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Rethinking Export Incentives in India

Anwarul Hoda

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Abstract

India's graduation from the ranks of low-income countries, making it ineligible under the WTO rules to grant export subsidies on manufactures has thrown up a new policy challenge. In this context, this paper argues for the government to rethink its export incentives programme altogether and take alternative policy actions and adopt measures that restore or improve export competitiveness but do not constitute subsidies at all under the WTO Agreement. First, it should introduce a comprehensive scheme for refund of unrebated state and central taxes, taking full care to stay within the parameters laid down in Annex II of the Agreement on Subsidies and Countervailing Measures. Secondly, it should undertake a mini - liberalising initiative to reduce import tariffs on capital goods to about half of the current level and make commensurate reductions in the tariffs of intermediate goods used in the production of capital goods. Thirdly, and most importantly, it should intensify the programmes underway to rapidly improve transport infrastructure, logistics and trade facilitation. The panel report in the dispute raised by the US in the WTO has gone against India but India has lodged an appeal. Since the Appellate Body has become dysfunctional the panel report will remain blocked indefinitely. Eventually India may have to take steps towards compliance or else it will face the threat of retaliation from the US. But it could and should argue for the US to agree on a staged compliance in view of the structural and fundamental nature of policy change recommended by the panel.

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Author's email: *ahoda@icrier.res.in*

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1. Introduction

When the WTO was established in 1995 public attention was focused on the new areas brought within the ambit of the multilateral disciplines, namely trade in services and trade related aspects of intellectual property rights. In the area of goods, agriculture was a big issue, not only for the major countries exporting farm products but also for those like India in which the sector provided livelihood to a large section of the population. Attention of a large number of developing countries exporting textiles and clothing was rivetted on the integration of this important segment of industry into the normal framework of rules of the WTO Agreement.

At that time, other changes in the framework of rules governing trade in goods did not catch the headlines. And yet there were important changes, particularly in one area of trade policy, namely subsidies, and an elaborate structure of regulations was given shape in the Agreement on Subsidies and Countervailing Measures (ASCM). This agreement covers all goods except agriculture to which the Agreement on Agriculture applies. In the pre-WTO era, the evolution of multilateral trade disciplines on subsidies was patchy, and it was only in the ASCM that a comprehensive set of regulations were developed. Subsidies were defined and classified into three categories (prohibited, actionable and non-actionable) and remedies against the first two categories stipulated. Subsidies contingent upon export performance (export subsidies) and subsidies contingent upon the use of domestic over imported goods are both put in the first, the prohibited category. Subsidies that cause adverse effect to the interests of other Members, by way of injury to domestic industry in importing countries, nullification or impairment of benefits (such as tariff commitments) or serious prejudice to the interests of other Members fall in the second, the actionable category. Certain types of subsidies, viz., assistance for research activities, assistance for disadvantaged regions and assistance to promote environmental adaptation were initially put in the third, the non-actionable category but the relevant provision (Article 8) which embodied the third category had a limited life of five years (with effect from the entry into force of the WTO Agreement, January 1, 1995) and its validity was not extended beyond December 31, 1999.

There are important provisions in the ASCM on special and differential treatment (S&DT) of developing countries. Most importantly, the prohibition of export subsidies does not apply to the least developed countries (LDCs) designated as such by the United Nations and to 20 low-income developing country Members of the WTO, listed in Annex VII of the ASCM. Annex VII (b) provides effectively for the graduation of individual low-income countries from this list, and the prohibition of export subsidies to become applicable to them once their per capita income has reached $ 1,000 per annum. At the Doha Ministerial Meeting an agreement was reached in principle that the Members listed in Annex VII (b) would remain eligible for the exemption from the prohibition on the use of export subsidies until their GNP per capita reached $ 1,000 in constant 1990 dollars for three consecutive years.

The Annex VII list of low-income developing countries includes India. With rapid economic development that followed economic liberalisation in 1991-92 it was inevitable for India to graduate out the category of low-income developing country sooner rather than later. According to the calculations made by the WTO Secretariat[1], India's GNP per capita in constant1990 dollars was $ 1,051 in 2013, $1,100 in 2014 and $1,178 in 2015. On the basis of these calculation, the prohibition on export subsidies became applicable to India under the ASCM in 2015.

The matter assumed urgency following a WTO dispute raised by the US against India in March 2018 and the composition of the Panel[2] in July 2018 (DS541, India- Export Related Measures). The dispute was invoked under the expedited dispute settlement procedures (remedies) for prohibited subsidies under Article 4 of ASCM, which require completion of these procedures within 180 days. It took a longer time because of congestion of cases, but the Report was finally circulated to Members on 31 October, 2019. The Panel Report has held that five export-related measures are prohibited subsidies and recommended their withdrawal within 90 to 180 days of its adoption by the Dispute Settlement Body. On November 22, 2019 India notified its decision to appeal certain issues of law and legal interpretation.

Before the hearing of the appeal could be scheduled there was a development of critical importance. With the retirement of two members on December 10, 2019 the Appellate Body is no longer functional with effect from December 11, 2019. The Appellate Body needs a quorum of three members, but only one remains in office. This situation has arisen because of US opposition to the filling up of vacancies in the Appellate Body from retirements since the beginning of the year 2016. The assessment is widely shared that the current administration in the US does not favour continuation of the automatic quasi-judicialized dispute settlement procedure in the WTO, and its ultimate objective is to create space for negotiations in the resolution of disputes. If the US succeeds eventually in achieving its ultimate objective it would put Members with greater economic strength and diplomatic clout like itself at an advantage in the resolution of disputes in the WTO. For this reason, the US may not lift its objection against filling up vacancies for a long time and the Appellate Body may continue to be dysfunctional indefinitely, and in the meantime the Panel Report together with India's appeal against it in DS 541 will lie in limbo.

The above development should in the long-term cause disquiet in India, as it would seem to tilt the balance of the rules based multilateral trading system in favour of the economically strong and influential Members. In the short term, however, it will give relief as it may release India from pressure to implement fundamental changes in the export incentives regime, even though it is inevitable that, having received a favourable Panel verdict in its complaint, the US would return to the subject bilaterally, sooner or later.

1 WTO Doc. G/SCM/110/Add. 14
2 WTO Doc. DS 541, India-Export Related Measures

If there is a change in the US stance, and the Appellate Body is revived and in deciding on the appeal it confirms the findings of the Panel, it would be difficult for India to maintain export incentive practices that are prohibited by the ASCM. On the other hand, if the present situation of abeyance of the Appellate Body continues and the US seeks action from India through negotiations in the light of the Panel report, it may turn out to be a different ball game. In that situation, the question that arises is whether India should try to negotiate a conclusion that is less than full and strict compliance with the ASCM rules and Panel recommendations.

In this context, this paper looks at all related issues and recommends the way forward for India to deal with these issues. Section 2 gives a summary analysis of the key provisions of the ASCM, Section 3 outlines the main features of India's existing export incentives programme and the findings of the Panel on their compatibility with the provisions of the ASCM, and identifies important changes that would need to be made in the programme if the dispute settlement process were to end up confirming the findings of the Panel. Section 4 examines various initiatives that could take to improve the competitiveness of India's exports, without subsidies that would expose them to countermeasures. Section 5 concludes with a summary of recommendations and also touches the position that India should take in the event the US seeks to conclude the dispute through bilateral negotiations, while the appeal is pending.

2. Key provisions of the WTO Agreement on Subsidies and Countervailing Measures (ASCM)

2.1 Definition of subsidy

The ASCM does not formulate a precise definition of subsidy but stipulates that a subsidy is deemed to exist if a government practice confers a benefit on an enterprise. The government practice may involve a direct transfer of funds (e.g. grants, loans or equity infusion), a potential transfer of funds or liabilities (e.g. loan guarantees), foregoing of a government revenue (e.g. tax credits) or provision of goods and services other than general infrastructure, or purchase of goods. If the government practice results in a benefit for an enterprise a subsidy is deemed to exist. If goods and services are supplied by a government entity to an enterprise at commercial rates the transactions cannot be said to involve a subsidy as no benefit can be said to have been conferred. The participation of government or a public body in making the financial contribution and the conferral of benefits on an enterprise are the two essential ingredients of a subsidy.

2.2 Exemption from indirect taxes not a subsidy

One of the key provisions of the ASCM provides that the exemption of an exported product from duties or taxes shall not constitute a subsidy. The full provision in Footnote 1 of the ASCM reads as follows: "In accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy".

2.3 Specific subsidy

Article 1.2 of the ASCM provides that remedial action can be taken or countervailing duty imposed, as provided in Part II, Parts III and V of the ASCM, and described later in Sections 2.5, 2.6. 2.8 and 2.9 of this paper only if a subsidy is specific. Article 2 lays down in its sub-paragraphs (a) (b) and (c) the following principles for determining whether a subsidy is specific:

(a) Where access to subsidy is explicitly limited to certain enterprises, the subsidy is specific;

(b) Where objective criteria or conditions govern the eligibility for or amount of subsidy, specificity shall not exist;

(c) Notwithstanding the appearance of non-specificity, the subsidy may in fact be specific.

An important footnote to Article 2 explains: 'Objective criteria or conditions, as used herein, means criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as the number of employees or size of an enterprise'.

