



## Research Article

# HARMONISATION OF THE FUNCTIONING OF SPECIAL ECONOMIC ZONES UNDER WTO RULES: THE INDIAN CASE

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## ABSTRACT

Every year, the number of special economic zones increases. On the one hand, this is a great chance to bust the state's economy and attract investors. On the other hand, there is a probability to create unfair market competition. This may place other WTO members in an unfavourable position, posing a mitigation risk. To avoid this, the government should implement only special economic zone schemes following WTO regulations. This article will study which incentives are allowed by the WTO law and prohibited. Apart from this, will be reviewed India's case as an example of the transformation from special and differential treatment to the generally applicable WTO rules. This will include an analysis of the regulations, WTO case law, and suggestions for future regulatory reform.

## KEYWORDS

Special economic zones, world trade organisation, SEZ in India, Indian development of the SEZ regulation.

## INTRODUCTION

The relations between the mechanisms of special economic zones (SEZ) and the World Trade Organisation's (WTO) policy are controversial.

According to the WTO policy, some preferences guaranteed within the SEZ can be considered unfair



trade practices.<sup>1</sup> The topic of reasonableness and fairness of using subsidies is widely discussed in economic and legal communities. Implications of similar rules and conditions for all the members of the WTO may place asymmetrical demands on the developing countries compared to the developed states.<sup>2</sup> Chang emphasises that developed states, during their formative period, actively used most practices that are now prohibited for developing countries.<sup>3</sup> This matter creates a lot of discussions in the legal and economic communities. From one side, WTO provides the same rules for all states to create fair practice. From other – developing states can't use the same benefits which historically were available for now developed countries.

Given that WTO on the subsidies is strict, there is a need to understand which practices can be used within the SEZ and which are not. Indian case in this matter is significant because India belonged to The Subsidies and Countervailing Measures Agreement (SCM) Special and different Treatment list, so it enjoyed several benefits, which were actively implemented in

the SEZ policy. Nevertheless, in 2005 India crossed the maximum level in the textile industry.<sup>4</sup> In 2017 India crossed the maximum level of per capita income, moved out from the exceptions list,<sup>5</sup> and became a part of the common treatment. Given the new circumstances, India was obliged to provide transition of its legislation in accordance with the general rules of WTO. Unfortunately, the implemented measures were insufficient, and India not only continued with the existing subsidies but presented new ones. As a result, in 2018, WTO proclaimed that Indian SEZ regulations violate the SCM Agreement.<sup>6</sup>

One of the first researchers on this topic were S. Creskoff and P. Walkenhorst.<sup>7</sup> Their study was fundamental for the future legal analysis of the question and provided a comprehensive understanding of the SCM Agreement's application to SEZ policies.

The World Bank Group team led by Gokhan Akinci and James Crittle of FIAS<sup>8</sup> examined 30 years of worldwide experience of SEZ functioning. They dedicated special

<sup>1</sup> P. Pal, Special Economic Zones in India and the WTO Agreement on Subsidies and Countervailing Measures: An Uneasy Coexistence, 2016 DOI: 10.13140/RG.2.1.3059.3043, p. 1

[https://www.researchgate.net/publication/291246781\\_Special\\_Economic\\_Zones\\_in\\_India\\_and\\_the\\_WTO\\_Agreement\\_on\\_Subsidies\\_and\\_Countervailing\\_Measures\\_An\\_Uneasy\\_Coexistence/related](https://www.researchgate.net/publication/291246781_Special_Economic_Zones_in_India_and_the_WTO_Agreement_on_Subsidies_and_Countervailing_Measures_An_Uneasy_Coexistence/related)

<sup>2</sup> J. Stiglitz, A. Charlton A Development Round of Trade Negotiations? 2004

[https://www.researchgate.net/publication/253205208\\_A\\_Development\\_Round\\_of\\_Trade\\_Negotiations](https://www.researchgate.net/publication/253205208_A_Development_Round_of_Trade_Negotiations)

