

**COMMENTS ON TRADE COMMITMENT COMPATIBILITY AND WTO
LEGALITY OF POSSIBLE INDUSTRIAL POLICY MEASURES TO PROMOTE
THE COMPETITIVENESS OF SOUTH AFRICAN PROCESSED FRUIT
EXPORTS**

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[Executive summary occurs at the end of the document]

The purpose of this document is to consider possible industrial policy measures that could be contemplated by the South African Government to provide support for the export competitiveness of the country's processed fruit products. It follows an earlier analysis by Don Ross, which argued for the conclusion that the industry meets key criteria for economically justifiable industrial policy assistance. That is, it offers a premium product that can be amplified in value by brand strengthening, can be positioned more advantageously than at present in international value chains, and would benefit from an environment made more competitive by liberalization of international trade practices and reduction in management of input prices (chiefly tin plate and sugar). In short: the main factors now limiting the competitiveness of the industry's exports derive neither from its product characteristics nor from independent market dynamics, but from exogenous constraints that are in principle correctible by policy.

Here, we evaluate possible such policy measures against limitations deriving from SA's commitments to its international trading partners. These include legal obligations applying to SA as a member of the World Trade Organization (WTO), and undertakings made by the Republic in its bilateral and plurilateral trade and commercial treaties with specific other countries.

In identifying "possible" measures we do not confine ourselves to policy ideas explicitly canvassed in the recent National Industrial Policy Framework and the August 2007 Industrial Policy Action Plan produced by the Department of Trade and Industry (DTI). This is because we believe that measures congruent with the Framework and Action Plan are best appreciated in the wider legal and regulatory context around industrial policy approaches that have been implemented by other countries and by SA in other contexts. We do, however, comment on whether a given measure we consider does or does not fall within the policy remit of the Framework and the Action Plan.

We also distinguish, throughout the document, between measures envisaged as temporary versus permanent. The Framework and the Action Plan indicate a clear preference for measures of the former type: industries supported by Industrial Policy should be helped to achieve competitive positions they can sustain by their own strategies and practices, rather than artificially stimulated as standing welfare programmes. International trade law is often, though not uniformly, more tolerant of temporary than of permanent industrial policy measures. It is clearly worthwhile that we indicate where this is and is not the case.

1. Domestic market protection

Though the DTI's Framework and Action Plan strongly emphasize promotion of export competitiveness, traditional industrial policies in many countries, including South Africa, have typically accorded a strong role to domestic protection, especially through tariffs and import quotas. The WTO is explicitly mandated to reduce protectionist barriers to international trade flows, but it is *not* mandated to aim to eliminate them altogether. SA's emphasis on export competitiveness promotion is in any case primarily voluntary and based on economic analysis, not a response to external demands or pressures. However, the Framework and Action Plan do not envisage a zero-tariff regime. Therefore, we assume that some level of domestic support will be an aspect of any national industrial policy, even if only in a background or minor supporting role. It is thus appropriate that we indicate the policy space allowed in this area by WTO law and by our treaty commitments.

1.1 Increased duties on imported processed fruit

Any contemplated increase in duties first requires determination of differences between current bound and applied rates. The current applied rate on processed fruit imports into SA is 5%, while the current bound rates for key products are 37% for prepared citrus fruits, 39% for prepared stone fruits, 55% for canned pineapples and 0 for mixtures. Thus there is no policy space for tariff increases on mixtures, but substantial such space where other main products are concerned.

Applications for official determinations of tariff adjustment scope take time and research to compile, and the International Trade Administration Commission (ITAC) generally requires between 12 and 18 months to complete investigations. Any contemplated increase in the applied rate would have to be considered against the background of the Doha Round of Multinational Trade Negotiations and the so-called 'Swiss formula' that will in all probability be the basis of required tariff reductions by all members if the Round eventually succeeds. The Swiss formula will mandate larger cuts to high tariffs but will still demand a minimum across-the-board cut in all tariffs. This could impact on the bound rate for processed fruit *unless* South Africa clearly indicated this to be a 'sensitive product'. Only a small percentage of a country's production sectors may be so indicated. Thus designating processed fruit as sensitive would entail denying such a basis for protection to some other industry or industries.

This being acknowledged, the Doha Round is currently stalled and will almost certainly remain so until at least mid-2009. There are therefore no legal impediments to the Government's applying a higher MFN rate to processed fruit imports as a means of increasing the industry domestic profitability. However, this would not affect imports from our partners in existing bilateral agreements that limit applied rates, namely, the EU, SACU members, and, to a more limited and indeterminate extent, Mercusor. (The treaty with Mercusor contains a number of promissory clauses that lack quantitative specification.) Since EU and Mercusor countries are major fruit exporters, a higher applied MFN rate might thus merely divert trade instead of reducing net imports. In any case, the principal hurdle in the way of such a measure is not international law but domestic policy orientation. Government appears to accept the view of the majority of economists that tariff increases are retrogressive industrial policy tools because they shield producers from competition – at the expense of domestic consumers – when the long-run national economic interest favours building improved competitiveness in foreign markets. In addition, because high tariffs tend to reduce competitiveness, they also have a tendency to become locked in and resistant to subsequent lowering. Thus they are not generally regarded as congruent with the current Industrial Policy Framework and Action Plan.