2.4 Classification of subsidies

The ASCM classifies subsidies into prohibited, actionable and non-actionable categories and provides for Members to take remedies against the use of prohibited or actionable subsidies by other Members. For these categories of subsidies, Members that are adversely affected have two options, either to raise a dispute for remedial action or to impose countervailing duties if the subsidised goods that are imported cause material injury to domestic industry.

2.5 Prohibited subsidies

Subsidies that are contingent on either export performance or on the use of domestic over imported goods are prohibited. Annex I of the ASCM (Illustrative List of Export Subsidies) contains 12 items that are considered to be prohibited export subsidies. The list in Annex I is not exhaustive and other practices could also constitute export subsidies if they are linked to export performance.

We give more details below of four items included in the Illustrative List as they are particularly relevant in the context of India's current export incentives programme.

First, any payment by governments of subsidies or grants to a firm or industry linked to export performance constitutes a prohibited export subsidy [Item (a) on the Illustrative List].

Second, any concession on direct taxes or social welfare related to export or export performance, by way of exemption, remission or deferral, constitutes a prohibited export subsidy. Similarly, any allowance of special deductions directly related to exports or export performance, in the calculation of the base for charging direct taxes is a prohibited export subsidy [Items (e) and (f) on the Illustrative List.]

Third, the exemption or remission of indirect taxes in respect of the production or distribution of an exported product in excess of those levied in respect of products sold for domestic consumption is a prohibited export subsidy. Similarly, the exemption, remission or deferral of prior-stage cumulative indirect taxes on goods or services used in the production of the exported product are prohibited if they are in excess of those allowed for the products sold in the domestic market. It is separately clarified that these levies may be rebated (exempted, remitted or deferred) in respect of the exported products even if the benefit is not extended to products sold for domestic consumption, if the prior-stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product (making normal allowance for waste). [Items(g) and (h) on the Illustrative List.]

Fourth, the remission or drawback of import charges on inputs is a prohibited export subsidy only when the remittance or drawback is in excess of the charges levied on imported inputs that are consumed in the production of the exported product [Item (i) of the Illustrative List). Drawback of import charges is also permissible for substitution drawback schemes, in which a firm initially uses a quantity of inputs obtained from the home market and subsequently imports (within a reasonable period of time not exceeding two years) an equal quantity of inputs with the same quality and characteristics.

The logic behind the differential treatment of direct and indirect taxes is that direct taxes are levied on producers while indirect taxes are levied on products. Direct taxes cannot, therefore, be said to be 'borne by the like product' for the remission to be deemed not to be a subsidy, as provided in the Note to Article XVI of GATT 1994 and reiterated in Footnote 1 of the ASCM.

A specific and important condition with respect to rebate of prior-stage cumulative indirect taxes or drawback of import charges on inputs used for production for exports is that the input should have been consumed in the process of production of the exported product (making normal allowance for waste). Footnote 61 clarifies that '[i]nputs consumed in the production process are 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'.

Actionable subsidies

The general scheme of the ASCM is that all specific subsidies other than those that are prohibited fall in the category of actionable subsidies. Subsidies can cause injury to the domestic industry of an importing Member or they may lead to the nullification or impairment of a tariff commitment made by the subsidising Member or they may cause serious prejudice to the interests of another Member. The substantive obligation on actionable subsidies is that no Member shall cause any of these adverse effects to the interests of other Members by the use of these subsidies.

The concept of serious prejudice is derived from GATT 1947 and has been elaborated in Article 6.3 of ASCM. According to this provision, serious prejudice may arise when the subsidy impedes or displaces imports from another Member into the market of the subsidising Member or in third country markets. It may also arise when the subsidy causes significant price depression or suppression not only in the market of the complaining Member but in the markets of the subsidising Member as well as in third country markets. For primary products or commodities there is the notion also of serious prejudice being caused by an increase in the world market share of the subsidised exports.

Article 6.1, originally provided for presumption of serious prejudice in certain cases such as when the ad valorem subsidy exceeded 5 per cent or when there was direct forgiveness of government held debt. Developing countries were given protection from the application of this article even at the outset. However, the provision had a limited life of five years and has not been renewed beyond 31 December, 1999.

2.6 Non-actionable subsidies

As already mentioned earlier, Article 8 of ASCM that provided for certain categories of specific subsidies to be non-actionable lapsed on December 31, 1999. Now only the subsidies that are not specific are non-actionable. Here it is also necessary to underscore that the exemption of exports from indirect taxes is also not actionable because such exemption is not deemed to be a subsidy at all, as provided in Ad Article XVI of GATT 1994 and reiterated in Footnote 1 of the ASCM.

2.7 Remedies against subsidies

The WTO Agreement provides for an accelerated time frame for completion of dispute settlement procedures involving either prohibited or actionable subsidies, giving the panel 120 days and the Appellate Body 60 days for the submission of their reports. In the case of a positive finding on the existence of a prohibited export subsidy, the panel or the Appellate Body are mandated to recommend withdrawal of the measure. Also, in the event of the panel or Appellate Body making such a recommendation the export subsidy must be withdrawn without delay. As far as actionable subsidies are concerned, it is not sufficient for the complainant merely to claim the existence of a subsidy. In order to get a verdict in its favour from the dispute settlement panel the complainant must also demonstrate that adverse effect has been caused to its interest.

The language of the ASCM on the above aspects leaves no room for ambiguity. Para 4.7 of Article 4 reads as follows: "If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendations the time period within which the measure must be withdrawn".

Article 4.10 provides: "If the recommendation of the DSB is not followed within the time-period specified by the panel, which shall commence from the date of adoption of the panel's report or the Appellate Body's report, the DSB shall grant authorization to the complaining Member to take appropriate countermeasures, unless the DSB decides by consensus to reject the request".

2.8 Countervailing duties

The ASCM gives two options to a Member facing adverse effects from import of goods benefiting from prohibited or actionable subsidies employed by other Members. It may either take recourse to the accelerated dispute settlement procedures provided for in the ASCM or it may consider imposing countervailing duties to neutralise the effect of the subsidy. The ASCM provides that the importing Member may raise a dispute or commence investigations for imposing countervailing duties in parallel but only one relief will be available.

The ASCM lays down procedures to be followed for imposing countervailing duties on imports benefiting from subsidies in the exporting countries. Formal investigations have to be held and interested Members and interested parties given a hearing. The calculation of the amount of subsidy must be done in terms of the benefit to recipient, consistently with guidelines provided in Article 14 of the ASCM. The determination of material injury to domestic industry or threat thereof is a pre-requisite for a countervailing duty to be imposed. Investigations need to be completed normally in a year but in no case in more than 18 months. Provisional duty may be imposed if the authorities reach a preliminary conclusion on the existence of both a subsidy and material injury to domestic industry. When the investigation is completed with a final affirmative determination on both subsidy and injury it is to be left to the Member concerned to decide whether to impose a duty at all. If the decision is to impose a duty, the Member must decide whether the countervailing duty must be equal to the total amount of subsidy or less than that, if such lesser duty is considered adequate to remove the injury to domestic industry.

It has already been explained above, while dealing with prohibited subsidies, that prior stage cumulative indirect taxes and import charges that are levied on 'inputs that are consumed in the production of the exported product' are allowed to be rebated and are implicitly not treated as an export subsidy. Annex II of the ASCM contains guidelines on the consumption of inputs in the production process to be followed by the investigating agencies in countervailing duty investigations in order to determine whether there is an over-rebate or excessive payment of drawback. Similar guidelines are laid down in Annex III for the determination of substitution drawback systems as export subsidies during countervailing duty investigations.

Importantly, footnote 61 to Annex II provides an explanation of the term 'inputs consumed in the production process'. The term covers only 'inputs physically incorporated, energy, fuels and oil used in the production process and catalysts that are consumed in the course of their use to obtain the exported product'. Thus, capital goods, spares and consumables are excluded from the purview of inputs 'that are consumed in the course of their use to obtain the exported product".

Annex II stipulates inter alia that the investigating authorities should adopt a two-step procedure in cases in which it is alleged that there is an over-rebate or excess drawback:

First, the authority must see whether a verification system is in place to confirm which inputs are used and in what proportion.

Second, the authority must evaluate whether the system is reasonable, effective and based on the commercial practices in the country.

Special provisions for developing countries

(a) The prohibition of export subsidies does not apply to the Least Developed Countries (LDCs) designated as such by the United Nations which are Members of the WTO and to the low-income developing country Members listed in Annex VII of the ASCM. However, the text of Annex VII (b) provides that the prohibition of export subsidies would become applicable to the listed developing countries once their per capita income has reached $ 1000 per annum. As mentioned earlier, according to a decision made during the Doha Ministerial Meeting the developing country Members listed in Annex VII (b) would remain eligible for the exemption until their GNP per capita reached $ 1000 in constant 1990 dollars for three consecutive years. On the basis of the calculations made by the WTO Secretariat India's GNP crossed the threshold in 2015 and the prohibition of export subsidies is now applicable to India.

(b) There was less flexibility given to developing country Members in respect of the use of domestic over imported goods. Developing country Members were exempted for five years and the LDCs for eight years from the date of entry into force of the WTO Agreement, so that now the prohibition is applicable to all Members.

(c) Annex VII countries are also mandated in Article 27.6 of the ASCM to phase out export subsidies on any product (defined as a Section heading of the Harmonised System Nomenclature or HS) in which their exports reach a share of 3.25 per cent of world trade.

