Export-Linked Subsidies in Apparels: India, Usa and the Wto

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Abstract *India has a large positive trade balance in apparels and is ranked among the top 10 apparel exporting countries. However, of late, the export growth has stagnated and the USA has taken India to the World Trade Organization's (WTO) Dispute Settlement Body over export-linked subsidies given to select sectors including apparel. According to USA, the subsidies given by India are prohibited under the WTO's Agreement on Subsidies and Countervailing Measures. While the Dispute Settlement panel will come up with a decision soon, this paper examines the concerns raised by the USA, the development thereafter and its likely impact on India's apparel exports. The paper makes policy recommendations on how to design WTO "smart" subsidies, which will not only be difficult to countervail but can also help improve the competitiveness, efficiency and productivity of the apparel sector.*

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I. INTRODUCTION

India is among the top global exporting countries for apparel and was ranked 5th in the year 2016 with a share of 4.27%.[4] The exports of apparel from India grew at 6.8% per annum since 2005, to reach US$17.1 billion in 2017.[5] India's apparel imports during 2005-2017 grew at 22% per annum to reach US$688.42 million in 2017.[6] Nevertheless, India's import share in world apparel imports is only 0.17% with a rank of 42. This indicates that India has a large positive trade balance in this sector.[7]

The United States of America (USA) accounted for 22.5% of India's exports in the year 2016, followed by the United Arab Emirates (UAE) with a share of 20.7%. The European Union (EU) is India's largest export destination with a share of 35.2% in total apparel exports from India in 2016. Thus, the USA and the EU together account for over 55%[8] of the export market and any decision taken by these two key players against India's export policies can have an adverse impact on the country's apparel exports.

Earlier this year, pursuant to Articles 4 and 30 of the World Trade Organization's (WTO) Agreement on Subsidies and Countervailing Measures (SCM)[9] USA raised objections to certain "export related" subsidies given by

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4 Authors' calculations based on data from UN COMTRADE, <https://comtrade.un.org/> (accessed July 30, 2018).
5 *Ibid.*
6 *Supra* note 4.
7 *Supra* note 4.
8 *Supra* note 4.
9 *See* Agreement on Subsidies and Countervailing Measures, Art. 4 (1996), World Trade Organisation, <https://www.wto.org/english/docs_e/legal_e/24-scm.pdf> at 231-32 (accessed Oct. 26, 2018).

India to a number of sectors, including apparels, specifically stating that they fall under the category of prohibited subsidies. In its submission to the WTO dated 19 March 2018,[10] the USA asked for consultations with the Government of India on the export subsidy measures, specifically referring to Export Oriented Units (EOUs), Merchandise Exports from India Scheme (MEIS) and Export Promotion of Capital Goods (EPCG) Scheme[11], the Special Economic Zones (SEZs)[12] and the duty-free imports for exporters programme[13]. The USA claims that as per the SCM Agreement, these measures are contingent upon export performance and hence, conform to the definition of a prohibited subsidy[14] and therefore, must be phased out at the earliest.

In their request for consultations, the USA stated that:

> *"India is subject to the obligations of Article 3.1(a) of the SCM Agreement because India's gross national product per capita has reached US$1000 per annum. Through each program, as reflected in the instruments listed above, India provides subsidies contingent upon export performance. The measures appear to be inconsistent with Article 3.1(a) of the SCM agreement, and India appears to have acted inconsistently with Article 3.2 of the SCM agreement."*

On 23March 2018, Canada and the EU requested to join the consultations.[15] On 11 April 2018, the USA held consultations with India, however both sides failed to resolve the dispute. Thereafter on 17 May 2018, pursuant to Article 4.4 of the SCM Agreement, USA requested the Dispute Settlement Body (DSB) for the establishment of a panel to examine the matter.[16] The DSB established a panel and on 23 July 2018 the Director-General appointed members to the panel to address the concerns raised by USA.[17]

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[10] India – Export Related Measures – Request for Consultations by the United States, WTO doc. WT/DS541/1G/SCM/D119/1 (19 March 2018).

[11] Given under the aegis of the Foreign Trade Policy (FTP) 2015-20 of the Directorate General of Foreign Trade (DGFT).

[12] Operating under SEZ Act of 2005, SEZ Rules of 10 February 2006, subsequent amendments to Rules and notifications related to SEZs.

[13] Notification Number: 50/2017, Customs, Ministry of Finance, Department of Revenue, June 2017.

[14] *See* WTO's Agreement on Prohibited Subsidies, Art. 3 (1996), World Trade Organization, <https://www.wto.org/english/docs_e/legal_e/24-scm.pdf> at 231 (accessed Nov. 5, 2018).

[15] India – Export Related Measures – Request to Join Consultations – Communication from the European Union, WTO doc. WT/DS541/2 (26 March 2018); India – Export Related Measures – Request to Join Consultations – Communication from Canada, WTO doc. WT/DS541/3 (26 March 2018).

[16] India – Export Related Measures – Request for the Establishment of a Panel by the United States, WTO doc. WT/DS541/4 (18 May 2018).

[17] India – Export Related Measures – Constitution of the Panel Established at the Request of the United States – Note by the Secretariat,WTO doc. WT/DS541/5 (24 July 2018).

In light of this, the objective of this paper is to examine the concerns raised by USA, and its likely impact on India's apparel exports. The paper also makes policy recommendations on how to design WTO "smart" subsidies. The paper is based on secondary information analysis and twenty comprehensive meetings with policy makers, WTO experts, lawyers, industrialists and academicians.

