Merchandise trade

6.13 India's exports have been witnessing robust growth and displaying a tendency of moving to a higher growth trajectory since 2002-03. The sharp recovery witnessed in 2002-03 was further consolidated in 2003-04, with exports registering a growth rate (in US dollar value and on customs basis) of 21.1 per cent on top of a rise of 20.3 per cent in the preceding fiscal (Table 6.4). Volume increase was the main contributor to this strengthening of export performance. Net terms of trade, which had increased on an average by 1.5 per cent per annum in the 1990s, have witnessed a continuous decline since 1999-00. This deterioration in prices of exports relative to imports has been significant in the last two years and seems to have been affected, *inter alia*, by the resurgence in international crude oil prices. However, given the strong growth in exports in volume terms, the income terms of trade, which measure the import purchasing power of exports, has consistently improved during the 1990s (except 1996-97). In the recent past, between 2000-01 and 2002-03, this capacity to import on the basis of exports increased by 10.0 per cent per year. It reflects the growing competitiveness of Indian exports, with volumes increasing with decline in relative unit prices.

6.14 Despite some slowdown in the second half, export growth continues to be buoyant in the current financial year. Exports registered an increase of 25.6 per cent in US dollar terms in April-January 2004-05, substantially higher than the annual target of 16 per cent as well as the rise of 11.7 per cent recorded in the corresponding period of the previous year. Under its newly announced Foreign Trade Policy 2004-09, Government, encouraged by a 20 per cent plus growth rate in three of the last four years, has fixed an ambitious target of US$150 billion for exports by the year 2008-09, implying an annual growth rate in US dollar terms of around 20 per cent, thus doubling the share of India in global exports to 1.5 per cent.

6.15 Both external and domestic factors have contributed to the satisfactory performance of exports since 2002-03. Improved global growth and recovery in world trade aided the strengthening of Indian exports. On the other hand, firming up of domestic economic activity, especially in the manufacturing sector, provided a supporting base for strong sector-specific exports. Recent recovery in international commodity prices and various policy initiatives for export promotion and market diversification seem to

Table 6.4 : Performance of the foreign trade sector
(Annual percentage change)

Year	Export Value in US dollar	Export Growth		Import Value in US dollar	Import Growth		Terms of Trade	
		Volume	Unit Value		Volume	Unit Value	Net	Income
1990-2000	7.7	10.6	8.4	8.3	12.4	7.2	1.5	11.7
1990-95	8.1	10.9	12.6	4.6	12.9	7.6	5.0	16.5
1995-2000	7.3	10.2	4.3	12.0	11.9	6.9	-2.0	7.0
2000-01	21.0	23.9	3.3	1.7	-1.0	8.2	-4.5	18.3
2001-02	-1.6	3.7	-1.0	1.7	5.0	1.1	-2.1	1.5
2002-03	20.3	21.7	0.3	19.4	9.5	10.7	-9.4	10.3
2003-04	21.1	-	-	27.3	-	-	-	-

Source : DGCI&S.

Table 6.5 : Export growth and share in world exports of selected countries

	Percentage growth rate				Share in world exports				2003
Country	1995-01	2002	2003	2004*	2001	2002	2003	2004*	Value $ billion
1. China	12.4	22.4	34.5	35.5	4.3	5.1	5.9	6.2	437.9
2. Hong Kong	3.6	5.4	11.9	16.5	3.1	3.1	3.0	2.9	224.0
3. Malaysia	6.6	6.0	6.5	26.9	1.4	1.5	1.3	1.4	99.4
4. Indonesia	5.7	3.0	5.1	-8.4	0.9	0.9	0.8	0.7	61.1
5. Singapore	4.1	2.8	15.2	25.3	2.0	1.9	1.9	2.0	144.2
6. Thailand	5.9	5.6	17.1	20.9	1.1	1.1	1.1	1.1	80.5
7. India	**8.5**	**13.6**	**15.8**	**28.1**	**0.7**	**0.8**	**0.8**	**0.8**	**57.1**
8. Korea	7.4	8.0	19.3	29.3	2.5	2.5	2.6	2.7	193.8
9. Developing countries	7.9	7.9	18.4	27.0	36.8	37.9	38.7	40.2	2878.1
10. World	5.5	4.8	15.9	21.6	100.0	100.0	100.0	100.0	7439.1

Source: IFS statistics, IMF. * January-August, 2004

have contributed as well. The entrenchment of the growth momentum in the 1990s, the opening up of the economy and corporate restructuring have enhanced the competitiveness of Indian industry. There is a far greater export-orientation of domestic manufacturers; they are pursuing new growth strategies in response to economic reforms. India's exports in recent past have continued to grow at a rate higher than that of world exports or exports from developing countries, except in 2003 when there were large US dollar price changes (Table 6.5). India's share in world exports rose from 0.6 per cent in 1999 to 0.8 per cent in 2003. Currently, India is the 31st leading exporter and 24th leading importer in world merchandise trade.