1.2 Increased incidence of anti-dumping investigations with respect to processed fruit imports

Anti-dumping investigations and duties are limited in scope and can only address unfair international trade as defined in the International Trade Administration Act and in the WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (the Anti-Dumping Agreement). This has not prevented SA from having made, by comparison with international norms, extremely frequent recourse to such actions. To prepare an application for an anti-dumping investigation takes between 3 and 9 months, depending on the consultants used and the availability of data on 'normal value', that is, domestic selling prices in the exporting country. Once a prima facie case of dumping has been established it must be shown that the exports in question are causing material injury to the SACU industry producing the impacted product. Scope could in principle be as wide as all processed fruit, as narrow as a specific type, e.g. canned sweetened apricots, or anywhere in between. The cost of lodging and successfully completing an anti-dumping investigation ranges approximately from R150 000 to R1 000 000 depending on the consultants used. (A typical cost is R300 000 to R450 000.) It would very likely be ineffective for SAFVCA or their individual members to undertake applications on their own, i.e. without consultants. If lawyers are involved the cost can increase further; appropriately knowledgeable lawyers charge up to R3 000 per hour.

There is also the possibility of lodging countervailing investigations, either as stand-alone moves or in tandem with anti-dumping investigations. Depending on the rate of increase in imports at a given time and the state of the industry with respect to its competitiveness in the domestic market (only), one could also consider a safeguard application. ITAC recently conducted its first safeguard investigation and experienced an extremely steep learning curve, including being taken on judicial review and losing the case. While this

may induce caution, it also suggests that ITAC will have gained useful experience and will be in a better position to conduct such investigations in future. However, the only possible relevance of such measures to export performance could lie in determining whether decreased exports contributed to the industry's injury due to imports. In general, interference with import flows can be perceived as poisoning the general international trade environment, and may to that extent negatively affect scope for negotiated improvements in export prospects.

2. Domestic market support

Again, measures to support domestic sales and profitability are at best only indirectly related to export competitiveness. They may positively support it, however, if they provide a security buffer that attracts capital investment in increased export capacity or in new export product development, or improve general industry economies of scale. With respect to the emphasis in the Framework and the Action Plan, then, such measures would be congruent with it only if temporary.

2.2 Equalize VAT payable on canned and frozen fruit

The current VAT rate on canned fruits and vegetables is 14%, while frozen fruit and vegetables are zero-rated. If the VAT rate on canned fruits and vegetables were also zeroed, this should theoretically decrease the price of such products by 12.3%, bearing in mind that value chain participants would not necessarily pass all or most gains to consumers. Government would also lose revenue, so overall welfare gains – the aim of sound industrial policy – would be ambiguous in advance of specific forecasting analysis driven by attention to domestic demand price elasticities. The industry notes that if canned vegetables became more competitive, this would allow more efficient utilization of fruit-canning plant during the off-season, and reduce seasonal fluctuations in employment. With respect to the brief of the present document, this change in tax policy would not qualify as a subsidy, whether general or specific, i.e. would not be actionable by any party. SA has unrestricted sovereignty to zero-rate basic foodstuffs.

3. Subsidies

3.1 Export subsidies for processed fruit

Around the world, export subsidies have competed with import tariffs as the most important force shaping patterns of international trade and pricing in agricultural products. In fruit processing specifically, it is estimated that the EU's subsidies regimes of 1993-2003 and 2003-2007 directly increased its export volumes by 80% within a few years, and vaulted it from the position of a minor player in world export markets to the status of largest global exporter. The United States provides large subsidies to growers of selected products, while providing none to producers in the majority of its sectors. Japan and South Korea provide large subsidies to all their commercial farmers.

However, policy freedom in this area is shrinking as WTO agreements limiting subsidies acquire force through rulings by the Dispute Settlement Body (DSB). The EU's new policy on fruit and vegetable subsidies, de-linking these from the current levels of production of any particular crop, is a response to a DSB ruling that found its previous regime illegal.

Article 3 of the WTO Subsidies Agreement, which places a prohibition on export subsidies, provides as follows:

“3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

- (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;*
- (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.*

3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1.”

