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Refunding The Border: Duty Drawback Rules In Preferential Trade And Wto Law

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Abstract—This paper evaluates how duty drawback—refunds of import duties on inputs embodied in exports or re-exported in the same state—is treated across regional trade agreements and whether such regimes cohere with WTO disciplines. Grounded in the rise of global value chains where intermediates dominate trade and imported content in exports is substantial, the analysis situates drawback as a pivotal policy tool for pricing inputs at world levels while maintaining border protection for domestic markets. Using doctrinal legal analysis, the study interprets MFN obligations under GATT Article I, limits on quantitative restrictions under Article XI, the conditions for regional agreements under Article XXIV, and the Enabling Clause for developing countries to assess RTA drawback provisions. It finds that common no-drawback rules in RTAs can disadvantage non-parties and lack firm justification under WTO law, recommending a shift toward more flexible, WTO-consistent allowance of drawback. The discussion clarifies how proper remission up to duties actually paid interacts with anti-dumping and subsidy rules, and distinguishes design choices such as full, partial, and substitution drawback. Policy guidance favors moving from blanket bans to calibrated permission with safeguards, reducing distortions and administrative burdens while aligning preferential regimes with multilateral norms.

Index Terms—Duty drawback, regional trade agreements, WTO law, global value chains, rules of origin, MFN treatment, trade policy.

I. INTRODUCTION

International trade has changed and any other area of economics has changed. Today's production processes are internationally fragmented intermediate goods composed nearly 60% of world merchandise trade, while imported content makes up about 40% of the average export [1]. The rise of the global value chains (GVCs) makes the importance of duty drawback clear. It refers to the refund of import duties on inputs used in exported goods or that are re-exported in the same state. By making sure that exporters are not burdened by the cost of pricing, drawback tackles trade distortions and enhances the competitiveness of their exports on global markets.

Duty drawback has a long history that predates the contemporary multilateral trading system. The first US tariff act of 1789 authorized drawback for certain products, such as salt, which is employed in curing flesh [2]. Though it has always played a role, the treatment of drawback in RTAs differs widely, reflecting different views of its economics and regulation. According to the WTO, some agreements allow drawback unconditionally, others subject it to restrictions or phase-out periods. Moreover, 63 of the 93 RTAs examined by the WTO Secretariat explicitly prohibit drawback. It is likely to create legal uncertainty and friction with WTO rules.

Whether the common RTA provisions which prohibit drawback are WTO consistent, is the main research question of this paper. More specifically, the question addresses whether the Most-Favoured-Nation (MFN) principle, prohibitions on quantitative restrictions, and 'conditions' of GATT Article XXIV for forming an

RTA are satisfied. Relying upon legal texts, WTO case law and previous scholarship, this article argues that no-drawback rules often lack solid justification under multilateral trade rules and may harm third countries. The analysis can be organised as follows. Section 2 sets out the economic rationale and legal basis of drawback. Section 3 surveys the treatment of drawback in RTAs. Section 4 assesses its consistency with WTO law. Section 5 analyses the impact on non-parties. Section 6 suggests reform. Section 7 concludes.

RELATED WORK

This paper undertakes a legal and economic analysis of duty drawback regimes in the context of regional trade agreements (RTAs) and WTO law. However, contemporary trade policy increasingly is influenced by and shapes the technological and socio-economic dimensions of global production. Studies on these broad themes provide a backdrop for understanding the operational problems and systemic effects of trade rules. The significance of these areas in relation to the study of drawback is presented below.

Research with respect to the air hockey RoboCup challenges shows the difficulty faced in bringing motors, sensors and control algorithms together and using them under dynamic constraints. Customs authorities are required to efficiently keep track, verify and refund on duty drawback that is claimed on imported inputs embodied in exports. Yet the system is vulnerable to fraud. Similarly requiring a very complex control and verification.

Working in the space of human-computer interaction like gesture recognition for remote control using advanced methods like Kernel PCA2019˘ s promise novel user-agnostic, reliable solutions for varied environment [3]. Thus, just like a wellstructured drawback scheme with adequate flexibility can standardize inputs and address complexities and non-linear trade relationships, an adaptable and robust legal framework for drawback will ensure greater consistency across various preferential trade regimes.