<sup>3</sup> H-J. Chang, Kicking away the Ladder? Policies and Institutions for Economic Development in Historical Perspective. London: Anthem Press, 2002 [https://www.jstor.org/stable/40722165#metadata\\_info\\_tab\\_contents](https://www.jstor.org/stable/40722165#metadata_info_tab_contents)

<sup>4</sup> P. Pal, Special Economic Zones in India and the WTO Agreement on Subsidies and Countervailing Measures: An

Uneasy Coexistence, 2016 DOI: 10.13140/RG.2.1.3059.3043, p. 8

<sup>5</sup> 2019 National Trade Estimate Report on Foreign trade barriers <http://trade.gov/enforcement/>

<sup>6</sup> DS436: United States — Countervailing Measures on Certain Hot-Rolled Carbon Steel Flat Products from India [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds436\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds436_e.htm)

<sup>7</sup> S. Creskoff, P. Walkenhorst. Achieving WTO Compliance for Special Economic Zones in Developing Countries. PREM Notes; No. 134. World Bank, Washington, DC. 2009 © World Bank

<https://openknowledge.worldbank.org/handle/10986/11122> p. 10

<sup>8</sup> FIAS Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development. 2008 The World Bank, Washington DC, E3. <https://documents1.worldbank.org/curated/en/3439014683>

attention to the public-private partnership in the SEZ development and implementation of WTO-compliant SEZ policy.

The topic is widely studied from an economic point of view. Madani,<sup>9</sup> Cling and Letilly,<sup>10</sup> and Schrank<sup>11</sup> examined in their states the relationship between free zones and economic reforms. Warr,<sup>12</sup> Jayanthakumaran,<sup>13</sup> and Sinclair<sup>14</sup> and Fabrice Defever, José - Daniel Reyes Alejandro Riaño, Miguel Eduardo Sánchez - Martín<sup>15</sup> conducted the cost-benefit calculations and the economic impact of SEZs.

Recently, the focus moved to national and regional-oriented studies. For example, the UNCTAD research, led by Amelia U. Santos Paulino under the guidance of

Richard Bolwijn and under the overall direction of James Zhan, talks about the SEZ in Africa.<sup>16</sup> M. Kh. Vokhidova<sup>17</sup> conducted the projects about the impact of WTO membership on SEZ on the example of China. Parthapratim Pal,<sup>18</sup> and Sherzod Shadikhodjaev<sup>19</sup> studied the Indian case.

This paper studies the World Trade Organization's Subsidies and Countervailing Measures Agreement and addresses its features in the context of Indian government policies and incentive programs. It determines if Indian trade promotion policies are compliant with WTO standards.

WTO regulation doesn't define or specifically mention SEZ. Agreement on Subsidies and Countervailing

30977533/pdf/458690WPoBox331soApril200801PUBLIC1.pdf

<sup>9</sup> D. Madani, A Review of the Role and Impact of Export Processing Zones. World Bank Development Research Group Policy Research Working Paper 2238 (November) <https://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-2238>

<sup>10</sup> J. P. Cling, and G. Letilly. Export Processing Zones: A Threatened Instrument for Global Economy Insertion? 2001 [https://www.researchgate.net/publication/44961691\\_Export\\_Processing\\_Zones\\_A\\_threatened\\_instrument\\_for\\_global\\_economy\\_insertion/citations](https://www.researchgate.net/publication/44961691_Export_Processing_Zones_A_threatened_instrument_for_global_economy_insertion/citations)

<sup>11</sup> A. Schrank, Export Processing Zones: Free Market Islands or Bridges to Structural Transformation? 2001 Development Policy Review, 19(2):223-242. [https://www.researchgate.net/publication/229718330\\_Export\\_Processing\\_Zones\\_Free\\_Market\\_Islands\\_or\\_Bridges\\_to\\_Structural\\_Transformation](https://www.researchgate.net/publication/229718330_Export_Processing_Zones_Free_Market_Islands_or_Bridges_to_Structural_Transformation)

<sup>12</sup> P. Warr, Export Processing Zones: The Economics of Enclave Manufacturing. 1989 World Bank Research Observer 4, No. 1, (January), 65-87. <https://www.jstor.org/stable/3986349>

<sup>13</sup> K. Jayanthakumaran, K. An Overview of Export Processing Zones: Selected Asian Countries. 2002 University of Wollongong Department of Economics Working Paper Series <https://ro.uow.edu.au/commpapers/800/>

<sup>14</sup> R.D. Sinclair, Export Processing Zones: An Ingredient for Successful Liberalization. 2001 Working Paper, The Maxwell School of Syracuse University.

