<u>Concept Note</u>

Background

For past many years, India has embarked upon medium-term Foreign Trade Policy (FTP) with an aim to promote the country's exports of goods and services along with employment generation and value addition. Over the years, the exporters' response to FTP across industries contributed significantly to the review of the ongoing export promotion schemes and various exemptions for sourcing of inputs from other countries. The current FTP (2015-2020) is quite comprehensive in its objectives, targets and incentive structures. To a great extent, the objectives and instruments for export promotion in FTP is intertwined with the 'Make in India' initiative. In order to assess the efficacy of various export promotion schemes and identify new priority areas, the Ministry of Commerce and Industry has initiated the mid-term review of FTP with different stakeholders including exporters, traders, industry associations, export promotion councils, commodity boards, concerned ministries, state governments and foreign missions. The major overhaul of the tax regime in the form of GST also prompts early review of the FTP to bring in suitable amendments to the policy so that changes in provisions and procedures can be effectively implemented. In this context, the Minister of Commerce and Industry has advised a mid-term review in place of annual review of FTP so as to ensure better predictability of tax rates and related policy announcements. Further, the exercise of mid-term review is necessary to account for the changes in the circumstances over period and as a measure of mid-term course correction. In continuation of the process the DGFT, Ministry of Commerce jointly with RIS shall hold a day long consultation on 06 May 2017 with senior experts, current and former policymakers and stakeholders from the industry to deliberate on critical dimensions of the FTP and the way forward.

Two years after the introduction of the FTP, the Indian Economy is on the cusp of a take-off reflected in the encouraging growth outlook in the medium term. According to the IMF World Economic Outlook, April 2017 the growth forecast for the Indian Economy in the year 2017 is 7.2 percent which is expected to rise to about 8 percent over the medium term. Such strong possibilities are corroborated by own estimates of the Government of India as well as that of the ADB. The durability of this economic growth is more convincing than ever before given sustained and strong double digit growth in merchandise exports in recent months (and an annual growth rate of 4.7 percent in Dollar terms during April-March 2016-2017 over the previous year). Moreover, the Indian Economy is expected to receive a fresh stimulus once the GST regime is formally launched in the financial year 2017-18.

Contours of Review of the FTP

The major objective of FTP has centered on formulating suitable policy strategies for promoting exports taking into cognizance of the evolving trends in the global economy especially in the major export destinations. In that perspective, the policy typically has several export promotion policies in the form of duty drawback, advance authorization, input tax credit, exemptions, focus market/sector schemes and a few special incentive schemes. Essentially, FTP has short-term and long-term implications for the country’s trade prospects with specific focus on achieving faster export growth. Some trade policy measures have significant tax implications whereas for some others it is insignificant. There is apprehension about the possible impact of the new tax regime once India migrates to the Goods and Services Tax (GST). Undoubtedly, GST will require substantial regulatory and compliance-related changes in the export promotion strategies and procedures. Besides tax-linked schemes there are a number of non-tax schemes which contribute to export promotion without serious revenue implications for the country. Some trade policy announcements like MEIS and SEIS have both short- and long-term implications. In addition, some measures particularly IT applications and trade facilitation are aimed to enhance efficiency in operational procedures and reduce transaction costs. Keeping in mind the various contours of trade policy and their links to the country’s overall economic development agenda, the medium-term review of FTP can be approached from a holistic perspective of improving export competitiveness, expanding exports to new and under-served markets, promoting new entrepreneurs, ensuring significant value addition and so on.

Major Issues

The effectiveness of trade policy depends on the design, scope and timely implementation of various export promotion schemes and incentives. The major issues that need attention of the policy makers are highlighted below:-

(a) Consolidated Schemes like MEIS, SEIS, etc

The current FTP seems to have merged several export promotion schemes into two different schemes for exports of goods and services called as MEIS and SEIS. One advantage of SEIS is to focus on issues relating to exports of services which were not explicitly dealt in the previous FTPs. It is pertinent to assess how robust and effective are those sector-specific schemes and what are the ways those schemes have improved the efficacy of export promotion measures. Further, the lessons of other countries in targeting exports of goods and services separately could be of immense interest for the exporters and industry associations. The FTP was introduced after careful consideration of the external challenges and domestic realties and was meant to provide an enduring strategy for promotion of trade across markets and reduction of transaction costs (through robust measures on trade facilitation and infrastructure development). Experts lauded the FTP as the most significant in the series of earlier FTPs for its most comprehensive yet rationalised approach.