(d) Countervailing duty investigations against imports benefiting from subsidies in any Member have to be terminated if the overall level of subsidies is de minimis or less than one per cent ad valorem or if the volume of subsidised imports is negligible. In the case of subsidised imports from developing countries the required overall level of subsidies has been raised to less than two per cent and the required volume of imports to less than four per cent of total imports for the investigations to be terminated. However,, the countervailing duty proceedings need not be terminated if the total imports from developing country Members account collectively for more than nine per cent.

3. Main features of India's export incentives programme

We examine below the major schemes in India's current export incentives programme, as incorporated in the latest version[3] of its Foreign Trade Policy (FTP) that are relevant in the

[3] Foreign Trade Policy, Government of India 1 April, 2015-31 March, 2020 as updated on 5 March, 2017)

context of the prohibition on export subsidies that has now become applicable to India on account of the rise in its GNP per capita, as provided in Annex VII (b) of the ASCM. Each of the schemes has myriad aspects, but we limit the analysis to the central features of each scheme.

3.1 Merchandise Exports from India Scheme (MEIS)

The objective of the scheme, as expressed in the Foreign Trade Policy (FTP) is to reward the exporters to 'offset infrastructural inefficiencies and associated costs' and further 'to promote the manufacture and export of notified goods/products'. The products and the rates of reward are published in Appendix 3 B of the FTP. The duty credit scrips granted as rewards for exports are freely transferrable and may be used for payment of customs duty on import of inputs or goods or for payment of central excise duty on the domestic procurement of inputs or goods.

Under the FTP, the duty credit scrips can be used only for payment of Basic Customs Duty and Additional Customs Duty under sections 3(1), 3(3) and 3(5) of the Customs Tariffs Act. Also, the scrips cannot be used for payment of Integrated GST and GST Compensation Cess on import of goods. In the case of domestic procurement of inputs, the benefit of using duty credit scrips has not been extended to GST. However, where the imported goods are covered by Central Excise, duty credit scrips may continue to be used.

Since the rewards under the MEIS are in terms of duty credit scrips that are transferrable and usable for payment of certain types of customs duty and Central excise duty, they constitute direct subsidies and fit squarely within the description given in item (a) of the Illustrative List at Annex I of the ASCM.

3.2 Export Promotion Capital Goods (EPCG) Scheme

Section 9.08 of the FTP defines capital goods as 'any plant, machinery, equipment or accessories required for manufacture, or production, either directly or indirectly, of goods or for rendering services, including those required for replacement, modernization, technological upgradation or expansion. It includes packaging machinery and equipment, power generating sets, machine tools, equipment and instruments for testing, research and development, quality and pollution control'.

Chapter 5 of the FTP provides for import of the following categories of capital goods at zero customs duty and exempt from IGST and Compensation Cess:

'(i) Capital Goods as defined in Chapter 9 including in CKD/SKD condition thereof; (ii) Computer systems and software which are a part of the Capital Goods being imported; (iii) Spares, moulds, dies, jigs, fixtures, tools & refractories; and (iv) Catalysts for initial charge plus one subsequent charge.'

The duty-free import is subject to an export obligation equivalent to 6 times of duties, taxes and cess saved, to be fulfilled in 6 years from the date of authorization. The export obligation under the scheme is over and above the average level of exports achieved by the exporter in the previous three years for the same or similar products.

A variation of the EPCG scheme is that EPCG duty credit scrips can be used by exporters who first import capital goods on full payment of the applicable duties.

The EPCG scheme is clearly an export subsidy as the benefit of remission of customs duty as well as of IGST and compensation cess on the capital goods is explicitly linked to export performance. Linkage of the scheme with export performance is enough for the scheme to be categorized as a practice prohibited by the ASCM.

No doubt, as mentioned in Section 2 above, Article XVI of GATT 1994 provides that the exemption or remission of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those that have accrued does not constitute a subsidy. In line with this rule of general application, the ASCM envisages that drawback of import charges will constitute a prohibited export subsidy only if is in excess of ‘those levied on imported inputs that are consumed in the production of the exported product’. However, the Guidelines at Annex II of the ASCM introduce a caveat that apart from energy, fuels, oil and catalysts, inputs can be deemed to be consumed in the production process only if they are physically incorporated in the product. Thus, the exemption of customs duty and indirect taxes on import of capital goods is not covered and constitutes a prohibited export subsidy.

In the Doha Round, India had argued for inclusion of capital goods and consumables within the definition of inputs consumed in the production process to the extent of their depreciation and actual consumption respectively. The relevant paragraph from India’s submission[4] in the Doha Round, which gives the legal and economic reasons for the proposal is quoted below:

‘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 the 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 rights of the contracting parties. The improvement can be brought about by an appropriate amendment of footnote 61 of the ASCM.’

India’s Doha Round proposal makes economic sense and is also in accordance with the destination principle of indirect taxation, which is implicit in the taxation systems around the world. But the suspension of the Doha Round has resulted in the ASCM remaining unchanged. Until such times as the rule can be changed in future negotiations, India cannot reimburse import duties on capital goods used in the production of exported products without contravening the prohibition on export subsidies.

[4] WTO Doc. TN/RL/W/12

3.3 Export Oriented Units (EOUs) and sector specific schemes, including Electronics Hardware Technology Parks (EHTPs) and Bio-Technology Parks (BTPs).

Only those units that are dedicated to export their whole production of goods and services (except the sales that are permissible in the Domestic Tariff Area or DTA) are allowed to be set up as EOUs, EHTPs or BTPs. There is a specific requirement in the FTP for the units under these schemes to have Net Foreign Exchange (NFE) earnings, according to the method of calculation given in the Handbook of Procedures (HBP).

The following method of calculation is given in paragraph 6.10 of the HBP:

Positive NFE= A-B> 0

NFE is net foreign exchange, 'A' is the FOB value of exports of a unit and 'B' is the total of CIF value of all imported inputs (raw materials, intermediate goods, components, consumables, parts and packing materials) plus the CIF value of all imported capital goods and payments of commission, royalty, fees, dividend and interest on external borrowings during the first five year period.

The FTP allows an EOU, EHTP or BTPs to import or procure from the DTA or from bonded warehouses in DTA 'all types of goods, including capital goods', that it may require. Capital goods are specifically mentioned, but the reference to all types of goods would seem to include raw materials, consumables and packaging. The FTP specifically mentions that "(t)he imports and/or procurement from bonded warehouse in DTA or from international exhibition held in India shall be without payment of duty of customs leviable thereon". It goes on to say that the imports and/or procurement shall also not require the payment of integrated tax and compensation cess. The units in EOUs, EHTPs and BTPs are thus exempted from customs duties as well as indirect taxes on import of capital goods, raw materials, consumables, spares, packing material etc.

It follows from the analysis of the EPCG scheme given in the previous paragraphs that, the remission of import charges and indirect taxes on imports of capital goods for the production of goods for exports constitutes a prohibited export subsidy. In the light of this analysis, in the EOUs and EHTPs schemes, while there is no difficulty in exempting import duty in respect of raw materials, intermediate goods, components, parts and packaging, such exemption in respect of capital goods is a contravention of the rules.

Earlier the EOUs and EHTPs were eligible for the exemption from income tax envisaged in Section 10B of the Income Tax Act, 1961 for profits derived from exports. But this benefit was discontinued from the assessment year beginning on 1 April, 2012, and now there is no benefit on income tax linked to exports from EOUs and EHTPs.

3.4 Special Economic Zones (SEZs)

The Special Economic Zones Act, 2005 provides that any goods and services exported out of, or imported into, or procured from the Domestic Tariff Area by a unit in the SEZs or a by developer shall be exempt from payment of duties and taxes or cess under various enactments, but subject to subject to terms, conditions and limitations that may be prescribed. Thus, SEZ units, like those in EOUs, benefit from duty-free imports of all goods, including raw materials, intermediate goods and capital goods. In addition, Section 10AA of the Income Tax Act provided the SEZ units with 100 per cent exemption of export income for the first five years, 50 per cent for the next five years and 50 per cent of ploughed back profits for the next five years, before the sunset clause applied to the provision on April 1, 2020. All these concessions are or were available to SEZ units only if they export or exported 100 per cent of their production. As in the case of EOUs/EHTPs/BTPs there is a requirement also for the units in the SEZs to earn a positive Net Foreign Exchange (NFE), that is, the FOB value of exports must be more than the CIF value of imports. If NFE is not earned the units are liable for penal action under the Foreign Trade (Development and Regulation) Act, 1992.

SEZ units function basically in a free trade regime manufacturing goods for exports but as our analysis of the EOU scheme shows, duty free import of capital goods falls in the category of a prohibited export subsidy. The concession on income tax to which the SEZs are eligible is also a prohibited export subsidy because the concession is linked to the requirement to export 100 per cent of their production. While there is little problem with the SEZs allowing duty free imports of raw materials and intermediate goods, there is a problem with the duty-free import of capital goods and the concession on income tax linked to export performance as these incentives constitute prohibited subsidies.

3.5 Duty-free Imports for Exporters Scheme (DFIS)

A notification issued by the Department of Revenue in the Ministry of Finance (No.50/2017-Customs dated 30 June 2017) consolidates Government orders exempting from the payment of customs duty and IGST a number of items used in the processing or manufacture of sea-food, handicrafts, textile or leather garments, leather and non-leather footwear, made-ups, pharmaceuticals, and sports goods. A number of items used for research and development in the agro-chemical sector are also included in the duty-exemption order. Duty-free imports are limited to a certain percentage of the FOB value of the final product exported in the preceding financial year. Where the items accorded exemption from customs duty or indirect taxes are physically incorporated in the exported product there is no problem of consistency with the WTO obligations as the duty exemption is not a subsidy in terms of footnote 1 of the ASCM. However, wherever the duty exemption is extended to capital goods the measure constitutes a prohibited subsidy, even if they have been used in the process of production of the exported product.

