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RETHINKING EXPORT INCENTIVES IN INDIA

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Key Highlights

- The risk management system (RMS) was established for imports in 2005, and for export consignments in 2013. The RMS has expedited the process of customs clearance and resulted in a large reduction in dwell time for imports and exports.
- A long-term trade facilitation aim of the Government of India has been to allow importers and exporters to lodge their clearance documents online at a single point without interface with the regulatory authorities.
- Under the Authorised Economic Operators (AEO) programme, the clients receive virtually automatic clearance of consignments on the basis of self-assessment or self-declaration.
- Direct Port Delivery (DPD) for imports and Direct Port Entry (DPE) for factory stuffed export containers, without the need for moving the consignments first to an off-dock container freight station (CFS), saves both time and cost.

EXECUTIVE SUMMARY

INDIA GRADUATES OUT OF ELIGIBILITY FOR SPECIAL TREATMENT IN THE WTO RULES ON SUBSIDIES

A recent WTO panel report has held that India's five main export incentives programmes fall in the category of prohibited subsidies under the WTO Agreement and has recommended that they be all withdrawn.

As a general rule, the WTO Agreement prohibits the use of export subsidies. However, by way of special and differential treatment, the prohibition does not apply to the least developed countries (LDCs) and 20 low-income developing countries listed in WTO Agreement. As might be expected, there is also a provision for graduation of individual low-income countries, once their per capita GNP has reached $ 1,000 per annum in constant 1990 dollars for three consecutive years.

The list of low-income developing countries includes India. With rapid economic development that followed economic liberalisation in 1991-92 it was inevitable for India to graduate out the category of low-income developing country sooner rather than later. According to the calculations made by the WTO Secretariat, India's GNP per capita in constant1990 dollars was consistently above $1,000 during the years 2013-15. On the basis of these calculation, the prohibition on export subsidies became applicable to India in 2015.

THE EXPORT INCENTIVE PROGRAMMES THAT ARE AFFECTED

- Merchandise Exports from India Scheme (MEIS)
- Export Promotion Capital Goods (EPCG) Scheme
- Export Oriented Units (EOUs) and sector specific schemes, including Electronics Hardware Technology Parks (EHTPs) and Bio-Technology Parks (BTPs).
- Special Economic Zones (SEZs)

- Duty-free Imports for Exporters Scheme (DFIS)

RETHINK EXPORT INCENTIVES-ESCHEW SUBSIDIES ALTOGETHER

It is true that India has notified its decision to appeal against the panel report and with the Appellate Body dysfunctional the final decision may not come at all. However, export subsidies are already prohibited and the international trade environment is becoming increasing difficult for the use of other categories of public subsidy as well, and the US, the EU and Japan are proposing to enhance disciplines on it in the WTO. Under the WTO Agreement, it is already possible for importing countries to levy countervailing duties if subsidized imports cause material injury to domestic industry in the importing country. There is no use granting more subsidies and then watch the importing countries mop up these payments as countervailing duties. Furthermore, having won the case at the panel level, the US is not going to sit idly and allow the opportunity of retaliatory action pass by. In the light of all this, India must rethink its strategy on export incentives and choose alternative policy instruments to improve its competitiveness in exports of manufactures and other goods.

ALTERNATIVE POLICY INSTRUMENTS FOR IMPROVING COMPETITIVENESS

Introduce a Comprehensive Scheme for Rebate of State and Central Embedded Taxes and Levies for all Export Segments