SA has been informally challenged in the WTO over an export subsidy it formerly provided to exporters of leather car seats as part of the Motor Industry Development Plan (MIDP) subsidy scheme, and in consequence had to withdraw the subsidy in question immediately under threat of the whole MIDP programme being scuttled. Furthermore, a consistent aim of SA's international trade diplomacy has been to appear as an exemplary WTO citizen, with respect to the letter of the law if not necessarily the spirit of the organization's mandate, so as to be able to attack rich-country subsidies from clean ground. We thus deem it highly unlikely that SA would be prepared to provide a fresh export subsidy to any industry that would invite challenges at the WTO. A direct export subsidy for processed fruit is therefore not a feasible policy option in our opinion.

In riposte to this, we can imagine someone arguing that a direct subsidy could be deemed to be governed by the WTO Agreement on Agriculture rather than the Subsidies Agreement, thereby opening policy space after all. The Agreement on Agriculture Article 9, which deals with agricultural export subsidies, provides as follows:

“1. The following export subsidies are subject to reduction commitments under this Agreement:

- (a) the provision by governments or their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board, contingent on export performance;*
- (b) the sale or disposal for export by governments or their agencies of non-commercial stocks of agricultural products at a price lower than the comparable price charged for the like product to buyers in the domestic market;*
- (c) payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved, including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived;*

- (d) *the provision of subsidies to reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services) including handling, upgrading and other processing costs, and the costs of international transport and freight;*
 - (e) *internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments;*
 - (f) *subsidies on agricultural products contingent on their incorporation in exported products.*
2. (a) *Except as provided in subparagraph (b), the export subsidy commitment levels for each year of the implementation period, as specified in a Member's Schedule, represent with respect to the export subsidies listed in paragraph 1 of this Article:*
- (i) *in the case of budgetary outlay reduction commitments, the maximum level of expenditure for such subsidies that may be allocated or incurred in that year in respect of the agricultural product, or group of products, concerned; and*
 - (ii) *in the case of export quantity reduction commitments, the maximum quantity of an agricultural product, or group of products, in respect of which such export subsidies may be granted in that year.*
- (b) *In any of the second through fifth years of the implementation period, a Member may provide export subsidies listed in paragraph 1 above in a given year in excess of the corresponding annual commitment levels in respect of the products or groups of products specified in Part IV of the Member's Schedule, provided that:*
- (i) *the cumulative amounts of budgetary outlays for such subsidies, from the beginning of the implementation period through the year in question, does not exceed the cumulative amounts that would have resulted from full compliance with the relevant annual outlay commitment levels specified in the Member's Schedule by more than 3 per cent of the base period level of such budgetary outlays;*
 - (ii) *the cumulative quantities exported with the benefit of such export subsidies, from the beginning of the implementation period through the year in question, does not exceed the cumulative quantities that would have resulted from full compliance with the relevant annual quantity commitment levels specified in the Member's Schedule by more than 1.75 per cent of the base period quantities;*
 - (iii) *the total cumulative amounts of budgetary outlays for such export subsidies and the quantities benefiting from such export subsidies over the entire implementation period are no greater than the totals that would have resulted from full compliance with the relevant annual commitment levels specified in the Member's Schedule; and*
 - (iv) *the Member's budgetary outlays for export subsidies and the quantities benefiting from such subsidies, at the conclusion of the implementation period, are no greater than 64 per cent and 79 per cent of the 1986-1990 base period levels, respectively. For*

developing country Members these percentages shall be 76 and 86 per cent, respectively.

3. *Commitments relating to limitations on the extension of the scope of export subsidization are as specified in Schedules.*
4. *During the implementation period, developing country Members shall not be required to undertake commitments in respect of the export subsidies listed in subparagraphs (d) and (e) of paragraph 1 above, provided that these are not applied in a manner that would circumvent reduction commitments.”*

The question may arise as to whether canned fruit must be regarded as an agricultural product and whether any subsidy payable to the canners would necessarily be regarded as an agricultural subsidy. Although not expressly so indicated it appears that the provisions regarding export subsidies in Articles 8 and 9 of the Agreement on Agriculture do not relate exclusively to basic (unprocessed) agricultural products. This opinion is supported by paragraph 7 to Annex 3, which provides that “*Measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products.*” Nevertheless, technically, if an export subsidy were provided and such subsidy met all requirements stated in Article 9 of the Agreement on Agriculture, it would be permissible within WTO rules.

Achievement of such a measure would be extremely difficult, especially in light of the decision of the WTO Panel and Appellate Body in *Upland Cotton* (WTO *United States – Subsidies on Upland Cotton* WT/DS267/R and 267/ABR). This panel found that, in accordance with the provisions of Article 21.1 of the Agreement on Agriculture, the Subsidies Agreement applied to agricultural export subsidies. Accordingly, agricultural export subsidies that do not meet the exact criteria stated in Articles 8 and 9 of the Agreement on Agriculture are to be considered in terms of the provisions of Article 3 of the Subsidies Agreement.

