

**THIRD SUBMISSION BY INDIA TO THE NEGOTIATING GROUP ON RULES
(AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES)**

The following communication, dated 13 June 2003, has been received from the Permanent Mission of India.

1. The Doha Ministerial mandate provides for negotiations aimed at clarifying and improving the disciplines under the Agreement on Subsidies and Countervailing Measures (ASCM). India had submitted a paper TN/RL/W/4, on certain implementation related issues in respect of the ASCM. This paper raises some additional issues for seeking clarification and improvement so as to ensure that the provisions and application of ASCM are fair and reasonable. This paper is without prejudice to further submissions that may be put forth by India in the course of the negotiations.

(a) Verification system for drawback and substitution drawback schemes

2. Annex II to the ASCM specifies the guidelines on consumption of inputs in the production process, while Annex III provides guidelines in the determination of substitution drawback systems as export subsidies. These guidelines, *inter-alia*, stipulate that the government of the exporting member has in place and applies a verification system or procedure to confirm which inputs are consumed in the production of the exported product and in what amounts. This would, *inter alia*, require verification of consumption of imported inputs in respect of each consignment. Further, such a verification would need to be undertaken in respect of each unit availing duty concessions. It has been India's experience that a separate verification of the inputs that are actually consumed in the production process in each transaction for every unit is impracticable and places an onerous burden due to the prevalence of a large number of small and medium enterprises which are not concentrated in and around certain cities but are dispersed all over the country including remote areas. The administrative machinery required for such verification of inputs would be prohibitive in terms of costs which may not be commensurate with the extent of duty concessions extended by the government. Absence of such a verification system may result in a finding of "subsidy" when no benefit may, in fact, have been conferred.

3. During the discussions on Implementation Related Issues and Concerns India had raised this concern in G/SCM/W/430 and had suggested a system of generalised and aggregate rate of remission of customs duty to take into account the problems faced due to large number of small and medium enterprises in developing countries. Taking note of the concerns raised by certain Members during the discussions on this Implementation proposal, India is of the view that one way of addressing this problem is to have a presumption that a reasonable and effective verification system is in existence wherever standard input-output norms or similar averaging procedures are developed fairly and systematically for determining the average amount of various inputs required for the manufacture of one unit of the final product and are used to determine the amount payable to the exporter on account of remission of indirect taxes or import duties.

4. This proposal would not represent a departure from existing practice of certain investigating authorities that have treated adherence to standard input-output norms as representing a reasonable verification system. Such a presumption would not have effects that could be argued to be trade-distorting as the investigating authority would be entitled under Article 12.6 of the ASCM to examine the records of each exporter to find whether the application of standard procedures has resulted in over-rebate in a particular instance. In those cases in which over-rebate is found the countervailing duty must be limited to the extent of over-rebate. This is not an alien concept to GATT/WTO as Members would recall that the report L/1141, adopted by the GATT Contracting Parties on 27 May 1960, provides that "... Countervailing duties should not be imposed on a product by reason of the exemption of such product from duties or taxes imposed on the like product when destined for consumption in the country of origin or exportation, or by reason of the refund of such duties or taxes. If, however, it were established that the exemption or the reimbursement exceeded the real charge which the product would have to pay in the exporting country, the difference could be considered as constituting a subsidy" (underline added). These clarifications need to be incorporated in Annex II/III of the ASCM.

(b) Capital goods and consumables to be included in the definition of inputs consumed

5. WTO rules allow exemption or remission of indirect taxes and import charges levied on "inputs consumed in the production of the exported product". Such exemption or remission does not constitute an export subsidy (or even a subsidy) and is therefore not countervailable. Annex II of the ASCM defines "inputs consumed in the production process" as "inputs physically incorporated, energy, fuels and oils used in the production process and catalysts consumed in the course of their use". Thus capital goods and consumables have been left out even though they can be said to have been used to the extent of their depreciation and actual consumption.