3.6 Export credit subsidies

On December 4, 2015 the Government of India announced the ‘Interest Equalization Scheme on Pre and Post Shipment Rupee Export Credit’ for five years with effect from April 1, 2015. The scheme was applicable to exports by manufacturers (MSMEs as well as non-MSMEs but not merchant exporters) in labour intensive industries and employment generating industries, under 416 Tariff Headings (four-digit tariff lines) and to all exports by MSMEs. Initially, the interest equalization scheme benefited all eligible exporters equally with a 3 per cent export credit subsidy, but the subsidy was enhanced to 5 per cent for MSME exporters with effect from November 2, 2018. With effect from January 1, 2019 the benefit of 3 per cent export credit subsidy has been extended further to merchant exporters also. Funds for the export credit subsidy are made available to the scheduled commercial banks by the Central Government through budgetary allocations, which have increased from Rs 2,000 crore in 2017-18 to Rs 2,910 crore in 2019-20.

Although the export credit scheme does not feature in the Foreign Trade Policy it is a major export incentive and is no less important than any of the five other schemes described above. The scheme did not figure in the US complaint in the WTO and consequently the Panel did not examine it. However, since the subsidy is linked to exports it is manifest that it falls under the category of prohibited subsidies.

3.7 Findings of the WTO Panel in India- Export Related Measures5

The analysis in Section 3.1 to 3.5 above is confirmed in the WTO Panel Report in the dispute raised by the US against India's export related measures. On some aspects, the Panel has brought out additional points that are relevant for determining how far the export incentive programmes are consistent with the obligations of the ASCM. Its findings in respect of the various export incentives listed in Section 3 above are summarized below:

MEIS: India had argued that the objective of the scheme was remission of indirect taxes borne by the exported product and in light of footnote 1 of the ASCM MEIS could not to be deemed to be a subsidy. The Panel did not accept this argument, pointing out that the provisions of the FTP did not bear out India's argument as entitlement to MEIS depends upon exports of notified products to notified markets and the rate of rewards specified in Appendix 3B of the FTP. The Panel has held that'the duty credit scrips awarded under MEIS are subsidies contingent upon export performance, inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement.'

EPCG: As in the case of MEIS, India had contended that the scheme was covered by footnote 1 and did not constitute a subsidy under Article 1 of the ASCM. The Panel has held that the customs duty exemption under the EPCG scheme does not meet the conditions of footnote 1 read together with item (i) on the Illustrative List in Annex I of the ASCM, as capital goods cannot be regarded as inputs consumed in the production process in terms of the guidelines contained in Annex II of the ASCM and the explanation in footnote 61 of 'inputs consumed in the production process', which are limited to 'inputs physically incorporated, energy, fuels and oils used in the production process and catalysts which are consumed in the course of their use to obtain the exported product'. The Panel has, therefore, held that 'the exemptions from customs duties on importation under the EPCG Scheme are subsidies contingent upon export performance, inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement.'

[5] WTO Doc. WT/DS/541/R

EOUs/EHTPs/BTPs: The Panel has held that the scheme does not meet the condition stipulated in footnote 1 to allow exemption of customs duty only for inputs consumed in the production process. The scheme envisages exemption of customs duty in respect of 'all types of goods, including capital goods, required for its activities' and not only in respect of inputs consumed in the production process as explained in footnote 61. Furthermore, the scheme allows exemption from customs duties on <u>any other items</u> on application, without the condition that it should be consumed in the production process of the exported product. Having found that the measure is not covered by the exception of footnote 1, the logic of the Panel's conclusion is easy to see: the exemption of customs duty confers a benefit on units functioning in the EOU/EHTP/BTP schemes, which is contingent upon export performance and consequently constitutes an export subsidy prohibited by Article 3.2 of the ASCM. The stipulation that the units must earn Net Foreign Exchange strengthens the conclusion that the benefit of duty exemption is contingent on export performance. The panel has held that 'the exemptions from customs duties on importation under the EOU/EHTP/BTP Schemes are subsidies contingent upon export performance, inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement'.

SEZs: Unlike in the case of EOUs/EHTPs/BTPs India had not argued that the exemption of duty in these schemes fell under footnote 1 of the ASCM. Rather its main line of argument was that the benefit of the SEZ scheme is not contingent on export either in law or in fact. The Panel has found that the scheme provides subsidies by way of (a) an exemption from customs duties, (b) an exemption from IGST and (c) a deduction from the taxable base of SEZ units for corporate income tax, and these are all contingent in law upon export performance and are therefore inconsistent with Article 3.2 of the ASCM. Rule 53 of the SEZ Rules, which imposes the requirement that the SEZ units must earn Net Foreign Exchange 'to be calculated cumulatively for a period of five years from the date of commencement of production' was a major consideration for the Panel to the conclusion on export contingency of the subsidies. The Panel has held that 'the exemptions from customs duties on importation and exportation, the exemption from IGST on importation, and the deductions from taxable income, all provided under the SEZ Scheme, are subsidies contingent upon export performance, inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement'.

DFIS: The Panel has held that the exemption of customs duty and IGST in respect machinery, equipment and tools used in the processing or manufacture of several exported product viz., sea-food, handicrafts, textile or leather garments, leather and non-leather footwear, made-ups, pharmaceuticals, and sports goods constitutes a prohibited subsidy. Similar exemption in respect of capital goods used for research and development in the agro-chemical sector has also been found to be a prohibited subsidy. The main reason for the special treatment of capital goods used in the manufacture of the exported product is that they are not inputs that can be said to be consumed in the process of manufacture of the exported product, as stipulated in paragraph (h) and (i) of Annex I of the ASCM. Duty-exemption of imports of samples of hand-knotted carpets has also been treated as a prohibited subsidy because the samples are not physically incorporated in the exported product. Wherever duty-exemption has been envisaged in respect of inputs that are physically incorporated in the exported product and thus can be said to have been consumed in the process of manufacture the measure has been found to be consistent with the obligations of the ASCM. In other cases, the Panel has held that exemptions from customs duties on importation 'are subsidies contingent upon export performance, inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement'.

The conclusion from the above analysis is that, in case the dispute India- Export Related Measures (W/DS541/R) is taken to its logical conclusion and the Appellate Body confirms the findings and recommendations in the Panel Report, the MEIS and EPCG schemes will need to be withdrawn in entirety. These schemes were compatible with India's WTO obligations up to 2015, but the rise in the country's GNP per capita since then has resulted in India being graduated out of eligibility for the flexibility to use subsidies contingent on export performance to promote exports.

The core of the schemes for EOUs/EHTPs/BTPs, SEZs and DFIS will remain essentially compliant with India's obligations but they will need modification to eliminate some elements in the schemes that are in conflict with the provisions of ASCM. In all three scheme the exemption from customs duty of imports by units or remission of indirect taxes will need to be restricted only to inputs consumed in the production process. In other words, capital goods, spare parts, equipment, machinery, tools and any other input outside the categories specifically mentioned in footnote 61 (physically incorporated inputs, energy, fuels and oil and catalysts) will need to be excluded from duty exemptions. It may not be necessary for India to take any corrective action with respect to the direct tax concessions for SEZ units, as the sunset clause in respect of these concessions becomes effective on April 1, 2020. The Panel had circulated its report on 31 October, 2019 giving India 180 days to comply in respect to the SEZ units.

Although the export credit subsidy scheme known as the Interest Equalization Pre and Post Shipment Rupee Export Credit is not covered by the Panel Report, it has to be recognized that the scheme clearly constitutes a prohibited subsidy and India is vulnerable to action by other Members seeking remedy under Article 4 of the ASCM.

4. Rethinking export incentives and other initiatives to improve international competitiveness of manufacturers

Although the WTO Panel has ruled against India's export incentives, India has lodged an appeal and at present the conclusion of the process is not in sight. The Appellate Body has become non-functional because of vacancies and there is no consensus among Members for filling them. However, if the dispute raised by the US were to run its full course, and the Appellate Body were to confirm the Panel recommendations India will have to withdraw or curtail a number of its export incentives schemes. There is also a very real possibility that India has to withdraw these incentives under the threat of retaliation from the US, which has the Panel report in its favour. Such a step is bound to considerably disincentivize the country's exports. In the post-WTO era, India got used to export incentives to which the low-income developing countries are entitled under the ASCM, and the loss of the benefit due to graduation will be a blow to its development efforts. As it is, with millions of new job-seekers joining the work force every year on top of a huge backlog of unemployment, Government faces a formidable task in helping its manufacturing industries to improve competitiveness. These industries need to be enabled not only to withstand competition from imports but also succeed in their endeavour to expand presence in international markets. To deal with the blow of graduation from the ranks of low-income developing countries eligible for the benefit of granting export subsidies, Government will need to take new initiatives and adopt alternative policy measures. Instead of trying to remodel export incentives, we should rethink the strategy totally and look for alternative policy instruments that do not envisage subsidies at all but have the potential of improving the competitiveness of the country's manufacturers. Subsidies contingent on export performance, such as those we have got accustomed to in the last 25 years or so, are ruled out altogether, as the prohibition of such subsidies in the ASCM now applies to India. We should eschew additional actionable subsidies as well. Government of India is already granting subsidies to induce technological upgradation and in future it may consider doing so, with the narrowly focused objective of attracting industrial units, which are at the cutting edge of technology and have the potential to generate momentum for the growth of ancillary and downstream industries. But it would be inadvisable to grant such subsidies in the context of the Panel (or Appellate Body) report, lest it be considered as a case of re-instrumentation of prohibited measures. The international trade environment is becoming increasing difficult for the use of subsidy and the US, the EU and Japan are proposing to enhance disciplines on it in the WTO. Under the ASCM it is already possible for importing countries to levy countervailing duties if subsidized imports cause material injury to domestic industry. There is no use granting more subsidies and the watch the importing countries mop up these payments as countervailing duties.