The layout of the paper is as follows: Section II provides a brief overview of the WTO's SCM Agreement with a focus on prohibited subsidies and Section II, Part A presents the concerns raised by the USA and recent developments in this matter. Based on the interviews, Section III, analyses the views of experts on the subject and the likely impact of the withdrawal of the subsidies on the apparel sector. Section IV makes recommendations on how to design WTO "smart" subsidies.

II. THE WTO'S AGREEMENT ON SUBSIDIES: PROHIBITED SUBSIDIES

The WTO was created to ensure free and fair trade. Since subsidies can lead to trade distortion, the WTO has established a set of rules to govern subsidies and export incentives in its member countries. For non-agricultural products, such as apparels, subsidies and export incentives are governed by the SCM Agreement.

The WTO's SCM Agreement contains a definition of the term "subsidy" based on three basic elements: (i) a financial contribution (ii) made by a government or any public body within the territory of a member, and (iii) which confers a benefit. All these elements must be satisfied in order for a subsidy to exist. Thus, the SCM Agreement applies not only to measures of national governments, but also to measures of sub-national governments, and of public bodies such as state-owned companies. A financial contribution may occur by means of direct transfer of funds (for example grants, loans), potential transfer of funds or liabilities (for example loan guarantees), foregoing of government revenue that is otherwise due (for example, fiscal incentives such as income tax holidays), among others.[18]

Even if a measure is a subsidy within the meaning of the SCM Agreement, it is not subject to the disciplines of the Agreement unless the concerned

[18] *See* Anwarul Hoda and Rajeev Ahuja, "Agreement on Subsidies and Countervailing Measures: Need for Clarification and Improvement" (ICRIER Working Paper No. 101, 2003), <http://icrier.org/pdf/WP101.pdf> (accessed Sept. 4, 2018).

subsidy is a "specific subsidy". The SCM Agreement in this context lists four types of "specificity"- enterprise-specificity,[19] industry-specificity,[20] regional-specificity[21] and prohibited subsidies.[22] Thus as per the SCM Agreement a "specific subsidy", implies subsidies that are specifically provided to a region, an enterprise or an industry, or a group of enterprises or industries. In other words, the SCM Agreement will treat a subsidy as a "specific subsidy" if the granting authority limits access of the subsidy to certain industries (in this case apparel) or regions.

All specific subsidies are actionable under the SCM Agreement.[23] Depending upon the trade distorting nature of specific subsidies, the SCM Agreement deals differently with prohibited subsidies and other types of specific subsidies, which can be actionable. The obligations of WTO members in respect of subsidies are laid down in terms of a traffic light approach – red, green and amber. These denote that some subsidies are prohibited (red), others are not only permissible but immune from action by trading partners (green), and some are generally permissible but actionable in certain circumstances (amber). Two categories of subsidies are defined as prohibited subsidies under Article 3 of the SCM Agreement. The first category consists of subsidies given to a firm or industry that are contingent on export performance. A detailed list of export subsidies[24] is annexed to the SCM Agreement and some of the export contingent subsidies enjoyed by the apparel industry such as the MEIS are "prohibited" under the SCM Agreement. The second category consists of subsidies contingent upon the use of domestic over imported goods ("local content subsidies") as a sole or one of the conditions. Such subsidies are absent in the apparel industry.

According to the SCM Agreement, if a country (in this case India) grants or maintains prohibited subsidies, then other member nations (in this case the USA) can initiate remedial actions against the offending country. According to Article 4 of the SCM Agreement, a complaining member can request for

[19] When the government targets a particular company or companies for subsidisation.

[20] When a particular industry (in this case, the apparel industry) or industries are targeted for subsidisation.

[21] When producers in a particular territory are targeted for subsidisation.

[22] When government targets export goods or goods using domestic inputs for subsidisation.

[23] The SCM Agreement, as it originally entered into force, contained a third category of specific subsidies called non-actionable subsidies. This category, applied provisionally for five years ending December 31, 1999, and pursuant to Art. 31 of the Agreement, could be extended by consensus of the SCM Committee. Since no such consensus has been reached, the SCM agreement no longer recognises this category of subsidies. Art. 31 of the SCM agreement has led to the expiry of these non-actionable subsidies listed in Art. 8 of the WTO SCM Agreement.

[24] *See* Agreement on Subsidies and Countervailing Measures Annex I (1996), World Trade Organisation, <https://www.wto.org/english/docs_e/legal_e/24-scm.pdf> at 262 (accessed Nov. 1, 2018).

consultations with the offending member. If the two members fail to arrive at a mutually agreed solution about the subsidy within a stipulated period, the matter is referred to the DSB of the WTO. If the dispute settlement procedure confirms that the subsidy is prohibited, it must be withdrawn immediately failing which the complaining country can take counter-measures, which may be in the form of charging extra duty (known as "countervailing duty") on subsidised imports. However, authorisation from the DSB is necessary for appropriate counter-measures.

The WTO rules permits "Special and Differential Treatment" for developing countries and Least Developed Countries (LDCs). Article 27.2 of the SCM Agreement exempts LDCs and developing countries with per capita income of less than US$1,000 from the prohibition of export subsidies. The list of these countries is given in Annex VII of the SCM Agreement.[25] According to the WTO rules of 1995, the threshold was calculated in terms of current prices. However, concerns were raised that a country may cross the per capita income threshold of US$1,000 merely because of inflation. Hence, in the Doha Round, the WTO has adopted an alternative methodology that calculates the threshold in constant 1990 US$. Moreover, to graduate, a country must reach or cross the US$1,000 threshold (measured in terms of constant 1990 US$) for three consecutive years. Based on these criteria and notification issued by the Committee on Subsidies and Countervailing Measures dated 11 July 2017,[26] India no longer qualifies for the "Special and Differential Treatment" and is not exempt from the applicability of prohibition of export subsidies.

