### **WORKING PAPER NO. 79**

# EXPORT INCENTIVES IN BRAZIL AND KOREA WITHIN THE WTO FRAMEWORK

**RAJEEV AHUJA** 

**APRIL**, 2002



INDIAN COUNCIL FOR RESEARCH ON INTERNATIONAL ECONOMIC RELATIONS Core-6A, 4<sup>th</sup> Floor, India Habitat Centre, Lodi Road, New Delhi-110 003

# **CONTENTS**

| Foe | oewordiii  |          |  |
|-----|--|----------|--|
| I   | Introduction   | 1        |  |
| II  | Agreement on Subsidies and Countervailing Measures (SCM Agreem   | ent) 3   |  |
|     | Export subsidies  Subsidies that favour use of domestic products over imported products  |          |  |
| Ш   | Brazil   | 6        |  |
|     | Brazil's Trade Policy: A Brief Perspective   | 6        |  |
| IV  | Subsidy Programs of GoB  | 11       |  |
|     | Export Promotion Programs  Regionally specific programs  Programs meant to encourage import substitution  Production Subsidies | 19<br>20 |  |
| V   | Korea  | 23       |  |
|     | Korea's Trade Policy: A Brief Perspective  Government Subsidy Programs  Production Subsidies  Regional Subsidies               | 26<br>31 |  |
| VI  | Concluding Observations  | 34       |  |
| Dof | omonaos  | 20       |  |

#### Foreword

This paper is a sequel to an earlier ICRIER Working Paper titled "Export Incentives in India within WTO Framework" by Rajeev Ahuja. Like India, both Brazil and Korea have sought to promote exports through a variety of export incentives. With the lowering of tariffs and elimination of many non-tariff barriers, the rationale for giving export subsidies has weakened in recent years. Indeed, a decline in export subsidies is observed in Brazil, Korea and India.

This study sheds light on the export incentives given by the governments in Brazil and Korea and examines their relevance for India. The study finds that export finance has been an important instrument of export promotion and still continues to be in vogue. The study clearly shows that India should continue to seek improvements in the WTO Agreement on Subsidies. It also shows that a generalised form of government support, such as through market intelligence, training to exporters, identifying potential markets, improving product quality and standards, is the direction to take in promoting exports. This is because the generalised support does not invite countervailing duties and also benefits small and medium exporters who can ill afford to undertake such activities. The study also points out that exports from Brazil and Korea have benefited more from production subsidies than exports from India, and that India, like Brazil and Korea, needs to quickly graduate to a full-fledged VAT system.

**Isher Judge Ahluwalia**Director & Chief Executive
ICRIER

March 2002

# **Exports Incentives in Brazil and Korea within the WTO Framework**

Rajeev Ahuja<sup>1</sup>

### I Introduction

In this paper export promotion programs of Korea and Brazil are analysed with the aim of understanding the nature of these programs, and studying their relevance for India. Also analysed is the status of the export promotion programs within the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement), that is, studying which of these programs are countervailable under the SCM Agreement and which are not. The basic objective of the study is to draw some lessons from these international practices for India. Export finance seems to be a preferred mode of promoting exports as it has survived the post-WTO era, when export subsidies are in general on the decline. Another important finding of the paper is that exports from the two countries have benefited, and continue to benefit, not only from export subsidies but also from production subsidies. Production subsidies have been quite prevalent both in Brazil and Korea. Such subsidies are given through discretionary as well as through well-established programs. Public enterprises particularly in the steel sector are the major beneficiaries of production subsidies.

Given the striking similarities between Brazil and India—both, the continental-size countries, pursued import substitution, as opposed to export promotion, strategy in the 50s, 60s and 70s and also during much of the 80s; during this period both countries tried promoting exports through range of export incentives; in both countries state had significant presence in economic activities, both pursued economic reforms and liberalisation in the early 90s and sought to reduce the role of state and placed greater reliance on markets; in both countries exports account for about 10% of its GDP---inclusion of Brazil was a natural choice.<sup>2</sup> The choice for Korea is conditioned by the fact

<sup>&</sup>lt;sup>1</sup> The author gratefully acknowledges the help provided by the Embassy of Brazil and the Embassy of Korea at New Delhi in furnishing trade related information. Anand Jain provided excellent research assistance.

Their share in the world trade is not much different either. However, Brazil's per capita income is considerably higher than that of India.

that it is one of the early developing countries to have followed export-oriented strategy, as opposed to import substitution strategy adopted by other developing countries. From mid-60s onwards, Korea gave several export incentives and was successful in increasing exports and achieving higher growth.

The extent to which export incentives or export subsidies promote growth in exports from a country is not clear. Nevertheless countries, both developed and developing, continue to subsidise their exports in several ways.<sup>3</sup> In developing country context, removal of anti-export bias (on account of high tariffs, non-tariff barriers, overvaluation of currency) that once provided a strong rationale for giving export subsidies has only been replaced by the rationale to offset domestic inefficiencies such as poor infrastructure, inefficient financial intermediation, and cascading tax structure.

Subsidies in general are considered to have a distorting effect on the economy.<sup>4</sup> On subsidies, the WTO is concerned only with the trade distorting effect of all subsidies-production subsidies as well as export subsidies. Export subsidies distort trade much more than production subsidies. Since exports may benefit from both production and export subsidies, the WTO Agreement on subsidies disciplines Member countries with respect to giving both these types of subsidies. Both these subsidies are countervailable in the sense that Member countries can impose duties (known as countervailing duties, CVDs for short) against subsidised exports to neutralise the effect of subsidies if such subsidies cause injury to the interest of the importing country Member.

Many of the export promotion programs especially of the developing countries have been countervailed by the Member countries. Between Jan 1995 and June 2001, total of 100 CVD cases were initiated by the developed countries of which 71 were

<sup>&</sup>lt;sup>3</sup> Agricultural subsidies of the US and the EC are, of course, well known. However, this paper deals only with non-agricultural export subsidies. To give an example of non-agricultural subsidies given by a developed country, the US federal government provides tax shelter to companies having foreign sales corporations. This case has been referred to the Dispute Settlement Body of the WTO.

<sup>&</sup>lt;sup>4</sup> Unless subsidies are meant to encourage activities having positive externalities. Such activities are likely to be undersupplied if their provision is solely left to the market.

against the developing countries. This could be because the developed country Members initiate CVDs more often than the developing country Members (developing countries initiated only 27 CVD cases, of which 13 cases were against developing countries) and also because subsidies by the developing countries are more overt and common.<sup>5</sup> The WTO allows for special and differential treatment to the developing country Members with respect to the provision of subsidies and the imposition of CVDs. This treatment varies even among different developing Member countries. In the next section (section 2) we briefly outline the SCM Agreement with the intention of bringing out the difference in the special and differential treatment given to countries like Brazil and Korea vis-à-vis countries like India. In section 3, after providing a brief historical perspective on the export policies of Brazil, we analyse export promotion programs currently being followed in the country and their status within the SCM Agreement. Likewise, section 4 is devoted to studying the Korean case.<sup>6</sup> In section 5 we conclude the paper by drawing some policy inferences for India.

# II Agreement on Subsidies and Countervailing Measures (SCM Agreement)<sup>7</sup>

The SCM Agreements broadly consists of two parts. Part one contains disciplines on subsidies provisions, and part two deals with the countervailing measures.

Under subsidies provisions (part one), two types of subsidies are prohibited for most countries. These are (i) export subsidies (that is, subsidies contingent on export performance), and (ii) subsidies that favour use of domestic products over imported products.

## **Export subsidies**

For a developed country Member export subsidies are prohibited. If any developed country Member is found to be giving export subsidy it can be straightaway

These figures are downloaded from the WTO web site: http://www.wto.org

<sup>&</sup>lt;sup>6</sup> Export promotion programs of India have already been studied in Ahuja (2001).

For a more detailed analysis of the SCM Agreement see Ahuja (2001).

taken to the Dispute Settlement Body of the WTO by any Member country. However, the provisions differ with respect to developing countries. For the developing countries listed in Annex VII, export subsidies are not prohibited but are actionable. That is, if export subsidies are found to be causing injury to the domestic industry of the importing Member country, the importing country can impose countervailing duties. For developing country Members not listed in Annex VII, (referred as "other" developing country Members), a period of eight years, from the date of entry into force of the WTO Agreement, is given for the removal of such subsidies, with a two year grace period. This eight year period ends on December 31, 2002.