(b) Focus Market/Sector Schemes

Despite significant growth in India's exports over the years, India's current level of trade with some regions and countries is still low. Latin America is one example of the under-served markets for export promotion. Iran is also viewed as a potential market for enhancing exports. In that context, a few focus market programmers like 'Focus LAC' has been introduced in the past. There is a need to examine the contribution of those strategies for expanding country's exports. Similar schemes can be designed for specific sectors like traditional goods, textiles, SME exports, etc. Those geographically-targeted export promotion measures apparently have low tax implications but of significant long-term implications for the country. The issues relating to the adoption and feasibility of such schemes need to be studied further. Rising protectionism in traditional markets and less than satisfactory quality standards in some segments of Indian exports need careful attention and corrections. The FTP has provisions of penalties for erring exporters as per law and has instituted a formal complaint committee to facilitate prompt redressal of quality or other issues avoiding punitive action. New and meaningful avenues of support for export from SMEs like post export issues in foreign markets and easier credit can be beneficial in more than one ways.

(c) Contribution of Duty Drawback, Exemptions and Input Tax Refund Schemes

FTP contains a plethora of schemes having features of duty drawbacks, exemptions and refund. Export Promotion for Capital Goods (EPCG) is one of those schemes. By design, this type of schemes creates a level playing field for the Indian exporters in the international market given high custom duties for some product categories. Those are the standard components of FTP which will continue in the future FTP as well. However, it is imperative to examine the effectiveness of those provisions from the objective of export promotion. In line with other country's experiences, there is a need to assess whether the present structure of exemptions and refund needs to be overhauled or not. By doing so, the government will not only rationalize the tax-lined incentives but also can plug the loopholes that lead to misuse of those schemes.

(d) Rise of Global Value Chains

India has been able to benefit from Global Value Chains (GVCs) in the production and export activities in textiles and apparel and auto component sectors. However, India lags behind in tapping the potential in electronics manufacturing that stands on very specialised global production networks. This sector has strong implications for employment generation as well. Apart from the corrections in duty structures, the government has already taken active policy measures to boost manufacturing in this sector. However, based on dynamic cost structures prevailing globally GVCs offer new opportunities in specialising in key manufacturing activities across sectors. Hence FTPs should be dynamic and responsive to such emerging opportunities. Active policy support should be provided to connect with global and regional hubs in GVC manufacturing and in making export of intermediates cost competitive. At the same time India needs to adopt a dual strategy for competitiveness in labour intensive sectors as well as value addition in high-tech products.

(e) Impact of GST

Exporters and agencies involved in trade would face a number of adjustments once India migrates to the new indirect tax regime, GST. GST will subsume several indirect taxes like excise duty, VAT and other state taxes into a uniform rate applicable across the country. The four-tier GST rates envisaged in the Model GST Law are believed to have differential impact on production and exports in different sectors. Literature on the subject identifies higher incidence of tax burden under the GST regime for exporters of certain sectors. Some sub-sectors of textiles may face adverse effects of GST as the overall tax burden rises after introduction of GST. It operates through the substitution and income effect. While substitution effect in short-term penalizes the producers and exporters of certain sectors, it is expected that the overall efficiency gains and elimination of cascading effects would have positive income effect that neutralizes the substitution effect. In general, GST will favour domestic production as well exporters across different sectors of the economy. Many of those issues can be studied and verified empirically. The exact nature of the impact of GST on exporters needs to be examined properly.