In the paragraphs that follow we explore policy instruments that can enhance the export competitiveness of our manufacturing industry but at the same time do not constitute a subsidy under the ASCM. Bearing in mind the provisions of Article XVI of GATT 1994 (Note to Article XVI) and Footnote 1 of the ASCM, the first preference must be given to achieving the objective of neutralizing exports of all duties and taxes. The Government of India already exempts all exports from GST, and in addition it has envisaged rebate of embedded taxes on textiles and clothing exports. What is needed is a comprehensive scheme for rebate of State and Central Embedded Taxes and Levies in all segments.

4.1 Introduction of a comprehensive scheme for rebate of taxes and levies embedded in production for exports

We have already seen that exemption from or remission of prior stage cumulative indirect taxes on goods or services or import charges on inputs consumed in the production of exported goods are not to be deemed as subsidies, as provided explicitly in the ASCM. To understand the scope for additional export incentives in India, we undertake initially an examination of the indirect taxation regime in the country with a view to identifying scope for payment of additional incentives.

4.1.1 Contours of Goods and Services Tax (GST) introduced in July 2017

How much scope is there for refund of embedded taxes in the indirect taxation system now in force in the country. Until a little over three years ago, myriad taxes applied on the manufacture and sale of goods in the country and on services, some imposed by the Central Government and others by the State Governments. However, with effect from 1 July 2017 a destination-based consumption tax, the Goods and Services Tax (GST) was introduced, replacing all these taxes (except a few described below). It is a comprehensive indirect tax levied on the manufacture, sale and consumption of goods and services at the national level. The GST is chargeable simultaneously by the Centre (CGST) and the State (SGST) in the location where and at the time when the supply takes place.

Under the Central Goods and Services Tax Act, 2017 the CGST is levied on all intra-State supplies of goods or services(except on the supply of alcoholic liquor for human consumption)at rates notified by the Government on the recommendations of the GST Council. At the same time, under the State Goods and Services Tax Act of the State Government concerned the SGST is levied at the same rateon the intra-State supplies of goods and services.

An Integrated Goods and Services Tax (IGST) is levied and collected under a Central legislation on interstate supply of goods and services. Accounts are settled from time to time and the SGST component is transferred to the State in which the goods or service is finally consumed.

A fundamental feature of the GST is that it amalgamates various central and state taxes under a single tax leaving no scope for cascading, which was the bane of the internal taxation system in India earlier. Every registered person is entitled to take credit of input taxes (whether central, State or integrated tax) paid on any supply of goods or services which are used at an earlier stage of the business.

IGST is also levied and collected by the Centre on imported goods and services. Exports are zero-rated supplies. Exporters have the option of either paying the output tax and claiming refund or exporting under bond without payment of tax. Thus, exporters have the facility of claiming refund of input tax credit for all the taxes paid on inputs at the earlier stages of production process.

The GST subsumes the central excise duty, excise duty on medicines and toilet preparations, additional excise duty on goods of special importance, additional excise duty on textiles and textile products, countervailing duties on imports, special additional duty of customs, services tax and central surcharges and customs, all levied earlier by the Central Government. The GST also subsumes State Vat, central sales tax, luxury tax, octroi and other entry taxes, entertainment tax, advertisement tax, purchase tax, taxes on lotteries, betting and gambling, and State surcharges and cesses all levied earlier by the State Government.

However, as mentioned above, a few taxes have not been included in the purview of GST for the present. Section 9 of the CGST Act and Section 5 of the IGST Act excludes altogether alcoholic liquor for human consumption from the purview of goods taxable under the legislations. It has also been provided in these sections that in respect of five petroleum products, viz. crude petroleum, petrol, high speed diesel, natural gas and aviation turbine fuel the taxes will be levied with effect from such date as may be notified. Since such a notification had not been made until the date of writing, in effect these six products remain exempted from GST. In order to allow some flexibility to the States to levy taxes on these goods, which have a high revenue potential, a political compromise has been made and the application of GST to them deferred. Article 279 (5) of the Constitution provides for the GST Council to recommend the date on which the GST will be levied on these products, and the GST Council has not yet made a recommendation in this regard. Where there is statutory exclusion, as in the case of alcoholic liquor, or until such times as the date has not been notified for five petroleum products, the States and the Centre retain powers to levy taxes on them.

Section 11 of the CGST Act and Section 6 of the IGST Act empower the Central Government to exempt certain services from the application of these Acts. Certain services have been exempted under these provisions, out of which the important ones are government services, certain transport services, insurance services, and certain public services, including transmission and distribution of services, services educational services provided by educational institutions and health care services provided by clinical establishments. Exclusion of transmission and distribution of electricity by notification has enabled many States to continue to levy electricity duty on the distribution of electricity in their jurisdiction outside of the GST.

If the GST were all inclusive it would have made compliance easier and boosted revenue. At the same time, it would have enabled manufacturers to claim full credit for, and exporters to obtain exemption from taxes on inputs paid across the value chain.

From the above description of the current indirect tax regime it appears that in the GST we already have a system whereby prior stage indirect taxes are taken into account and credit is given for taxes on inputs, and under the IGST Act exports are zero-rated. However, the date of entry into effect of the GST on five petroleum products has not been notified as yet and electricity is exempted from the purview of GST.

Consequently, there is no automatic system for refund of taxes on these inputs used in the production process and taxes on these important inputs in the value chain remain embedded in the product. According to the definitions given in the ASCM, energy, fuels and oils are deemed to be inputs consumed in the production process of the exported products along with physically incorporated inputs and catalysts and rebate of indirect taxes on these inputs is specifically permitted.

In a submission[6] dated July 19, 2018 addressed to the DGFT, Department of Commerce, the Engineering Export Council (EEPC) have indicated their estimation of the unrefunded prior stage indirect taxes on a number of exported products. According to the calculations made by the EEPC on a few specific products, the unrebated taxes work out to 3.5 per cent on fine tungsten and molybdenum wires manufactured in Mysore, 3.5 per cent on iron and steel castings, manufactured in Kolkata, and 3.75 per cent on pumps (place of manufacture not mentioned). In the case of cast iron articles, the manufacturing process of which is energy-intensive the incidence of electricity duty alone is said to be very substantial.

4.1.2 Duty drawback for import taxes levied on inputs

The Department of Revenue has a system for refund of customs duty levied on inputs used for the production of exported products. The system has been well described in a Department of Revenue circular issued recently[7] to Export Promotion Councils and other bodies, calling inter alia for data for the review of All Industry Rates (AIR) of duty drawback for the year 2019. Export Promotion Councils, commodity boards, trade and industry associations and chambers of commerce have been asked to furnish data on the customs duty paid on inputs used for the manufacture of the export products. The data has been sought from the addressed organisations in respect of at least five representative units of manufacturers or manufacturer-exporters for each product. These organisations have also been requested to compile the data submitted by individual manufacturers and exporters for the product. A specific point mentioned in the circular is that the data should be based on relevant documents such as bills of entry for the imported input and shipping bills for the exported products, duly certified by the Chartered Accountant of the manufacturer. The manufacturers or exporters have to be ready for inspection of records by customs officials for verification of the veracity of information. This procedure of calling for data for review is repeated annually.

One feature of the drawback system is that the Department of Revenue uses the same system for seeking information on the incidence of central excise on inputs that have been used in the manufacture of exported goods but are excluded from the ambit of GST. As stated earlier, indirect taxes on five petroleum products are excluded from the GST chain and these products pay taxes and duties levied by both State and Central Governments. The Department of Revenue uses a common procedure for drawback of customs duty and refund of Central excise on petroleum products used as inputs in the production of the exported product.

It is learnt that while the Central excise duty is refunded to the extent that petroleum products are used for trawlers and other fishing boats used for capture of marine products and for petroleum products used for running captive power generation equipment during the manufacture of exported products, no such refund is provided for diesel and motor spirits used for the transportation of parts and components needed for the manufacture of the exported finished product.

6 A copy of this submission has been made available by email to ICRIER by the EEPC on 4 October, 2019
7 Department of Revenue, Ministry of Finance, notification No. F. No. 609/30/2019-DBK dated 01-10-2019

On the basis of the circular dated 1 October, 2019 issued by the Department of Revenue it can be stated that as far as import charges on inputs consumed in the production of the exported products are concerned the Government of India has a system in place and applies a procedure to confirm which inputs are consumed and in what amounts. The fact that data are sought from individual manufacturers (duly certified by chartered accountants) as well as from representative bodies and inspections and test checks are carried out, it is likely that investigating authorities in importing countries will assess the procedures to be 'reasonable, effective for the purpose intended, and based on the generally accepted commercial practices in the country of export". We have seen that a parallel system has been devised for the refund of Central excise on petroleum products used as inputs in prior stages of production of all exported products.