A. Recent Developments in the WTO and India

As mentioned earlier, the DSB established a panel to look at the concerns raised by the USA against India. According to Article 4.5 of the SCM Agreement, after the establishment of the panel, the panel could request for the assistance of the Permanent Group of Experts (PGE) to determine whether the measures in question are in fact prohibited subsidies. The PGE has to immediately review the evidence and provide an opportunity for the member (India) maintaining the subsidy to demonstrate that the subsidy in question is not a prohibited subsidy. The PGE has to report its conclusions to the panel within a time-limit determined by the panel and their conclusions

[25] The Annex VII countries are Bolivia, Cameroon, Congo, Côte d'Ivoire, Dominican Republic, Egypt, Ghana, Guatemala, Guyana, India, Indonesia, Kenya, Morocco, Nicaragua, Nigeria, Pakistan, Philippines, Senegal, Sri Lanka and Zimbabwe.

[26] Committee on Subsidies and Countervailing Measures – Subsidies – Annex VII(b) of the Agreement on Subsidies and Countervailing Measures – Updating GNP per ca[...]e by the Secretariat – Addendum, WTO doc. G/SCM/110/Add.14 (11 July 2017).

of whether or not the measure in question is a prohibited subsidy has to be accepted by the panel. Adhering to Article 4.6 of the SCM Agreement, the panel has to submit its final report to the parties (in this case India and the USA) involved in the dispute and circulate this report to all WTO members within a period of 90 days.[27]

If the export related measures are indeed found to be prohibited subsidies then the panel in accordance with Article 4.7 of the SCM Agreement, would recommend that the subsidising member (in this case India) withdraw the subsidies without delay. In this regard, the panel would recommend a time period within which the measures must be withdrawn. In its written submission[28] to the WTO the USA stated that,

> *"United States respectfully reiterates its request that the panel specify, pursuant to Article 4.7, that the time period for withdrawal be 90 days after the DSB adopts its recommendations in this dispute".*

If the parties involved in the dispute do not appeal the panel's decision, then as per Article 4.8 of the SCM Agreement, the DSB has to adopt the report. However, if either India or the USA appeals against the panel's report, then an Appellate Body has to be setup to address the appeal.[29]

Since this dispute concerns only export-contingent subsidies, the expedited timelines as mentioned under Article 4.12 of the SCM Agreement apply.[30] This implies that the timelines under the general Dispute Settlement Understanding (DSU) are shortened by half. This ideally meant that the panel should have come up with their report regarding the dispute by October or

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[27] Art. 12.9 of the Understanding on Rules and Procedures Governing the Settlement of Disputes read in conjunction with Art. 4.6 of the SCM Agreement provides that if the panel cannot issue its report within 90 days then it must inform the DSB in writing and indicate the reasons, together with an estimate of the time period within which it will issue its report.

[28] *See* First Written Submission of the United States of America (23 August 2018), United States Trade Representative, <https://ustr.gov/sites/default/files/enforcement/DS/US.Sub2_3.pdf> at 45 (accessed Nov. 1, 2018).

[29] After the appeal is heard, the Appellate Body, as per Art. 4.9 of the SCM Agreement has to issue a decision within 30 days from the date when the party to the dispute formally notifies its intention to appeal. When the Appellate Body considers that it cannot provide its report within 30 days, it needs to inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report. However, despite the delays, the Appellate Body has to provide its report within 60 days. The Appellate Body report has to be adopted by the DSB and unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the report within 20 days following its issuance to the members.

[30] *See* Second Written Submission of the United States of America (11 October 2018), United States Trade Representative, <https://ustr.gov/sites/default/files/enforcement/DS/US.Sub2_3.pdf> at 3 (accessed Nov. 1, 2018).

November 2018. This would have implied that if the panel came up with a decision favouring the USA, then India would have had to phase out all prohibited subsidies by February 2019. However, on 3 December 2018 the Chairman of the Panel sent a communication[31] that,

> *"The beginning of the Panel's work has been delayed as a result of a lack of available resources in the Secretariat. The Panel expects to issue its final report to the parties not before the second quarter of 2019."*

This may give India sometime to redesign its subsidies to make them WTO compliant.

When the initial complaint was raised by the USA in the WTO, India argued on the basis of interpretation of the SCM Agreement and the time period given to developing countries to phase out the export subsidies, which is 8 years. As per Article 27.2[32] of the SCM Agreement, Article 3.1(a) regarding prohibition of export subsidies would not apply to a developing country member for a period of 8 years from the date of entry into force of the WTO Agreement, which is 1995. Also, as per Article 27.4, a developing country has to phase out its export subsidies within that time period in a progressive manner and cannot increase the level of subsidies. Thus, a developing country had the right to grant export subsidies till 1 January 2003 (completion of the 8 year time period) unless the country requested for and was granted an extension (Article 27.4). As per Article 27.2 (a), there is an exception to this which is specified in the Annex VII (b) of the SCM Agreement. However, as discussed above, India has recently graduated from the Annex VII country list. Nevertheless, India argued that as the Secretariat revealed the results in 2010, it should ideally get a period of 8 years (till December, 2018) to phase out its subsidies.[33] USA responded to this claim by pointing out that,"*India erroneously claims that under Article 27 of the SCM Agreement it is entitled to an eight-year phase out period to end these schemes*"[34]. Discussions with policymakers from other WTO members such as the EU and Japan show that they share the same view as the USA.

