

**MULTILATERAL TRADE  
NEGOTIATIONS  
THE URUGUAY ROUND**

RESTRICTED

MTN.GNG/NG10/W/33  
30 November 1989

Special Distribution

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Original: English

Group of Negotiations on Goods (GATT)  
Negotiating Group on Subsidies  
and Countervailing Duties

ELEMENTS OF THE FRAMEWORK FOR NEGOTIATIONS

Submission by India

1. India had earlier submitted certain proposals to the Negotiating Group which are contained in GATT document MTN.GNG/NG10/W/16 dated 1 February 1988. Since then an extensive exchange of views has taken place in the Group. Further, at the Mid-Term Review, the Ministers have agreed to a framework for discussions in the Group. The framework is intended to guide in a balanced way the conduct of negotiations in the Group with the objective of improving GATT disciplines relating to all subsidies and countervailing measures that affect international trade. In order to facilitate the negotiations in the Group, India submits the following proposals in accordance with the agreed framework. It must be stressed that these proposals have been conceived by India as an integral whole, i.e. each of the elements is to be viewed as part of a single package.

Prohibited subsidies

2. In the area of prohibited subsidies, a basic question for consideration is whether the existing prohibition of export subsidies on non-primary products and primary mineral products should be extended to agricultural products as well. This is an extremely important issue that requires consideration in all its aspects. However, as there is a separate Negotiating Group on Agriculture to go into the whole gamut of measures for liberalization of international trade in agriculture, and one of the issues before it is "subsidies and export competition", this issue could be reviewed in this Group after it has been considered in the Group on Agriculture.

3. In respect of subsidies other than export subsidies, signatories have clearly recognized in the Subsidies Code that these are widely used as important instruments for promotion of social and economic policy objectives. It will therefore not be appropriate to extend the concept of prohibition to any category of domestic subsidies. It is not feasible to lay down quantitative criteria for prohibiting the use of domestic subsidies.

4. A number of changes are, however, necessary in the illustrative list of export subsidies contained in the Subsidies Code. In items (h) and (i) of the illustrative list, the test of physical incorporation has been stipulated. Rebate of prior stage cumulative indirect taxes or import

charges is treated as an export subsidy if such taxes or charges are levied on goods or services which are not physically incorporated in the exported product. Thus, rebate of taxes on auxiliary materials, capital goods and services employed in the production of exported goods falls under the definition of export subsidy. The physical incorporation test also applies to drawback or remission of export charges levied on imported inputs used in the exported product. The physical incorporation test is bad from the point of view of both equity and economic efficiency. It places at a disadvantage countries with multi-stage cumulative tax systems vis-à-vis those with value-added tax systems as in the latter, there is no impediment to the exporter collecting full credit for all prior stage taxes paid on inputs. If global efficiency is to be promoted, then such taxes levied not only on the final product and the raw materials, but also those levied on the inputs should be allowed to be rebated, as they also have a price-raising effect. The physical incorporation test is also not consistent with Article XI:4 of GATT as it is manifest that prior stage taxes paid on inputs, whether or not physically incorporated in the final product, are "borne by the like product".

5. The proviso to item (k) of the illustrative list has given licence to OECD countries to subsidize export credits on capital goods. It is anomalous that the exception not only provides for the signatories to the Code being bound by the decisions already taken by a limited number of signatories in another forum, but also for these signatories to be bound in future by subsequent decisions of those limited number of signatories. The proviso should, therefore, be replaced by a self-contained provision on official export credit containing such elements as minimum rates, amortization periods, etc.

6. As regards remedies in third country markets and the home market of the subsidizing country, the only remedy for violation of a prohibition can be recourse to multilateral dispute-settlement procedures. These procedures envisage, as a last resort, authorization of retaliatory counter-measures. As far as the market of the importing country is concerned, there are two choices for remedies: imposition of countervailing duties for which material injury is a prerequisite (Track I) and recourse to the dispute-settlement procedure (Track II). The existing rules give freedom to the importing country to follow either Track. This freedom should be allowed to continue. In fact, it would be normally expected that the importing country would follow the countervailing duty alternative for which it does not need prior multilateral sanction. It is only in exceptional cases that recourse to the dispute-settlement procedures might become necessary.