6.16 The strengthening of Indian exports has been aided by positive trends in global demand, which was also reflected in world trade. After a sharp downturn in 2001, volume growth of world merchandise trade rebounded to 3.0 per cent in 2002 and further increased by 4.5 per cent in 2003 (Table 6.6). The trade recovery in 2003 benefited from strong import demand in developing Asia, the transition

Table 6.6: Growth in volume of world merchandise trade by slected region, 1995-03

(Annual percentage change)

EXPORTS				Region	IMPORTS			
1995-00	2001	2002	2003		1995-00	2001	2002	2003
7.0	-0.5	3.0	4.5	World	7.0	-0.5	3.0	5.0
7.0	-5.5	-2.5	1.5	North America@	10.5	-3.5	4.0	5.5
9.5	2.0	-0.5	4.0	Latin America	10.0	-1.0	-7.0	0.5
6.0	2.0	1.5	0.5	Western Europe	6.0	0.0	0.5	1.5
6.0	1.5	1.0	0.5	European Union (15)	6.0	0.0	0.0	1.5
7.0	8.0	8.0	12.5	C/E. Europe/Baltic States/CIS	7.5	14.5	7.5	11.5
8.5	-4.0	10.5	12.0	Asia	5.5	-1.5	8.5	11.0
4.5	-10.0	8.0	5.0	Japan	4.5	-1.5	1.5	7.0
9.5	-6.5	8.0	9.5	Six East Asian traders	4.0	-7.0	6.5	5.0

Source: International Trade Statistics, 2004 WTO @ Excluding Mexico

economies and the US, with Western Europe and Latin America posting weak import growth due to their sluggish economies. The most dynamic trading regions in 2003 were Asia and the transition economies, recording exports and imports expansion in real terms of 11-12 per cent. US import growth at 5.7 per cent exceeded global trade expansion, thus contributing significantly to mitigating sluggish world trade growth. However, US import growth continued to exceed export growth, further widening its trade deficit. According to World Trade Organization (WTO), real merchandise trade accelerated by nearly 10 per cent in the first half of 2004, and is estimated to have grown in 2004 by 8.5 per cent, or nearly twice as fast as in the preceding year.

6.17 The rebound in world trade was stronger in nominal than in volume terms. Value of world merchandise exports registered a rise of around 16.0 per cent in 2003, two thirds of the rise being attributable to US dollar price changes. Commodity prices and exchange rate changes are estimated to have resulted in a 10.5 per cent strengthening of world merchandise trade prices in US dollar terms, with prices in all the broad categories (viz. fuels, non fuel commodities and manufactured goods) rising in 2003. The impact of price and exchange rate developments on nominal trade flows differed sharply by region. While price changes accounted for most of the nominal increase in exports of Western Europe, due to strong appreciation of these currencies vis-à-vis the dollar, in Asia, price changes accounted for less than one-third of the increase in the US dollar value of the region's merchandise exports. Asia's merchandise trade growth was driven primarily by intra-regional trade, which rose by 20 per cent in 2003. China became the largest market for its Asian neighbours, accounting for 10.1 per cent of Asia's exports, exceeding for the first time the share of Japan (8.8 per cent). In the first half of 2004, commodity prices and exchange rate developments led to an increase in US dollar prices of internationally traded goods at close to 10 per cent, with world merchandise trade increasing by about 20 per cent in value terms. Above-average export growth was reported by the transition economies, Asia and to a lesser extent Latin America. Exports of Western Europe and North America expanded by 18 per cent and 14 per cent respectively, which was less rapid than world exports.