### Subsidies that favour use of domestic products over imported products

Like export subsidies, developed country Members are prohibited from giving subsidies that favour use of domestic products over imported products. For all developing country Members a five-year period was granted for removal of these subsidies. For developing country Members, this period lapsed on Jan 1, 2000. Now developing country Members are prohibited from giving subsidies that favour use of domestic products over imported products.

Since both Korea and Brazil have per capita income greater than US \$1000, they are therefore outside the group of countries listed in Annex VII of the SCM Agreement.<sup>12</sup> They fall under the category of "other" developing countries and are therefore allowed a period of eight years for the removal of export subsidies. On the other type of prohibited subsidy (subsidy that favours use of domestic products over imported products) Brazil and Korea, like all developing country Members, were required to withdraw in 5-year

No injury proof is required in this case.

Annex VII countries are the least-developed country Members as well as developing country Members with per-capita income (GNP) less than US\$1000.

<sup>&</sup>lt;sup>10</sup> The conditions under which CVDs can be imposed are defined in the SCM Agreement.

For the least developed country Members a period of eight-year, instead of five-year, is given for the removal of subsidies that favours use of domestic products over imported products.

Brazil has per-capita GDP of \$ 4228 and Korea of \$ 9600. Of course, India with a per-capita GDP of around \$ 400 is among the countries listed in Annex VII of the Agreement.

period ending Jan 1, 2000 any program that encouraged the use of domestic goods over imported goods.

Now we turn to the part two of the SCM Agreement that deals with the countervailing measures. As in the case of subsidy provisions (part one) where developing country Members enjoy special and differential treatment, so is the case with respect of disciplines relating to Countervailing Measures (part two). Any countervailing duty investigation of a product originating in a developing country Member is terminated if:

- the subsidy level does not exceed de minimis level which is 1 percent for a developed country Member, 2 percent for "other" developing country Member, and 3 percent for Annex VII country Member (if "other" developing country Member eliminated export subsidy prior to the expiry of the eight year period the de minimis level would be 3 percent, instead of 2 percent); Or
- the volume of subsidised exports represents less than 4 percent of the total imports of the like product in the importing Member country, unless imports from developing country Members, whose individual shares in total imports represent less than 4 percent, collectively account for more than 9 percent of total imports of the like product in the importing Member.

Having briefly looked at the special and differential treatment given to the developing countries in the SCM Agreement, we now turn to export promotion schemes of Brazil in the next section and of Korea in the subsequent section. We begin each of these sections by outlining briefly the changes on trade front in each country.

### III Brazil

# Brazil's Trade Policy: A Brief Perspective<sup>13</sup>

Like India, Brazil also pursued import substitution strategy, and within this strategy, it tried promoting its exports through several incentives and through a crawling peg exchange rate regime that protected the real exchange rate from inflation. Early attempts to promote exports from Brazil can be traced to the 50s when limited tax incentives were given to exporters but availing of these incentives was difficult as one had to cut through the complex web of bureaucratic controls. However, it was not until the early 60s when the government realised the need for promoting exports. This realisation came when Brazil ran into BOP problems when it needed to import intermediate inputs and primary products that it could not produce domestically. Thereafter, in order to promote exports the Brazilian government started giving several export incentives such as tax exemptions. For example, exemption of federal value added tax, called tax on industrial production (IPI), was given in 1965. In 1967, states followed suit and exempted exports from state value added tax, called ICMS. These, together with other, incentives did help increase exports from the country, particularly in the early and mid 70s, the oil crisis notwithstanding.<sup>14</sup>

These incentives specifically benefited manufactured exports. In response to the external shocks of the early 80s, the Brazilian government further enhanced export incentives and sharply devalued the currency. This gave a fillip to manufactured exports from Brazil, leading to their seven-fold increase. This improved their share in total exports---from 24.1% in 1974 to 49.6% in 1987. Between 1973 and 1987, total exports registered a growth of 11.9% per annum.

11

For information on Brazil we've relied on, among other sources, the working papers of the Institute of Brazilian Issues, George Washington University, downloaded from the Institute's website <a href="http://www.gwu.edu/~ibi/minerva/pesquisa.html">http://www.gwu.edu/~ibi/minerva/pesquisa.html</a> See the reference list at the end of the paper.

Because of high growth rate and low inflation during 1968-1973, this period is also referred to as "Economic miracle."

According to Pinheiro and Moreira (2000), export subsidies in Brazil averaged 50% of the value of manufactured exports during the 70s and 80s and were rather costly and failed to turn exports into "more than just a poor alternative to domestic policies." By the end of the 80s, manufactured exports accounted for less than 10% of manufactured output. Also, manufactured exports remained highly concentrated. In 1990, 53 companies accounted for about 44% of all manufactured exports from Brazil.

During 70s and 80s, even though government provided several incentives to exporters, the import substitution policy restricted competition through high tariffs that made production for domestic market more lucrative than production for exports. Brazil's heavy reliance on foreign firms, particularly in capital intensive sectors, is also considered to be a factor that restricted access of its exports to the markets of developed countries. Macro economic problems in the 80s, together with the fact that Brazil didn't make long term investments in the upgradation of its production facilities and that it lacked strategic vision to focus on products in which it had a comparative advantage, led to the decline of the competitiveness of Brazilian exports in the international market since mid 80s. This was reflected in its declining share in important markets such as US, Japan and Germany to other countries.

During 1985 and 1990, Brazil experienced high inflation rate that averaged 856 percent in sharp contrast to a modest rate of 30 percent during 1965 and 1979.<sup>17</sup> High inflation necessitated the government to increase its expenditure and also forced it to look for ways to curtail the same. This made it difficult for government to support export promotion programs, leading to some friction between the state and the business.<sup>18</sup> In

According to Moreira (1995) these subsidies in case of Korea—a country widely believed to be an aggressive exporter—were only 20%, on average, during the same period.

The 80s decade was marked by prolonged crisis with alternate years of growth and recession, and high inflation during late 80s. For this reason, the decade of the 1980s and the early 1990s is also referred to as the "Lost Decade."

Despite this divergent inflationary experience, the growth rate during these two periods was not significantly different (4.5 percent and 5.9 percent respectively).

In 1988 the country was given a new constitution that transferred significant amount of financial power to the states while leaving the responsibility for social programs with the federal government. In an

1990, real GDP stagnated and it in fact fell in 1992. The economic condition forced the Brazilian government to embark on economic liberalisation and reforms program.

In the early 90s, the Brazilian government started economic reforms, that comprised trade reforms, privatisation and deregulation. Trade reform on the import side saw removal of most non-tariff barriers in 1990, and the announcement of a tariff reduction program which brought the average nominal tariff down from 32.2% in 1990 to 14.2% in 1993. On the export side, subsidies were eliminated and incentives reduced to a minimum. Pinheiro et al (2001) report that these incentives fell from an average of 3.1% of GDP in 1981-84 to 1.3% in 1990-91. However, the government continued to exemption tax on exports and also strengthened export financing schemes. Trade reforms also saw establishment of Mercosul: a market with Argentina, Uruguay and Paraguay, having common external tariff to be implemented from January 1, 1995. Also, with financial liberalisation, the Brazilian economy started becoming more financially integrated with the world economy.

After the launching of reforms in the early 90s, the earlier rationale for export incentives namely to offset export bias, which was so strong in the 70s and 80s was no longer valid. Furthermore, the growing pressure on the government to keep its fiscal position in control, and the countervailable nature of many export incentives may have necessitated the Brazilian government to terminate/withdraw several of its export promotion programs that were adopted in the 70s and 80s. The following list provides some of the important subsidy programs that were terminated.

- preferential working capital financing for export by CACEX (terminated from August 30, 1990)
- over-rebate of state value added tax on goods destined for exports

attempt to stabilise the economy, five new economic plans and four new currencies were adopted within a short span of 1986 and 1991 but without any success.

<sup>19</sup> The CET to initially cover 85 percent of 9,000 tariff items, and by 2006 to extend to all items.