Research on reinforcement learning for robotic singulation shows how the structure of an agent's policy space deeply influences its robustness and interaction success in cluttered environments [4]. In like manner, the design space of a drawback policy in RTAs as to whether to allow full, partial, or no drawback directly impacts the effectiveness and WTOconsistency of the trade regime and the success of the parties, especially developing countries, in the clutter of global value chains.

According to research on pragmatics, such as the exhaustivity interpretation of wh-questions, meaning is not inherent to language, but instead relies on context and speaker intention [5]. This insight is similar to the interpretation of trade rules: the economic effect and legal permissibility of a no-drawback rule cannot be assessed in isolation but must be assessed within the context of the RTA's objective, the parties' intention and effect on the trade of third countries the same objective that the WTO seeks to achieve to prohibit the presence of disguised restrictions on trade.

In computational mechanics, Krylov subspace method based algorithms have been efficiently designed to deal with nonlinear problems while optimally using resources and eliminating costly computations, [6].

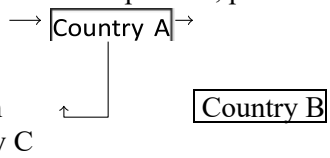
II. ECONOMIC RATIONALE AND LEGAL FOUNDATIONS OF DUTY DRAWBACK

Duty drawback serves as a critical tool for neutralizing the cost of import duties on inputs used in export production. In a typical scenario, a country imposes a tariff on imported inputs; if the final good incorporating those inputs is exported, the initial tariff is refunded. This prevents double taxation and ensures that exporters face world market prices for their inputs, thereby maintaining international competitiveness. The economic rationale is particularly compelling in the context of GVCs, where production stages are dispersed across countries and tariffs on intermediates can cumulate, distorting trade flows and reducing efficiency.

From a legal standpoint, drawback is addressed in several WTO agreements. The Agreement on Subsidies and Countervailing Measures (SCM Agreement) explicitly allows duty drawback, provided the refund does not exceed the duties actually paid on the imported inputs [7]. This treatment distinguishes permissible drawback from prohibited export subsidies. Similarly, the GATT recognizes that drawback should not be subject to anti-dumping or countervailing duties merely because of the duty remission [8]. These provisions

reflect a careful balance: drawback is tolerated as a legitimate tool for export promotion, but it must not confer an unfair advantage exceeding the duties originally levied.

The SCM Agreement further elaborates on the types of inputs eligible for drawback, including not only physically incorporated materials but also energy, fuels, and catalysts used in the production process [7]. Additionally, it permits substitution drawback systems, where duties on imported inputs are refunded when equivalent domestic inputs are used in export production. This flexibility acknowledges the practical realities of modern manufacturing, where sourcing patterns may shift between domestic and foreign suppliers. Overall, the WTO legal framework accommodates drawback as a non-subsidizing measure that promotes fair competition, provided it is administered correctly.



Despite this clear legal foundation, the application of drawback in preferential trade contexts has been contentious. Opponents argue that drawback can create "export platforms" for third-country inputs, allowing non-party materials to benefit indirectly from RTA preferences [9]. Others contend that drawback distorts competition between imported and domestic inputs, to the detriment of local industries [10]. These concerns have led many RTA negotiators to restrict or prohibit drawback, raising questions about the compatibility of such restrictions with WTO obligations. The following sections explore these issues in detail.

III. TREATMENT OF DUTY DRAWBACK IN REGIONAL TRADE AGREEMENTS

The Duty Drawback Regulation within RTAs is Very Heterogeneous. Based on a survey conducted by the WTO of 93 agreements, four broad categories emerge – those that allow drawback in full, those that restrict drawback either by time or scope, those that prohibit drawback in express terms, and those that are silent on this issue [11]. The differences in national interests, negotiating power, and economic structures lead to this variation.

Agreements like the Canada–Chile FTA and Mexico–Israel FTA provide full permission of drawback. In these instances, the parties recognize drawback as a legitimate policy instrument and do not take further measures to restrict its use. The WTO's flexible framework favours the proposal which can benefit exportoriented industries using imported inputs. In contrast, other agreements, such as the North American Free Trade Agreement (NAFTA), at the outset allowed drawback but later replaced it with a system that refunds the lower of the duties paid on inputs and the duties that are payable on the final good in the importing party [12]. The hybrid model aims to balance the interests of input producers and final goods exporters.