6.18 Trade policy reforms in the recent past, with their focus on liberalization, openness, transparency and globalization, have provided an export friendly environment with simplified procedures for trade facilitation. Such continued trade promotion and trade facilitation efforts of the Government have also aided the current strengthening of export growth. The Union Budget 2004-05 reiterated the policy approach of lowering customs duties in a measured way to align India's tariff structure to those of ASEAN countries. It underlined the need for a special fiscal and regulatory regime for the Special Economic Zones (SEZs), given their role as growth engines that can boost manufacturing, exports and employment. Towards this, a Bill for regulating SEZs, to make India a major hub for manufacturing and exports, is proposed. Other proposals announced in the Budget included: identification of another 85 items to be taken out from the SSI reservation list to provide space to these units to grow into medium enterprises; proposal to set up a Fund for regeneration of traditional employment generating industries (like coir, handloom, handicrafts, sericulture, leather, pottery and other cottage industries) for development of their export potential; abolition of the mandatory Cenvat duty regime and introduction of a new tax regime for the textile sector to make the sector more efficient and competitive; and a proposal to set up a National Manufacturing Competitiveness Council as a continuing forum for policy dialogue to energize and sustain the growth of manufacturing industries and to enhance competitiveness in the manufacturing sector. Various trade facilitation measures announced in the review of credit policy by the RBI in October 2004 included liberalization of guarantee by Authorized Dealers (ADs) for trade credit, relaxation of time limit for export realization for Export Oriented Units (EOUs), relaxation in booking of forward contracts by exporters/importers and undertaking of a fresh survey by RBI for evaluation of the impact of the measures taken by it to reduce the transaction cost for exports. Government also announced, on August 31, 2004, a new Foreign Trade Policy for the period 2004-09, replacing the hitherto nomenclature of EXIM Policy by Foreign Trade Policy (FTP). A vigorous export-led growth strategy of doubling India's share in global merchandise trade in the next five years, with a focus on the sectors having prospects for export expansion and potential for employment generation, constitute the main plank of the Policy (Box 6.3). These measures are expected to enhance international competitiveness and aid in further increasing the acceptability of Indian exports.

Box 6.3 : Highlights of foreign trade policy 2004-09

Objectives and strategy

The new Foreign Trade Policy (FTP) takes an integrated view of the overall development of India's foreign trade and essentially provides a roadmap for the development of this sector. It is built around two major objectives of doubling India's share of global merchandise trade by 2009 and using trade policy as an effective instrument of economic growth with a thrust on employment generation. Key strategies to achieve these objectives, inter alia, include: unshackling of controls and creating an atmosphere of trust and transparency; simplifying procedures and bringing down transaction costs; neutralizing incidence of all levies on inputs used in export products; facilitating development of India as a global hub for manufacturing, trading and services; identifying and nurturing special focus areas to generate additional employment opportunities, particularly in semi-urban and rural areas; facilitating technological and infrastructural up-gradation of the Indian economy, especially through import of capital goods and equipment; avoiding inverted duty structure and ensuring that domestic sectors are not disadvantaged in trade agreements; upgrading the infrastructure network related to the entire foreign trade chain to international standards; revitalizing the Board of Trade by redefining its role and inducting into it experts on trade policy; and activating Indian Embassies as key players in the export strategy.

Special focus initiatives

The FTP 2004 has identified certain **thrust sectors** having prospects for export expansion and potential for employment generation. These thrust sectors include agriculture, handlooms and handicrafts, gems & jewellery and leather and footwear sectors. Sector specific policy initiative for the thrust sectors include, for agriculture sector, introduction of a new scheme called *Vishesh Krishi Upaj Yojana* (Special Agricultural Produce Scheme) to boost exports of fruits, vegetables, flowers, minor forest produce and their value added products. Under the scheme, exports of these products qualify for duty free credit entitlement (5 per cent *of f.o.b* value of exports) for importing inputs and other goods. Other components for agriculture sector include duty free import of capital goods under Export Promotion Capital Goods (EPCG) scheme, permitting the installation of capital goods imported under EPCG for agriculture anywhere in the Agri-Export Zone (AEZ), utilizing funds from the Assistance to States for Infrastructure Development of Exports (ASIDE) scheme for development of AEZs, liberalization of import of seeds, bulbs, tubers and planting material, and liberalization of the export of plant portions, derivatives and extracts to promote export of medicinal plants and herbal products. The special focus initiative for handlooms and handicraft sectors include extension of facilities like enhancing (to 5 per cent of *f.o.b* value of exports) duty free import of trimmings and embellishments for handlooms and handicrafts, exemption of samples from countervailing duty (CVD), authorizing Handicraft Export Promotion Council to import trimmings, embellishments and samples for small manufacturers, and establishment of a new Handicraft Special Economic Zone. Major policy announcements under gems and jewellery sector encompass: permission for duty free import of consumables for metals other than gold and platinum up to 2 per cent of *f.o.b* value of exports; duty free re-import entitlement for rejected jewellery allowed up to 2 per cent of *f.o.b* value of exports; increase in duty free import of commercial samples of jewellery to Rs.1 lakh, and permission to import of gold of 18 carat and above under the replenishment scheme. Specific policy initiatives in leather and footwear sector are mainly in the form of reduction in the incidence of customs duties on the inputs and plants and machinery. The major policy announcements for this sector include: increase in the limit for duty free entitlements of import trimmings, embellishments and footwear components for leather industry to 3 per cent of *f.o.b* value of exports and that for duty free import of specified items for leather sector to 5 per cent

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of *f.o.b* value of exports; import of machinery and equipment for Effluent Treatment Plants for leather industry exempted from customs duty; and re-export of unsuitable imported materials (such as raw hides and skin and wet blue leathers) has been permitted. The threshold limit of designated '*Towns of Export Excellence*' has also been reduced from Rs.1,000 crores to Rs.250 crores in the above thrust sectors.