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[31] India – Export Related Measures – Communication from the Panel, WTO doc WT/DS541/6 (4 December 2018).

[32] *See* Agreement on Subsidies and Countervailing Measures on Special and Differential Treatment for Developing Country Members, Art. 27 (1996), World Trade Organisation, <https://www.wto.org/english/docs_e/legal_e/24-scm.pdf> at 3 (accessed Nov. 1, 2018).

[33] Committee on Subsidies and Countervailing Measures – Minutes of the Regular Meeting held on 25 April 2017, WTO doc. G/SCM/M/101(4 August 2017).

[34] *See* Second Written Submission of the United States of America (11 October 2018), United States Trade Representative, <https://ustr.gov/sites/default/files/enforcement/DS/US.Sub2_3.pdf> at 2 (accessed Nov. 1, 2018).

In addition to the above, Article 27.5 of the SCM Agreement states that any developing country which had reached export competitiveness[35] in a product has to phase out the export subsidies given to the product over a period of 2 years. However, if a country belongs to Annex VII group, it would get a time period of 8 years to phase out the subsidies. In 2010, based on a request by the USA, the WTO Secretariat had calculated the export competitiveness for India's textiles and clothing sector and found that it had achieved export competitiveness.[36] In fact, between January 1995 and December 2016, Indian textiles and textile articles have been countervailed twice for availing subsidies from the government.

Focusing on the DSB panel, countries/regions such as Brazil, Canada, China, Egypt, the EU, Japan, Kazakhstan, Republic of Korea, the Russian Federation, Sri Lanka, Taiwan and Thailand have third party rights,[37] which implies that they have an opportunity to be heard by the panel and to make written submissions as third parties, even if they have not participated in the consultations.[38] In this context, it is worth mentioning that the EU has recently come up with a concept paper on WTO modernisation in which it has referred to low level of compliance with the SCM Agreement and lack of transparency in notifying subsidies.[39] It called for improved transparency in subsidies, their alignment with the SCM Agreement and made certain suggestions towards achieving the same. For instance, it suggested the potential expansion of list of prohibited subsidies.[40]

Thus, India seems to be under pressure from its key trading partners, USA and the EU on the export-linked subsidies. The Indian Ministry of Commerce and Industry is aware of this tough stand taken by some of the key importing countries and in April 2018, an informal Committee was set up under the DGFT. It included members from Federation of Indian

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35 As per Art. 27.6 of the SCM Agreement export competitiveness for a product is attained when a product reaches a share of at least 3.25% in world trade for two consecutive calendar years.

36 US files WTO Challenge over India Export Subsidy Schemes, International Centre for Trade and Sustainable Development, <https://www.ictsd.org/bridges-news/bridges/news/us-files-wto-challenge-over-india-export-subsidy-schemes> (accessed Nov. 1, 2018).

37 India – Export Related Measures, World Trade Organisation <https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds541_e.htm> (accessed Nov. 1, 2018).

38 For details on the role of third parties see Chapter 6.3 of the Dispute Settlement System Training Module, <https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c6s3p1_e.htm> (accessed Nov. 1, 2018).

39 *See* WTO Modernisation: Future EU Proposals on Rulemaking (2018), European Council <http://trade.ec.europa.eu/doclib/docs/2018/september/tradoc_157331.pdf> (accessed Nov. 1, 2018).

40 *See* WTO Modernisation: Future EU Proposals on Rulemaking (2018), European Council <http://trade.ec.europa.eu/doclib/docs/2018/september/tradoc_157331.pdf> at 4 (accessed Nov. 1, 2018).

Chambers of Commerce and Industry (FICCI), Confederation of Indian Industry (CII), Federation of Indian Export Organisations (FIEO) and the Ministry of Commerce and Industry's think-tank Indian Institute of Foreign Trade (IIFT), among others. The role was to review the existing export promotion schemes; however the recommendations of the Committee are not in the public domain.[41]

While the Ministry of Commerce and Industry is working on the re-designing of the export-linked schemes, it has requested the line ministries and other stakeholders to adhere to India's WTO commitments while designing their export promotion policies.[42]

III. LIKELY IMPACT OF THE WITHDRAWAL OF SUBSIDY ON THE APPAREL EXPORTS

Among the export-linked subsidies that are challenged by the USA, the meetings with experts and stakeholders showed that the apparel sector is a major user of the MEIS and the duty drawback scheme. Most of the apparel exporters are not located in the SEZs[43] and some of them have EOUs.

In India, there is no data on the amount of export-linked subsidies enjoyed by the apparel sector. According to the USA's first written submission to the WTO,[44] the export subsidy programmes of India in 2017 amounted to approximately US$7.3 billion, out of which the MEIS accounted for US$1.9 billion and the duty drawback scheme accounted for US$996 million.[45] However, the apparel sector is only one of the sectors enjoying these subsidies. The USA also pointed out that India has been continuously increasing the amount of subsidies provided under these export-contingent schemes. For example, in case of the MEIS, in May 2018, the rate of duty scrips availed by

41 Amiti Sen, "Commerce Ministry Looking for Alternatives to Export Subsidies", *Business Line*, April 8, 2018.

42 See "Suresh Prabhu Reviews Progress of Sectoral Export Promotion Strategy", (3 October 2018), Press Release, Department of Commerce, Ministry of Commerce and Industry, <http://commerce.gov.in/PressRelease.aspx?Id=6613> (accessed Nov. 5, 2018).