<sup>15</sup> F. Defever, J. D. Reyes, A. R. Miguel, E. Sánchez - Martín. Special Economic Zones and WTO Compliance: Evidence from the Dominican Republic. *Economica*, Vol.86, Issue 343. p. 532-568 <https://doi.org/10.1111/ecca.12276>

<sup>16</sup> A. U. Santos Paulino, F. Bartalucci, A. Chaudhary, S. Frick, and I. Radouane. UNCTAD Handbook on special Economic zones in Africa. Towards economic diversification across the continent 2021 <https://www.pacci.org/handbook-on-special-economic-zones-in-africa-towards-economic-diversification-across-the-continent/>

<sup>17</sup> Vokhidova, M. Kh. Impact of WTO membership on special economic zones, 2020 *Economics and Innovative Technologies*: Vol. 2020: No. 3, Article 5. <https://uzjournals.edu.uz/iqtisodiyot/vol2020/iss3/5>

<sup>18</sup> P. Pal, Special Economic Zones in India and the WTO Agreement on Subsidies and Countervailing Measures: An Uneasy Coexistence, 2016 DOI: 10.13140/RG.2.1.3059.3043 [https://www.researchgate.net/publication/291246781\\_Special\\_Economic\\_Zones\\_in\\_India\\_and\\_the\\_WTO\\_Agreement\\_on\\_Subsidies\\_and\\_Countervailing\\_Measures\\_An\\_Uneasy\\_Coexistence/related](https://www.researchgate.net/publication/291246781_Special_Economic_Zones_in_India_and_the_WTO_Agreement_on_Subsidies_and_Countervailing_Measures_An_Uneasy_Coexistence/related)

<sup>19</sup> S. Shadikhodjaev, The WTO Agreement on Subsidies and Countervailing Measures and Unilateralism of Special Economic Zones, *Journal of International Economic Law*, Volume 24, Issue 2, June 2021, Pages 381-402, <https://doi.org.eres.qnl.qa/10.1093/jiel/jgab013>

Measures (SCM Agreement) gives a list of incentives which are prohibited but typical for the SEZ, for example, subsidy.

WTO forbids actions connected to direct governmental support. Article 3 of the SCM Agreement defined two forms of unlawful subsidies typical for SEZ: export and domestic content subsidies. Export subsidies basing on export share requirements. To get the benefit, companies located in the SEZ must export a part of their output.<sup>20</sup> If a company wants obtain the domestic subsidy, it has to use indigenous items instead of imported goods.

SEZ measure becomes a subsidy only if it satisfies three conditions of article 1.1 SCM Agreement. It has to be a beneficial financial contribution provided by the state within its territory.<sup>21</sup> Also, the subsidy has to be specific, i.e., it must be given to an area, business or industry, or a set of businesses or industries. In other words, if the awarding body restricts access to the subsidy to specific firms or regions. It means that if the government offers a support only to one area, it will be recognised as specific, even if it is available to all businesses of that territory. However, if the subsidy is available to all the state's businesses, it does not cause market distortions or resource allocation and does not

consider specific. Unspecific measures can not constitute a matter of dispute.<sup>22</sup>

Researching the possible inconsistency of SEZ benefits and WTO restrictions, it's crucial to remember that SEZ can be public and private. WTO rules are applicable only to its members, i.e., states, but most of the SEZs are privately owned, developed, and operated.<sup>23</sup> This means that policies of private SEZ can become a matter of dispute under the WTO regulation only in the case of implementation of governmental measures.