Direct export subsidies tend by their nature to be strongly defended indefinitely by industries that benefit from them. Government has substantial experience of this fact and its consequent difficulties. Thus direct export subsidies are not congruent with the emphasis in the DTI’s Framework and Action Plan.

Taking all of the above considerations together, we cannot quite say categorically that direct export subsidies are legally prohibited. However, we believe that scope for instituting them is so severely restricted as to make the general policy option untenable.

3.2 Freight and/ or wharfage subsidies

There is no prohibition under the Subsidies Agreement on subsidies for services industries; the Agreement does not extend to them at all. The Agreement on Agriculture, however, specifically provides in Article 9.1(d) that “the provision of subsidies to reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services) including handling, upgrading and other processing costs, and the costs of international transport and freight” is subject to reduction commitments.

Any new subsidy in this regard would therefore fall foul of this provision. This does not indicate a *prohibited* subsidy, but does indicate one that is *actionable* by other WTO members. We thus again draw attention to (i) Government's demonstrated aversion to putting itself in actionable territory, and (ii) the failure of subsidies – in general – to be seen as temporary support measures of the sort envisaged in the DTI's current Framework and Action Plan.

3.3 Soft loans

Soft loans would qualify as a permissible form of subsidy to industry, provided they are not made conditional on exports, in which case they immediately qualify as a form of prohibited subsidy. Permissible soft loans could either be extended directly to the canners or alternatively to the growers conditional on sales to canners. Note that if the industry could demonstrate that it is hindered in improving its export competitiveness by a capital hurdle – for example, failure of investment in some complementary infrastructure sector due to absence of a commitment signal indicating future export growth and enhanced revenues – then soft loans could plausibly be claimed to be congruent with the current policy emphasis on temporary measures. In this respect they differ from more direct forms of subsidisation.

3.4 Subsidies for purchases of cans, sugar or energy, directly or through rebate system

In WTO law, direct subsidies and rebates differ completely in nature. If fruit processors have access to imported raw materials, including sugar, with full rebate of the duty for purposes of export sales, this will be fully WTO-consistent. Current SA industrial policy already provides for this possibility, so no innovation would be required here; the fruit processing industry need merely apply for the appropriate rebates if it has not already done so. It is open to the industry to apply either for a 521.00 rebate, in which case any duties paid are refunded after proof has been submitted that the imported raw materials were incorporated into exported final products, or in the form of the 470.03 rebate, in terms of which a pre-importation permit is obtained and no duties are payable. Proof has to be supplied within a certain period that the product in question has actually been exported. The latter permit has very specific cash flow advantages for canners, while the former negates the requirement of a bonded warehouse facility and all the difficulties that such warehouses entail. As far as could be ascertained no duty is now payable on tin – all duties under chapter 72 were removed in 2006. If the rebate is to be extended to raw materials used for local consumption products, a special industrial rebate would have to be created under Schedule 3 of the Customs Act. This could take several months, but if the duties are relatively high, e.g. in the case of sugar, this is something that in our opinion merits serious consideration. This is also not viewed as a subsidy in terms of either the Agreement on Agriculture or the Subsidies Agreement, even though it is essentially the foregoing of revenue by the government.

It is worth noting in connection with this topic that if processors use tins imported from the EU in their export sales to the EU, they may be able to apply for a reduction of duties into the EU on the basis of 'EU local content'. This may erode some of the duty

advantage currently held by the Chileans. The same may apply in the case of exports to the US if US tin is used.

3.5 Subsidies and/or capitalization of domestic production of double-rolled steel plate

Contrary to some perceptions, SA's canned fruit industry does not appear to be competitively disadvantaged by the fact that there is no domestic manufacture of double-rolled steel. Such steel appears to be extensively used only by the US industry, which is not a major exporter. However, it may be that the SA industry could gain a positive competitive advantage if, due to use of cans made from double-rolled steel, it could increase its per-unit utilisation of freight containers. (This is presently limited by weight restrictions.) There are two possible means by which double-rolled steel could be sourced: it could be imported, or capacity could be developed to produce it domestically. A barrier to the second approach is that domestic steel producers may not find it financially prudent to invest in the absence of a commitment signal for increased export volumes and revenues in canned fruit. This opens clear space for an industrial policy measure of an appropriately temporary nature: government could facilitate capitalisation of the investment. Would this be legal under the WTO?

