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EUROPEAN UNION - COUNTERVAILING MEASURES ON CERTAIN POLYETHYLENE TEREPHTHALATE FROM PAKISTAN

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Overview

1. Assessment of the Dispute
2. How are Indian and South Asian businesses countervailed by US and EU Investigating Authorities
3. Moving forward....

Subject of the Dispute

- **Subject Matter:** This dispute concerned countervailing duties imposed by the European Union on imports of certain polyethylene terephthalate (PET) from Pakistan.
- **Legal Provisions:** The most relevant legal provisions governing the dispute are located in the Agreement on Subsidies and Countervailing Measures: namely,
 - Article 1.1(a)(1)(ii) and Footnote 1
 - Article 3.1(a) and Annexes I, II and III

Identifying a subsidy



Factual Background

- Manufacturing Bond Scheme (**MBS**) is a duty drawback scheme.
- Permits licensed companies to import duty-free production input materials if utilized in the production of a product that is subsequently exported.
- *Novatex* is one such Pakistani PET producer and exporter that obtained remissions of import duties on imported PET production inputs.

- **Issue:** Considered that all duties remitted to *Novatex* – rather than just excess remissions – constituted a countervailable subsidy.
- **Reasoning:** Pakistan lacked a reliable system of confirming what inputs *Novatex* used in producing its exported PET.

Arguments by Pakistan

- Accepted that the issue related only to “excess remissions”
- BUT contested that the government revenue foregone that is otherwise due is only applicable to the “excess remission”
- SINCE EC countervailed the whole quantum, the assessment of a financial contribution is incorrect.

EU's Counter Argument

- Agrees that Article 1 (SCM) and footnote 1 makes reference to Annexes.
- Annex I(i) provides for situations that certain types of subsidies are prohibitive. Annex I(i) does not speak about how to determine whether the remission of import duties was “in excess”
- Annex II does not discuss how to calculate the amount of subsidization.
- Annex II – second part – mentions steps/rules that Investigating Authority should take to determine inputs. No mention what happens if Investigating Authority can not determine what inputs were consumed.

Contd.

- *Novatex* had provided 500 transactions relating to verification of inputs. However:
 - No “effective” control by the Government of Pakistan on the consumption register
 - *Novatex* was selling domestically as well as importing
- Therefore, the entire amount of import duties was countervailed

Panel Assessment

- Annex I: Part (g), (h), (i) are most relevant; (i) specifically describes this issue. Restate the “Excess Remission Principle”
- Annex II (I):
 - 1. Indirect tax rebate schemes can allow for exemption, remission or deferral of prior-stage cumulative indirect taxes levied on inputs that are consumed in the production of the exported product (making normal allowance for waste). Similarly, *drawback schemes can allow for the remission or drawback of import charges* levied on inputs that are consumed in the production of the exported product (making normal allowance for waste).
 - 2. The Illustrative List of Export Subsidies in Annex I of this Agreement makes reference to the term "inputs that are consumed in the production of the exported product" in paragraphs (h) and (i). Pursuant to paragraph (h), indirect tax rebate schemes can constitute an export subsidy to the extent that they result in exemption, remission or deferral of prior-stage cumulative indirect taxes in excess of the amount of such taxes actually levied on inputs that are consumed in the production of the exported product. *Pursuant to paragraph (i), drawback schemes can constitute an export subsidy to the extent that they result in a remission or drawback of import charges in excess of those actually levied on inputs that are consumed in the production of the exported product.* Both paragraphs stipulate that normal allowance for waste must be made in findings regarding consumption of inputs in the production of the exported product. Paragraph (i) also provides for substitution, where appropriate

- Effectively, the Panel acknowledges duty drawback schemes and notes that there is no language that restricts “Excess Remissions Principle”
- Annex II (I) is context to Annex II (II).
- Annex II (II)(1): [a.] Determine whether the Member has a system for tracking the inputs consumed in export-marked goods; and [b.] assess whether the system is reliance.
- Annex II (II)(2): If the system is not verifiable, then the DA has to conduct a “further examination”. However, this examination must be in context of the Excess Remission Principle.