India began to reform its export-import policy in the 2000<sup>th</sup>. SEZ Act of 2005<sup>th</sup> outlined the basic SEZ principles and provided duty-free imports for all units operating within Indian SEZs. In July 2010 government presented a final document which regulates the creation, functioning, administration, benefits and exit from the SEZ in India.<sup>24</sup> The establishment of SEZs benefited the entire Indian economy, especially importers and production platforms.<sup>25</sup>

The WTO guidelines related to the Indian SEZ regulation have undergone substantial revisions considering the growth of the Indian economy. Initially, India had the right to exploit the Special and Different Treatment criteria. To be included in the list

<sup>20</sup> F. Defever, A. Riano Subsidies with export share requirements in China," *Journal of Development Economics*,

126, 33{51, 2017  
<https://www.sciencedirect.com/science/article/pii/S030438781630102X>

<sup>21</sup> Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 U.N.T.S. 14  
[https://www.wto.org/english/docs\\_e/legal\\_e/24-scm.pdf](https://www.wto.org/english/docs_e/legal_e/24-scm.pdf)

<sup>22</sup> Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World

Trade Organization, Annex 1A, 1869 U.N.T.S. 14  
[https://www.wto.org/english/docs\\_e/legal\\_e/24-scm.pdf](https://www.wto.org/english/docs_e/legal_e/24-scm.pdf)

<sup>23</sup> D. Marjanac, A.M. Alfrević, Special economic zones: the impact and implications on economic growth with reference to the Chinese model. *Acta Economica*, 2020, 18(32), 85–106.  
<https://doi.org/10.7251/ACE2032085M>

<sup>24</sup> SEZ Rules incorporating amendments upto July, 2010  
[http://sezindia.nic.in/upload/uploadfiles/files/14\\_SEZ\\_Rules\\_July\\_2010.pdf](http://sezindia.nic.in/upload/uploadfiles/files/14_SEZ_Rules_July_2010.pdf)

<sup>25</sup> Dezan Shira & Associates India's Special Economic Zones: A Primer (2021) <https://www.india-briefing.com/news/guide-indias-special-economic-zones-9162.html/#thedevelopmentofsezsinindiaHeader>



of Annex VII of the SCM Agreement, state should be recognised by the World Bank as a developing country with a per capita income of less than \$1,000 USD annually.<sup>26</sup> Indian SEZ legislation was developed considering the special status under the SCM Agreement and implemented several strategies, which are generally prohibited. However, since 2017, India no longer belongs to the developing states.<sup>27</sup> In light of this, several existing initiatives are now in violation of WTO regulations and must be amended.

The new stage of the development of Indian SEZ regulation started with publishing the WTO Panel's Report in the case DS 541 India - Export Related Measures.<sup>28</sup> The main question of the dispute was the adaptation of the current export subsidies to the general rules during the phase-out period.<sup>29</sup> The discussion appeared because there was no clear explanation if the right to the phase-out period belongs to the state naturally or with additional permission for it. The Panel's interpretation was not in favour of India. According to it, there is no possibility for any further flexibility in Indian SEZ regulation. The eighth – years phase-out period starts from the date of

the WTO Agreement's entry into force, not from the moment when India lost its status. As a result, India no longer has the right to grant industrial products export subsidies.<sup>30</sup>

The Panel established a four-criteria test to examine whether the challenged customs duty exemption under the EOU/EHTP/BPT Schemes is “deemed to be a subsidy” following footnote 1 of the SCM Agreement. To be called a subsidy, the measure has to be remission, drawback, exemption, or postponement of import duties on imported production waste of the exported product, on production waste consumed during the manufacture of the exported product and not above those paid on such inputs.<sup>31</sup>

In the examined scheme, the third criteria was not fulfilled.<sup>32</sup> The Panel reasoned that these schemes exempted a wide range of products from paying customs taxes, including capital assets that are not “inputs consumed in the manufacturing of the exported product.”<sup>33</sup>

The Panel's conclusion regarding whether or not the Indian export subsidies are export conditional and

<sup>26</sup> Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 U.N.T.S. 14 art. 27.2. [https://www.wto.org/english/docs\\_e/legal\\_e/24-scm.pdf](https://www.wto.org/english/docs_e/legal_e/24-scm.pdf)