43 As of February 2017, out of the 206 exporting SEZs, there were 7 SEZs in the textile/apparel/wool sector and a few apparel units were located in 21 multi-product SEZs.

44 *See* First Written Submission of the United States of America (23 August 2018), United States Trade Representative, <https://ustr.gov/sites/default/files/enforcement/DS/US.Sub2_3.pdf> at 2 (accessed Nov. 1, 2018).

45 Statement of Revenue Impact under the Central Tax System, Receipts Budget 2018-2019, <https://www.indiabudget.gov.in/ub2018-19/rec/annex7.pdf> (accessed October 30, 2018).

the garments and the made-up sector was increased from 2% to 4%.[46] There is no information in the public domain on the exact amount of subsidies given to the apparel sector under the MEIS and other schemes/policies.

A number of subsidies are enjoyed by the apparel sector. Authors' discussion with the industry representatives confirms that around 60 different subsidies are availed by the apparel sector, which is provided by both the Central and state governments. Among them, at the central level, subsidies related to export promotion are provided through the Department of Commerce, Ministry of Commerce and Industry while sector-specific subsidies (related to the development of infrastructure, up-gradation of technology and skill development, etc.) are provided through the Ministry of Textiles. The Ministry of Micro, Small and Medium Enterprises (MSME) provides various subsidies (related to financial, marketing and training assistance), for MSMEs and some of them are availed by the apparel industry. State governments provide subsidies to this sector through their industrial policies or sector-specific policies,[47] which cover capital investment and interest subsidies, cluster development, financial incentives for acquiring quality certification, among others.

In spite of providing around 60 different types of subsidies, apparel exports from India are stagnating. During the fiscal year 2017- 18, apparel exports declined by 3.8% in dollar terms and by 7.6% in rupee terms.[48] This is a cause for concern. Further, as mentioned earlier, the rate of duty scrips availed by the apparel sector has increased from 2% to 4% in May, 2018. Thus, subsidies may not have helped to increase export competitiveness but may have helped to reduce the decline in exports.

To investigate the likely impact of withdrawal of subsidies on exports, there is need for time-series data on the amount of subsidies given and export trends. While export trends are available, there is no data available on subsidies given for exports. Since subsidies are given out of taxpayers' money, amount of subsidies given to different sectors should be made available in the public domain. This will also make the process more transparent as is suggested by the EU's concept paper. The EU has specifically pointed out that the absence of comprehensive information on subsidies provided by member

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[46] *See* Public Notice 07/2015-2020, (2018), Directorate General of Foreign Trade, Department of Commerce, Ministry of Commerce and Industry, <http://dgft.gov.in/sites/default/files/PN-07%28e%29.pdf> (accessed Aug. 1, 2018).

[47] Some examples of State policies that are applicable to the apparel industry are Karnataka New Textile Policy (2013-18), Gujarat Garment and Apparel Policy (2017), Odisha Apparel Policy (2016) and Chhattisgarh Industrial Policy (2014-19) for Textiles.

[48] The Wire, <https://thewire.in/economy/squeezed-domestically-and-globally-indias-garment-exports-are-beingstretched-thin> (accessed August 3, 2018).

countries is one of the biggest drawbacks in implementation of the WTO's SCM Agreement.[49]

The meetings with policy experts, lawyers, industrialists and academicians indicate that most likely India will lose the case against the USA in the WTO and will have to withdraw the export-linked subsidies. However, industry has pointed out that due to factors such as high logistics and other costs (for example, high costs of power), low ease of doing business, etc., they require subsidies to retain their export competitiveness and to compete with other developing countries in key export markets. In this context, it is worth mentioning that India's ease of doing business indicators are improving (see Table 1).

Table 1: Cross Country Comparisons of "Ease of Doing Business" across Sub-Indicators (2017 and 2018) [50]

	India		***Vietnam***		***China***		***Republic of Korea***	
	2017	**2018**	2017	**2018**	2017	**2018**	2017	**2018**
Overall Ranking	100	**77**	68	**69**	78	**46**	4	**5**
Overall Score	60.60	**67.23**	66.77	**68.36**	65.00	**73.64**	84.15	**84.14**
Dealing with construction permits	39.69	73.81	79.03	79.05	41.21	65.16	84.41	84.43
Enforcing contracts	41.19	41.19	60.22	62.07	78.97	78.97	84.15	84.15
Getting credit	75.00	80.00	75.00	75.00	60.00	60.00	65.00	65.00
Getting electricity	88.64	89.15	78.69	87.94	65.71	92.01	99.89	99.89
Paying taxes	65.23	65.36	81.67	88.33	62.90	67.53	86.92	86.91
Protecting minority investors	80.00	80.00	55.00	55.00	55.00	60.00	73.33	73.33
Registering property	43.09	43.55	70.61	71.09	74.99	80.8	76.34	76.34
Resolving insolvency	40.75	40.84	35.16	34.93	55.82	55.82	83.08	83.01
Starting a business	73.90	80.96	82.02	84.82	85.47	93.52	95.83	95.83
Trading across borders	58.56	77.46	70.83	70.83	69.91	82.59	92.52	92.52

According to World Bank's Ease of Doing Business Index (2018), India ranks 77th among 190 countries in 2018, which is an improvement of 23 places from 2017 and 53 places from 2016 position.[51] However, this rank is still lower when compared to other apparel exporting countries such as the

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49 *See* WTO Modernisation: Introduction to Future EU Proposals, (2018), European Council <http://trade.ec.europa.eu/doclib/docs/2018/september/tradoc_157331.pdf> at 4 (accessed November 1, 2018).

