ports; – etc.
Tax privileges in the form of exemptions:	– Taxes on profits derived from exports; – Taxes, duties and fees on the importation of raw materials, goods and packaging for use in the handling, processing, or manufacturing of products for export; – Export taxes and duties; – Taxes on capital and net assets; – Sales taxes, consumer taxes, and duties levied on remittances abroad; – etc.
Other economic-related privileges:	– Exemptions from making payment to social security; – Exemptions from application of general labour law provisions, such as minimum wage; – Exemptions from applying environmental law provisions, such as provisions imposing limits to emissions or exemption from payment of fines in case of infringement of environmental law provisions.

37 For a more detailed analysis on this topic, see the Policy Research Working Paper S. Creskoff and P. Walkenhorst, *Implications of WTO Disciplines for Special Economic Zones in Developing Countries*, The World Bank, April 2009."

Table 3.1 Free zone advantages: types and examples (cont'd)

Type of advantage	Example of advantages
Privileges not directly having an economic impact:	– Removal / lessening of barriers to investment such as onerous bureaucratic systems; – Development of an investor friendly image and environment; – Development of strategic, focused marketing programmes, and the effective implementation of those programmes; – Development of a supportive environment for technological development through encouraging and supporting increased interaction between scientific institutes, universities and industry; – Simplified procedures to repatriate investments; – etc.

Some examples of benefits granted

An EC countervailing investigation listed the following benefits for companies operating under the Export Oriented Units scheme of India:

- "Exemption from import duties on all types of goods (including capital goods, raw materials and consumables) required for manufacture, production, processing, or in connection therewith;
- Exemption from excise duty on goods procured from indigenous sources;
- Reimbursement of central sales tax paid on goods procured locally;
- The facility to sell part of the production on the domestic market, up to a limit of 50% of the FOB value of exports, subject to fulfilment of positive NFE earnings upon payment of concessional duties, i.e. excise duties on finished products;
- Partial reimbursement of duty paid on fuel procured from domestic oil companies;
- Exemption from income tax normally due on profits realized on export sales in accordance with Section 10B of the Income Tax Act, for a 10-year period after starting its operations, but no longer than up to 2010;
- Possibility of 100% foreign equity ownership."[38]

A countervailing investigation carried out by the United States Department of Commerce on coated free sheet paper from China found as follows:

> "According to Yangpu local tax regulations, enterprises located in the Economic Development Zone of Hainan may enjoy several tax preferences. These preferences are described in Preferential Policies of Taxation, which includes the eligibility criteria needed to qualify for the preferences. Under "Preferential Policies Regarding Investment by Manufacturer," high-tech or labour-intensive enterprises with investment over RMB 3 billion and more than 1000 local employees may be refunded 25% of the VAT paid on domestic sales (the percentage of the tax received by the local government) starting in the first year the company has production and sales. The VAT refund can continue for five years."[39]

38 EC Council Regulation imposing a definitive countervailing duty on imports of sulphanilic acid originating in India, OJ L 276/6 (2008), available at *http://eur-lex.europa.eu/JOIndex.do?ihmlang=en*.

39 Coated Free Sheet Paper From the People's Republic of China: Amended Preliminary Affirmative Countervailing Duty Determination, available at *http://ia.ita.doc.gov/esel/china/07-0409.html#IE*.

In the Philippines, there are three schemes for companies in the so-called special economic zones:

Table 3.2 The Philippines' special economic zones

Special Economic Zone Act of 1995	Zamboanga City Special Economic Zone Act/ Cagayan Special Economic Zone Act
Benefits: – Incentives under executive order 226, which includes income tax holidays (ITH); – Tax and duty free importation of capital equipment, spare parts, raw materials and supplies which are needed for the registered activity; – After the lapse of the ITH period, the enterprise must pay a preferential final tax of 5% of the gross income in lieu of all national and local taxes; – An amount equivalent to one half of the value of training expenses incurred in developing skilled or unskilled labour, or for management development programmes incurred by the Philippine Economic Zone Authority (PEZA) firm, can be deducted from the national government's share of the 3% final tax.	Benefits: (Same as SEZA)

Source: Based on information contained in Joaquin Cunanan Co./ PriceWaterhouseCoopers' publication Investment incentives in the Philippines: Synopsis of incentives under various Philippine Laws (February 2004).

In Europe, Serbia's free zones also provide different types of incentives to companies that establish themselves in free zones. These include the following:

- Importers in free zones are not liable for VAT on imported goods;
- Imports and exports of goods and services into and out of a zone are unlimited, i.e. not subject to quantitative restrictions, permits, licenses etc;
- Raw materials used for finished goods that are meant for export can be imported duty-free;
- Fixed assets, machines, and construction materials can be imported duty-free;
- Companies in free zones can freely make use of foreign currency earned through operations within the zones;
- Goods from the zones can be distributed on the domestic market after customs duties have been paid. If goods distributed on the Serbian market are produced in a free zone from domestic and imported components, customs duties are only paid on the imported components;
- Companies in free zones can lease, buy, or build manufacturing facilities, warehouses, or commercial buildings.[40]

40 Serbia Investment & Export Promotion Agency (2005), *Free zones in Serbia*, available at *http://www.siepa.sr.gov.yu/site/en/home/1/setting_up_a_business/free_zones/*.

In addition to the above, there a number of tax exemptions and other financial incentives offered to companies in free zones. These include exemptions from certain municipal administrative fees and expenses; urban land use fees; installation fees for local water and sewer utilities; etc.

While some of the benefits granted appear at first sight to be WTO-consistent such as the exemption of exported products from import duties or indirect taxes, others appear to fall within the category of prohibited subsidies such as direct subsidy contingent upon export performance. Countries using FTZ thus have to make sure that the incentives or measures employed in relation to a FTZ are consistent with their obligations under the WTO Agreements and, in the first place, the ASCM.

Chapter 4

Conclusion

There are strict rules under both the ASCM and the AoA concerning subsidies intended to promote exports.

The ASCM expressly prohibits subsidies that are contingent upon export performance (so-called "export subsidies"). The AoA also prohibits export subsidies listed in the agreement, unless countries made some specific notifications about the use of such subsidies on certain products in their commitment schedules to the WTO. It is thus difficult to set up export promotion schemes that do not fall within the definition of "export subsidies".

However, due to the special and differential treatment to which they are entitled, most developing countries escape the above-mentioned outright prohibition on export subsidies under the ASCM either on a temporary basis (for developing countries that benefit from an exemption pursuant to Article 27.4 of the ASCM) or on a permanent basis (for LDCs and developing countries with low income).

For these countries, under the ASCM, export subsidies are not prohibited outright and may therefore be useful tools to promote investment and exports. Developing countries actually make use of export promotion schemes that would otherwise be prohibited under the ASCM.

It must, however, be noted that even if not prohibited outright, export subsidies that are being set up by developing countries may be the target of legal action in terms of countervailing duty investigations by other WTO members if they cause "adverse effects" to these members' domestic industry. But developing country Members can overcome these challenges by taking benefit of the so called *de minimis*[41] provision.

41 Article 27.10 of the ASCM, explained in Section 2.3.2 of this book.

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