6. India had raised this issue and made a proposal in (G/SCM/W/30) during the discussions on Implementation Related Issues and Concerns. Suggestions were made by certain members that this problem could be addressed if the customs duty on capital goods were to be reduced. In India's view this does not take into account the reality in certain developing countries in which customs tariff contribute significantly to government revenue and are necessary for meeting crucial developmental expenditure.

7. Capital goods and consumables must be included in the list of goods that are consumed in the process of production. A fundamental rule of GATT 1947 was that no product must be subject to countervailing duty "by reason of the exemption of such product from duties or taxes borne by the like product when destined for consumption in the country of origin or exportation, or by reason of the refund of such duties or taxes." The basis of this rule was the destination principle of indirect taxation. By excluding capital goods and consumables from the list of goods deemed to be consumed in the production process the ASCM unjustifiably abridged the pre-existing GATT rights of the contracting parties. The improvement can be brought about by an appropriate amendment of footnote 61 of the ASCM.

(c) No obligation for the exporter concerned to import the inputs of same quality and characteristics as the domestic substitute

8. In accordance with item (i) of Annex I and Annex III to the ASCM, substitution drawback schemes are permitted in those cases in which domestic substitutes have been temporarily used and subsequently inputs having same quality and characteristics as the domestic substitute are imported. There is no explicit requirement for the exporter himself to import the inputs. In fact, it may not be economically viable for the exporter to do so, given the small size of his operations. It has been India's experience that often small and medium sized exporters do not directly import the inputs and

instead source it from bulk importers who find it economical to import the inputs, given the quantities involved.

9. It is India's view that the obligations relating to substitution drawback scheme would be complied with even in those cases in which the exporter were to sell his "entitlement" for importing inputs having same quality and characteristics as the domestic substitute to another individual who would subsequently import such inputs within two years. Accordingly, a clarification to Annex III to the ASCM would be necessary to the extent that sale of the entitlement to obtain the duty free imported inputs in substitution drawback schemes would not be considered a subsidy, provided such inputs are imported within two years and sale of such entitlement is not made at a premium.

(d) Export competitiveness provisions to be improved

10. Discussions have been held in the SCM Committee on the implementation proposal regarding export competitiveness under Articles 27.5 and 27.6 of the SCM Agreement. Essentially the proposal discussed pertained to the provision that a developing country member which has reached 3.25 per cent in world trade of a product for two consecutive calendar years shall phase out its export subsidies over 2 year period. In respect of Annex VII countries a longer phase out over 8 years period has been provided. There is, however, a gap in the ASCM as there is no provision to address the eventuality that after reaching export competitiveness in a particular product, subsequently the export competitiveness is lost. In India's view the discussions held on this Implementation issue in the SCM Committee provide a useful basis for addressing this issue during the Rules Negotiations.

(e) Export credit schemes

11. Export credit on preferential terms has been a long-standing export incentive programme in various countries. While certain countries have carved out a safe "haven" from prohibition against export credits, it has been India's experience that unreasonable benchmarks have been used by certain investigating authorities against developing country exports while determining the benefit to the recipient arising out of such incentive schemes.

12. It needs to be recognised that export credits can be provided for either in the currency of the exporting country or in foreign currency in accordance with the circumstances of each case. Generally for developing countries the interest rate for loans in the currency of the exporting country is considerably higher than the interest rate for loans in foreign-denominated currency. Certain investigating authorities have resorted to the use of interest rate for loans in the currency of the exporting country as a benchmark for loans obtained in foreign denominated currency, resulting in unreasonable level of subsidy.

13. Another issue of concern relating to export credits arises from certain investigating authorities disallowing the cost-to-government approach in determining the existence and extent of subsidy, when such an approach is implicit in item (k) of the Illustrative List.

14. In India's view, these issues merit discussion by NG Rules for clarification in the ASCM.

15. India has certain other concerns relating to export credits that would be elaborated in its further submissions.