A standing subsidy to steel producers would be regarded as a specific subsidy that could be countervailed by any of the countries to which SA exports canned fruit. However, a country taking such action would have to show that the imports in question were causing material injury *as a result of the subsidy*. The amount of the subsidy for purposes of market-impact determination would be governed by different rules in different jurisdictions: the EU uses a so-called 'straight-line' methodology whereas the US considers the time value of money as reflected in the final price of the product. Thus, if government, e.g. through the Industrial Development Corporation (IDC), invested R100 million in a new steel plant, the life expectancy of the plant (minimum of 10 years) would have to be determined in order to calculate the value of the subsidy in any given year. To this has to be added the applicable interest rate. Second, the total output of the plant would have to be calculated in the particular year, which would give the subsidy per unit. Third, the effect of this subsidy on the total price of a can of peaches in the relevant market would have to be determined and then expressed as a percentage of the CIF export price in the case of the EU and FOB export price in the case of the US. Simplifying, and using the EU's straight-line methodology, if the subsidy were R100 million, with an interest rate of 10%, the machine life were 10 years and the company produced 100 000 tons per year, the subsidy would be valued at R120/ton or R0.12/kg. (R100 million/10 = R10 million, plus interest at 10% on the outstanding amount of R20 million = R2 million; total R12 million/100,000 tons). If 100g were used per tin, this would amount to a subsidy of R0.012/tin. If the export price were R1.00/tin, the subsidy would be 1.2%. The de minimis level of subsidisation for SA, as a developing country, is 2%. This means that no countervailing action may be taken in terms of the Subsidies Agreement (Article 27.10(a)) if the total value of subsidies is less than 2% of the export price.

The methodology used to determine the time value of the subsidy in the US is as follows:

$$S_k = \{y/n + [y - (y/n)(k-1)]i\}/(1+i)$$

where: S_k = the amount of the subsidy countervailable in year k ; k = the year under review; y = the face value of the grant; n = the average life cycle of the plant; and i = the interest rate.

The subsidy countervailable in year eight can thus be calculated as follows:

$$\begin{aligned} S_k &= \{100\,000\,000/10 + [100\,000\,000 - (100\,000\,000/10)(8-1)]0.1\}/(1+0.1) \\ &= \{10\,000\,000 + [30\,000\,000]0.1\}/1.1 \\ &= R11,818,181.81 \end{aligned}$$

This must then be divided by the total tonnage produced in that year to determine the value per ton and then must be further diluted by the effect thereof on the final price of a can (product by product, for each relevant HS line). In our example this would render a subsidy of 1.818%, which is still *de minimis* and cannot be countervailed.

Thus WTO law allows at least *prima facie* policy space in this area.

Government assistance with capitalization of new steel capacity, by contrast with a standing subsidy, would not be actionable by other countries if the assistance were not specifically linked to export performance. It could, however, be made conditional on sales of the new underwritten production to specific industries – e.g., fruit canners – at a competitive price, without raising any issues of international trade law.

3.6 Subsidies to and/or capitalization of growers

Exactly the same points as made under 3.5 above apply in this case. Government is free to adapt any measures to boost the productivity or capacities of growers as long as such assistance is not tied to export performance of specific products. In this regard special cognizance must be taken of Article 6.4 of the Agreement on Agriculture, which provides as follows:

- “(a) A Member shall not be required to include in the calculation of its Current Total AMS and shall not be required to reduce:
- (i) product-specific domestic support which would otherwise be required to be included in a Member's calculation of its Current AMS where such support does not exceed 5 per cent of that Member's total value of production of a basic agricultural product during the relevant year; and
 - (ii) non-product-specific domestic support which would otherwise be required to be included in a Member's calculation of its Current AMS where such support does not exceed 5 per cent of the value of that Member's total agricultural production.
- (b) For developing country Members, the *de minimis* percentage under this paragraph shall be 10 per cent.”

(Note: AMS = Aggregate Measure of Support¹)

This indicates that South Africa may subsidise the production of deciduous fruit to a maximum of 10 per cent of the total production volume of such fruit in any given year on a specific basis. In addition, it may apply a general agricultural production subsidy (not limited to deciduous fruit) of an additional 10 per cent of the total value of agricultural production. These subsidies may only be paid to the producers themselves and not to processors, but could still be made contingent on certain criteria, e.g. that a specific minimum percentage of production must be sold to the canners (without specifying that any fruit must be destined for the export market).

4. Brokerage in domestic supply chain relationships

4.1 Encouragement to can manufacturers to reduce prices to the canning industry

There are no legal or treaty restrictions on Government's rights to facilitate inter-industry clusters and networks.