<sup>27</sup> 2019 National Trade Estimate Report on Foreign trade barriers <http://trade.gov/enforcement/>

<sup>28</sup> DS 541 Export Related Measure Report <https://www.wto-ilibrary.org/content/reports/25189832/237>

<sup>29</sup> Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 U.N.T.S. 14 art. 27.5 [https://www.wto.org/english/docs\\_e/legal\\_e/24-scm.pdf](https://www.wto.org/english/docs_e/legal_e/24-scm.pdf)

<sup>30</sup> Panels Report in the case DS541: India — Export Related Measures World Trade Organisation 31 October 2019 1907313 WT/DS541/R

[https://www.wto.org/english/tratop\\_e/dispu\\_e/541r\\_e.pdf](https://www.wto.org/english/tratop_e/dispu_e/541r_e.pdf)

<sup>31</sup> ELP ELP export update Summary report in India Export related measures (DS541) (2019) <https://elplaw.in/wp-content/uploads/2019/11/ELP-Export-update-Summary-of-the-panel-report-in-India-Export-related-measures-DS541.pdf>

<sup>32</sup> India – Export Related Measures – Report of the Panel para. 7.204 [https://docs.wto.org/dol2fe/Pages/FE\\_Search/FE\\_S\\_Soo6.aspx?Query=\(%20wt/ds541/\\*\)&Language=ENGLISH&Context=FomerScriptedSearch&languageUICanged=true#](https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_Soo6.aspx?Query=(%20wt/ds541/*)&Language=ENGLISH&Context=FomerScriptedSearch&languageUICanged=true#)

<sup>33</sup> India – Export Related Measures – Report of the Panel para. 7.222 [https://docs.wto.org/dol2fe/Pages/FE\\_Search/FE\\_S\\_Soo6.aspx?Query=\(%20wt/ds541/\\*\)&Language=ENGLISH&Context=FomerScriptedSearch&languageUICanged=true#](https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_Soo6.aspx?Query=(%20wt/ds541/*)&Language=ENGLISH&Context=FomerScriptedSearch&languageUICanged=true#)

hence incompatible with Article 3.2 of the SCM Agreement was next. EPCG, EOU/EHTP/BTP, DFIS and MEIS were export-reliant due to the terms and conditions for obtaining the advantages.

The Panel heavily discussed the significance of achieving positive net foreign exchange regarding the SEZ and EOU/EHTP/BTP Schemes. Many approaches can be used to fulfil a condition, for example, domestic sales. The Panel determined that the variety of ways the subsidy may be obtained is immaterial. A subsidy is export contingent in the meaning of Article 3.1 even though it can be got in a variety of situations that do not involve export contingency. As a result, such a norm is incompatible with the art. 3.2 SCM Agreement.<sup>34</sup>

The Panel came to the following conclusion:

- Exemptions of customs tax on capital goods imports under the EOU/EHTP/BTP Scheme, the EPCG Scheme, and the DFIS are inconsistent with Articles 3.1 (a) and 3.2 of the SCMA.
- Exemptions from customs duty, IGST, and taxable income deductions under the SEZ Scheme are in violation of the ASCM's Articles 3.1 (a) and 3.2. of the SCMA.
- MEIS duty credit scrips are incompatible with Articles 3.1 (a) and 3.2 of the SCMA.<sup>35</sup>

The Panel recommended that India withdraw the banned DFIS subsidies within 90 days of the Report's adoption and the prohibited subsidies under the

EOU/EHTP/BTP Schemes, EPCG Scheme, and MEIS schemes within 120 days of the Report's adoption.

This was the first dispute under the SCM Agreement addressing the developing state's phase-out period. The Panel's interpretations are significant for other developing countries which might deal with similar difficulties in the future. It also motivates India to take the next step in developing SEZ regulations.