4.1.3 RoSCTL scheme of Ministry of Textiles

In 2016, even before the introduction of the GST, the Department of Revenue had adopted a mechanism[8] for the Rebate of State Levies on Export of Garments (ROSL). The mechanism was later extended to cover made-ups as well. Since then, the guidelines have been revised and the Ministry of Textiles has issued two notifications on 7 March, 2019 and 8 March, 2019[9] (RoSCTL) for apparel and made-ups. The notification dated 7 March, 2019 spells out the guidelines and the notification dated 8 March, 2019 lists the rate of levies and taxes to be refunded, sub-heading wise. The notifications envisaged that the scheme will be implemented through a Merchandise Exports from India Scheme (MEIS) type of scrip system but such a system had not become operational until the date of writing (9 December, 2019). It is expected that the scheme will be implemented eventually and we examine the contents of these notifications.

4.1.4 Levies and taxes taken into account for RoSCTL

The notification No. 14/26/2016-IT (Vol II) dated 7 March, 2019 identifies the levies that are sought to be rebated. State level taxes comprise VAT on fuel used in transportation and captive power, 'farm sector', mandi tax, duty on electricity, stamp duty on export documents, embedded SGST paid on inputs such as pesticides, fertilizers etc. used in the production of raw cotton, tax on inputs purchased from unregistered dealers, tax on coal used in the production of electricity and 'inputs for transport sector'. Central taxes and levies comprise central excise duty on fuel used in transportation, embedded CGST paid on inputs such as pesticides, fertilizers etc. used in the production of cotton, taxes on inputs purchased from unregistered dealers, 'inputs for transport sector and embedded CGST and Compensation Cess on coal used in production of electricity.

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8 Rebate of State Levies on Export of Garments, Department of Revenue Notification No F No. 605/42/2016-DBK (Pt II)

9 Scheme to Rebate State and Central Embedded Taxes and Levies to support the Textile Sector, Ministry of Textiles, Notification No. 14/26/2016-IT (Vol. II), dated the 7th March, 2019 and dated the 8th March Gazette of India: Extraordinary, www.taxguru.in (accessed 30-10-2019)

In evaluating the components enumerated above we have to recall that prior stage indirect taxes and customs duty levied on inputs consumed in the production process that can be refunded comprise only of 'inputs physically incorporated, energy, fuels and oils used in the production process and catalysts…'. Stamp duty on export documents is clearly inadmissible for refund. 'Inputs for the transport sector' mentioned in both State and Central taxes lacks clarity, because fuel used in transportation is separately listed. 'Farm sector' is mentioned under State taxes but the tax or levy sought to be rebated is not precisely identified. Another element that may not be acceptable to India's trading partners is 'taxes on inputs purchased from unregistered dealers' as the value put against this item will be regarded as difficult to verify.

A significant aspect of the RoSCTL scheme is that at both State and Central levels taxes on fuel used in transportation are sought to be refunded. To the extent that this refers to the transportation of raw materials and intermediate products that have been physically incorporated in the exported product we have to consider whether transportation can be regarded as a part of the production process. Manufacturing has always involved transportation of raw materials and semi-processed good, but in modern manufacturing parts and components are obtained from specialized suppliers over long distances, and the proportion of parts and components outsourced to other manufacturers has been increasing in recent decades. Manufacturing has evolved considerably from the time it used to be done largely on a single factory floor. International production sharing and supply chains involve moving consignments of parts and components across international borders and from the ports and airports to the factory. Indeed, supplies of parts and components manufactured within the country involves a large amount of transportation. It can be argued that the fuel consumed in the transportation of raw materials and intermediate goods (part and components) that are physically incorporated in the exported product is covered by the term 'ínputs that are consumed in the production of the exported product', and the taxes on such fuel can be refunded consistently with the WTO rules.

4.1.5 Procedure for determining rates of refund in RoSCTL

It is mentioned in the notification dated 7 March, 2019 that rates of RoSCTL on exports of garments and made-ups have been recommended by the Drawback Committee constituted by the Central Government.

The notification dated 8 March, 2019 contains four Schedules, 1,2,3 and 4. Schedule 1 lists the rate of State taxes and levies and Schedule 2 similarly lists the Central taxes and levies on apparel and made -up items, sub-heading wise under HS Chapters 61, 62 and 63. Schedules 3 and 4 list the State and Central taxes for apparel exports when the fabric only has been imported duty free under the Special Advance Authorization Scheme.

In Schedules 1 and 2 the rates are generally in the range of 2-3 per cent, whereas in Schedule3 and 4 there are uniform rates of State and Central levies 1.37 and 1.08 per cent, respectively for all categories of apparel.

Undoubtedly, the notified rates of refund are the result of due diligence by the Drawback Committee but obviously they are the result of internal calculations in the Committee. But in the absence of detail it would be difficult for a third party like the investigation agencies in importing countries in a future countervailing duty case to conclude that India 'applies a procedure to confirm which inputs are consumed and in what amounts'. Consequently, it would be difficult for such investigation agencies to assess that the procedures are 'reasonable, effective for the purpose intended, and based on the generally accepted commercial practices in the country of export.

4.1.6 Introduction of a Comprehensive Scheme for Rebate of State and Central Embedded Taxes and Levies for all Export Segments

In the light of the analysis in sections 4.1.1 to 4.1.5 above it seems to be appropriate for the Government of India to introduce a comprehensive scheme for rebate of State and Central taxes and levies covering all export segments. In fact, extension of the RoSCTL to cover all exported products is under the active consideration of government. On September 14, 2019 the Minister of Finance has announced the Remission of Duties or Taxes on Export Product (RoDTEP) scheme, which is expected to come into force during the year 2020.

In considering the introduction of such a general scheme for refund of unrebated State and Central taxes and levies Government should limit the refund of taxes to 'inputs physically incorporated, energy, fuels and oils used in the production process' as stipulated in the ASCM (Footnote 61). There is a good case for refunding taxes on fuel used in the transportation of inputs for the manufacture of the exported product. While analyzing RoSCTL we have already argued that this would be not only in conformity with the provisions of the ASCM but will also accord with the destination principle of indirect taxation, which is internationally accepted.

Further, the rates of refund should be determined in such a manner that they give confidence to agencies in importing countries that there is a procedure in place to confirm which inputs are used and in what proportion and the procedures are reasonable and effective. For instance, it can be done on the same basis as for the determination of drawback rates for refund of customs duty levied on inputs used for the production of exported products.Data can be sought in the same manner from the Export Promotion Councils, Commodity Boards and the Chambers of Commerce on the taxes and levies paid on inputs physically incorporated, energy, fuels and oils used in the production process.

4.2 Is there scope for the introduction of non-specific subsidies that would be non-actionable?

The Engineering Export Promotion Council of India have suggested that new benefits, such as preferential credit, could be given to the MSMEs, taking advantage of the apparent exclusion from action ability of subsidies deemed to be non-specific under sub-paragraph (b) of Article 2.1 of the ASCM.As mentioned earlier, this sub-paragraph provides that where objective criteria or conditions governing eligibility for, and the amount of, a subsidy have been established,'specificity shall not exist'. Jackson[10] and Muller[11] have explained the broad policy argument underlying the stricter treatment of specific subsidies in the rules. However, others have raised questions on the rationale of certain aspects of the rules. Coppens[12] finds it difficult to understand how the application of objective criteria can make a difference on the question of specificity, "since those subsidies would remain confined to 'certain enterprises'". The absence of case law in which a subsidy practice has been accepted as non-specific as a result of the application of the objective eligibility criteria adds to the difficulty in interpretation of the provisions in the ASCM on non-specificity. At this stage it is doubtful that a new incentive can be adopted for the MSMEs on the assumption that it would be non-actionable if applied on the basis of objective criteria.

There are a number of schemes already in existence, in which various types of subsidies are granted to MSMEs. In 2006, the Union Government enacted the Micro, Small and Medium Enterprises Development Act, 2006 (No. 27 of 2006), which according to its Preamble is aimed at 'facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises'.

The Micro, Small and Medium Enterprises Development Act, 2006 (as amended up to date) defines micro-enterprises as those that are engaged in the manufacture, processing or preservation of goods, with investment in plant and machinery not exceeding Rs. 25 lakh. The investment limit in plant and machinery for small enterprises is Rs 5 crore and for medium enterprises Rs 10 crore. For enterprises providing services, the corresponding investment in plant and machinery are Rs 10 lakh, Rs 2 crore and Rs 5 crore respectively. Government is considering a proposal to define the micro, small and medium enterprises in terms of limits on turnover of Rs 5, 75 and 250 crore respectively. The change in definition in terms of turnover has been recommended by the Expert Committee on Micro, Small and Medium Enterprises headed by Mr. U K Sinha established by the Reserve Bank of India, which submitted its Report on 25 June, 2019.

The Government of India has already granted a number of financial benefits to MSMEs such as collateral free bank loans, subsidy on patent registration, protection against delayed payment of bills (through the requirement of payment of interest in the event of delay in such payment, and reimbursement of ISO certification charges. A significant benefit provided to Micro and Small Enterprises is the Credit Linked Subsidy Scheme for Technology Upgradation. Under this scheme, a capital subsidy of 15 per cent is provided to micro and small enterprises on institutional finance of up to Rs 1 crore availed by them.