#### Non-countervailable, non-actionable subsidies

7. The major test for classifying subsidies in this category should be whether the measure is one which causes distortions or eliminates existing distortions. If the subsidy is neutral or compensatory in nature, it should be non-countervailable/non-actionable. Subsidies which are generally available are non-distortive. Other examples of non-distortive subsidies are regional development assistance to support basic

infrastructure for general public use, adjustment assistance provided to workers and assistance to research and development. It should be noted that just as designated geographical areas in developed countries have disadvantages which are sought to be offset by regional development assistance, in developing countries, the entire territory faces a multitude of distortions which need to be corrected for promoting efficiency. These distortions are caused inter alia by inadequate exploitation of economies of scale, factor market imperfections, underdeveloped infrastructure, high cost of inputs, fragmented capital markets, inadequate foreign-exchange market and poor marketing infrastructure. Subsidies therefore become necessary to compensate the industry or the exporter for such distortions. In some cases, because of paucity of resources, developing countries have to limit their corrective measures to the export sector only. The subsidies, including export subsidies, serve merely to offset an existing handicap even though they may not meet the test of general availability. In view of the above, the following categories of export subsidies should also be non-countervailable/non-actionable:

- (a) any subsidy for providing exporters access to raw materials, components, intermediate inputs and capital goods at international prices;
- (b) any subsidy directed at reducing the international transport freight cost to the level generally available in international markets; and
- (c) provision of export credits at rates below those applicable to other users provided that the rates are not below the cost of funds to the institution providing credit.

8. Suggestions have been made for special safeguard procedures in respect of non-actionable subsidies. India supports the proposal for reference to a multilateral Panel for determination of non-actionability of a subsidy practice on which an affirmative preliminary determination of subsidization has been made in an importing country.

Non-prohibited but countervailable or otherwise actionable subsidies

9. The following conditions should apply cumulatively for a measure to be countervailable or otherwise actionable:

- (a) there should be a financial contribution from the government;
- (b) the measure should not be generally available; and
- (c) the measure should not be one which merely corrects an existing distortion.

10. As far as remedies are concerned, in the case of third country markets and the market of the subsidizing country, recourse to the dispute-settlement procedures has to be taken. In the market of the subsidizing country, the following circumstances must exist for a claim for nullification or impairment to arise:

- (a) there should be a subsisting tariff concession;
- (b) the domestic subsidy should not have been in existence at the time of the tariff concession or it should have been increased substantially since then.

In every case, the affected country would have to demonstrate adverse effects.

11. In third country markets, the adverse effects to the interests of another signatory required to demonstrate nullification or impairment or serious prejudice may arise through the effects of the subsidized exports in displacing exports of like products of another signatory. An existing interpretative note in the Subsidies Code clarifies that the term "displacing" shall be interpreted in a manner "which takes into account the trade and development needs of developing countries and in this connection is not intended to fix traditional market shares". During the Tokyo Round, a major concern of the developing countries was that the promotional measures taken by them to get access into third country markets where suppliers of other countries are already entrenched should not provide cause of action against them. To give further substance to these provisions, it is proposed that developing country suppliers should not be deemed to be causing displacement unless they have acquired the status of a substantial supplier to the third country markets.

12. In regard to the markets of the importing countries, the following suggestions are made on various issues which have been discussed in the Negotiating Group:

- (a) As regards the definition of the term "domestic industry", India favours a narrow definition of the term "like products" as confirmed in the reports of the two Panels which are pending for adoption by the Committee on Subsidies. The industries producing the raw materials or components are distinct from the industries producing the final product. Further, for the sake of uniformity in interpretation, the term "major proportion" in Article 6.5 of the Subsidies Code should be interpreted as more than 50 per cent of the total domestic production.
- (b) In order to minimize the possibility of countervailing duty investigations becoming a non-tariff measure, there should be a presumption of absence of material injury if the share of subsidized imports in the importing country is below a certain threshold of market penetration. Similarly, if it is found that the per unit incidence of subsidy benefits is less than an agreed minimum, the investigations should be terminated.
- (c) The concept of material injury has been considerably diluted by some participants and positive findings have been made almost in every case on the existence of material injury. The practice of cumulation of imports for the purposes of determining material injury has made the position of small exporters particularly

vulnerable. The principle of cumulation should not be applied against small suppliers. A small supplier to the market is by definition a price taker who attempts to match the terms on which larger exporters supply to the market. Action against the major exporters will suffice to rectify the material injury caused by subsidized exports. As a general rule, it would be appropriate to exempt suppliers with an import share of less than 5 per cent from application of the cumulation principle.