- preferential financing to exporters if they maintained certain minimum level of deposit of foreign exchange (September 20, 1988)
- export premium for the IPI (May 1, 1985)
- financing for the storage of merchandise destined for exports
- income tax exemption for export earnings (April 12, 1990)
- preferential financing for trading companies (August 31, 1990)
- preferential price or price equalisation program (February 1986)
- Preferential medium-and long-term financing for manufactured exports under FINEX (October 15, 1990)

Beside trade reforms, the economic reforms included initiation of privatisation program in 1990 with the aim to reduce the size of government and to improve its fiscal position. Before the 1990s, state-controlled monopolies impeded competition. The government had strong presence mainly in heavy chemical industry either through its ownership or through its participation (at Federal or State level). As part of reforms, the government started withdrawing itself from production through the privatisation program. The sectors that it initially focussed on were steel, fertiliser, petrochemicals and aircraft.

However, by June 1994, when inflation skyrocketed and real interest rates soared (at 122 percent) overnight, economic stability became the main concern of the government. Accordingly, the government with the aim to stabilise the economy adopted "Real Plan" that involved undertaking economic restructuring designed to reduce inflation, dismantle state control and reduce market barriers and encourage greater private sector investment. The exchange rate policy after Real Plan was not linked to export promotion and started to reflect more adequately market fluctuation. In 1995, the privatisation program was extended to include sectors such as power, financial services, railways and mining.

Trade reform enabled exporters to access modern capital goods and inputs at international prices. This, coupled with structural changes, increased the potential for competition by exposing Brazilian producers to competitive pressures particularly from

foreign imports. This led to higher productivity growth and greater specialisation, and also gave Brazilian firms stronger incentives and better conditions to penetrate international markets. Nevertheless, trade balance in 1995--for the first time in more than 15 years--turned negative. This was because export growth lagged behind import growth, even though Brazilian trade more than doubled—increased from \$52 billion to \$114 billion--between 1990 and 1997. Nevertheless, the export concentration was still high. Around 1997, about 250 large Brazilian companies accounted for about 85% of Brazil's total exports.

Of course, export growth achieved in the decade between late 80s and late 90s was much lower (5.7% per annum) than what was achieved during the prior decade. In the 90s, when the pressure on external account started interfering with economic growth, the government realised the need for laying special stress on promotion of exports.

Accordingly, in 1997, the Brazilian government came out with the Export Promotion Program called (PEE) with the explicit objective of doubling exports by 2002. The program was designed to increase exports through the joint effort of the public and the private sector. Under this program 56 productive sectors were identified that would receive special attention from the government in gaining markets in other countries. These sectors contributed 88% of exports from Brazil in 1997. The management of PEE was conducted at two levels. One, through meetings of management teams with the President of the Republic, and two through the Chamber of Foreign Trade—CAMEX, who was entrusted with the responsibility to co-ordinate the functions of several ministries involved in foreign trade, and also to manage, monitor and support the program.

In 1997, the Brazilian government also created a new National Export Promotion Agency (APEX), aimed at promoting Brazilian products overseas and bringing small-and-medium businesses into the export business. Several export market development

-

In setting of target and defining a strategy for achieving the target, India is doing in 2002 what Brazil started in 1997.

trade organisations work with APEX.<sup>21</sup> APEX provides matching funds to these organisations. The matching funds by APEX cannot be over 50% of the total export promotion budget of each organisation. APEX encourages formation of consortia by small firms in foreign trade by providing finance for trade missions, fairs and exhibitions. APEX operates in each SEBRAE—technical institutions meant for the development of micro and small firms (Monteiro 2001).

The second half of the 90s also saw rebuilding of the export financing system on a market-friendly basis. Despite the reduction of trade bias a substantial gap between internal and external markets prevailed until the devaluation in 1999.<sup>22</sup> Even after devaluation of the currency by about 50% in January 1999, Brazilian export did not increase substantially. In fact, inflation during 1999 and 2000 dampened the effect of devaluation.<sup>23</sup>

Having briefly outlined the changes on trade front in Brazil, we now turn to examining selected export incentives of Government of Brazil (GOB), and analyse the status of these incentives within the WTO Agreement on Subsidies (SCM Agreement).

# IV Subsidy Programs of GOB<sup>24</sup>

Exports can benefit from export subsidies as well as production subsidies. In the imposition of countervailing duties (CVDs), the importing country takes both these subsidies into account while calculating the duty margin against subsidised exports. Brazil has been giving both export subsidies and production subsidies. Even though Brazil has terminated many of its export subsidies that were in place in the 70s and 80s, it

The Indian counterpart of these organisations are Export Promotion Councils (EPCs).

The devaluation was the direct result of the change in exchange rate regime in response to the Asian financial crisis in 1997, which as followed by Russia's moratorium in mid 1998. This made the currency more flexible.

<sup>&</sup>lt;sup>23</sup> For slow response of exports to the new initiative on trade liberalisation see Pinheiro and Moreira 2000.

Information on subsidy programs has been compiled from several sources, including CVD cases imposed against exports from Brazil.

still has a few programs that qualify as export subsidies under the SCM Agreement and these programs have been countervailed by a few member countries. (See Table 1a for the CVD cases currently in force against Brazil.) For example, export finance popularly called PROEX that makes finance available to exporters on international terms is an export subsidy<sup>25</sup>. Similarly, exemption of tax/duties on import of equipment and other goods not physically incorporated in the production of exports too is an export subsidy. We examine these and other schemes in some detail below.

# **Export Promotion Programs**<sup>26</sup>

# Advanced Payment Under Foreign Exchange Contract (ACC)/ Advanced Payment Under Export Document (ACE):

These are short term financing programs used to help Brazilian exporters. These instruments do not depend on government support and can cover a vast range of products, including raw materials. They give an edge to exporters once costs are trimmed and exporters can pay in longer terms. Private banks are mostly providers of this sort of credit, using their own resources as well as foreign funding. Even though ACC is a credit given prior to shipment and ACE is given after shipment, both loans can be used in a single credit operation. Maximum terms are established by Central Bank. ACC operations can be carried out with financing programs of BNDES-Exim as well as PROEX.

It duration ranges from 180 days prior to the shipment of goods (ACC) to 180 days after shipment and before payment by the importer (ACE). This anticipation constitutes a financing in national currency of the foreign currency to be received from the importer.

This subsidy was referred to the WTO's Dispute Settlement Body that considered the earlier version of the scheme to be a prohibited subsidy. Brazil has since modified the scheme.

The list of subsidy programs is not exhaustive but covers only important programs. Given the dynamic nature of trade policy changes, it is possible if some of these programs discussed in the paper have been terminated or discontinued recently.

Status of the Program: Even if a financial benefit is conferred under this program to the users who are exporters, it cannot qualify as subsidy, let alone export subsidy. This is because the agency involved in the program is a non-government agency, namely private banks who do not receive any financial support from the government in carrying out this program.

### Export Financing by Social and Economic Development National Bank (BNDES):

*Pre-shipment Financing:* Since 1991 only BNDES through a specific program called BNDES-exim, gives loans to production destined to export using instruments that are similar to those from the international market.

Mostly loans can cover up to 100% of the value of the operation and a 30-month term (including grace period); it depends on production cycle. The interest rate covers financial costs plus basic spread and risk spread. Thus, interest rate is normally LIBOR+1% (basic spread)+risk spread.

Post-shipment Financing: The BNDES, using internal or external resources, finances exports of goods and services bringing the same competitiveness of the international market. Almost all products can be financed as well as services associated with those products. The financing can achieve 100% in terms of export value and the term range may vary from 60 days to 12 years. The interest rate includes LIBOR+1%+spread. BNDES also takes part in post-shipment financing through PROEX, used as interest-rate equalisation.

Status of the program: BNDES is a government agency. Under this program, its loans, at least foreign currency denominated loans have not been found to be conferring financial benefit to its recipients (as the rates have been found to be above the benchmark rates). Therefore its loans (at least foreign currency loans) do not qualify the subsidy test even though these loans are meant for exporters only.

## Guarantee Fund for Competitive Promotion (FGPC)

This instrument, managed by BNDES, is meant to complement guarantees required to obtain pre-shipment financing from BNDES for export operations. This instrument is mainly for small businesses whether exporters or those involved in production of inputs used by exporters. FGPC covers risk of credit used (i) for expansion, relocation or modernisation of plant with the aim of improving its competitiveness (ii) for production for exports (iii) for buying capital goods or install outlays, and (iv) to meet working capital associated with financing.

Status of the program: Since the details about the terms of this program are not known it is not possible to evaluate the status of this program under the SCM Agreement. Going by the BNDES provision of pre-shipment credit, which doesn't confer any financial contribution, one can infer that this program too is most unlikely to confer any financial benefit to those who avail of credit guarantee from BNDES.

