Trade policy

6.34 Over the years, trade policy has undergone fundamental shifts to correct the earlier anti-export bias through the withdrawal of quantitative restrictions (QRs), reduction and rationalization of tariffs, liberalization in the trade and payments regime and improved access to export incentives, besides a realistic and market based exchange rate. The focus of these reforms has been on liberalization, openness, transparency and globalization with a basic thrust on outward orientation focusing on export promotion activity and improving competitiveness of Indian industry to meet global market requirements. In early 2002, the Government presented a Medium Term Export Strategy (MTES) for 2002-07 providing a vision for creating a stable policy environment with indicative sector-wise targets, with a mission to achieve one percent of global trade by 2007. The new Export and Import (EXIM) Policy framed for the period 2002-07 and unveiled on 31 March, 2002 also seeks to usher in an environment free of restrictions and controls (Box 6.1). Synergy between these policies/ strategies is expected to realize India's strong export potential and enhance the overall competitiveness of its exports.

6.35 Policy measures announced in the Union Budget 2002-03 included a comprehensive package for development of Special Economic Zones (SEZ) including entitlement by these Zones to procure duty free equipment, raw materials, components, etc. whether imported or purchased locally, further decontrol and deregulation of agriculture sector to encourage higher exports of farm products (with measures like decanalisation of export of agricultural commodities, phasing out of remaining export controls, setting up of more Agri-Export Zones in various states and enhanced incentives for export of food grains), de-reservation from small scale industry (SSI) provisions for over 50 items (of knitwear, selected agricultural implements, chemical & drugs and others) to facilitate higher investment, technology up-gradation and exports from these sectors and fiscal measures for strengthening certain key industries (including textiles, steel, non ferrous metals and IT industry) for improving their competitiveness and exports. The Budget announced a reduction in peak customs duty from 35 percent to 30 percent and also provided an indication of further reductions/ rationalization in these duties into only two slabs of 10 percent (for raw material, intermediate and components) and 20 percent (for final products) by 2004-05. A detailed roadmap has been recommended by the Finance Ministry Task Force on Indirect taxation for, *inter alia*, further reforms in areas related to customs tariffs, rationalization of export promotion schemes, trade facilitation and other changes in tax administration (Box 6.2).

Box 6.1 : Export import (EXIM) policy 2002-07

The Special Economic Zone (SEZ) scheme has been strengthened by permitting the setting up of offshore Banking Units, hedging of commodity price risks and sourcing of short term External Commercial Borrowings. Supplies by domestic units to SEZs would entitle the former to avail of Duty Entitlement Passbook Scheme benefit. The policy has also ensured procedural simplification in the process of subcontracting carried out by the SEZ units. To ease the power situation in and around the SEZs, units for generation and distribution of power have been permitted to be set up in the SEZs

The Policy gives a major thrust to agricultural exports by removing export restrictions on designated items. The efforts to promote exports of agro and agro-based products in the floriculture and horticulture sector have been sustained with the notification of 32 Agri-Export Zones across the country. Non-actionable subsidies such as transport subsidy have been provided for the export of fruits, vegetables, floriculture, poultry and dairy products. All Quantitative restrictions on exports (except a few sensitive items) have been removed with Only a few items being retained for export through State Trading Enterprises**.** To improve the productivity and export competitiveness of small scale, cottage and handicrafts sector, the Policy provides a package of incentives, including exemption from maintaining the average export obligation under the Export Promotion Capital Goods (EPCG) scheme, permission to achieve a lower threshold level for achieving the Export House status, preferential access to Market Access Initiative funds and duty free access to trimming and embellishment for achieving value added exports. The towns of export excellence **(**such as Tirupur for hosiery, Panipat for woolen blanket and Ludhiana for woolen knitwear) are intended to be regional rural motors of economic development for the small scale sector, focusing on plugging critical infrastructural bottlenecks and enhancing quality of support services for industrial development.

To provide the necessary impetus to star achievers, EXIM Policy provides a strategic package for status holders comprising of new/special facilities like issuance of Licence on self-declaration basis, fixation of input-output norms on priority, exemption from compulsory negotiation of documents through banks, cent percent retention of foreign exchange in Exchange Earners' Foreign Currency account, enhancement in normal repatriation period from 180 days to 360 days and not mandating exports in each of the three licensing years for achieving the status. The Policy has operationalised the procedure for duty free import of fuel under the Advance Licensing Scheme, provided the license holder has a captive power plant.

In view of phasing out of all restrictions on textile products by 2005 under the Agreement on Textile and Clothing (ATC), the EXIM Policy has focused on measures to encourage value added exports in the garment sector. Electronic Hardware Technology Park (EHTP) scheme has been modified to enable hardware sector to face the zero duty regime under Information Technology Agreement (ITA-1), mandating only a positive net foreign exchange as a percentage of exports criteria and obviating any other export obligation for units in Electronic Hardware Technology Parks. The changes carried out in the gems & jewelry scheme include abolition of the licensing regime for the import of rough diamonds, reduction in the value addition norms for export of jewelry and permitting personal carriage of jewelry.

The medium term Policy continues with all the duty exemption/remission schemes**,** along with existing dispensation of not having any value caps. Procedural simplifications introduced in the policy include abolition of DEEC Book and withdrawal of Annual Advance License under the Advance License scheme, dispensation with technical characteristics for audit purposes under the Duty Free Replenishment Certificate scheme, 12 years export obligation period with 5 years moratorium for Export Promotion Capital Goods licenses of Rs.100 crore or more and supplies under deemed exports to be eligible for export obligation fulfillment along with deemed export benefits.