Many RTAs, especially those utilizing the pan-European (PANEURO) rules of origin system, restrict drawback explicitly. The agreements between the European Union and several Eastern European and Mediterranean partners include no-drawback clauses. The rationale is to prevent third-country inputs from 'free riding' on preferential tariff margins and to encourage the use of originating materials within the RTA. Yet this may penalize exporters in developing countries which use imported inputs because they lack competitive domestic industrial capacity.

Some RTAs finally do not mention drawback and leave it to the parties concerned. For example, it is common in cooperation agreements with the EU and Maghreb countries. This flexibility may allow for the conclusion of agreements more easily, but it can also create legal uncertainty and inconsistent application of the RTA. Table I presents a comparative summary of the treatment of drawback in selected RTAs. The analysis illustrates the diversity of treatment and their potential implications on trade and investment flows.

RTA

Drawback: Allowed or Banned?

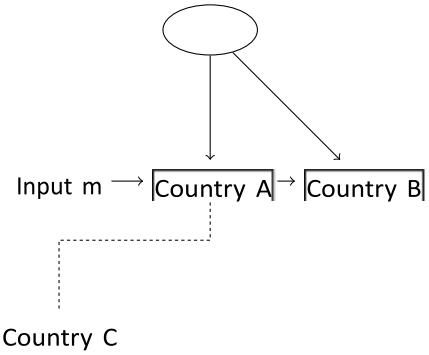


TABLE I CLASSIFICATION OF DUTY DRAWBACK PROVISIONS IN SELECTED RTAS

RTA Type	Allow Draw-back	No-Drawback Rule	Not Mentioned
PANEURO (50)		✓	
EC–Mexico		✓(2 years)	
Canada–Chile	✓		
NAFTA		✓(transition)	
ASEAN AFTA	✓		
MERCOSUR	✓	✓(auto sector)	

IV. WTO CONSISTENCY OF NO-DRAWBACK RULES

One of the key issues is whether RTA provisions prohibiting drawback are WTO law compliant. In particular, are they compliant with the MFN principle in Article I of GATT, the quantitative prohibition in Article XI, and the RTA exception in Article XXIV? Different legal issues are raised by each of these areas which will be examined in turn.

A. MFN Treatment under GATT Article I

According to Article I:1 of the GATT, an advantage that is granted to a product originating in or exported from any country should be accorded immediately and unconditionally to the like products originating in or exported from all other Members. Rules that impose no drawback results may infringe this principle if they de jure or de facto discriminate between exporting countries. In the Hungary–Lithuania FTA, drawback was prohibited only for inputs which came from countries outside the PANEURO cumulation zone, which led the US to question its MFN consistency. Such restrictions based on source clearly breach the unconditional MFN obligation.

Facially neutral rules that do not draw back can still discriminate. A drawback prohibition for an RTA party having multiple agreements with different partners may lead to sourcing from within the RTA party network and disadvantages suppliers from non-party countries. This indirect impact may result in the malformation of trade flows and degrade the level playing field intended by the MFN principle. While there remains debate in the WTO jurisprudence about its precise meaning and scope, it is clear that there is a risk

of violation of "unconditionality" in Article I:1. In particular, drawback restrictions could affect the competitive relationship between input suppliers.

B. Quantitative Restrictions under GATT Article XI

The Article XI:1 imposes restrictions on quantitative inspection of exports and imports of goods. By decreasing the necessary third-country inputs, no-drawback rules could indirectly restrict the importation of products. According to the panel's finding in Colombia – Ports of Entry, limiting the ports through which certain goods could enter Colombia was a restriction within the meaning of Article XI [13]. Similarly, an import prohibition on intermediate goods through the denial of drawback could be challenged by analogy.

The drawback restrictions do not seem to fall under the exceptions of Article XI:2, which applies to temporary bans on export, standards-related measures and agricultural support measures. As a result, a no-drawback rule found to restrict trade would most likely breach Article XI. This is more relevant for developing countries that use imported inputs for export production because the prohibition of drawback can hinder their entry in GVC and industrial development.

C. Regional Integration under GATT Article XXIV

According to article XXIV, RTA can be exempted from the MFN principle but should meet certain internal and external requirements. Commercial restrictions referring to duties and any other restraints must be abolished on "substantially all trade" between the parties. The Regional Trade Agreement (RTA) must not increase trade barriers against non-parties. No-drawback rules can be evaluated in relation to both requirements.