New export promotion schemes

A new scheme to accelerate growth of exports called '***Target Plus***' has been introduced. Under the scheme, exporters achieving a quantum growth in exports are entitled to duty free credit based on incremental exports substantially higher than the general actual export target fixed. Rewards are granted based on a tiered approach. For incremental growth of over 20 per cent, 25 per cent and 100 per cent, the duty free credits are 5 per cent, 10 per cent and 15 per cent of *f.o.b* value of incremental exports. Another new scheme called ***Vishesh Krishi Upaj Yojana*** has been introduced to boost exports of fruits, vegetables, flowers, minor forest produce and their value added products. Export of these products qualify for duty free credit entitlement equivalent to 5 per cent of *f.o.b* value of exports. The entitlement is freely transferable and can be used for import of a variety of inputs and goods. To accelerate growth in export of services so as to create a powerful and unique '*Served from India*' brand instantly recognized and respected the world over, the earlier duty free export credit (DFEC) scheme for services has been revamped and re-cast into the '***Served from India'*** scheme. Individual service providers who earn foreign exchange of at least Rs.5 lakhs, and other service providers who earn foreign exchange of at least Rs.10 lakhs are eligible for a duty-credit entitlement of 10 per cent of total foreign exchange earned by them. In the case of stand-alone restaurants, the entitlement is 20 per cent, whereas in the case of hotels, it is 5 per cent. Hotels and restaurants can use their duty credit entitlement for import of food items and alcoholic beverages. To make India into a global trading-hub, a new scheme to establish **Free Trade and Warehousing Zone** (FTWZs) has been introduced to create trade-related infrastructure to facilitate the import and export of goods and services with freedom to carry out trade transactions in convertible currencies. Besides permitting FDI up to 100 per cent in the development and establishment of these zones, each zone would have minimum outlay of Rs.100 crores and five lakh sq. mts. built up area. Units in the FTWZs qualify for all other benefits as applicable for SEZ units.

Simplification/rationalization/modifications of ongoing schemes

EPCG scheme has been further improved upon by providing additional flexibility for fulfillment of export obligation, facilitating and providing incentives for technological upgradation, permitting transfer of capital goods to group companies and managed hotels, doing away with the requirement of certificate from Central Excise (in the case of movable capital goods in the service sector) and improving the viability of specified projects by calculating their export obligation based on concessional duty permitted to them. Import of second hand capital goods without any restriction on age has been permitted and the minimum depreciated value for plant and machinery to be re-located into India has been reduced from Rs.50 crore to Rs.25 crore. The new policy has allowed transfer of the import entitlement under Duty Free Replenishment Certificate (**DFRC**) scheme in respect of fuel to the marketing agencies authorized by the Ministry of Petroleum and Natural Gas to facilitate sourcing of such imports by individual exporters. The Duty Entitlement Passbook (**DEPB)** scheme will continue until replaced by a new scheme to be drawn up in consultation with exporters. Additional benefits have been provided to export oriented units (**EOU)**, including exemption from service tax in proportion to their exported goods and services, permission to retain 100 per cent of export earnings in Export Earners Foreign Currency (**EEFC**) accounts, extension of income tax benefits on plant and machinery to DTA units which convert to EOU/Electronic Hardware Technology Park (EHTP)/ Software Technology Park (STP)/Bio-technogy Park (BTP) units, allowing import of capital goods on self-certification basis and permission to dispose of (for EOU in textile and garment manufacture) leftover materials and fabrics up to 2 per cent of *c.i.f* value or quantity of import on payment of duty on transaction value only. Minimum investment criteria has been also waived for brass hardware and hand-made jewellery EOUs (this facility already exists for handicrafts, agriculture, floriculture, aquaculture, animal husbandry, IT and services). The FTP proposes setting up of BTPs by granting all facilities of 100 per cent EOUs. The FTP 2004 has introduced a new rationalized scheme of **categorization of status holders** as Star Export Houses, with benchmark for export performance (during the current and previous three years) varying from Rs 15 crore (for One Star Export House) to Rs 5000 crore (for Five Star Export House). The new scheme is likely to bestow status on a large number of hitherto unrecognized small exporters. Such Star Export Houses will be eligible for a number of privileges including fast-track clearance procedures, exemption from furnishing of bank guarantee, eligibility for consideration under Target Plus Scheme, etc.