Annex II (II)

In examining whether inputs are consumed in the production of the exported product, as part of a countervailing duty investigation pursuant to this Agreement, investigating authorities should proceed on the following basis:

1. *Where it is alleged that an indirect tax rebate scheme, or a **drawback scheme, conveys a subsidy by reason of over-rebate or excess drawback** of indirect taxes or **import charges** on inputs consumed in the production of the exported product, the investigating authorities should first determine whether the government of the exporting Member has in place and applies a system or procedure to confirm which inputs are consumed in the production of the exported product and in what amounts. Where such a system or procedure is determined to be applied, the investigating authorities should then examine the system or procedure to see whether it is reasonable, effective for the purpose intended, and based on generally accepted commercial practices in the country of export. The investigating authorities may deem it necessary to carry out, in accordance with paragraph 6 of Article 12, certain practical tests in order to verify information or to satisfy themselves that the system or procedure is being effectively applied.*
2. *Where there is no such system or procedure, where it is not reasonable, or where it is instituted and considered reasonable but is found not to be applied or not to be applied effectively, a further examination by the exporting Member based on the actual inputs involved would need to be carried out **in the context of determining whether an excess payment occurred**. If the investigating authorities deemed it necessary, a further examination would be carried out in accordance with paragraph 1.*

Operation of MBS

- Pakistan's MBS permits licensed companies to import duty-free production input materials
 - if such materials are consumed in the production of a product that is subsequently exported.
- Under the MBS, when a licensed company imports inputs, it posts securities in the amount of import duties due on those inputs.
- Pakistan remits the security to that company upon export of the company's products
 - if the company presents documents indicating that inputs for which remissions are requested were used in its production of the exports.
- Schemes like the MBS are commonly referred to as duty drawback schemes.

WTO finding w.r.t. MBS

- The WTO Panel in **EU – PET from Pakistan** held that:
 - Even if the exporting Member has no reliable system of tracking inputs consumed in the production of a relevant exported product and
 - in the absence of a further examination by the exporting Member of that issue,
 - investigating authorities should still determine if an excess remission occurred.
 - Therefore, by failing to provide a reasoned and adequate explanation for why the entire amount of remitted duties was "in excess of those which have accrued"
 - within the meaning of footnote 1 of the SCM Agreement,
 - the Commission acted inconsistently with Article 1.1(a)(1)(ii) of the SCM Agreement.

Duty drawback schemes in India

- India has a duty drawback scheme to which the Excess Remission Principle does not apply
- The MBS equivalent schemes in India are AAP and DFIA (duty exemption programs)
- Authorisation can be issued to:
 - a manufacturer exporter, or
 - merchant exporter tied to supporting manufacturer.
- Rate of drawback is under AAP and DFIA is determined and fixed by the Central Excise Authority.
- To enable verification:
 - Applicant must indicate clearly details of duty paid input.
 - RA must also clearly endorse details of such duty paid inputs in the condition sheet of the Authorisation.

AAP vs DFIA

AAP

Authorisation under AAP is issued to allow duty-free import of input, which is physically incorporated in export product (making normal allowance for wastage).

The quantities of imported materials and exported finished products are *inter alia* linked through SION established by the GoI or self-declared/ad hoc norms.

Minimum value addition required to be achieved under Advance Authorisation is 15%.

Imports under Advance Authorisation are exempted from payment of BCD, ACD, Education Cess, AD, CVD, Safeguard Duty (including Transition Product Specific Safeguard Duty), wherever applicable.

DFIA

DFIA is also issued to allow duty-free import of inputs to be physically incorporated in export product.

Unlike AAP, DFIA be issued on post-export basis for products for which SION have been notified.

Minimum value addition of 20% is required to be achieved.

Authorization under DFIA is exempted only from payment of BCD. Additional customs duty/excise duty, being not exempt, shall be adjusted as CENVAT credit.

Authorization Process Flow-Chart



Accounting of Input

- The FTP 2015-20 specifically deals with accounting of input under para 4.12 for AAP and DFIA. It provides that:
 - *unless the name of the specific input [used in manufacturing the export product]*
 - *gets indicated / endorsed in the relevant shipping bill, and*
 - *these inputs, so endorsed, match the description in the relevant bill of entry,*
 - *the concerned Authorization will not be redeemed.*
 - Additionally, if a single quantity in any SION has been indicated against more than one inputs,
 - then quantities of such inputs for import shall be in proportion to the quantity of these inputs actually consumed in production (within overall quantity against such group of inputs).
 - Proportion of these inputs actually consumed in production of export product shall be clearly indicated in shipping bills.