50 Compiled from Ease of Doing Business Rankings (2018), World Bank, <http://www.doingbusiness.org/en/rankings> (accessed November 8, 2018).

51 India was ranked 100th in 2017 and 130th in 2016.

Republic of Korea, Vietnam and China. Cross-country comparative data shows that the logistics costs in India are higher than other apparel exporting countries (see Table 2 and Figure 1). As per the World Bank's Logistics Performance Index (2018), India ranked 44th among 160 countries in 2017, which is a fall of 8 places as compared to 2015, when it ranked 35th.

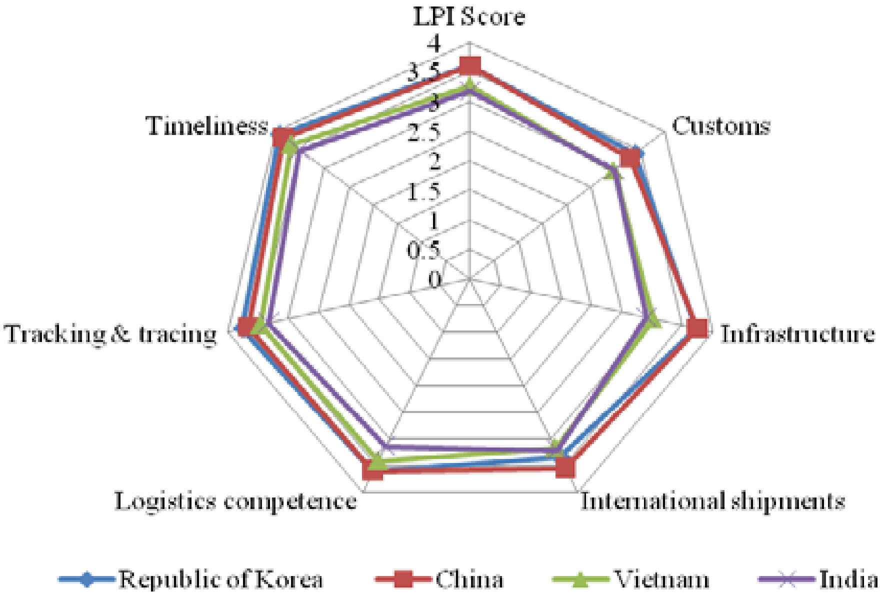
Table 2: Cross Country Comparison of "Logistics Performance Index" across Sub-Indicators (2015 and 2017)[52]

	India		***Vietnam***		***China***		***Republic of Korea***	
	2015	2017	2015	2017	2015	2017	2015	2017
Overall Rank	35	**44**	64	**39**	27	**26**	24	**27**
Overall Score	3.42	**3.18**	2.98	**3.27**	3.66	**3.61**	3.72	**3.61**
Customs	3.17	2.96	2.75	2.95	3.32	3.29	3.45	3.40
Infrastructure	3.34	2.91	2.70	3.01	3.75	3.75	3.79	3.73
International Shipments	3.36	3.21	3.12	3.16	3.70	3.54	3.58	3.33
Logistics Quality and Competence	3.39	3.13	2.88	3.40	3.62	3.59	3.69	3.59
Tracking and Tracing	3.52	3.32	2.84	3.45	3.68	3.65	3.78	3.75
Timelines	3.74	3.50	3.50	3.67	3.90	3.84	4.03	3.92

In 2017, India's rank is lower *vis-à-vis* competing economies like the Republic of Korea, China and Vietnam. As can be seen in Figure 1, India compared to other apparel exporting countries performs poorly on all the sub indicators.

[52] Compiled from Logistics Performance Index Rankings, (2018), World Bank, <https://lpi.worldbank.org/international/global/2018> (accessed December 4, 2018).

Figure 1: India's Logistics Performance Index vis-à-vis Apparel Exporting Countries across Sub-Indicators (2017)[53]



Thus, the concerns raised by the industry may be partially correct. A survey-based study[54] by the authors shows that there are certain firm level issues that are impacting the productivity, efficiency and global competitiveness of the Indian apparel industry. These include low level of investment in research and development (R&D), lack of technology adaptation and skill development, fragmented small-sized apparel firms and inadequate product diversification, among others. With these hurdles in the apparel sector, the decision from the panel will have a huge impact on the Indian economy. While the Department of Commerce is aware that it has to phase out the WTO prohibited subsidies, the discussion has to now focus on how to design WTO "smart" subsidies in order to prepare better for future.

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53 *Ibid.*

54 Arpita Mukherjee, Anusree Paul, Angana Parashar Sarma and Soham Sinha, "Trade, Trade Agreements and Subsidies: The Case of Indian Apparel Industry" (ICRIER Working Paper No. 365, 2018) <http://icrier.org/pdf/Working_Paper_365.pdf> (accessed November 9, 2018).