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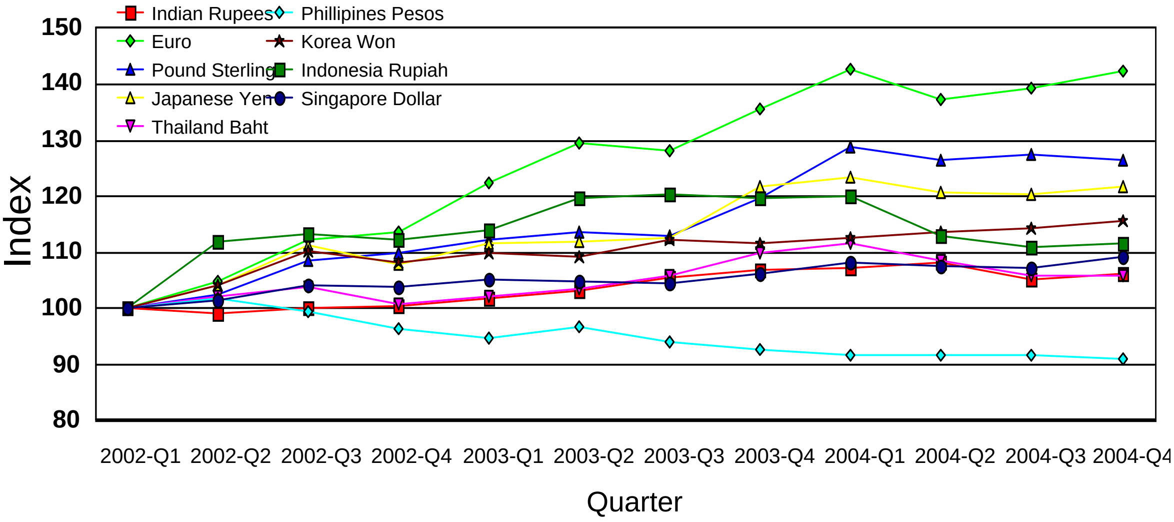
Simplification of rules and procedures and institutional measures

Policy measures announced to further rationalize/simplify the rules and procedures include exemption for exporters with minimum turnover of Rs. 5 crore and good track record from furnishing bank guarantee in any of the schemes, service tax exemption for exports of all goods and services, increase in validity of all licences/entitlements issued under various schemes uniformly to 24 months, reduction in number of returns and forms to be filed, delegation of more power to zonal and regional offices, and time-bound introduction of electronic data interface (EDI). Institutional measures proposed in the FTP 2004 include revamping and revitalizing the Board of Trade, setting up of an exclusive Services Export Promotion Council to map opportunities for key services in key markets and setting up of Common Facility Centres for use of professional home-based service providers in state and district level towns. Pragati Maidan in Delhi is proposed to be transformed into a world class complex, with state-of-the-art, environmentally controlled, visitor friendly exhibition areas and marts. The FTP 2004 also proposes provision to deserving exporters, on the recommendation of the Export Promotion Councils, of financial assistance for meeting the costs of legal expenses connected with trade related matters.

6.19 Vis-à-vis the US dollar, the Indian rupee, which started strengthening from June 2002 onwards, steadily appreciated (except during May to August 2004) by about 12 per cent over the past 32 months (January 2005 over May 2002) on monthly average basis. On an annual average basis, against the US dollar, the rupee appreciated by 5.3 per cent in 2003-04 and further by 2.1 per cent in April-January 2004-05. These movements in the rupee value were smooth and orderly, avoiding any significant adjustment costs to the industry. Given the weakness of the US dollar against most other currencies of the world, the relative appreciation of the rupee was not high (Figure 6.1). The relative appreciation of the rupee has been less pronounced in trade-weighted effective terms. Given the inflation differential, in terms of the Real Effective Exchange Rate (REER), 5-country index with base 1993-94, on an annual basis, the rupee appreciated by 1.8 per cent in 2003-04 and by 1.5 per cent in April-November 2004,.

6.20 Further productivity gains in the export sector require a deepening of domestic reforms, greater use of currency hedging, shift in the pattern of currency invoicing and reduction in tariffs. Constraints like infrastructure bottlenecks, outdated/inflexible labour laws, SSI reservations and high transaction costs need to be attended to

Fig. 6.1 **Indices of exchange rates against US dollar**
(US dollar per local currency) Q1 2002=100



Source : International Financial Statistics, IMF, January, 2005 *2004-Q4 pertains to October-November 2004

urgently to reach the ambitious target of US$150 billion exports by 2008-09. With the importance of sector-specific fiscal incentives reduced in a general atmosphere of declining tariffs and movement towards a WTO-compatible trade regime, export strategy needs to focus more on easing supply side constraints and providing infrastructure and institutional support to exporters. Introduction of a uniform Value Added Tax (VAT) and refund of all state and local levies to exporters will help exports. Exporters need to place more emphasis on non-price factors like product quality, brand image, packaging, delivery and after-sales service. A more aggressive push to foreign direct investment (FDI) in export industries will not only increase the rate of investment in the economy but also infuse new technologies and management practices in these industries. Availability of adequate export credit at competitive rates continues to be another important policy consideration of the Government. However, as per latest available information, so far in 2004-05, there has been a slowdown in export credit growth (Table 6.7). Further, as against a stipulated level of 12 per cent, export credit as a proportion of net bank credit (NBC) has also declined in the last few years from 9.8 per cent on March 24, 2000 to 7.6 per cent on March 19, 2004.