### Preferential Export Financing under the PROEX Program

PROEX was established in June 1991 to substitute another program, called FINEX. Its objective is to support Brazilian exports of goods and services by giving its exporters the financial conditions of the international market. This program for financing is supported by the national treasury resources. It is operated in two systems: PROEX-Financing and PROEX-Equalisation. In both cases the exporter gets paid immediately. The financing is operated exclusively by Banco do Brazil, acting as Brazilian Treasury agent, in which it is possible to finance up to 85% of export value in the negotiated INCOTERM. The repayment period varies from 60 days to 10 years depending on the degree of industrialisation required for production.

*PROEX-Financing:* Under this program loans are given to exporters (supplier's credit) or foreign buyers (buyer's credit). The bank of Brazil has authority to decide on credit operations only up to a certain amount (\$8 million), beyond which the cases are referred to a council called CCEx (Exports Credit Committee) which scrutinises the

application. In order to finance 85% of the export value, the PROEX rules demand that at least 60% of components must be Brazilian.

PROEX-Equalisation: In the equalisation funding is provided by commercial banks that provide loans to exporters or importer of Brazilian goods and services. In this system the Brazilian Treasury pays part of the expenses in order to equalise the differences between the maximum reference rates previously determined by BACEN (Brazilian Central Bank) and the minimum interest rate used internationally for financing. The payment is made through the Bank of Brazil to international or Brazilian banks. The equalisation is paid in case of supplier's credit as well as buyer's credit and the credit terms are the same as PROEX-Financing.

Status of the program: In 1999, a WTO panel found PROEX interest equalisation payments used to finance the sale of regional aircraft manufactured in Brazil to be a prohibited export subsidy because of the local content requirement condition. The WTO Appellate Body upheld this finding. The Government of Brazil modified PROEX to bring it into conformity with WTO subsidy rules, but Canada challenged the modified scheme also in the WTO. The United States intervened in this challenge as a third party and also expressed some concerns about the adequacy of Brazil's implementation of the panel's findings. Whatever be the status of the modified program, this program even without local content requirement is definitely an export subsidy and therefore countervailable under the SCM Agreement.

### Export Credit Insurance by Brazilian Export Credit Insurance Company (SBCE)

Export credit insurance protects the financial interest of exporters in the event of default on the part of importers. Since purchase of insurance involves vetting of the financial health of the importer, this also helps in the screening of buyers. Besides, it can be used as a debt-collecting instrument. In Brazil, export credit insurance is provided by a private company (SBCE) that has many Brazilian companies as its shareholders. It provides insurance cover up to 85% of the credit against commercial risks and 90% against political and extraordinary risks.

Status of the program: In Brazil, this instrument is managed by the Brazilian Export Credit Insurance Company (SBCE), which is a private company. Since the company doesn't depend on any financial support from the government in providing credit insurance, no financial benefit is deemed to be conferred. Hence the program does not qualify as a subsidy.

# Tax Exemptions

Export of goods and services are not levied many taxes such as IPI (Industrial Product Tax), ICMS (Sales Tax), COFINS (Contribution to Social Security Financing), and PIS (Social Integration Program Tax). All these taxes represent roughly 30% of product price in the internal market. Goods that are expected to be re-exported are also exempted from import tariffs.

Brazilian IPI (Industrial Product Tax) is a federal value-added tax levied on most domestic and imported manufactured products. This tax is assessed either at the point of sale by the manufacturer or processor, with respect to domestically produced goods, or at the point of Brazilian Customs clearance, in case of imports. A counterpart of IPI at state level is ICMS.

The PIS/PASEP and COFINS are monthly federal social contributions, calculated as a percentage of sales. The contributions are due with respect to each local transaction, usually included in sales price to customers, then remitted to federal government social contribution fund.

Status of the program: Exemption, refund or remission of all indirect taxes such as import duties, value added taxes paid on the inputs used in the production of exports is allowed under the SCM Agreement. Since IPI and ICMS are in the nature of indirect taxes, their exemption on exports doesn't constitute a subsidy. In the context of CVD, taxes on revenues such as PIS and COFINS too are considered in the nature of indirect

taxes and not direct taxes. For this reason exemption of exports from these taxes is allowed under the SCM Agreement and therefore not considered to be countervailable. Since Brazil has value added tax system in place, the case for any excess of refund of these taxes is rather weak.<sup>27</sup>

## Drawback Regime

The following three types of Drawback systems are available to Brazilian exporters:

*Drawback Suspension:* Raw materials and goods imported and exported after an industrial process are free of import duty, IPI and ICMS. The permission of this regime is ruled by the Foreign Trade Office (DECEX) of the Ministry of Industry and Commerce which verifies all the plan of exportation.

Drawback Exemption: An exemption of import duty, IPI and ICMS are allowed on importation of raw materials and goods in order to replace the stock of a company, after an industrial process and consequently exportation of products. The raw materials and goods have to be equal in quantity and quality of the products used before. Similar to the Suspension regime DECEX rules the permission to import under an exemption. In this particular case the importer has to prove with the export documents the exportation made before.

Drawback Refund: In the case of regular importation of raw materials and other goods submitted to an industrial process and then exported, the importer can request (in 90 days) to the tax authorities for a refund. The importer has to prove the importation and the exportation of the products with the import and export declarations and also the tax payment forms. If the request is approved, the importer will get a Tax Credit Certificate to be used on next importation.

17

-

These taxes have not even been included in the list of programs alleged to have provided countervailing subsidies in the initiation of CVD case by the US against import of Carbon and Certain Alloy Steel Wire Rod from Brazil. The Initiation of the Countervailing Duty Investigations (2001) can be downloaded from <a href="http://ia.ita.doc.gov/frn/0110frn/01-24503.txt">http://ia.ita.doc.gov/frn/0110frn/01-24503.txt</a>

Status of the program: The first two schemes are quite similar to those followed in India. Drawback suspension is similar to Advance Licence (AL) scheme in India and the Drawback Exemption is similar to Duty Free Replenishment Certificate (DFRC) in India. However, the difference is in the third scheme. Although the Drawback Refund system in Brazil appears quite close to the Indian Duty Entitlement Pass Book (DEPB) scheme, the essential difference lies in the fact that the scheme is based on the taxes actually paid by the exporters since the exporters are required to furnish tax payment forms.

## Exemption of IPI and Import Duties on Imports Under Decree/Law 2324 (E)

This Law provides exporters of manufactured products exemptions from IPI and duties on imported spare parts and machinery.

Status of the program: This program is countervailable because it allows duty free import of goods not physically incorporated into the production of exports and thereby confers financial benefit to exporters. Since this is contingent on export performance it constitutes an export subsidy and hence is countervailable.

### Minerals Tax Incentive

GOB establishes a tax on minerals call IUM. This tax is lower for iron ore pellets sold domestically than for exported pellets. Payment of IUM exempts the firms from all other taxes except the income tax and all charges for the use of public services. This exemption includes social security taxes and property taxes.

Status of the program: The IUM exempts the firms from direct taxes (such as social security taxes) and because the tax rate is lower for export than for domestic sales, the program confers financial benefit to the exporters of the product. Since the benefit is linked to the export performance the program is deemed to be an export subsidy and hence countervailable.

### Regionally specific programs

# Program for Development of backward regions (SUDENE and SUDAM)

SUDENE and SUDAM program were created to promote the development of Brazil's Northeast region and Amazonia region respectively. Both these programs are administered by the Federal government and allow either a partial or complete tax exemption on the standard income tax for Brazilian companies. Under both the programs, companies are allowed 100 percent tax exemption if they make initial investment in these regions, increases capacity in the applicable region, or modernises its facilities in the specific region. Companies that do not meet these criteria are allowed partial tax exemption on income from facilities in these regions.

Status of the programs: Under the SCM Agreement, government assistance/incentives meant for the development of backward regions was considered to be non-specific subsidy and hence non-actionable for the first five years from the date of entry into force of the WTO Agreement.<sup>28</sup> This period lapsed from January 1, 2000. All government subsidies meant for the development of backward region are now considered to be a specific subsidy. Under SUDENE and SUDAM, tax exemption on income generated in these regions amounts to forging revenue due to the government and thereby conferring financial benefit. Since this benefit is given only to the units located in these regions, the benefit is regionally specific and hence countervailable.