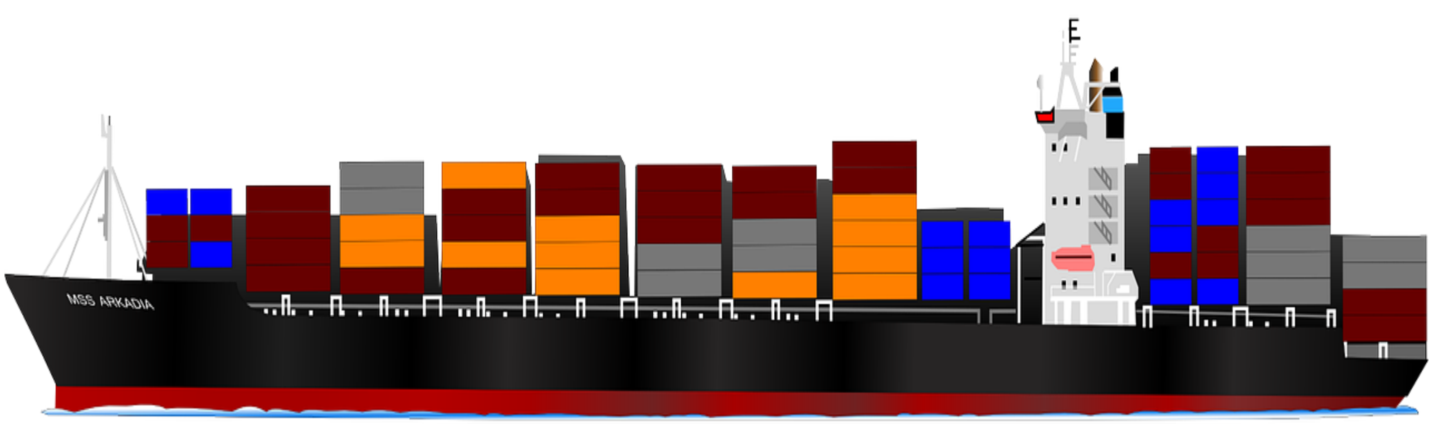
The first preference must be given to achieving the objective of neutralizing exports of all duties and taxes. The Government of India already exempts all exports from GST, and in addition it has envisaged rebate of embedded taxes on textiles and clothing exports. What is needed is a comprehensive scheme for rebate of State and Central Embedded Taxes and Levies in all segments. In fact, the Central Government is already in the process of in the process of introducing a new scheme by the name of Remission of Duties on Export Products (RoDTEP).

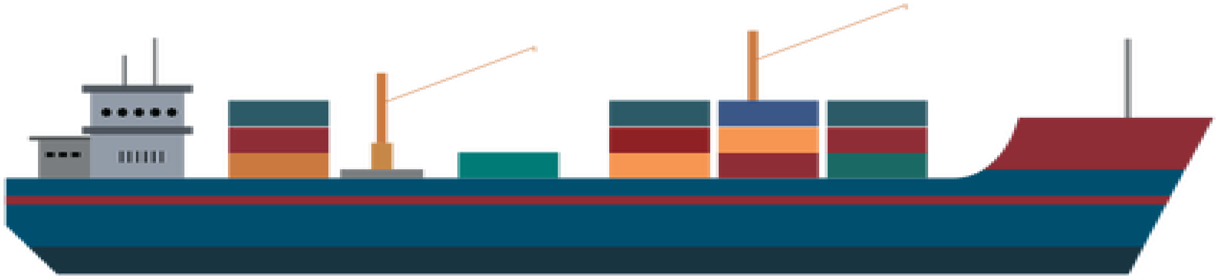
In introducing such a general scheme for refund of unrebated State and Central taxes and levies Government should bear in mind both the limitations and flexibilities that the WTO rules provide. It is necessary to ensure that the refund of taxes is limited to 'inputs physically incorporated, energy, fuels and oils used in the production process' as stipulated in the WTO Agreement. On the other hand, there is a good case for refunding taxes on fuel used in the domestic transportation of inputs, as these taxes are high and increase considerably the overall cost of manufacture of the exported product. In modern times, manufacturing increasing involves transportation of inputs over long distances and there is every reason to refund the taxes on fuel used in transportation.

Further, the rates of refund of taxes should be determined in such a manner that they give confidence to agencies in importing countries that there is a procedure in place to confirm which inputs are used and in what proportion and the procedures are reasonable and effective. Already, for the determination of drawback rates for refund of customs duty levied on inputs used for the production of exported products the Department of Revenue is obtaining data from the Export Promotion Councils, Commodity Boards and the Chambers of Commerce on the taxes and levies paid on inputs physically incorporated, energy, fuels and oils used in the production process. The same procedure can be adopted for ascertaining the incidence of taxes and levies for the comprehensive scheme on refund of embedded taxes. Transparency is crucial for credibility.

Reduce import duty on capital goods

India has a moderate level of import duty on capital goods. If the reimbursement of the duty on capital goods used for the manufacture of the exported product is not possible in future because of the WTO rules what is the alternative?