Table 6.7 : Export credit

Outstanding as on	Export credit (Rs crores)	Variations (Per cent)	Export credit as per cent of NBC
March 24, 2000	39118	9.0	9.8
March 23, 2001	43321	10.7	9.3
March 22, 2002	42978	-0.8	8.0
March 21, 2003	49202	14.9	7.4
March 19, 2004	57687	17.2	7.6
October 29, 2004	59222	2.7	–

Source : Report on trends and progress of banking in India, RBI, various issues.

6.21 Contingency trade policy and non tariff measures (NTMs) have become significant barriers to market access to exports from developing countries. Such barriers are considerably stiffer for products with lower value addition and technological content (e.g. agriculture, textiles, and leather products), which are of major interest to developing countries like India. According to one estimate, about 35 per cent of India's total exports to US in value terms faced NTMs in 2002, with their incidence in other developed countries being more or less similar. Use of contingent protection measures like anti-dumping duties and countervailing duties has increased over time, with 105 anti-dumping cases and 40 subsidy cases having been initiated against India so far. Major initiators of these cases against India include European Community, USA, South Africa, Canada and Brazil.

6.22 India, which has been a leading user of the anti-dumping instrument (Table 6.8), has

Table 6.8 : Top ten users of anti-dumping measures, 1995–2004

Country	1996	1997	1998	1999	2000	2001	2002	2003	2004 Jan-June	1995-June 2004
India	**21**	**13**	**27**	**65**	**41**	**79**	**81**	**46**	**4**	**383**
United States	22	15	36	47	47	76	35	37	21	350
European Community	25	41	22	65	32	29	20	7	13	287
Argentina	22	14	8	23	45	26	14	1	7	187
South Africa	33	23	41	16	21	6	4	8	4	172
Australia	17	42	13	24	15	23	16	8	2	165
Canada	5	14	8	18	21	25	5	15	4	126
Brazil	18	11	18	16	11	17	8	4	6	114
Mexico	4	6	12	11	7	5	10	14	3	76
China, P.R	NA	NA	NA	NA	6	14	30	22	11	83
All Countries	**224**	**243**	**256**	**355**	**294**	**366**	**310**	**231**	**101**	**2537**

Source : WTO Secretariat

significantly reduced such new investigations since 2003, with 4 new investigations initiated in the first half of 2004. The countries figuring in these investigations include China PR, Chinese Taipei, Indonesia and Thailand with narrow woven fabric and gypsum plaster board as the products of such investigations. For the full calendar year 2004, India initiated 20 anti-dumping investigations with China PR, Chinese Taipei and EU prominently figuring in these investigations, with chemicals, petrochemicals, pharmaceuticals, fibre/yarn and consumer goods being major product categories of these investigations. As of March 2004, the Directorate of Safeguards had initiated 17 investigations, out of which safeguard duty had been imposed on 10. While trade restrictions on imports from other trading partners is commonplace, trade policy instruments, like export taxes, export bans, regulated exports and supervised exports to restrict exports have also been used by countries to tackle the problem of commodity price instability or to ensure adequate domestic supply of essential goods at reasonable prices (Box 6.4).

Box 6.4 : Export taxes

Declines in prices of some commodities and high price volatility over the years have presented significant challenges for commodity-dependent developing countries. It has often been argued that export taxes can be used to improve the terms-of-trade, smoothen export earnings volatility, foster diversification of the production structure and also as a means of income distribution to the poor. The economic impacts of export taxes on an economy are, however, complex and are not limited to the market of the taxed commodity or to the country imposing the tax. Economic analysis shows that the share of the cost of an export tax that falls on the foreign consumer is higher, the lower the price elasticity of world export demand and higher the price elasticity of supply. But all this is dependent on factors like whether the country which imposes the export tax is a major producer of the item and whether there are substitutes for the item.