Except for the credit linked subsidy scheme for technology upgradation, the above-mentioned financial benefits involve no or de minimis subsidy. The criteria for classifying enterprises as MSMEs in terms of investment in plant and machinery are indeed objective and neutral. But

[10] Cited by Muller

[11] Muller, W (2017). WTO Agreement on Subsidies and Countervailing Measures: A Commentary. Cambridge University. P163

[12] Coppens, D (2014), WTO Disciplines on Subsidies and Countervailing Measures: Balancing Policy Space and Legal Constraints, Cambridge University Press, p 106.

we have to recognize that the definition of MSMEs covers only manufacturing and service enterprises and does not include agricultural and mining enterprises. Even if we were to take into account the exclusion of agriculture from the disciplines of the ASCM, we have still to reckon with the fact that mining is not covered by the definition of MSMEs. Subsidies granted to MSMEs are, therefore, likely to be treated as specific (and, therefore, actionable) subsidies in most jurisdictions. Three factors combine to undermine confidence in pushing the case for MSME benefits to be regarded as non-actionable: lack of logical basis for treating subsidies as non-specific when objective criteria govern eligibility, the absence of case law on non-specific subsidies, and the exclusion of mining enterprises for eligibility.

4.3 Reduction of import duty on capital goods

In the light of the provisions of the ASCM the exemption or remission of customs duty on capital goods used in the production of the exported product constitutes a prohibited subsidy. If the Appellate Body is revived and it confirms the panel findings, it will be necessary eventually for the Government to make changes in four of the major export incentives schemes, viz., EPCG, EOUs/EHTPs/BTPs, SEZs and DFIS so as to withdraw from manufacturers/exporters the benefit of duty-free treatment with regard to capital goods. In the event of a bilateral engagement with the US the benefit of duty rebate on capital goods in various export incentives schemes is likely to be a major US target. Withdrawal of rebate for customs duty on capital goods used for the production of exported goods will raise the price of exported goods and lower India’s competitiveness.

The WTO rules apply to all Members equally and none can exempt exported products from the customs duty levied on capital goods. Other Members also impose customs duty on capital goods, and do not make any refund on exports for the production of which these capital goods are used. Since the ASCM rules compel Members to absorb the customs duty on capital goods in the price of the exported goods, the level of such duty affects the international competitiveness of exporting countries. It is relevant in this context to look at the comparative picture of the simple average of customs duty, applied on an MFN basis on selected but representative capital goods products in key countries.

Comparative picture of applied import tariffs on selected capital goods in key countries

Tariff Subheading	China	E.U.	India	Japan	Korea	U.S.
845221	12	3.7	7.5	0	8	0
845320	8.4	1.7	7.5	0	8	0
845811	9.7	2.7	7.5	0	8	4.4
846120	15	1.7	7.5	0	8	4.4
846210	10.85	2.2	7.5	0	8	4.4
846330	10	2.7	7.5	0	8	4.4

Source: WTO-IDB

Note: All tariff rates are for 2016 except China in which they are for 2015

It would be seen that the developed countries have generally very low or zero tariffs except Korea in which the duty is uniformly set at eight per cent. China's import tariff on capital goods is the highest among leading manufacturing countries in the world. But because of the high level of China's competitiveness in manufacturing due to a number of factors such as the quality of infrastructure and low level of logistics cost the country is perhaps able to absorb the cost disadvantage of the relatively higher duties on capital goods.

The adverse effect of the implementation of the Panel Report with regard to capital goods could be neutralized if the Central government were to decide to eliminate customs duty on imports of all capital goods. However, such a step is not conceivable in the short run as we have a substantial capital goods industry, which will be adversely affected, particularly because import tariffs apply on several intermediate products such as steel plates, copper and aluminum and instrumentation.

After economic liberalization in 1991-92, India's import tariffs on non-agricultural products were reduced drastically, with a few exceptions such as automobile products. The peak tariffs on non-agricultural products were reduced from 150 in 1991-92 to 10 per cent in 2007-08, with the tariff on capital goods being generally set generally at the level of 7.5 per cent. The liberalization processed stopped thereafter, the immediate reason being the onset of the great recession globally. In fact, the trend in recent years has been to increase tariffs, and in a number of instances the MFN rates have been raised even above the bound level. This development has led to disputes being raised in the WTO by our trading partners.

Taking all aspects into account the line of action that is worthy of consideration by the Government is the initiation of a mini-liberalization initiative in tariffs involving mainly a gradual reduction of peak tariffs on capital goods. Initially, a reduction could be envisaged from 7.5 to 4 per cent. Along with the gradual reduction of tariffs on capital goods it will be necessary to undertake reduction of tariff on intermediate goods as well, such as steel, aluminum, copper and measuring and checking instruments. A mini-liberalization of tariffs encompassing capital goods and inputs for the capital goods industry will alleviate the situation for manufacturer exporters, adversely affected by the withdrawal of the EPCG scheme and the exclusion of capital goods from the benefit of exemption or remission of duty in EOUs/EHTPs/BTPs, SEZs and DFIS .

4.4 Improvement of trade infrastructure and logistics and trade facilitation

One of the main reasons for the lack of competitiveness of the goods manufactured in India is the higher cost incurred by the trade in port logistics and in the moving the goods in the domestic area by rail or road. The higher cost is the cumulative result of the inadequacies of rail, road and port infrastructure and inefficiencies in the processes adopted in regulating the flow of goods. A recent report[13]estimates that the average cost incurred by exporters and importers on port logistics alone in India is 15 per cent of the value of consignment. Government of India's Foreign Trade Policy, 1st April 2015- 31st March, 2020, acknowledges that the objective of various export incentive schemes 'is to provide rewards to exporters to offset infrastructural inefficiencies and associated costs'. No doubt, both Central and State governments have been making efforts in past decades to improve the country's physical infrastructure, including the transport infrastructure. However, with the prospect of existing export incentives being eliminated, and the limited extent to which the loss of incentives can be redressed by introducing alternative schemes that are not actionable or countervail able, it is time to redouble efforts on trade infrastructures and logistic processes.

India has lacked world class road infrastructure, and this has been a major reason for higher logistics cost. No doubt considerable construction work was carried out in the National Highways Development Programme (NHDP) launched in 1999-2000to improve the quality of roads, particularly on the major routes on the Golden Quadrilateral connecting the four major metro cities viz., Mumbai, Delhi, Kolkata and Chennai. However, the main deficiency of roads in the country is that multiple types of vehicles moving at different speeds on the same roads slow down the traffic and inflates the logistics cost. What is needed is access-controlled expressways of the type they have in the developed countries and in China, which allow only fast-moving traffic and excludeslow-moving vehicles. And we need these expressways particularly in the routes connecting the production centres with the ports. In the NHDP, a stretch of only 1000 km of expressways was planned but eventually it was not taken up at all. Outside the centrally-sponsored projects there were some initiatives by the State governments and several access-controlled expressways came up, the longer ones being Mumbai-Pune (2002), Noida-Agra (2012), Eastern Peripheral Highway (2018), Western Peripheral Highway (2018), and Agra-Lucknow (2017), but none of these is important from the point of view of freight movements. Theambitious road construction programme, the Bharatmala Project, launched in 2017, envisages construction of 66,100 km of roads, of which 1,900 will be expressways. Bharatmala also includes 4,100 km of coastal and port connectivity roads, although the programme has not taken concrete shape. Since more than 70 per cent of the movement of containers is concentrated on the western economic corridor, an expressway from Delhi to Mumbai will contribute considerably to the reduction of logistic cost for manufactured goods.

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[13] Dun & Bradstreet -Port Logistics Issues &Challenges in India, 2018.

From the point of view of both the economic cost and the environment it would be even more advantageous to achieve a modal shift of freight movements in the country. Freight movement by rail has not flourished in India for two reasons. First, congestion of traffic in key corridors makes the use of railways for freight movements unreliable, as the shipper is not given any assurance on when the consignment will be delivered at the destination. Second, the Railways cross-subsidise low passenger fares with high freight charges. As a result, the railway share of container movement in the country is at the low level of 18 per cent. To decongest railway traffic the Railways have already undertaken the 1,506 km Western Dedicated Freight Corridor (WDFC) from Dadri in Haryana to JNPT in Maharashtra, and the 1,337 km Eastern Freight Corridor (EDFC) from Ludhiana in Punjab to Dankuni in West Bengal. Four other corridors, running North-South, East-West, East-South and South-South are in the planning stage. When all these railway freight corridors have been completed, there will be a quantum reduction in logistics cost in the country. The WDFC, which is nearing completion, will make the maximum contribution as a high proportion of container movements already takes place on the routes in this part of the country. The corridor is already being built to serve JNPT, but it would be necessary to connect it to two other container ports, viz., Mundhra and Pipavav. To maximise benefits, rationalisation of rail freight charges must also be undertaken as soon as possible.

As for ports, a favourable development in recent decades has been that non-major ports that are more efficient handle a rapidly growing share of the cargo traffic. But major ports still handle the bulk of the traffic. These ports have a capacity of 1,514 million tonnes per annum (March, 2019) against which they handled a traffic of 699.09 million tonnes in 2018-19[14] . There is thus not so much of a capacity constraint in the port infrastructure at present. But, as a recent report by Dun & Bradstreet (2018) has pointed out, the increase in capacity of major ports over the past years has not been accompanied with a commensurate increase in the supporting infrastructure, as a result of which users suffer from time delays and the hold ups translate into increased cost. The report points out deficiencies particularly in safety & security equipment, berthing, cargo handling equipment, quality of IT infrastructure, warehousing/storage, scanning facilities and testing facilities/ laboratories. Elimination of these deficiencies in the ports will lead to a substantial reduction of logistics cost.