### Special Free-trade Zones

As in many developing countries, Brazil too has special free-trade zones, denoted as ZPEs. These zones are considered to be outside the Brazilian territory for purposes of customs control. Products manufactured in ZPEs are for export only and their import into Brazilian territory is strictly prohibited. Currently, there are four ZPEs in Brazil.

Along with government subsidies for regional development, two other types of government subsidies

were not considered to be specific, and hence non-actionable. These are: research and development assistance and assistance for promoting investment in environmentally sound technologies. Since no further action was taken in extending this provision, all these types of subsidies are now considered as specific and hence are actionable.

Companies operating in ZPEs are offered exemption for 20 years from import duties and from customs and administrative restrictions and controls for goods imported or exported. These companies pay income tax according to the rules applicable to Brazilian companies, except for depreciation of imported goods, which is non-deductible.

Status of the program: The companies located in these zones are free from import duties, customs control and restrictions. To the extent the freedom from such controls and restrictions also apply to import of capital goods and equipment that is not generally applicable to companies outside these zones, the companies stands to financially benefit by locating in these zones. Since the financial benefit is specifically given to companies located in the designated zones, the benefit constitutes regional subsidy and hence countervailable. However, part of this financial benefit gets offset by the fact that depreciation on imported goods in these zones is not allowed, as is the case otherwise.

### Programs meant to encourage import substitution

### Accelerated Depreciation for Brazilian-Made Capital Goods

Under this program any company that purchases Brazilian made equipment and has an expansion project approved by the Industrial Development Council (CDI) may depreciate this equipment at twice the rate normally permitted under the Brazilian tax laws.

Status of the program: Allowing higher depreciation on selected equipment confers financial benefit on the user of such equipment. Since the benefit is available only on Brazilian made equipment the program clearly favours use of Brazilian made equipment over imported equipment. Therefore, the program is deemed to encourage import substitution and hence specific. Any subsidy program that favour use of domestic products over imported products is prohibited since January 1, 2000 for countries like Brazil that fall under "other" developing countries category.<sup>29</sup>

\_

<sup>&</sup>lt;sup>29</sup> The least-developed country Members are given eight-year period to eliminate these subsidies.

# Financing for the Acquisition or Lease of Machinery and Equipment through Special Agency for Industrial Financing:

This program called FINAME is administered through BNDES and other agent banks in Brazil. Under this program capital financing is given to companies in Brazil for the acquisition or leasing of new machinery and equipment. This financing is mostly provided for machinery and equipment manufactured in Brazil. This facility is given on non-Brazilian machinery and equipment only when such machinery and equipment is not manufactured in Brazil.

Status of the program: Since capital finance under this program is available on preferential terms, it confers financial benefit to its recipient. Moreover, since this facility is generally given only on Brazilian machines and equipment, the program is deemed to encourage import substitution and hence specific. For these reasons the program constitutes a subsidy within the meaning of the SCM Agreement and hence countervailable. This subsidy program has become prohibited since January 1, 2000.

In addition to the above mentioned programs, Brazil has other programs that are in the nature of production subsidies. For example, incentives ranging from equity infusion on terms inconsistent with the commercial considerations to infrastructure support to fiscal benefits to selected industries/firms or for the development of geographical regions to loans/credit given on preferential terms to selected industries/firms. Exports that have benefited from these programs too have been countervailed by some member countries. Also, doubts have been raised on the Brazil's privatisation program by the Member countries.

### **Production Subsidies**

Going by the number and the range of subsidy programs, production subsidies seem to be more common than export subsidies in Brazil. Production subsidies take both non-recurring and recurring forms. Non-recurring subsidies are given in the form of equity infusion, debt forgiveness, debt to equity swap, and long-term financing while recurring subsidies are given in the form of fiscal benefits through a variety of

exemptions and rebates of indirect taxes such as import duties, federal and state value added taxes. Production subsidies are especially targeted to benefit selected industries. In Brazil the four industries that have specifically been given government support are aircraft, automobile, shipbuilding and steel.

It is observed that government has had significant presence in certain basic industries especially the steel industry. The steel industry is given special benefits by the government in a variety of forms such as injection of equity, infrastructure support. Admittedly, there may be a bias for steel industry since a number of CVDs cases have come up against steel exports from several countries, and therefore government subsidy programs to the steel industry have come to light. Such benefits may actually be common in other industries as well, particularly those in which government has significant presence.

Some of the major programs of GOB meant to benefit the steel industry/firms are listed below:

- Disproportionate lending to the steel sector through BNDES
- Debt-to-Equity Conversions to COSIPA in 1992 and 1993
- Equity Infusions/Debt Forgiveness to Usina in 1988
- Equity Infusion to a pipe company and to certain steel companies
- Government provision of operating capital
- IPI rebate for capital investments in steel industry
- Program to benefit upstream suppliers of steel inputs
- Provision of infrastructure (subsidised port facilities and transport subsidies)

Since the focus of the paper is not on production subsidies but on export subsidies we do not study these programs here. Given the importance of the GOB privatisation program with respect to the steel companies (as exports from these companies have been countervailed), we outline the privatisation program below.

### GOB Privatisation of Steel Companies

In 1974, two government-owned steel companies, referred as COSIPA and CSN, were transferred to another government holding company referred as SIDERBRAS. In

the same year a majority interest of USIMINAS, a steel joint venture in which the government was one of the stakeholders, too was transferred to SIDERBRAS. In 1990, when the government started privatisation program it decided to put SIDERBRAS, including its operating companies, into liquidation. Accordingly, in 1991, USIMINAS was partially privatised, and in 1993, both COSIPA and CNS were partially privatised. In 1994 additional government-held shares in all the three companies were sold.

After this, the new ownership pattern that emerged was such that USIMINAS had significant ownership in COSIPA, sufficient to influence the functioning of the latter. Similarly, in the case of CSN, the two entities that had significant ownership in CSN also had meaningful holdings in both USIMINAS and COSIPA. This complicated structure made it difficult to ascertain the financial benefit given to individual companies prior to 1992 (prior to their privatisation) when all three companies received equity infusion and credit from the GOB on terms inconsistent with the normal commercial decisions. Prior to their privatisation, GOB debt-for-equity swaps provided to COSIPA and CNS, were made on inconsistent terms. These companies continue to benefit from such inconsistent commercial practices of the GOB made in the past. Therefore exports from these companies have been countervailed. We now turn to the Korea case.

## V Korea

# Korea's Trade Policy: A Brief Perspective $^{3\theta}$

Korea has been successful in achieving high export and economic growth in the 60s and 70s. For example, exports climbed from \$ 175 million to \$5 billion between 1965 and 1975, and further to \$20 billion by 1981. In increasing its exports, the Korean government is considered to have played a crucial role in which it switched from import substitution strategy pursued during 1948-1962 to export promotion or export-orientated strategy. The Korean government relied extensively on export promotion measures with

\_

For an excellent monograph on Korea's Trade and Industrial Policies from 1948 to 1998, see Sohn et al (1998). For this section is partly drawn from the monograph.

the aim of increasing exports from the country. Sohn et al (1998) lists export promotion measures that the government introduced during 1962-1972. These are:

- Preferential export credits
- Tariff exemptions on the imports of intermediate goods used export production
- Reductions of taxes on export income
- Linking import permits and quotas to export performance
- Exemptions from tariffs and indirect taxes for domestic suppliers of intermediate goods used for export production
- Accelerated depreciation for fixed assets of major export industries etc.

Besides, in 1965 the government devaluated the won and this improved competitiveness of the Korean industry. Government also invested in improving infrastructure facilities such as ports, power plants and highways. According to Soha et al (1998) firms producing goods for exports could borrow official interest rate that was lower than market rate. The difference between these two rates was as high as 18.5% in 1968. The basic system remained in place till early 1980s. Besides giving these incentives, the government also set up a system whereby export targets were set up by exporting firms, and government periodically reviewed these targets in its trade promotion meetings.

To what extent these measures helped Korea achieve high export growth has remained a controversial and unsettled issue. At one extreme, the view is that high export growth wouldn't have been possible without government's role in export promotion and in providing stable macro economic environment (Wade 1990). The other extreme view is that export promotion measures at best had a limited impact in achieving high export growth in Korea. High export growth, according to this view, was the result of policies that encouraged investment in the country (Rodrik 1995). Both these view relate to "supply side" factors. A different view that has also been put forward stresses not so much on the "supply side" factors but on the "demand side" conditions. This view is based on the argument that the impetus for export growth came from the external sources, in particular from Japan (Castley 1995).