Imposition of export taxes to improve terms of trade of the exporting country, while being valid for a “large” country, may be a risky policy for many developing countries (whose exports represent a small fraction of world exports) and may diminish rather than increase national welfare by reducing their export competitiveness. Export taxes have also been justified on infant industry grounds, as export taxes on primary commodities (especially unprocessed) work as an indirect subsidy to higher value added manufacturing or processing industries. However, evidence and theoretical arguments seem to suggest that export taxes on raw commodities may not be a suitable measure to achieve sustained development. Distributional effects, imperfections in internal and international markets and the possibility of negative environmental consequences suggest caution on imposition of such taxes. Export taxes are not usually used these days as a means of Government revenue collection and such revenues are also highly unstable, given the volatility in international prices of commodities, supply fluctuations and variability in real exchange rates. An export tax on commodities might also not benefit poor households, as benefits arising from lower prices might be offset by lower real wages. Today, the most common reasons for which countries are resorting to export taxes are ensuring adequate domestic supply of commodities both for consumption and further processing in the value added chain, conserving precious resources, environmental protection and sometimes as a temporary substitute of the export quotas levied earlier.

Export taxes are not prohibited by the WTO. About one third of WTO members impose export duties. For example, Indonesia applies taxes on palm oil exports and Madagascar on vanilla, coffee, pepper and cloves. Other examples include Mexico on sub-products of endangered species, Guatemala on coffee, Costa Rica on bananas, Mozambique on cashews, Ghana on cocoa, bauxite and manganese, Pakistan on raw/wet blue hides and skins and Malaysia on certain fish, birds eggs, fruit, nut, palm seeds, gums and resins. To ensure availability of raw materials for industries or to promote further processing, Sri Lanka levies export cesses on tea, coconut products, raw hides and skins. Brazil imposes export tax on cashew nuts with shells, tobacco, leather and skins to ensure domestic market supply, Thailand on hides, wood, rubber and metal scrap to protect its environment, Norway on fish and fish products, Canada on Canadian manufactured tobacco, Hong Kong on clothing and footwear, and Turkey on raw skins, hazelnuts and semi processed leather. New Zealand also imposes commodity levies and some recovery charges on some exports. In contrast, on the basis of recognition that export taxes distort trade, many regional trade agreements (like EU and NAFTA) and bilateral trade agreements (like Canada-Chile, Japan-Singapore and EU-Mexico trade agreements) have prohibited export taxes. Export taxes are mainly used by developing and least developed countries (LDCs). According to one recent study, among the 15 LDCs and 30 OECD countries reviewed in the context of the WTO Trade Policy Review Mechanism, 10 LDCs and 3 OECD countries impose export duties. The products on which export taxes are primarily imposed include agricultural products such as sugar, coffee and cocoa, forestry products and leather, hides and skins products. India, which is not a major user of export taxes/duties, maintains export tax on hides, skins, and leathers, tanned and untanned (not including manufacture of leather) to ensure export of high value-added leather goods, and very nominal cesses on certain commodities.

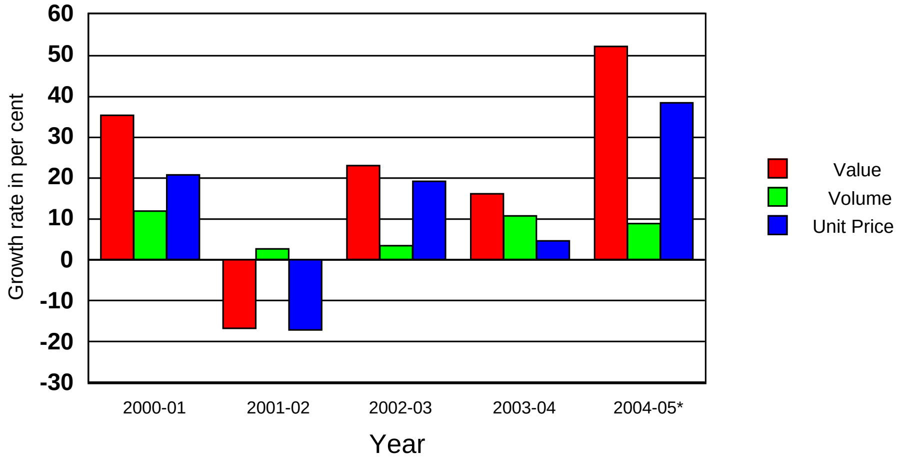
Export taxes have not found favour as these result in overall efficiency losses, reduced welfare and lower growth in the long term, especially for countries without market power. These taxes generate serious economic distortions and disincentives and are poor instruments, from both efficiency and equity standpoint, for encouraging higher value addition activities. In revenue generation, they are likely to be dominated by other tax instruments and should be viewed as a transitional measure at best. Distributional effects, imperfections in internal and international markets and the possibility of negative environmental consequences suggest caution on imposition of such taxes. In this age of liberalization globalization, countries should not resort to exports taxes unless there are very strong and compelling reasons for the same.