The FTP stands on two main pillars– export incentives and trade facilitation measures. Sound trade facilitation infrastructure has been institutionalised including IT enabled services for issuance of importer/exporter codes; complaint registration; and Electronic Data Interchange (EDI) connecting Customs, Banks and EPCs for reduced documentation and time lag. Importantly, Time Release Studies under WCO guidelines (for effective implementation and monitoring) has been implemented. Handholding schemes for new entrepreneurs like Niryat Bandhu was introduced. Implementation of GST should be able to adequately benefit from such measures. The key component of the success of the GST for promoting exports would be time bound refund so that there are no shadow taxes on exporters. The existing mechanism has to be revised to incorporate changes that may be required to adapt to new tax structures under GST. Moreover the IT enabled services for trade facilitation must be compatible with the larger technology backbone created to support GST implementation called GSTN (Goods and Services Tax Network).

(f) Impact of GST on Sectoral Export Competitiveness

Some of the critical sectors in manufacturing have been held back on their prospects of achieving higher export intensity and competitiveness due to inadvertent inverted duty structures leading to import bias. Introduction of GST is most likely to change that scenario. The earlier special differential excise duty regime for mobile handsets and tablet computers was meant to provide protection against imports. While in some sectors like LCD TVs custom duty has been raised on the final products. However, post GST with lower tax on inputs as well as on such “protected” final products some substitution effect may be visible within the sector. But this may be less severe depending on the final tax rates (income effect). Both sectoral substitution and income effects would depend on the tax rationalisation after GST, depending on current tax structures prevailing in States. On the other hand, with the introduction of GST one has to examine how much additional benefit EPCG would provide to exporters. GST together with EPCG is expected to make domestic capital goods industry more competitive. The impact on the export competitiveness of the pharma sector would depend on relative effective tax rates between APIs vis-a-vis formulations.

(g) Special Incentives

The current FTP continues to have the special schemes like ‘Status Holder’ which incentivizes the performers favorably compared to the ordinary exporters. These schemes are designed with a specific purpose of rewarding the performers for enhancing exports in the future. For instance, Market Access Initiative (MAI) provides support to exporters in exploring market opportunities. Likewise, Niryat Bandhu scheme is aimed at nurturing the new entrepreneurs in different sectors. One Star Export Houses and Units located in the Northeast and J&K receive double weightage for their export performance. In addition, the units located in these two regions enjoy lower export obligation. How relevant are those special incentives when overall trading environment is becoming liberal? There are some special provisions for EOUs, SEZs, deemed exports and so on. SMEs and exporters from NE and J&K were accorded liberal criteria while defining better export performance and associated incentives. It requires more debate whether to widen the scope of these schemes or to restructure their modalities for greater impact and operational efficiency.

(h) International Experience

In order to boost exports, countries adopt various policies, schemes and provide various incentives to the exporters, companies, manufacturers and others. The export incentives can be categorized into tax, non-tax, financial and other incentives. Malaysia provides tax exemptions on statutory income with various thresholds on the value added and zero-rated GST on exports as fiscal incentives. Similarly, Singapore has double tax deduction scheme for overseas business development, Zero-GST warehouses, and GST exemptions for non-dutiable inputs to promote expansion of exports. While Thailand provides tax concessions on export oriented investment projects, Australia gives advanced authorization to exporters in the form of Tradex scheme wherein upfront exemption (condition based) on customs duty and GST paid on goods imported for exporting. Chinese exporters have exemptions and zero-GST in various exported goods.

Export Finance and Insurance Corporation in Australia; China EximBank; China Export and Credit Insurance Corporation (Sinosure) and alike provide financial as well as technical support to companies, manufacturers, and exporters. Apart from financial institutions, governments also create various funds or grants such as Market Development Grant and Service Export Fund in Malaysia, Global Company Partnership Grant and Market Readiness Assistance Grant in Singapore to accelerate the international expansion of SMEs by supporting pre-determined activities focused on helping them in overseas ventures, identification of business partners and overseas market promotion. Furthermore, various tailored services are provided to organizations (seeking to export or expand their export markets) to improve the competitiveness as well as quality of their exports in the international market.