Elimination of import duty altogether is not something that can be done easily, more so because many of the raw materials and intermediate goods for capital goods like steel and non-ferrous metals as well as instrumentation have to pay import duties. It would become an egregious case of inverted duty structure. We therefore suggest a via media of gradual reduction of import duty on capital goods as well as on important intermediate goods that go into the production of these goods.

Redouble effort to improve the transport infrastructure

One of the main reasons for the lack of competitiveness of the goods manufactured in India is the higher cost incurred by the trade in port logistics and in moving the goods in the domestic area by rail or road. The higher cost is the cumulative result of the inadequacies of rail, road and port infrastructure and inefficiencies in the processes adopted in regulating the flow of goods. A recent report estimates that the average cost incurred by exporters and importers on port logistics alone in India is 15 per cent of the value of consignment. It is time to redouble efforts on trade infrastructure and logistic processes.

India has lacked world class road infrastructure, and this has been a major reason for higher logistics cost. Since more than 70 per cent of the movement of containers is concentrated on the western economic corridor, an expressway from Delhi to Mumbai will contribute considerably to the reduction of logistic cost for manufactured goods.

From the point of view of both the economic cost and the environment it would be even more advantageous to achieve a modal shift of freight movements towards rail. The Western Dedicated Freight Corridor, which is nearing completion, will make the maximum contribution as a high proportion of container movements already takes place on the routes in this part of the country.

As for ports, while non-major ports handle a growing share of the cargo traffic, the major ports still account for the bulk of it. At present, it is not capacity constraint in the ports but insufficiency of support infrastructure that causes time delays and hold ups, which translate into additional cost of transportation.

Intensify trade facilitation

Considerable improvement in competitiveness has been brought about through trade facilitation in past years. But there is scope for greater progress in reducing the time spent by consignments in ports and customs:

- The risk management system (RMS) was established for imports in 2005, and for export consignments in 2013. The RMS has expedited the process of customs clearance and resulted in a large reduction in dwell time for imports and exports. However, the proportion of consignments benefiting from RMS in India is still low at 80-85 per cent, against what may be considered the gold standard of 97-98 per cent in the developed countries.
- A long-term trade facilitation aim of the Government of India has been to allow importers and exporters to lodge their clearance documents online at a single point without interface with the regulatory authorities. This objective was substantially achieved with the introduction of e-SANCHIT on the import side in October 2017 and on the export side in August 2018. However, the related programme for enabling similar action in respect of licenses, permits, certificates and other authorisations issued by regulatory agencies is still work in process.

- Under the Authorised Economic Operators (AEO) programme, the clients receive virtually automatic clearance of consignments on the basis of self-assessment or self-declaration. A weakness of the programme is that the benefit can be suspended or the AEO status downgraded, even at the stage of the issuance of a show-cause notice for an infraction or non-compliance that has been detected.

- Direct Port Delivery (DPD) for imports and Direct Port Entry (DPE) for factory stuffed export containers, without the need for moving the consignments first to an off-dock container freight station (CFS), saves both time and cost. The DPD system results in a decrease of logistics costs of import consignments by quickening the pace of cargo clearance, shortening the dock dwell time, and eliminating intermediaries in the supply chain ecosystem. Similarly, DPE results in a decrease of logistics costs in respect of export consignments. Although the procedures have been established, the systems have not been functioning smoothly.

- In the past, stoppage of truck traffic for checking at interstate borders slowed down the movement of goods by road significantly. Fortunately, the introduction of GST has eliminated this big impediment but stoppages and soliciting of bribes by other government staff (police, transport officials and others) are still impeding movement of goods by road and more reform is needed. A February 2020 report attempted to quantify the corruption and bribery faced by truck drivers, and estimated the illicit payment by them to be Rs 1,257 on the average per trip and Rs 47, 852 per year.

India will get a little time to consider and implement the alternative strategies spelt out above. It can be reasonably expected that the US would approach India bilaterally and exert pressure for compliance. But there would be no reason for India to agree to full and strict compliance with the panel recommendations. The talks would be taking place as normal trade negotiations outside of the legal framework of the Dispute Settlement Understanding, and in such negotiations the US would have to be receptive to reasonable requests. India could and should argue for the US to agree on a staged compliance, in view of the structural and fundamental nature of the policy change recommended by the Panel.

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