Procedural simplifications have been made in the EXIM policy to further reduce transaction costs covering Directorate General of Foreign Trade, customs and banks. These include adoption of 8 digit commodity classification for imports which would eliminate the classification disputes, reduction of maximum fee limit for electronic filing from Rs.1.5 lakhs to Rs.1 lakh, introduction of same day licensing, new norms for reduction in percentage of physical examination of export cargo, introduction of the simplified brand rate of drawback scheme and permitting direct negotiation of export documents. Other salient features of the EXIM Policy 2002-07 include widening of the scope of the Market Access Initiative scheme to include activities considered necessary for a focused market promotion of exports, setting up of "Business Centre" in India missions abroad for visiting Indian exporters/businessmen for ensuring a facilitatory environment for exporters, transport subsidy for exports to units located in North East, Sikkim and J&K and introduction of Focus Africa with Focus CIS to follow, to diversify markets.

Box 6.2 : Task Force on indirect taxation – proposed roadmap for trade reforms

The Finance Ministry Task Force (Kelkar Committee) on indirect taxes has suggested a road map for further reforms in, inter alia, areas like customs tariff and exemptions, customs procedures and trade facilitation, export promotion and improving automation and tax administration. On **customs tariff and exemption**s, the Task Force has recommended, besides a zero duty for essential items, 10 percent duty for raw material, inputs and intermediate goods and 20 percent for final goods by 2004-05. Following introduction of State VAT, these duties are proposed to be reduced further to 5 percent (for basic raw materials), 8 percent (for intermediate goods), 10 percent (for finished goods) and 20 percent (for consumer durables) by 2006-07. The Task Force has refrained from suggesting any proposed rates for agricultural products since these products stand on a different footing. Suggesting reduction in multiplicity of levies, it advocates retention of only three types of duties (viz. Basic Customs Duty, Additional Duty of Customs and Anti-dumping/Safeguard duties) with all other duties being removed, with the removal of SAD being linked to implementation of State level VAT. Removal of all exemptions except in case of life saving goods, goods of security and strategic interest, goods for relief and charitable purposes and international obligations, has been recommended as a policy, with upfront budgetary provisions in other cases where relief is justified. End-use based conditional exemption should be avoided and if unavoidable, the confirmation of end-use should be done on the basis of selective post clearance checks by using risk assessment techniques. As a general policy, there should be no exemption from countervailing duty and further there should be a move away from specific rates towards ad valorem rates.

The Task Force has recommended systemic changes in **customs procedures and trade facilitation,** based on modern best-practice which relies on self-compliance, risk analysis and management and is supported by periodic post audits of records. The recommendations in this direction include a universal green channel, expansion of EDI network to all ports and all processes, replacement of verification of declaration through pre-clearance by risk assessment and post clearance audit, introduction of a system of self assessment of bill of entry by the importer, permission to file period bill of entry, and permission to release imported goods at minimum documentation for importers with good track of compliance. Other recommendations for improved customs administration include availability of customs officers on holidays, especially at international airports, so that exports are not held up, framing of export valuation rules, permission for payment of customs duty through cheques, provision for acceptance of Export Obligation Discharge Certificate without delay, expansion of scope of confiscation provisions in respect of export goods to include non-dutiable goods as well as goods not covered under drawback scheme and suitable amendment to the Trade and Merchandise marks Act and the Copyrights Act to empower the Customs officers to enforce IPR. To ensure better service and accountability, suggestions have also been made to streamline the licensing and functioning of Custom House Agents.

Recommending doing away with multiplicity of **export promotion schemes**, the Task Force has identified a viable export strategy to focus on Special Economic Zones (SEZ) and Export Oriented Unit (EOU) schemes for grant of duty exemption on all goods required for export production, Advance Licensing scheme to grant duty exemption to actual users on capital goods, raw material etc. , subject to post clearance intelligence and audit based verifications, and Drawback scheme to provide the mechanism of refund of duties. Access to Domestic Tariff Area (DTA) for EOU/EPZ units using wholly indigenous raw materials is proposed to continue at 50 percent on payment of central excise duty, and for other EOU/EPZ units, 100 percent DTA access to be allowed subject to payment of full customs duty on like goods, as if imported. Improvements suggested in the drawback scheme include expansion in the scope of the scheme to provide for rebate of all duties and on all goods going into export product, modification in software to ensure amount of drawback blocked does not exceed the amount of drawback under dispute, acceptance by the customs of bank realization certificates as proof of realization and payment of penal interest by the Department on delayed drawbacks beyond one week. Duty Exemption Pass Book scheme should be merged with the Drawback scheme from April 1, 2005. Suggestions to facilitate better coordination between the Directorate General of Foreign Trade (DGFT) and the Customs include simultaneous notification of duty exemptions along with the policy announcement, use of EDI technology by DGFT and customs for exchange of information and setting up of an appropriate institutional arrangement to resolve the co-ordination problems between the two. Another important recommendation of the Task force relates to suitable strengthening of independent body such as the Tariff Commission to carry out investigations relating to injury determination, dumping margin, etc. relating to Safeguard duties and Anti-dumping duties.

The Report on direct taxes has recommended continuation of the phase out programme for withdrawal of export related incentives under sections 80HHB, 80HHBA, 80HHC, 80HHE, 80-O, 80R, 80RR and 80RRA. It has also recommends elimination of tax exemption u/s 10A and 10B of the Income Tax Act for all taxpayers other than those engaged in manufacturing computer software.

The proposed reforms in indirect taxes are expected to reduce the transaction costs of Indian exports by around 50 percent, the potential gains to the economy being around Rs.4000-5000 crores per annum. Such reduction in transaction costs is important not only for boosting exports and foreign direct investment but even for creating an appropriate framework for vibrant domestic business.