In terms of external requirement, the main inquiry is whether the prohibition of drawback makes the RTA's trade regulation more restrictive than before the RTA. The elimination of the drawback facility will divert trade away from third-country inputs that may create de facto barriers to trade, contrary to Article XXIV:5. The Appellate Body in Turkey – Textiles states that if a measure increases restrictiveness, it must be subjected to an "economic test" [14].

Internally, the no-drawback rules may complicate the use of the RTA preferences by raising the cost of non-originating inputs. When the share of trade receiving preferences is too low the "substantially all trade" requirement is unlikely to be met. Furthermore, administrative difficulties linked to establishing no-drawback can hinder the use of preferences, defeating the trade-facilitating objectives of the RTA.

V. IMPLICATIONS FOR NON-PARTIES AND DEVELOPING COUNTRIES

RTAs include no-drawback rules that have damaging impacts on non-parties, especially developing countries that specialize in intermediate goods exporting. By discouraging flexibility in terms of inputs from third countries, these rules restrict the market access of non-party suppliers. In the process, it distorts global sourcing decisions. Pharmaceuticals, drugs and automobiles are among the many items that got costlier in the last year and a half, but moreover the global business imported, the bigger delivery came from China.

According to the Enabling Clause, developing countries participating in South-South RTAs enjoy a greater degree of flexibility than contemplated by article XXIV in that there is no requirement to eliminate barriers on "substantially all trade". Nonetheless, it does require that such measure do not increase barriers or cause undue difficulty on the trade of other WTO Members [15]. The no drawback regulation, which discourages imports from non-parties, could breach this external requirement if they cause extensive trade diversion.

In addition, developing nations may not have the administrative capacity to comply with complex rules of origin and drawback restrictions. Cost-related issues around certification and verification can be prohibitive for small and medium-sized enterprises and could impede preferential trade agreement use. Simplifying the drawback procedure and allowing partial refunds will help increase inclusion and support development objectives.

[2]

VI. REFORMING DRAWBACK REGIMES IN PREFERENTIAL TRADE [3]

No-drawback rules should be reformed considering WTO[4] inconsistencies and negative spillovers caused by them. The section suggests increasing liberalization and movement of[5] drawback in RTAs, from prohibition towards a more flexible[6] development-friendly regime.

To the maximum extent possible, RTAs should introduce[7] a full "yes-drawback" rule allowing refunds of duties on all inputs used. This approach is fully consistent with WTO[8] law, since it merely restores the competitive neutrality that [9] drawback is intended to provide. It also prevents diversion of trade and bolsters the multilateral trading system by providing indirect benefits to inputs from non-parties.

Secondly, for sensitive sectors, partial drawback may be[10] allowed, limited to a percentage of duties paid as refund. For instance, if two parties to an RTA have different MFN tariffs [11] on an input, the amount of refund could be limited to the lower of the two rates so as to minimize the risk of distortion while providing some benefit to the exporters. Balancing interests of[12] input producers, final goods exporters is this compromise.

Third, we can use derogations for a limited period of time[13] to ease the transition to full drawback. For instance, the [14] Korea–EU FTA allows for consultations to limit drawback[15] in case of sourcing pattern change. Such mechanisms offer a cushion without irreversibly ruling out duty remission.

To stop fraud and circumvention, administrative cooperation should be enhanced. Instead of prohibiting drawback, parties could bolster customs enforcement and information sharing to ensure refunds are given only for bona fide exports. By focusing on specific issues, this approach does not take away from policies' economic benefits.

VII. CONCLUSION

In a world of global value chains, duty drawback is an important tool for enhancing export competitiveness. The problem arises when the RTAs provide for outright prohibition of drawback contrary to the WTO principles. This type of curban can hamper the operation of non-party suppliers, divert trade flows and become legally problematic under the MFN clause, and discipline on quantitative restrictions and RTA exception.

Modifying drawback regimes to permit full or partial refunds would be WTO consistent and enhance competitiveness, as well as help developing countries integrate into world trade. As countries still engage in debates concerning regionalism and multilateralism, liberalizing drawback in a way offers a constructive gesture. Future research could examine the trade and welfare effects of various drawback regimes empirically; this would provide more evidence for policymakers to design fairer and more efficient trade agreements.

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