### CONCLUSIONS

This article examined the Subsidies and Countervailing Measures Agreement and assessed its elements from the perspective of the most prevalent SEZ measures. Provided analysis showed that India has several SEZ schemes that are in violation of WTO standards. Most of these initiatives have elements of actionable subsidies. Such policies were permitted while India had the status of a developing state. However, because the status has changed, the legislation also has to adopt. In order to comply with the WTO, should be made a stronger emphasis on the distinction between prohibited and actionable export promotion methods. It is crucial to ensure that no export incentive is included in the forbidden category. This can be accomplished only by carefully revising the existing SEZ legislation and eliminating unlawful subsidies.

The following adjustments can be made to reorganise the Indian SEZ regulation in accordance with the evolving circumstances.

1. Adoption of the new SEZ law, which reflects India's current situation and status. Indian

<sup>34</sup> India – Export Related Measures – Report of the Panel para. 7.524

[https://docs.wto.org/dol2fe/Pages/FE\\_Search/FE\\_S\\_S006.aspx?Query=\(%20wt/ds541/\\*\)&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true#](https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=(%20wt/ds541/*)&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true#)

<sup>35</sup> J. Nedumpara, S. Janardhan Developing Countries and Export Subsidies: WTO Panel's report in DS541 (2019) <http://regulatingforglobalization.com/2019/11/15/developing-countries-and-export-subsidies-wto-panels-report-in-ds541/>



Commerce and Industry Ministry has already suggested a new Act. It will allow SEZs to sell goods in the domestic market at low duties and give the possibility to units to accept Indian currency as payment.

2. Adoption and the integration of the new bonded manufacturing spaces concept with SEZ. Manufacturers have to be excluded from paying import tariffs on production waste used during the manufacturing of the export goods. This variant of the policy is WTO compatible because it does not link tax exemptions on imported raw materials and capital products with export performance.
3. India should also consider the implementation of smart WTO-compliant subsidies. Rather than foreign exchange gains, incentives might be connected to investments in research, development and job creation in SEZs. Such initiatives are considered smart because, while they may be subject to WTO action, they are unlikely to be challenged. Proving that such subsidies are unfair under the SCM agreement or have affected another country's competitiveness is challenging. The provision of subsidies through the Department of Commerce rather than specialised trade-oriented entities may also serve to decrease the apparent trade link of such programs, making them more effective and difficult to challenge.
4. Another possibility is to provide subsidies for the services, as the WTO has not yet imposed any restrictions in this area. Grants could be used to improve worker skills, lower marketing and advertising costs, and compensate for transportation costs.
5. Improvement of the worker skilling and productivity through training. It has the potential to increase efficiency and cut costs for export

product producers in Indian SEZs, allowing them to compete more effectively on the global stage.

1. P. Pal, Special Economic Zones in India and the WTO Agreement on Subsidies and Countervailing Measures: An Uneasy Coexistence, 2016 DOI: 10.13140/RG.2.1.3059.3043, p. 1 [https://www.researchgate.net/publication/291246781\\_Special\\_Economic\\_Zones\\_in\\_India\\_and\\_the\\_WTO\\_Agreement\\_on\\_Subsidies\\_and\\_Countervailing\\_Measures\\_An\\_Uneasy\\_Coexistence/related](https://www.researchgate.net/publication/291246781_Special_Economic_Zones_in_India_and_the_WTO_Agreement_on_Subsidies_and_Countervailing_Measures_An_Uneasy_Coexistence/related)
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3. H-J. Chang, Kicking away the Ladder? Policies and Institutions for Economic Development in Historical Perspective. London: Anthem Press, 2002 [https://www.jstor.org/stable/40722165#metadata\\_info\\_tab\\_contents](https://www.jstor.org/stable/40722165#metadata_info_tab_contents)
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12. P. Warr, Export Processing Zones: The Economics of Enclave Manufacturing. 1989 World Bank Research Observer 4, No. 1, (January), 65–87. <https://www.jstor.org/stable/3986349>
13. K. Jayanthakumaran, K. An Overview of Export Processing Zones: Selected Asian Countries. 2002 University of Wollongong Department of Economics Working Paper Series <https://ro.uow.edu.au/commpapers/800/>
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