4.2 Relief for the fruit processing industry from a share of the burden of subsidizing domestic sugar production

Sugar is currently subsidised in any number of countries worldwide, including in Brazil, the EU and India. The latter has recently implemented a new direct export subsidy of between US\$53/ton and US\$89/ton or around R0.38/kg to R0.64/kg, which probably equates to roughly 15% to 25% of the ex-factory price.² Government could increase its

¹ Article 1 of the Agreement on Agriculture provides that "Aggregate Measurement of Support" and "AMS" mean the annual level of support, expressed in monetary terms, provided for an agricultural product in favour of the producers of the basic agricultural product or non-product-specific support provided in favour of agricultural producers in general, other than support provided under programmes that qualify as exempt from reduction under Annex 2 to this Agreement, which is:

- (i) with respect to support provided during the base period, specified in the relevant tables of supporting material incorporated by reference in Part IV of a Member's Schedule; and
- (ii) with respect to support provided during any year of the implementation period and thereafter, calculated in accordance with the provisions of Annex 3 of this Agreement and taking into account the constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member's Schedule".

² The following is an extract of a draft document submitted by one of the present authors (Brink) to the Bangladesh Tariff Commission on 1 October 2007, indicating results of research into 'unfair' imports of sugar into that country (along with several other products):

"As regards India, Bangladesh producers have submitted information showing that the central Government of India (GOI) pays a subsidy of Rs1,350/ton in Maharashtra and South Mills and Rs1,450/ton for central and Uttar Pradesh mills, while the Maharashtra regional government pays an additional subsidy of Rs1,000/ton for provincial producers. In addition, the Bangladesh producers estimate that the value of the DEPB is at least 5% of the export price. Using the average exchange rate as per oanda for the first 8 months of calendar 2007, these subsidies can be calculated to be as follows:

- Maharashtra (GOI plus Maharashtra) Tk3,951.90/ton plus DEPB (5% * Tk25,530/ton) Tk1,276.50/ton = Tk5,228.40/ton, equating to 20.48% of the average export price in the second half of FY2007 (or 19.33% if the average export price for the full FY2007 is used). This does *not*

current level of subsidization on the same legal terms as apply to fruit products above, i.e., it is free to do as long as subsidy amounts are not tied to current export volumes. (They may be linked to historical export volumes.)

There would be no international legal issues if Government chose to exempt fruit processors from unilateral national regulatory restrictions with respect to purchasing that currently apply, and which it continued applying to other industries. However, such asymmetries would be expected to have permanent distorting effects on domestic prices and capital allocation, and thus might not be regarded as congruent with the DTI's current policy Framework and Action Plan.

5. Trade diplomacy measures

5.1 Prioritize market access issues for the industry in bilateral and multilateral trade negotiations, especially those with the EU, China, India, Russia, and other African countries

Obviously, WTO law does not discourage any country from seeking improved access to markets in other countries – quite the contrary. Unfortunately the current Doha Round of multilateral trade negotiations is stalled, and is unlikely to be revived before mid-2009. The TDCA with the EU is open for renegotiation every few years. This is especially pertinent in light of the EPA negotiations currently underway for SA's neighbouring countries, and in which SA is a participant through its membership in SADC. The EPA negotiations are supposed to be concluded by the end of 2007. If this deadline is adhered to, then new industrial policy is too late to be brought to bear on or reflected in EPA bargaining. On the other hand, there is some possibility that the deadline will be allowed to slip, with a temporary interim agreement put in place for the expiry of the status quo preferences (which were found illegal under the WTO).

In the TDCA SA negotiated terms of access to the European market which have been undermined in economic value by the subsequent FTA signed between the EU and Chile: tariffs on the main processed fruit products that both Chile and SA import into the EU are being phased out for the former but not for the latter. Nothing in WTO law restricts the EU's right to maintain this asymmetry, but is uncontroversial that it is contrary to the WTO's broad policy mandate. SA can and should emphasize this in all trade negotiations involving the EU.

Large potential new markets for SA's processed fruit have been identified in China, India, Russia and other African countries. By WTO law, these countries may not grant

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- take into consideration that the GOI in August 2007 increased the DEPB rate, which will therefore increase the margin of subsidisation. [This translates to approximately US\$74/ton]
- Rest of India: Tk2,438.41/ton plus DEPB = Tk3,714.91, i.e. 14.55% of the export price in the second half of FY2007 (or 13.84% if calculated for the full FY2007). [approximately US\$53/ton]
 - If the sugar is exported via ISEC (Indian Sugar Export Council), an additional export subsidy of \$15/ton is payable, i.e. an additional Tk1,062.33/ton or between 3.85% and 4.16%, depending on whether the full FY2007 or only the second half of FY2007 is used."

SA preferential terms of market access for processed fruit except in the context of comprehensive trade agreements ('FTAs').³ Current SA trade policy is to seek such FTAs. An FTA allows the tariff on any product, in either direction, to be set at anywhere between 0 and the prevailing MFN rate.