6.23 Merchandise imports also displayed strong growth in 2003-04, and rose faster than exports. Lower tariffs, a cheaper US dollar and a buoyant domestic economy boosted imports. Imports, in US dollar terms and on customs basis, increased by 27.3 per cent in 2003-04, on top of a rise of 19.4 per cent in the previous fiscal. Bulk of the increase was contributed by growth in non-oil imports, which shot up from 17.0 per cent in 2002-03 to 31.5 per cent in 2003-04. The acceleration of such imports was mainly due to higher imports of capital goods, industrial raw materials and intermediate goods. It reflected the higher domestic demand and firming up of industrial growth. A significant contributor to the rise in non-POL imports was the 59.9 per cent jump in imports of gold and silver, mainly due to a revival in rural demand on the back of the rebound in agricultural output. But even after excluding these imports, non-oil, non-bullion imports increased by 28.5 per cent in 2003-04, as against a rise of 20.3 per cent in the previous year, indicating a step up in domestic demand and investment. POL imports increased by a moderate 16.6 per cent, mainly on account of increased volume. Larger imports filled the gap between growing demand and stagnant domestic crude oil production.

6.24 Imports continued to surge at a rate faster than that of exports in the current financial year, rising by 34.7 per cent in April-January 2004-05 on back of good industrial performance and rising international crude oil prices. The rise has been contributed by a continuing robust growth in non-POL imports of 32.7 per cent and acceleration in POL imports by 40.1 per cent. The higher non-POL non-bullion imports are indicative of the economy's growing absorptive capacity for imports. These along with rising trends in domestic production of capital goods and strong growth in non-food credit indicate a quickening pace of investment activity during the current fiscal.

6.25 Unlike in 2003-04, the surge in POL imports in the current year is dominated by the price impact (Figure 6.2). International crude oil prices, which have been trending upwards since 2001 with crude oil prices (Brent variety) rising from US$24.4 per barrel in 2001 to US$28.9 per barrel in 2003, and increasing further to US$38.3 per barrel in 2004. The stiffening of global crude oil prices, which peaked in the third week of October 2004 at around $52 per barrel, was contributed by a volatile combination of heightened demand, limited spare capacity and geopolitical threats to the existing capacity.

Fig. 6.2 **Growth in POL imports (value, volume and unit price)**



Source : Ministry of Petroleum and Natural Gas *** 2004-05 pertains to period April-December.**

Crude oil prices have moderated since October 2004 and currently rule around $43 per barrel. The surge in crude oil prices have focused the spotlight on the adverse impact of such volatility in prices on the domestic economy and the need to minimize such an impact. Given India's relatively high oil intensity and increasing dependence on imported crude oil, efforts are being made to diversify sourcing of such imports away from the geopolitical sensitive regions (*See* Chapter 7). Another development has been the decision to build up strategic oil reserves, equivalent of about 15 days requirement, to minimize the impact of crude price volatility in the short term. In a related initiative, India is coordinating with large oil importing countries in Asia, in exploring possibilities for evolving an Asian products marker, in place of an Asian premium, which would reduce the premium paid by Asian countries and thus, to some extent help in controlling the country's oil import bill. However, there is a need to expand domestic production capacity, diversify energy sources and enhance conservation to tackle such energy issues more effectively.

6.26 After a decline of 6.4 per cent in the previous year, gold and silver imports (excluding imports through passenger baggage) picked up sharply by 59.9 per cent in 2003-04, notwithstanding a rise in international bullion prices. These imports seem to have been buoyed up by recovery in domestic demand, on the back of agricultural rebound, and strengthening of the rupee against the US dollar. The duty reduction on imported gold from Rs. 250 to Rs. 100 per 10 gram, and liberalization of such imports as per trade facilitation measures announced in January 2004 may have also provided a demand fillip. Rising international bullion prices, fired by a resurgent Euro and inflationary fears fanned by high crude oil prices, have resulted in a deceleration of these imports from 74.9 per cent in April-October 2003 to 22.8 per cent in April-October 2004. International gold prices, up almost 50 per cent in the last three calendar years, climbed at a 16-year high of US$459 per troy ounce on December 2, 2004. Although bullion prices have moderated since December 2004 to around $420 per troy ounce currently, a weak US dollar and output declines in South Africa, the biggest producer, is likely to support current levels of international gold prices in the near future. To make India a gold trading hub, Government has constituted a committee to examine the regulatory structure of the Indian gold industry. The committee would, *inter alia*, recommend appropriate customs and foreign trade measures required to facilitate manufacturing and trading in gold, particularly now that futures trading in gold has commenced in the country from October, 2003.

6.27 The trade deficit, which reflects excess of imports over exports, has been showing a widening trend in the recent years and stood at a high of US$14.3 billion in 2003-04. With imports continuing to grow at a relatively higher rate, the deficit has increased further by around 68 per cent to US$22.7 billion in April-January 2004-05.