IV. THE WAY FORWARD: DESIGNING WTO COMPLIANT "SMART" SUBSIDIES

A number of developing countries including Vietnam, Turkey and China give subsidies along with other fiscal and non-fiscal benefits to their apparel manufacturing firms to gain scale and for exports. However, they have smartly designed their subsidies to ensure that they are not prohibited under the WTO's SCM Agreement. Since export incentives are no longer a viable policy option for India, the country needs to design "smart" alternative subsidies that cannot be challenged at the WTO in the future. The government has a few alternatives in this regard, which are now adopted by a number of other countries. *First*, the government may remove the export contingency clause of the incentives given through the different schemes[55] and instead link subsidies to other performance indicators such as requirement of employment or investment in technology, which focuses on scale expansion and growth. *Second*, since the WTO is yet to develop rules on subsidies in services, with increased servicification of manufacturing, services used in the apparel supply chain[56] of exports can be subsidised. *Third*, an argument for giving subsidies in India is the high cost and low ease of doing business. The government may focus on non-fiscal incentives which can improve ease of doing business. *Fourth*, the Government of India could alter the channel through which a subsidy is provided, for example, instead of providing subsidies through a trade-linked institution such as DGFT, the government could provide the subsidy through the Department of Commerce, Ministry of Commerce and Industry. This would reduce the specificity of the subsidy being provided and more importantly, it would require trade linkages to be first established, which would then make it more difficult to challenge. Some examples of "smart" subsidies that can be provided are discussed below:

A. Can India Design a Production-Linked Subsidy?

Production-linked subsidies, if given to a specific industry, can be actionable before the WTO, but if it is given across all industries, it is difficult to challenge. Even if production-linked subsidies are given, in such cases, the

[55] For example, in Indian SEZs, there is a mandatory requirement for the units to be net foreign exchange (NFE) earners within a period of five years. This criterion puts forward an exclusive export contingent element which is prohibited as per WTO's SCM agreement. The NFE is defined as the value of exports from a unit of an SEZ minus the value of total imports made by that unit of the SEZ.

[56] *See* Sebastien Miroudot, "The Servicification of Global Value Chains: Evidence and Policy Implications", (2017), UNCTAD Multi-Year Expert Meeting on Trade, Services and Development, Geneva, <https://unctad.org/meetings/en/Presentation/c1mem5_2017_124_S3_Miroudot_2.pdf> (accessed October 10, 2018).

importing country has to prove injury[57] and this could be difficult if the subsidy is "smartly" designed.

However, in case of India, there are some fundamental issues in designing production-linked subsidies. First, there is no official data on apparel production. According to the Annual Survey of Industries, conducted by the Ministry of Statistics and Programme Implementation, in 2014-15 around 22% of apparels that were produced in the country were exported. Thus, if the government has to replace export-linked subsidies by production-linked subsidies, it may have a severe implication on the budget. Second, since production-linked subsidy is available to all, government needs to design production-linked subsidies in a way that it benefits the exporting units/firms more than the units/firms catering to the domestic market. Therefore, the government needs to collect detailed data and information on (a) total apparel production in the country by firm sizes and location (b) what kind of firms are more likely to export (c) what proportion of the production of the firms are exported and (d) what kind of subsidies are being claimed by the companies that are producing for exports. Further, one has to examine the apparel value chain for the domestic and exporting units and identify the different cost components within the two value chains and compare the likely costs faced by the exporting units and units catering to the domestic market. For example, exports may require product traceability, which can be technology based. A carefully designed subsidy can support such software implementation. Similarly, exporters may have higher transportation and logistics costs, which can be subsidised through targeted subsidies to cover logistics costs at ports and airports or cost of transportation by sea may be subsidised.

B. Designing Subsidies to Ensure Targeted Benefits for the Industry

It was evident from the discussions that while 60 different subsidies are listed in various government documents, the apparel industry at any given point of time does not use/are not eligible for more than 10 types of subsidies. Thus, once subsidies are given to the industry, it is important to collect data on its impact (i.e. whether or not it has been beneficial and/or is being used). Since subsidies are now being challenged in the WTO, it is important to (a) know which types of subsidies are more likely to be used and (b) understand the impact of the subsidy that is being given. Furthermore, if subsidies are not able to have their targeted impact or if they are not being used then they

[57] *See* WTO Agreement on Subsidies and Countervailing Measures, Art 7.1.

should be replaced or phased out.[58] In other words, India needs to prune down its subsidy list and look at other support mechanisms, which are not challenged in the WTO.

C. Re-orienting Subsidies towards Services

As the WTO is yet to develop a discipline for subsidies in services, subsidies can be given to services used in apparel manufacturing. In this context, India can examine the subsidies given by countries such as Vietnam and Turkey. Vietnam's National Trade Promotion programme helps in export marketing through trade fairs, exhibitions and sponsorships.[59] Turkey's "TURQUALITY" programme supports not only market access and development, but also puts special focus on providing an umbrella branding for Turkish apparels and boosts exports credibility through the TURQUALITY brand.[60]

The Indian government can provide support for market development assistance, employee training, shelters for the workforce and employee transportation, to name a few. The Ministry of Commerce and Industry already runs two popular schemes for market access and market development namely Market Access Initiative and Market Development Assistance. Allocations under these schemes can be increased. In addition, workers training and skill development fall under services. Since skill development has the potential to boost productivity and efficiency and meet international standards, India can look into Vietnam's Vocational and Technical Education Training (known as VTET) and modular employable skills (known as MES)[61] programme and specifically, subsidise courses and training programmes for use of information and communication technology (ICT) in garment manufacturing.[62] India can also look into Turkey's model of skill development, and partner with global retailers and their sourcing agents to provide skill training in garment manufacturing clusters in India. The government can also link Industrial Training Institutes (ITIs) with the industry such as apparel

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58 National Institute of Public Finance and Policy, <http://www.nipfp.org.in/media/pdf/books/BK_56/Chapters/1.%20Subsidies%20Concepts.pdf> (accessed August 29, 2018).