- (d) In regard to the calculation of the amount of a subsidy, the fundamental divergence of views as to whether the measure of the amount of a subsidy should be the cost to the government or the benefit to the recipient needs to be resolved. India is of the view that determination of the countervailable amount should be based on the financial contribution of the government rather than on the benefit to the recipient. Administrative convenience in determining the amount of subsidy should be the most important criterion.
- (e) Before commencing investigations, the investigating authorities should verify the standing of the petitioner and ensure that they represent the major proportion of the domestic industry, i.e. 50 per cent thereof. The term "industry affected" for the request for initiation of an investigation in Article 2.1 is to be interpreted as "domestic industry" as defined in Article 6.5 of the Subsidies Code.
- (f) There should be a sunset clause whereby all existing countervailing duty orders would lapse at the end of the five years. During the period of validity, there should be provision for suo moto review every two years and for review at any time, if any of the affected parties claims a material change in circumstance.
- (g) The investigation authorities should provide for a reasonable period of time following initiation of an investigation for enabling exporters and importers to respond to the allegations by the petitioner. In determining the time to be given, there is a trade-off between the objective of concluding the investigation speedily and the objective of giving enough time to the exporters and importers. There should be provision for enabling exporters and importers to request for additional time in suitable cases.
- (h) The levy of countervailing duties should not be made compulsory in domestic law even if there are positive findings on the existence of subsidy, material injury and causal relationship between the two. In such cases, the final decision whether or not countervailing duties should be levied, should be taken only after the conclusion is reached that the measure would be in the public interest, taking into account, inter alia, the welfare of the consumer.

Special and differential treatment of developing countries

13. Article 14 of the Subsidies Code recognizes that subsidies are an integral part of the economic development programmes of developing countries. It has been clarified that developing countries are not prevented from adopting measures and policies to assist their industries including those in the export sector. These provisions have a sound economic basis. Developing countries have to be allowed to use subsidies including export subsidies in order to neutralize the distortions faced by them. It is acknowledged that subsidy on production, consumption or factor use is the best policy for correcting domestic market distortion. In the developing countries, there is widespread incidence of market distortions, but governments lack budgetary resources to correct them through domestic subsidies. In the circumstances, they are compelled to follow the second best policy of correcting distortions through taxes on imports and subsidies on exports. The export incentives adopted to them replicate a free trade and monetary régime for the exporters only as there are constraints for adopting the measures across the board for the entire economy.

14. There is thus adequate economic justification for the provisions of the Subsidies Code in respect of developing countries. India is of the view that Article 14 of the Code should continue unchanged. It may be mentioned here that this Article, while giving certain flexibility to the developing countries, does not give them a carte blanche. There are three important safeguards from the point of view of the trading partners as indicated below:

- (i) it is provided that developing countries shall not use export subsidies in a manner which causes serious prejudice to the trade or production of other countries;
- (ii) it is provided that developing countries should endeavour to enter into a commitment to reduce or eliminate export subsidies when the use of such export subsidies is inconsistent with its competitive and development needs;
- (iii) it is provided that any interested signatory may request the Committee to undertake a review of a specific export subsidy practice of a developing country to examine the extent to which the practice is in conformity with the objectives of the Subsidies Code.

Dispute settlement

15. In principle there does not seem to be justification for having different dispute-settlement procedures for any of the non-tariff barrier codes as compared to the general procedures. The whole question needs to be reviewed in the Negotiating Group on Dispute Settlement and thereafter it would be appropriate to consider it in the Negotiating Group on Subsidies and Countervailing Measures as well.