6. Coordinated national branding campaign

SA's processed fruit enjoys a generally perceived quality premium that supports an average global price premium of about 10%. Its exports in this area are thus ideally placed for efforts at capture of extra value chain returns through increased exploitation of the national brand. Measures that Government could undertake in this regard include giving prominence to quality fruit products in industrial promotions abroad, endorsing a uniform national logo for use on cans and other packages, coordinating advertising abroad for generic national product images, supporting an 'SA premium quality' theme at diplomatic functions, on consulate and embassy wall and window posters, encouraging airlines flying to SA to feature 'SA premium quality fruit' in cabin menus and in-flight promotions, and promoting bargaining power with foreign retailers by encouraging clustered export marketing of processed fruit with other SA foods and beverages (e.g., wines) aimed at quality-seeking consumers.

The DTI regularly undertakes trade missions abroad alongside industry. The WTO Agreement on Agriculture specifically indicates that "widely available export promotion and advisory services" may be given to an industry. There is thus no legal impediment to undertaking and devoting public resources to an 'export through quality' promotion drive.

In some countries, notably Canada, agricultural exports are sold by national marketing boards that purchase the products from producers and hold ownership of them prior to disbursal abroad. This is legally allowed by WTO rules but is under strong challenge – including by SA – in the Doha Round agenda. It is unlikely that SA would wish to undermine the joint campaign with its allies against state marketing boards by instituting such boards itself.

7. Sharing exchange-rate risk

SA's fruit processing industry has recently experienced some hardship due to sharp month-on-month changes in export volumes contingent on currency fluctuations. The resulting uncertainties in both revenues and optimal capacities discourage new investment in infrastructure for export, a key objective of the DTI's current Framework and Action Plan.

Some other developing-world governments have sought to share exchange-rate risk with their leading exporters. India is a noteworthy example. Its Duty Entitlement Passbook Scheme (DEPB), which had been in the process of being phased out, this year increased the effective subsidy to its exporters from 3% to 8% in consequence of the strengthening of the Rupee against the US Dollar. This can be regarded as an export subsidy that varies

³ Technically this does not apply to Russia because it is not a WTO member. In aiming to qualify for membership, however, Russia has been conducting its trade policy in conformity with WTO rules.

directly with current export volumes. As such, it is prohibited under the Subsidies Agreement. We therefore expect India's upward revision of the DEPB to be challenged at the WTO and through the DSB.

SA has a lengthy and fraught history of attempts to manage exchange rates. In consequence, the democratic Government and the Reserve Bank have been consistently committed to the idea that businesses must learn techniques for surviving in the context of a freely floating, low-volume, heavily traded currency. Potential legal problems at the WTO aside, we find it highly unlikely that the domestic policy agenda would accommodate itself to provision of public insurance against exchange-rate movements in the foreseeable future.

8. Infrastructure support

8.1 Investments to reduce delays due to congestion and capacity constraints at ports

SA is presently embarked on a large national programme to elevate structural growth bands by investment in infrastructure capacity. In keeping with the DTI's current Framework and Action Plan, there is a particular emphasis on infrastructure related to export capacity: transport networks between production hubs and shipping points, especially ports.

From the perspective of international trade law, the following distinction is crucial. Publicly provided infrastructure that supports trade *in general* is not restricted by WTO treaties. Indeed, the WTO, IMF and World Bank assist developing and poor countries in planning and arranging funding for such investments. However, if a public infrastructure investment is economically justified exclusively by reference to a specific product whose trade it supports, then the investment in question counts as a countervailable subsidy. If it is directly linked to the *export* of a specific product then it becomes a prohibited subsidy. For example, suppose that Government provided cranes at Cape Town harbour that were explicitly designed to load, and only to load, distinctively shaped processed fruit containers; provision of these cranes would be deemed a prohibited subsidy if challenged at the DSB by another WTO member. More realistically, if Government built a road that ran from a fruit canner's loading dock to a main highway, connecting no other addresses, this would be deemed a prohibited subsidy.

The implication of this is that, from the legal point of view, care should be taken to ensure that there are economic arguments for any given infrastructure investment that make reference to ranges of products. This is typically not difficult. For example, even if there were fruit-specific cranes built in Cape Town harbour, one could point out that they benefited exports in general by releasing demand pressure on other loading facilities in the same harbour.

Thus, with only a basic modicum of care, public infrastructure investment constitutes WTO-compatible industrial policy for promotion of export competitiveness which could benefit more than just the fruit processing industry.

8.2 Dedication of special funding for research aimed at improving or innovating industry-related products and processes

In terms of paragraph 2(a) of Annex 2 to the Agreement on Agriculture “research, including general research, research in connection with environmental programmes, and research programmes relating to particular products” are exempt from any reduction commitments. Government is therefore free, e.g. through institutions such as the CSIR, to assist with any research that may be undertaken to the benefit of the industry. Of course, care must be taken to ensure that benefits from such research are made available to all firms within the sector. However, there is public-policy motivation for this that is independent of, and more efficacious than, international legal obligation in any case.