In sharp contrast to the export promotion policy of the 60s, the government in 70s targeted the development of heavy manufacturing and chemical industries (HCI). Giving incentives by way of finance was the most important way in which development of HCI was promoted. Strong emphasis given to large enterprises and chaebols. This adversely affected the light manufacturing industries and resulted in lack of development of small and medium-sized enterprises. This was only to be expected as resources got diverted towards developing HCI. This led to an unbalanced development. To correct this imbalance created by the previous government due to its strong intervention policies, the new government that took charge moved away from the intervention policy and towards greater reliance on the market in the period 1980 to 1993. During this period, the government pursued a wide range of market liberalisation policies. It started deregulating financial sector and undertook import liberalisation. Steps taken to severe the ties between the government and businesses during this period were not very successful as informal ties remained in place.

During 1994-1997, Korea moved towards globalisation by joining the WTO, APEC and the OECD. It further liberalised trade and modified its trade and industrial policies to make them WTO consistent. For example, Korea abolished the direct export subsidies. Four subsidies that violated WTO regulation, Korea eliminated by 1998. These subsidies are:

- Reserves for Export Losses<sup>31</sup>
- Reserves for Overseas Market Development<sup>32</sup>
- Facility Investment Loans provided by the Small and Medium Enterprises Foundation Fund

A domestic person or a corporation engaged in foreign exchange earning business was allowed to establish a reserve amounting to the lesser of one percent of foreign exchange earning or 50 per cent of net income for the respective tax year. If certain export losses occurred, these could be offset using money in the reserve fund. Any amount that was not used to offset a loss was to be returned to the income account and taxed over a three-year period, after a one-year grace period. All of the money in the reserve would eventually go into income account and subjected to corporate tax either when it is used to offset export losses or when the grace period expired and the funds were returned to taxable income. Deferral of taxes owed to government amounted to an interest-free loan in the amount of the company's tax savings. This program is an export subsidy as it is contingent upon export performance and confers financial benefit to its recipient.

<sup>&</sup>lt;sup>32</sup> Similar to Reserves for Export Losses outlined in the previous footnote.

# • Tax Credit for Investment in Facilities<sup>33</sup>

In 1997, the Asian Crisis began in Thailand in July 1998 and spread to Korea towards the end of 1997. With capital flight from the economy, many weaknesses of the economy, particularly the cosy relationship between the government and chaebols were exposed and this in turn fuelled capital flight from the country, depleting Korea's foreign exchange reserves. The situation turned so precarious that it had to sign standby arrangement with the IMF. Subsequent to that, interest rate increased and banks became more reluctant to lend. This credit crunch caused recession in Korea when imports of all kinds of goods declined and export failed to pick up despite more than 40% depreciation in the won. The government used the crisis as an opportunity to carry forward market-oriented reforms, to restructure its trade and industrial policies, and to correct several economic weaknesses present in the country such as distorted industrial development, which it tried to correct by promoting the development of small and medium enterprises. With this brief outline, we turn to the main export promotion measures of the Government of Korea (GOK) in the section below.

### **Government Subsidy Programs**

### Duty Drawback on Non-Physically Incorporated Items and Excessive Loss Rates:

Under the Korean Customs Act, Korean exporters may receive an excessive abatement, exemption, or refund of import duties payable on raw materials used in the production of exported goods. It has been found that the drawback on imported raw materials when the raw materials are not physically incorporated into the exported item sometime results in excessive drawback duty.

Even though in working out the usage rate of inputs for manufacturing of one unit of output, recoverable scrap is also taken into the calculations, it sometimes results in

\_

The companies in Korea were allowed to claim tax credits for various kinds of investments. If the tax credits cannot be used at the time they are claimed, the company is authorised to carry them forward for use in later tax years. Because Korean companies received a higher tax credit for investments made in domestically produced facilities, investment tax credits received under several Articles constituted an import substitution subsidy.

excessive drawback. The GOK comes out with average raw material usage rates and such rates are periodically revised. This is done for all products under Korea's duty drawback regime. Producers with stable technology can use these rates. However, if a producer becomes appreciably more efficient than the average, it is supposed to use its own rate. If, upon inspection, a producer is found to be overcompensated for its duty drawback, it is liable for a penalty assessment. According to GOK, only physically incorporated raw materials are eligible for drawback and that this rule applies to all merchandise exported from Korea.

In exports of industrial belts and stainless steel cooking ware drawback received was found to be excessive and therefore countervailed. In case of certain steel products it was not found to be excessive and therefore not countervailed. Therefore whether there is an excessive drawback seems to vary from product to product.

### Fixed Amount Refund System (FARS)

This scheme is similar to DEPB refund scheme of India. Under this scheme there is no obligation to import any inputs for the production of the exported product. Whether this scheme is currently being practised is not known but the scheme has been countervailed by EC not long ago in 1999.

Status of the Scheme: Like DEPB scheme in India, EC considers the FARS to be neither a duty drawback scheme nor a substitution drawback scheme within the meaning of the SCM Agreement. Therefore the entire financial benefit given under the scheme is considered to be a financial contribution made by the GOK. Since the refund is based on the FOB value of exports, the scheme is considered to be based on export performance and hence deemed to be specific. The issue of excess remission is not examined at all. As per this interpretation, even if the refund under the scheme is less than the import duties actually paid on import of goods actually used in production of exports, the scheme would still be considered countervailable.

## Export Credit Financing from Export-Import Bank of Korea (KXMB)

In 1973, GOK established a fund called the National Investment Fund (NIF) through which funds were given to banks for the purpose of loan. These funds are used to finance development or to finance exports on a deferred payment basis. Only deferred export financing through NIF is wholly administered by the Export-Import Bank of Korea. The KXMB provides two types of export credit (i) a pre-delivery loan to cover the period of construction of the project, and (ii) a deferred export credit in the form of a post-delivery loan for ten years including a two-year grace period.

Status of the program: Because the loans are contingent upon export and the rates are less than those on comparable commercial financing, these loans confer financial benefit to its recipient and therefore constitute an export subsidy.

### Export financing loan

There are two types of trade financing programs: production financing and raw material financing. A bank provides production financing when a company needs funds for the production of export merchandise or the production of raw materials used in the production of exported merchandise.

Status of the program: The program is countervailable because the interest rates charged on the loans were less than what a firm would have had to pay on a comparable short-term commercial loan.

## Export Credit Insurance by the Export-Import Bank of Korea

The KXMB operates an export insurance program which provides commercial, political and managerial risk insurance. A separate budget for this program is maintained by the KXMB. Purchase of this insurance is compulsory on all loans provided by the KXMB

Status of the program: To be a subsidy, a government-operated export insurance program has to charge premiums which are adequate to cover the long-term operating costs and losses of the program. Because the premiums charged to exporters allow the KXMB to cover its losses and its long-term operating expenses, this program is determined not to constitute a subsidy.

### Export Guarantees from the KXMB

The KXMB provides guarantees for exports of large capital goods and project, and no guarantee are offered for sales of consumer goods. Due to non-availability of information regarding the terms of these Guarantees an assessment cannot be made about the status of this program within the SCM Agreement.

### Tax Incentives

GOK used to give several tax incentives to achieve specific national economic objectives under the Tax Exemption and Reduction Control Law (TERCL) under its various Articles and Foreign Investment Promotion Act (FIPA). However, on January 1, 1999 the Act was replaced by the Special Tax Treatment Control Law (STTCL) and from May 1999, FIPA too was subsumed into STTCL. All tax incentives under STTCL already have sunset rules whereby an incentive comes to an end after the expiry of certain period, unless it's extended.

With this replacement of TERCL with STTCL, many programs under TERCL that were deemed to be countervailable have been withdrawn and the tax incentives given under STTCL are non-specific in nature.<sup>34</sup> However, these programs have yet to be evaluated in the CVD investigations. If exports continue to benefit from a government program that once existed but doesn't exist anymore, the benefit from that program is still countervailed even after the program is withdrawn. In the recent CVD investigations tax incentives under TERCL may be countervailed if the lingering effect of those programs continue to benefit exports.

29

We are not analysing here various incentives given under TERCL that have been countervailed.

GOK claims that most of the tax incentives now given under STTCL are based on objective criteria. For example, tax incentives to small and medium-sized enterprises is based on the number of employees or the amount of capital or turnovers.