Accounting of Input

- FTP further provides:
 - The name/description of the input used (or to be used) in the Authorization must match exactly with the name/description endorsed in the shipping bill.
 - At the time of discharge of export obligation (issue of EODC) or at the time of redemption, RA must allow only those inputs which have been specifically indicated in the shipping bill.
- Appendix 4H (Register for accounting the consumption) to identify any excess remission and get it signed by a Chartered Accountant upon verification
 - Consumption of duty free imported or domestically procured inputs allowed under advance authorisation / DFIA
- Therefore, India has an effectively applied verification system to monitor the input to output ratio.

Verification of the Indian System

- The EU and the US authorities have time and again held that the GoI does not have a system to track the consumption of input in the exported product.
 - The European Commission in CVD investigation against polyester textured filament yarn (PTY) from India (2002), with respect to AAP in its earlier form i.e. Advance License Program/ALP) observed:
 - *“there was no system or procedure in place to confirm whether and which inputs are consumed in the production process of the exported products. The system only shows that the goods imported duty-free imported have been used in the production process, with no distinction between the destination of the goods (domestic or export market).”*
 - The US DOC in CVD investigation against CORE from India (2015), with respect to DFIA, observed:

Verification of the Indian System

- *“the GOI does not have in place, and does not apply, a system that is reasonable and effective ... to confirm which inputs, and in what amounts, are consumed in the production of the exported products, making normal allowance for waste, nor did the GOI carry out an examination of actual inputs involved to confirm which inputs are consumed in the production of the exported product, and in what amounts.”*
- With respect to AAP, in the **AR of CVD investigation against PET from India (2006)**, the US DOC specifically noted the following concerns :
 - the GOI’s inability to provide the SION calculations that reflect the production experience of the PET Film industry as a whole;
 - the lack of evidence regarding the implementation of penalties for companies not meeting the export requirements under the ALP or for claiming excessive credits; and,
 - the availability of ALP benefits for a broad category of “deemed” exports.

Verification System - Adequacy of Results as per the WTO



- In the **EU – PET from Pakistan** case the Panel held that:
 - “Results” (as in Article 12.6, ASCM) provided by EC to Novatex related only to certain observations concerning the MBS.
 - Such observations did not constitute adequate provision of the “results” of the verification visit to Novatex.
- They fail to sufficiently communicate:
 - information in the questionnaire response or other information supplied for which supporting evidence was requested (and whether such evidence was provided),
 - whether the Commission requested further information at the verification visit (and whether such information was provided),
 - what comprised the universe of documents the Commission collected, and
 - whether the Commission confirmed the accuracy of the information for which supporting evidence was requested.

Implications of the WTO's decision



- If an investigating authority lacks "necessary information" with respect to a specific issue, it may rely on facts available under Article 12.7 ASCM
 - An investigating authority might permissibly determine that all remitted duties under a drawback scheme are "excess" in the absence of reliable information with which to calculate the excess amount.
 - That outcome results from the lack of necessary information, not from the non-applicability of the Excess Remissions Principle.
 - This is an important distinction because it may be possible for an exporter to supply the necessary information in circumstances where the exporter's government failed to conduct a further examination under Annex II(II).

EC Decisions using Facts Available

- The Commission has in the past used other information to determine the extent of excess remissions.
- In **CVD investigation against polyester textured filament yarn (PTY) from India (2002)**, with respect to ALP the Commission observed:
 - “... the investigated companies were able to demonstrate that the quantities of imported materials, which were exempted from import duties, did not exceed the quantities used for the exported goods. It was therefore concluded that, in the case in question, the exemption of import duties on inputs were granted in accordance with the provisions of Annex I to III of the basic Regulation.”
- Therefore, the Commission held that there is no benefit granted to the companies under this scheme (in this proceeding).

Open Issues

- Whether an investigating authority is supposed to inform the government of the exporting member that a further examination is required under Annex II(II)(2)?
- If not, how will the exporting member come to know that there is a need for a further examination?
- If such further examination is not performed, or does not yield conclusive results, what should an investigating authority do?
- Can it then consider the entire drawback amount to be an excess remission?
- Does the report suggest that the investigating authority could apply facts available to determine if there was an excess remission, and if yes, by what amount?

Moving Forward

- Blockchain?
- Calibrated assessment of subsidies in future disputes?
- Could India improve its verification system?