59 *See* Study on Enhancing Export Competitiveness in Textile Sector (2016), Ministry of Textiles, <http://texmin.nic.in/sites/default/files/Enhancing_Export_Competitiveness_Textile_Sector_03042018.pdf> (accessed August 28, 2018).

60 PwC, <https://www.pwc.com.tr/en/turquality> (accessed August 30, 2018).

61 *See* Study on Enhancing Export Competitiveness in Textile Sector (2016), Ministry of Textiles, <http://texmin.nic.in/sites/default/files/Enhancing_Export_Competitiveness_Textile_Sector_03042018.pdf> (accessed August 28, 2018).

62 See Study on "Garment Sector to Understand Their Requirement for Capacity Building", (2018), Ministry of Textiles, available at <http://texmin.nic.in/sites/default/files/Garment%20Study%20-%20Annexures%20-%2026.02.2018.pdf> (accessed August 6, 2018).

industry and create opportunities for the ITI students through programmes such as "Earn as you Learn"– whereby the students work in an industry as part of their course curriculum to gain industry experience.

D. Provide Subsidies for Technology Up-gradation

The use of advanced technology and skilled workforce is low in the Indian apparel industry.[63] Therefore, the Government of India can provide subsidies for technology up-gradation. In India, the firm size is small, which adversely impact economies of scale and ability to invest in technology. They have to compete with large-size firms from other developing countries such as China, Vietnam and even Bangladesh that have made significant investments in R&D and have adopted advanced technology, design and international quality standards.[64] Therefore, India needs to "smartly" design the subsidies so that these encourage industry to invest in R&D, technology and help upgrading scale of production.

To conclude, as developed countries have raised concerns on the use of subsidies to promote exports, developing countries such as India have to look at alternative measures to improve the competitiveness of their export-oriented industries. This can be done through lowering corporate taxes, reducing the cost of borrowing, rationalising import duties on raw materials, reducing the burden of high transport and power costs and cushioning the high costs of logistics. As is the case in Vietnam and Bangladesh, competitiveness can also be achieved by imposing zero (rationalising) import duties for machinery and equipment imports.[65] In India, post Goods and Services Tax (GST), the import duties for machines have been reduced, but not eliminated. LDCs such as Bangladesh are trying to ensure 24x7 quality power supply to the apparel SEZs at competitive rates.[66] Bangladesh Investment and Development Authority (BIDA) allows for the exemption of Value Added Tax (VAT) on electricity or taxes on sale of self-generated or purchased electric power for

63 For details *see* Study on "Garment Sector to Understand Their Requirement for Capacity Building", (2018), Ministry of Textiles, <http://texmin.nic.in/sites/default/files/Garment%20Study%20-%20Annexures%20-%2026.02.2018.pdf> (accessed August. 6, 2018).

64 *See* Khondaker Golam Moazzem and Farzana Sehrin, "Economic Upgrading in Bangladesh's Apparel Value Chain During the Post-MFA Period", 17(1) South Asia Economic Journal, Institute of Policy Studies of Sri Lanka 73-93 (2016).

65 *See* Study on "Garment Sector to Understand Their Requirement for Capacity Building", (2018), Ministry of Textiles, <http://texmin.nic.in/sites/default/files/Garment%20Study%20-%20Annexures%20-%2026.02.2018.pdf> (accessed August 6, 2018).

66 *See* Arpita Mukherjee, Parthapratim Pal, Saubhik Deb, Subhobrota Ray and Tanu M. Goyal, *Special Economic Zones in India: Status, Issues and Potential*, (2016), Springer India, <http://www.springer.com/in/book/9788132228042> (accessed August 28, 2018).

use within economic zones (for 10 years).[67] In India, agriculture faces zero tariff rate for electricity while industry faces a higher tariff. Such anomalies have to be addressed as they are making the domestic industry non-competitive in global markets. In addition to this, learning from the best practices of countries such as the Republic of Korea, China, Vietnam and Bangladesh, the Government of India should support Indian apparel manufacturers by providing them with non-fiscal incentives such as single-window/fast-track clearances and simplified import-export procedures. This would help the industry gain competitiveness and improve the overall ease of doing business in the country.

Additionally, there is an urgent need for institutional reform within the Ministry of Commerce and Industry. With globalisation and development of value chains, trade policy, which is under the Department of Commerce, cannot be delinked from domestic policy, which is under the Department of Industrial Policy and Promotion, and there is need for a holistic policy approach. Further, it may not be viable to route subsidies through DGFT as it is perceived as an export promotion department by India's trading partners. The Ministry of Commerce and Industry should design incentives that are targeted towards improving the overall global competitiveness, productivity and efficiency of the Indian industries, in general, rather than sector-specific export-linked incentives, which are challenged under the WTO's SCM Agreement. To design subsidies, there is need for data collection and detailed studies on (a) identification of the requirements of the apparel industry (b) likely impact of the subsidies and (c) subsidies *vis-à-vis* other incentives that are linked to trade facilitation and ease of doing business.

[67] Bangladesh Investment Development Authority, <http://bida.gov.bd/incentives> (accessed September 4, 2018).