While upgrading the physical logistics infrastructure, viz., roads, rail and ports, will make a big contribution towards improving the competitiveness of merchandise exports, it will be equally important to give attention to the regulatory processes that delay movement of goods for both imports and exports. Government of India has already taken multiple trade facilitation measures to reduce the hurdles but more is needed as outlined in the illustrative list below:

(i) The risk management system (RMS) was established for imports in 2005, whereby only selected Bills of Entry (BE) were taken up for assessment and examination and the remaining were cleared on the basis of self-assessment, after payment of duty. The RMS was extended to export consignments in 2013. The RMS has expedited the process of

[14] Economic Survey, 2020.

customs clearance and resulted in considerable reduction in dwell time for imports and exports. However, the proportion of consignments benefiting from RMS in India is still low at 80-85 per cent, against what may be considered the gold standard of 97-98 per cent in the developed countries, the EU and the US

(ii) A long-term trade facilitation aim of the Government of India has been to allow importers and exporters to lodge their clearance documents online at a single point without interface with the regulatory authorities. This objective was achieved with the introduction of e-SANCHIT on the import side[15] in October 2017 and on the export side in August 2018. e-SANCHIT is an online application that enables a trader to submit all supporting documents for clearance of consignments with digital signatures, dispensing with the need for submitting paper documentation.

A related programme of the Central Board of Excise & Customs isfor enabling the uploading of licences, permits, certificates and other authorisations (LPCOs) issued by the regulatory agencies as a part of the implementation of the Single Window Interface for Trade (SWIFT)[16]. Under this programme, when importers and exporters lodge their customs clearance documents at a single point with the customs, the necessary permission from other regulatory agencies, referred to as participating government agencies or PGAs, such as Food Safety Standards Authority (FSSAI), Department of Plant Protection, Animal Quarantine, Drug Controller, Textile Committee and Wild Life Crime Control Boardis obtained online. The PGAs have been enabled to upload digitally signed Licences, Permits, Certificates and other Authorizations (LPCOs) on e-SANCHIT at all locations As many as 50 regulatory agencies of Government concerned with clearance of imports and exports have come on board (up to 10 February, 2020) and importers/ exporters are being given online clearance without the need to approach the agencies separately. CBEC is in the process of consulting with these agencies for developing criteria for risk-based selection of consignments in which it will be compulsory to make a reference to them for a no objection certificate. This will take trade facilitation further forward. So far this has been finalized only with respect to a few regulatory agencies and work is ongoing with respect to others.

(iii)The Accredited Clients Programme (ACP) was introduced at the time of introduction of the RMS in 2005 for reputed importers with a good track record of voluntary compliance and meeting specific criteria, who were to be provided with assured facilitation. The clients' benefit included virtually automatic clearance of consignments on the basis of self-assessment or self-declaration. Subsequently, in the context of the development of international supply chains, the foundation was laid in the World Customs Organisation for the Authorised Economic Operators (AEO) programme. In India, the AEO programme was launched in 2011 (Customs Circular No 37/2011 dated 23.08.2011) applicable to importers, exporters, logistics providers and customs house agents (CHAs). The two facilitation schemes were later merged into a combined three-tier(T1,T2 and T3).

15 Circular No. 40/2017 dated 13.10.2017

16 Circular No. 11/2020-Customs, F. No. 450/148/2015- Cus-IV

AEO Programme, with the importers and exporters in T3 receiving the maximum facilities. A weakness of the programme is that the benefit can be suspended or the AEO status downgraded, even at the stage of the issuance of a show-cause notice for an infraction or non-compliance that has been detected.

(iv) Container freight stations (CFS) have been established near ports to enable freight shipments to be consolidated or deconsolidated and examination by customs to take place outside the port area, which is often congested because of space constraint. Although the CFS system is convenient for both exporters and importers, it causes delays and increases transaction cost. For this reason, Direct Port Delivery (DPD) for imports and Direct Port Entry (DPE) for factory stuffed export containers have been envisaged and implemented.DPD enables importers to clear their cargo directly from the wharf within a short time of landing at the port, without the need for moving it first to an off-dock container freight station (CFS), thus saving both time and cost. The DPD system results in a decrease of logistics costs of import consignments by quickening the pace of cargo clearance, shortening the dock dwell time, and eliminating intermediaries in the supply chain ecosystem. Similarly, DPE results in a decrease of logistics costs in respect of export consignments. A Customs notification of 5th September, 2019 makes only the following categories of importers eligible for DPD:

(a) importers who have already been accorded AEO Tier I, II or III status;

(b) importers with a clear track record of compliance and an import volume of 25 Full Container Load (FCL) TEUs through a particular port or otherwise in the preceding financial year.

Although the procedures for DPD and DPE have been established there appear to be some obstacles impeding implementation. The Dun & Bradstreet Report referred to earlier has found that against the target of 70 per cent set for DPD for FY 2018, by June 2017 only 28 per cent of deliveries were delivered directly to consignees at JNPT and only 13 per cent at Chennai.

(v) In the past, stoppage of truck traffic for checking at interstate borders slowed down the movement of goods by road considerably. Fortunately, the introduction of GST has eliminated this big impediment but stoppages and soliciting of bribes by other government staff (police, transport officials and others) are still impeding movement of goods by road and more reform is needed. A February 2020 report[17]has attempted to quantify the corruption and bribery faced by truck drivers. According to estimates made in the study, for every trip the average bribe is Rs 1,257 and the total amount paid as bribe by truck drivers and fleet owners is Rs 47,852per year.

[17] Save Life Foundation, Status of Truck Drivers in India (www.savelifefoundation.org, accessed 29 February, 2020.

5. Concluding remarks

If the dispute raised by the US on India's export incentives programme were to run its full course and the Appellate Body were to confirm the findings and recommendations of the Panel, India would not be eligible any more to grant or maintain subsidies contingent upon export performance.

Consequently, it would become incumbent for the Government of India to withdraw the MEIS and EPCG programmes. The substance of the schemes for EOU/EHTP/BTPs and DFS is compliant with the WTO obligations but these schemes too would need modifications for full compliance. In particular, duty exemption of capital goods would have to be discontinued in all the schemes. Although export credit subsidies granted by the Central Government under the interest equalization scheme has not been included in the US complaint, the Government may have to consider its withdrawal also.

The above changes in the export incentives programme would seriously affect the international competitiveness of India's exports. In order to redress the situation, the Government of India can take action as recommended in Section 4 above and summarized below:

1. It may introduce a comprehensive scheme for refund of unrebated State and Central taxes and levies for all exports, as it is already reported to be considering. However, in implementing such a scheme, it may need to limit refunds to taxes on 'physically incorporated, energy, fuels and oils used in the production process and catalysts which are consumed in the course of their use to obtain the exported product'.
2. It may consider lessening the burden of import duties on capital goods used in the production of exported goods the Government of India by undertaking a general reduction of duties on capital goods. In order to ensure that a reduction of import duties on capital goods does not create an inverted duty structure it may consider undertaking a mini-liberalization initiative of the statutory tariffs so as to bring down the general level of import duty on capital goods from 7.5 to say 4 per cent, and make commensurate reduction in the import duty on intermediate goods used in the production of capital goods, such steel, copper, aluminum and instrumentation.
3. It may accelerate the implementation of programmes already under way for the improvement of transport infrastructure, logistics and trade facilitation.

Buton December 11, 2019 the Appellate Body of the WTO became dysfunctional when retirements reduced the number of members of the Body to less than three required to hear and decide an appeal under Article 17 of the Dispute Settlement Understanding (DSU). This has brought about a fundamental change in the process of dispute settlement in the WTO, at least temporarily. Under the DSU, there is no compulsion on a Member to take steps to comply with a Panel report, once an appeal has been made, and the appeal has not been completed. Since the Appellate Body has been put in abeyance this situation may continue for a long time.

However, it can be reasonably expected that the US would approach India bilaterally and exert pressure for compliance. Even if this happens, there would be no reason for India to agree to full and strict compliance with the Panel recommendations. The talks would be taking place as normal trade negotiations outside of the legal framework of the Dispute Settlement Understanding, and in such negotiations the US would have to be receptive to reasonable requests. India could and should argue for the US to agree on a staged compliance, in view of the structural and fundamental nature of the policy change recommended by the Panel. India should also ask the US to show understanding on some substantive issues as well. For a long time, India has been consistently expressing the view that the inputs consumed in the production process must also include capital goods for the purpose of refund of taxes and it submitted a paper containing the proposal during the negotiations on the Doha Development Agenda (TN/RL/W/120). The proposal makes economic sense and is also in accordance with the universally recognised destination principle of indirect taxation. If the US concedes the logic of our argument in favour of allowing refund of duties on capital goods used in the process of production of the exported product, in four out of the five schemes included in the US complaint against India structural changes would not be required, and the MEIS will be the only major scheme that would need to be withdrawn. If the US were to agree only to the staging request it would give India more time to implement the actions for redressal of adverse effect of withdrawal of existing export incentives.

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