Beneficiation campaigns of the sort observed in other countries are, therefore, WTO-compatible in general.

We note that this is not best regarded as a *temporary* industrial policy measure. It nevertheless seems to be a core such measure, in almost ideal accord with all *other* principles of the DTI’s current Framework and Action Plan. This suggests at least an element of less than fully resolved tension in these documents.

8.3 Provision of enhanced third-party grading

Strengthening of quality assurance for processed fruit products bearing the national brand might be thought to be an essential concomitant to public investment in such branding. The right of Government and industry to institute such grading is unrestricted by WTO rules so long as it is applied without prejudice to all exporting firms, including foreign-owned ones.

9. Regulation

The provision of enhanced third-party grading as in 8.3 above might be given force of law through revision of the Agricultural Product Standards Act. The remarks made with respect to 8.3 apply.

Executive Summary of document

1. Applied domestic tariff rates on imported processed fruit products other than mixtures could be increased substantially without breach of WTO law except for imports from the EU and other SACU countries. The situation with respect to Mercusor is unclear in this respect. However, such a measure accords poorly with SA’s general industrial and trade policy stance.
2. WTO rules allow initiation of anti-dumping investigations at any time. However, these actions should be motivated according to their individual merits, on a case-

by-case basis. Increased anti-dumping vigilance does not in itself constitute an industrial policy for this sector.

3. There are no international legal barriers to equalizing VAT payable on canned and frozen fruit. (Frozen fruit is currently zero-rated.)
4. Provision of direct subsidies to processed fruit exporters is not categorically excluded by WTO law. However, such subsidies could not be linked to export performance, nor to use of domestically sourced inputs by the fruit processors (e.g., fruit, tins and sugar). We doubt that such subsidies would be tenable.
5. Freight and wharfage subsidies for processed fruit exports are not strictly prohibited by WTO law but are actionable.
6. Soft loans to the industry from Government are permissible under trade law and commitments so long as they are not directly linked to current exports.
7. Fruit processors may apply for rebates of duties paid on all imported inputs to manufacture of exported products. This includes tin or tin cans, and sugar.
8. If the SA industry uses inputs imported from the EU, they may apply for a reduction of tariffs into the EU on the basis of 'EU local content'.
9. There is some (strictly limited) room under WTO rules for subsidization of steel-based inputs if these are linked to export performance and no restriction on such subsidies if they are not linked to export performance.
10. Public provision of capital for development of domestic capacity in double-rolled steel is neither prohibited nor actionable under WTO rules so long as such assistance is not linked to export performance.
11. There is some (strictly limited) room under WTO rules for subsidization of growers if these are linked to export performance and no restriction on such subsidies if they are not linked to export performance.
12. Public provision of capital for development of growers' capacity or productivity is neither prohibited nor actionable under WTO rules so long as such assistance is not linked to export performance. Direct subsidization may also take place in terms of Article 6.4 of the Agreement on Agriculture, as long as the total direct subsidy does not exceed 10 per cent of the value of deciduous fruit produced in a year.
13. There are no legal or treaty restrictions on Government's rights to facilitate inter-industry clusters and networks, including clusters that result in reduced prices of inputs to export production.

14. There are no legal or treaty restrictions on Government's rights to exempt fruit processors from any cross-industry subsidization obligations that presently apply to them.
15. It is consistent with WTO member privileges to persistently remind the EU that the asymmetric market access it has granted to SA and Chile with respect to processed fruit violates the general mandate (though not the statutes) of the WTO.
16. Any new FTAs that SA signs could set tariffs against SA's exports into the FTA partner in question at anywhere between 0 and the prevailing MFN rate.
17. There are no legal or treaty impediments to SA launching a coordinated global effort around promotion of a national premium brand presence for processed fruit.
18. Establishment of national marketing boards to buy agricultural products from producers and sell them forward into export markets is not currently illegal, but SA is among countries pressing to ban this in the current round of WTO negotiations.
19. Public provision to the processed fruit industry of insurance against exchange-rate changes is prohibited under WTO rules.
20. Public investment in infrastructure to boost export capacities and / or competitiveness is legal under the WTO provided that such investment does not benefit only one targeted export industry.
21. There are no legal or treaty impediments to provision of public funding for research aimed at improving or innovating industry-related products and processes.
22. The right of Government and industry to institute voluntary or mandatory third-party grading for quality assurance is unrestricted by WTO rules so long as this is applied without prejudice to all exporting firms, including foreign-owned ones.