In case of Korea it has been observed that many government program that prime facie appeared to be non-specific were upon closer examination found to be de facto specific. Therefore, specificity test becomes the crucial issue here. This is particularly so with programs that define eligibility criteria (horizontal in scope and neutral in application) in such a way as to benefit only selected industries. In the last 5 years or so, the US has been the only country that has imposed CVDs against exports from Korea, and these duties are invariably against steel exports from Korea. See Table 2 for CVDs cases Korea.<sup>35</sup>

### **Export Credit Insurance**

Korea export insurance corporation (KEIC) is Korea's official export credit insurance institution. KEIC is a specialised non-profit corporation under the guardian authority of the Ministry of Commerce, Industry and Energy. Its operations has the sovereign guarantee of the government. KEIC helps in promotion of exports by providing export insurance. During 2000, it supported 17.9% of Korea's total exports. Korea's official export credit insurance institution. The GOK provides annual contributions to an export insurance program.

Status of the program: Information on individual insurance schemes of KEIC is not available therefore, assessing whether KEIC is making profit or loss on individual schemes is not possible. Whatever the case be, it is reasonable to expect that in its overall

From January 1, 1995 to June 30, 2001, EC had initiated 5 CVD cases against South Korea, but these cases were dropped because the subsidy levels were found to be de minimis.

30

operations it is breaking even. The scheme has also not been countervailed in any CVD investigations.<sup>36</sup>

### **Production Subsidies**

The following production subsidies are either currently being given or were given till recently by the GOK. Such subsidies are both recurring and non-recurring in nature. Also, these scheme are ad hoc/discretionary as well as given through well-defined programs.

### The Government of Korea's Direction of credit

In the past, GOK had a strong control over its financial sector. In the 80s, as a part of GOK's strategy to liberalise the economy, it started reducing its control over the financial sector in general and the banking sector in particular. It tried introducing reforms in the sector in the late 80s and the early 90s. But such attempts were either abandoned or proved to be unsuccessful--only that the formal controls were replaced by informal controls. In the 90s as well, government continued to wield control, directly or indirectly, over the lending practices of government owned banks and other domestic banks.<sup>37</sup> It directed credit to specific sector, often to specific companies. The steel industry was one of the major beneficiaries of such government directed lending.<sup>38</sup>

To the extent that interest rate charged on directed loans was less than the interest rates on comparable commercial loans, the regulated loans conferred a benefit on the recipients. Steel producers were one of the major beneficiaries of such loans. These loans have been countervailed as production subsidy and not an export subsidy. The US has

Details about (i) special depreciation as a tax deductible cost contingent on exports and (ii) export industry facility loans could not be obtained. So these programs are not discussed.

Loan from the Korean branches of foreign banks was not subject to the government's control and direction. Therefore such loan did not confer benefit to the recipient of such loans and hence were not countervailed.

<sup>&</sup>lt;sup>38</sup> After the 1997 financial crisis, GOK liberalise its financial sector a great deal. The government under a number of steps: announced closure of some banks, launched the financial supervisory commission to monitor the competitiveness of financial institutions, liberalised foreign currency transactions, introduced a new foreign investment promotion act for direct foreign loans to Korean companies.

countervailed imports of different steel products from Korea. This is because Korean steel exports have benefited from government subsidies, both production subsidies and export subsidies. Production subsidies appear to have benefited steel exports from Korea more than export subsidies. This could be because steel is being produced mainly by public sector companies who are given both discretionary and non-discretionary benefits.

A government-owned steel company, called POSCO, has benefited by the government in several ways: ranging from infrastructure development primarily used by POSCO or POSCO being given favourable treatment in respect of use of the infrastructure facilities to making finance available on terms inconsistent with commercial considerations etc. It has also been subjected to government control as seen in the POSCO's pricing policy. We mention below some of the ways through which POSCO was conferred financial benefit and this benefit qualified as a subsidy under the SCM Agreement.

## POSCO's provision of steel inputs for less than adequate remuneration

POSCO is the only Korean producer of hot-rolled stainless steel coil, which is the main input used in the merchandise subjected to CVDs. During the period of investigation, POSCO sold hot-rolled coil to Inchon products that were consumed in Korea as well as used in the subject merchandise. GOK through its ownership and control of POSCO set prices of steel inputs used by the Korean steel industry at less than adequate remuneration. In May 1999, POSCO switched over from it's two tiered pricing system, that explicitly favoured its output used for exports, and established unit prices applicable for sales to all customers. This change in pricing didn't alter the fact that the price set is less than adequate remuneration thereby conferring benefit to all Korean Steel Exporters buying from POSCO. Under the two-tier pricing system, the program was both a production subsidy and an export subsidy. But after POSCO switched over to a unit price, the program is deemed to be a production subsidy only and hence is still countervailable.

## GOK infrastructure investment at Kwangyang Bay

GOK infrastructure investments at Kwangyang Bay over the period 1983-1991, predominantly benefited POSCO. Hence the benefit was deemed specific and hence countervailable under the SCM Agreement.

### Exemption of Bond Requirement for Port Use of Asan Bay

GOK made investments for development of infrastructure at Asan Bay. GOK had built port berths in the Poseung area. In 1997, POSCO signed a three-year lease agreement with the Inchon Port Authority for the exclusive use of one of the port berths, constructed by the GOK, and paid the applicable user fee. In the same year, GOK entered into a lease agreement for the exclusive use of the other port berths with a consortium of six companies. The consortium of companies was required to purchase bonds, which the GOK would repay without interest after the lease expired in 10 years. However, POSCO was not required to purchase a bond for the exclusive use of port berth. Since the waiver of the bond purchase was only provided to POSCO, the program was deemed to be specific and moreover, since the waiver conferred financial benefit by forgoing collecting of revenue the waiver was considered a subsidy.

These are some of the ways through which financial benefit was conferred on government-owned POSCO. However, production subsidies are not confined to providing benefit to POSCO alone. Such subsidies are provided fairly widely and in numerous ways. Some of these ways are listed below:

- Electricity Discounts under Request Load Adjustment Program (RLA)
- Private Capital Inducement Act
- Energy-Savings Facilities Investment Reserve Funds
- Industry Promotion and Research and Development Subsidies
- Scrap Reserve Fund

• Overseas Resource Development Program<sup>39</sup>

• Technical Development Reserve Funds<sup>40</sup>

Overseas Resource Development Program. Loans under this program are although not contingent on export performance are subsidies since these are available on terms that confer financial benefit on its recipients.

- Finance by Export-Import Bank of Korea to encourage investments abroad<sup>41</sup>
- Loans to Promising Small and Medium Enterprises
- Asset Revaluation

### **Regional Subsidies**

Besides, there are regionally specific subsidies to courage investments in certain regions or to encourage relocation of industry from large cities to places outside metropolitan areas. One such program is designated as special cases of tax for balanced Development among areas. Preferential treatment given to the units located in Export promotion Zones or Special Economic Zones with respect to charging rents or certain taxes and duties can be also considered as regionally specific subsidies and exports from these zones that benefit from such subsidy can be countervailed.

## VI Concluding Observations

Brazil and Korea being 'other' developing Member countries have to phase out their export subsidies soon. However, exports from these countries can get the benefit of production subsidies. But these subsidies are actionable. In case of production subsidies, the specificity test becomes important. That is, a government program may prime facie be non-specific (that is, neutral in nature and is not seen to be benefiting any particular region or industry) but may de facto be specific, in which case it qualifies as production subsidy and hence an action can be taken in the form of imposition of CVDs. However, India being Annex VII Member country is allowed to give export subsidy but such subsidies are also actionable. Not all exporters avail of various export promotion programs and not all Member countries impose CVDs. In the absence of any solid quantitative study on the net benefit of various export subsidies, policy makers have to

<sup>40</sup> Under this program, companies operating in manufacturing or mining, or in a business prescribed by the Presidential Decree, are allowed to appropriate reserve funds to cover the expenses needed for development or innovation of technology. Differential treatment given to capital goods and capital intensive industries on one hand and all other industry on the other makes the program specific and confers financial benefit.

Under this program KXMB charges lower interest rate on foreign investments. But this facility is not linked to export performance and therefore it is not an export subsidy but a more general subsidy.

exercise their judgement in deciding whether or not to give subsidies and in choosing appropriate type of subsidies.

Based on the foregone analysis of Brazil and Korea one can make some observations. One is that the export subsidies are in general on the decline. However, subsidy in the form of export finance is still common. Besides, government is increasingly providing exporters with generalised support functions such as export logistics, export data, market information, training to exporters, identifying potential markets, improving product quality and standards and so on. These support functions have positive externalities, as once these benefits are provided these become available to several exporters at the same time. These functions are beneficial for small and medium exporters who can ill afford to invest in such activities. Perhaps because these functions are not directly linked to export performance and because the amount spent is not high, these kind of functions of the government in Brazil and Korea, as also in other countries, have not attracted CVDs.

Small and medium exporters played an important role in exports from a country. Because of high concentration of exports in both Brazil and Korea, governments in these countries are currently laying special emphasis on promotion of exports through small and medium enterprises. Many quasi-government agencies, state promotion boards and other private sector associations are playing important role in promotion of exports.

Exports from the two countries have been countervailed on account of export subsidies as well as production subsidies. Exports from Brazil and Korea seem to have benefited from production subsidies more than exports from India. This is certainly true of steel exports that have been countervailed by the USA from all three countries. Production subsidies are given both in discretionary and non-discretionary ways. Government owned companies, particularly in the steel industry have been the recipient of non-discretionary benefits in a variety of ways.

Despite the fact that subsidy provisions differ with respect to Brazil and India, India could still join with countries like Brazil who are giving drawback benefit on import of capital goods used in export production, in asking for the improvements (particularly, allowing drawback, refund, remission of duties on import of capital goods used in export production) in the Agreement in the next round.

Both Brazil and Korea have long moved to VAT system of tax.<sup>42</sup> Because of the administrative ease and simplicity of VAT, not only that double taxation of inputs is avoided but also any possibility of excess drawback or refund of taxes on inputs used in exports can be checked. For this reason none of the drawback schemes in Brazil and Korea has been countervailed.<sup>43</sup> India has not yet moved fully to VAT. This is considered to be the reason behind the complicated tax refund schemes that have been countervailed by some Member countries. In particular, the Duty Entitlement Passbook Scheme has been countervailed. EC and US have countervailed the scheme for the full benefit and not just the excess benefit provided under the scheme.

Like India, Brazil too has Special free-trade zones. These zones are considered to be in territory outside Brazil for the purpose of customs control. Units in these zones are exempted from customs duty and administrative restrictions and controls for goods imported or exported. If these zones also allow duty free import of capital goods (not allowed to units located outside these zones) without there being any link with the export obligation then such a scheme is not an export subsidy but a regionally specific subsidy. For countries like Brazil for whom export subsidies will soon be prohibited, this type of subsidy is not prohibited but can surely invite CVDs. Setting up infrastructure in these zones and making space available at a rate lower than at which it is available outside these zones though not directly linked to exports, still constitutes a regionally specific subsidy. Similarly export promotion programs that are of a general nature such as export

-

Korea introduced the Value Added Tax system on July 1, 1977.

Except for one scheme in Korea called fixed amount refund system that was countervailed by the EC on import of stainless steel wires. Despite the fact that full benefit (not just the excess benefit) under the scheme was countervailed, the total benefit from several export promotion programs was found to be below de minimis level and hence the case was dropped.

market development are not linked to exports performance seems to be alright as per the agreement.

Finally, high cost and lack of easy accessibility of credit in developing countries (especially Annex VII countries) due to several reasons such as capital market imperfections, calls for government intervention in providing subsidised export credit to its exporters. There is a genuine case for giving such a benefit to exporters (Sucupira & Moreira). Maybe developing countries can collectively make a case for it or can 'buy' this option by making concessions elsewhere in the next round of negotiations.

### References

Ahuja, R. (2001). Export Incentives in India within WTO Framework, ICRIER Working Paper No. 72, Delhi.

Averbug. A, (1999). Brazilian Trade Liberalization and Integration in the 1990s, downloaded from: http://www.bndes.gov.br/english/studies/trade.pdf

Cardoso, L.A. (2001). Analysis of Brazilian Export Policies: A comparison of some of the most important Latin America's economies, Paper of the Institute of Brazilian Issues, The George Washington University, Washington, DC.

Castley, R.J. (1995) Korea's Export Growth: An Alternate Explanation. Downloaded from <a href="http://idpm.man.ac.uk/idpm/dispap43.htm">http://idpm.man.ac.uk/idpm/dispap43.htm</a>

Marahnao, C.A. (1998). Brazilian Foreign Trade and its Role in International Competitiveness, The George Washington University, Washington, DC. Downloaded from <a href="http://www.gwu.edu/~ibi/minerva/Fall1998/Carlos.Maranhao.html">http://www.gwu.edu/~ibi/minerva/Fall1998/Carlos.Maranhao.html</a>

Pinheiro, A. C., Giambiagi, F., and Moreira, M. M. (2001).Brazil in the 1990s: A Successful Transition? Downloaded from: http://www.bndes.gov.br/english/studies/td91-ing.pdf

Pinheiro, A.C, and Moreira, M.M. (2000). The profile of Brazil's Manufacturing Exporters in the Nineties: What Are The Main Policy Issues, Textos Para Discussao do BNDES 80, Rio de Janeiro, June – 2000.

Monteiro, S.S.M (2001). International Marketing Strategies for Small Firms in a Globalised Economy, Paper of the Institute of Brazilian Issues, The George Washington University, Washington, DC.

Rodrik, D. (1995). "Trade Strategy, Exports, and Investment: Another Look at East Asia," NBER Working Paper No. 5339, November 1995.

Sohn et al (1998) Korea's Trade and Industrial Policies: 1948-1998: Why the Era of Active Trade Policy is Over? Korea Institute for International Economic Policy, KIEP Working Paper 98-05.

US Department of Commerce CVD Cases Reports: Final, Preliminary and Sunset Reviews.

Robert, W. (1990). Governing the Market - Economic Theory and the Role of Government in East Asian Industrialization. Princeton University Press.

Sucupira, R. and Moreira, M. M. Development, Exports and Trade Finance: Brazil's recent experience. In Hufbauer, G. and Rodriguez, R. (eds.), *Exi-Im Bank in the 21 st century: a new approach?* Institute for International Economics, Washington, Jan. 2001.

WTO (2000). Brazil: November 2000, Trade Policy Review, downloaded from <a href="http://www.wto.org/english/tratop">http://www.wto.org/english/tratop</a> e/tpr e/tp140 e.htm

WTO (2000). Korea: September 2000, Trade Policy Review, downloaded from <a href="http://www.wto.org/english/tratop">http://www.wto.org/english/tratop</a> e/tpr e/tp138 e.htm

US Department of Commerce list on Brazil Subsidies Programs: General, 2002

US Department of Commerce list on Brazil Subsidies Programs Aimed at Industrial Sector, 2002

US Department of Commerce list on Korea Subsidies Programs: General, 2002

US Department of Commerce list on Korea Subsidies Programs: Aimed at Industrial Sector, 2002

Table 1 a
CVD Measures in Force Against Exports from Brazil by WTO Members as on
December 31, 2000

| <b>Member Countries</b> | Products  |
|-------------------------|---|
| Canada                  | Stainless Steel Round Bar   |
| USA                     | Brass Sheet & Strip Cut-to-Length Carbon Steel Plate Iron Construction Castings |
| Mexico                  | Hot-rolled sheet<br>Cold-rolled sheet<br>Plate in Coils                         |

Source: Reports of Countervailing Duty Actions downloaded from WTO website

Table 1 b CVD cases initiated against exports from Brazil by WTO Members for the period  $1^{st}$  July  $-31^{st}$  December 2000

| Member Countries | Products                  |
|------------------|---------------------------|
| Canada           | Stainless Steel Round Bar |

Source: Semi-Annual Reports of CVD Actions downloaded from WTO website

Table 2 a
CVD Measures in Force against Exports from South Korea by WTO Members as
on December 31 2000

| Member Countries | Products  |
|------------------|---|
| USA              | Certain Cut-to-Length Carbon Quality Steel Corrosion-Resistant Carbon Steel Stainless Steel Sheet and Strip in Coils Structural Steel Beams Top-of-the-Stove Stainless Steel Cooking Ware |

Source: Reports of Countervailing Duty Actions downloaded from WTO website

| <b>Member Countries</b> | Products                           |
|-------------------------|------------------------------------|
| USA                     | Stainless Steel and Strip in Coils |
|                         | Structural Steel Beams             |
| Republic of Korea       | Polyethylene Terephthalate (PET)   |
| South Africa            | Wire Ropes                         |

Source: Semi-annual reports of CVD actions downloaded from WTO website