PONDICHERRY UNIVERSITY

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Foreign Trade and Policy

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MBA - INTERNATIONAL BUSINESS

IV - Semester

Authors

- **Prof. Kesawaram**
- **Prof. V. Natarajan**
- **Prof. Gurumurthy**
- **Prof. S. B. Rajendra Prasad**
- **Prof. Pramod Kumar**

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MBA (International Business) - IV Semester **Paper Code: MBIB 4002**

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Foreign Trade and Policy

Objectives

- To understand the policy framework of India which will enhance the conceptual knowledge, and
- Ability to apply the fundamental concepts to apply the fundamental concepts to complex business realties.

Unit - I

International Trade - Theories of foreign trade – absolute and comparative advantage theories; Modern theory of trade – Hecksher- Ohlin theory; Terms of trade; Theory of international trade in services; Balance of payments and adjustment mechanism.

Unit - II

Commercial Policy Instruments - Tariffs, quotas, anti dumping/countervailing duties; Technical standards; Exchange controls and other non-tariff measures.

Unit - III

India's Foreign Trade and Policy - Direction and composition of India's foreign trade; Export – Import policy; Export promotion and institutional set – up; Deemed exports; Rupee convertibility.

Unit - IV

Instruments of Export Promotion - Export assistance and promotion measures; EPCG scheme; Import facilities; Duty exemption schemes; Duty drawback; Tax concessions; Marketing assistance; Role of export houses, trading houses and state trading organizations; EPZs and SEZs & EOUs.

Unit - V

Foreign Investment Policy - Policy and frame work for FDI in India; Policy on foreign collaborations and counter trade arrangements; Indian joint ventures abroad; Project and consultancy exports.

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UNIT - I

Foreign Trade and Policy

Learning Objectives

The main objectives of this unit are:

- To analysis similarities and differences between internal and international trade.
- To provide an overview of various theories in foreign trade.
- To evaluate the terms of trade between the nations.
- To analysis the concept of Balance of Payment and Adjustment Mechanism in Balance of Payment.

Introduction

The international trade has been growing faster than world output indicates that the international market is expanding faster than the domestic markets. There are indeed many Indian firms too whose foreign business is growing faster than the domestic business. Business, in fact, is increasingly becoming international or global in its competitive environment, orientation, content and strategic intent. This is manifested/ necessitated/ facilitated by the following facts: (a) The Competitive business Environment (b)Globalisation of management (c) The universal liberlisation Policy by member countries.

Growth of World Merchandise Exports

Year	Value of merchandise exports (in billions of US $)
1950	55
1960	113
1970	280
1980	1846
1990	3311
2000	6350
2002	6272

Table shows the growth of world merchandise exports. The table indicates that during 1950-60, the value of world exports more than double. In the next decade it increased nearly 2 ½ times. During the 1970s, the value of the world exports increased by about 5 ½ times. Worldwide inflation, particularly the successive hikes in oil prices, significantly contributed to this unprecedented sharp increase in the value of world exports. During 1980-90, the value of world exports increased by 80 per cent. Between 1990 and 2000, it increased by over 90 per cent. In fact, exports of developing countries have been increasing faster than those of the developed.

Historically, trade growth consistently outpaced overall economic growth for at least 250 years, except for a comparatively brief period from 1913 to 1950 characterised by heavy protectionism which was almost a by-product of the two World Wars. Between 1720 and 1913, trade growth was about one-and-a-half times the GDP growth. Slow GDP growth between 1913 and 1950 - the period with the lowest average economic growth rate since 1820 – was accompanied by even slower trade growth, as war and protectionism undermined international trade. This period was also plagued by the great depression.

The Second half of the twentieth century has seen trade expand substantially faster than output. In the last two decades of the twentieth century, world trade has grown twice as fast as world real GDP (6 per cent versus 3 per cent).

That trade has been growing faster than world output means that a growing proportion of the national output is traded internationally. The foreign trade-GDP ratio (i.e., the value of the exports expressed as a percentage of the value of GDP) generally rises with economic development. This ratio has been generally high for the economically advanced countries when compared with that of the less developed countries. However, by the beginning of the 1990s, the developing countries overtook the developed countries in the trade-GDP ratio and today it is substantially high for developing countries over the developed ones. There are some extreme cases like Singapore and Hong Kong with exceptionally high foreign trade-GDP ratio of well over 200 per cent.

Because of the faster trade growth, by the beginning of the 1990s, the developing countries overtook the developed countries in the trade-GDP ratio and today it is substantially high for developing countries over the developed ones. In 2001, the trade-GDP ratio was 38 per cent for high income economies and 49 per cent for the developing countries. The developing countries, thus, are much more integrated than the developed ones with the global economy by trade. Among his developing countries, it was 51 per cent for middle income economies and 39 per cent for low income economies.

India presented an interesting case. There was near stagnation in its foreign trade-GDP ratio for about four decades since the commencement of development planning. During this period it hovered around 15 per cent. The inward looking economic policy, import compression and very slow progress on the export front were responsible for this.

Since the economic liberalization, ushered in 1991, there has, however, been an increase in India's foreign trade-GDP ratio – it is about 20 per cent now. This unit concentrate on the main dimension of foreign trade and policy namely various trade theories, Terms of Trade, Balance of Payments and Adjustment Mechanism in Payments.

Meanings of International Trade

Internal trade or domestic trade refers to the exchange of goods and services between the buyers and sellers within the political boundaries of the same country. It may be carried on either as a wholesale trade or a retail trade. External trade or international trade, on the other hand, is the trade between different countries i.e. it extends beyond the political boundaries of the countries engaged in it. In other words, it is the trade between two countries. Hence, it is also known as foreign trade.

The need for international trade was not so compelling in those days. Trading with nations beyond the seas was not, however unknown to ancient Indians. Evidences about our international trade are found in the ancient literatures of our country particularly in our Sangam Literatures.

There was a regular "Trade Route" across the seas to the distant Jawa and Sumatra islands in the east and up to the Arabian Peninsula in the west. But the volume of such trade was insignificant and continued to remain so tight through the middle ages and up to the advent of the British rule in India. It is only after the establishment of the British rule that India's foreign trade took a definite shape.

International trade on large scale has become a phenomenon of the 20^{th} century especially after the Second World War. There is practically no country today, which is functioning as a closed system.

Even socialist countries like Russia and China are now taking concrete steps to capture foreign markets for the products produced in their country. International trade, thus, has become as essential ingredient of the normal economic life of any country. In terms of economic development, international trade is a potentially effective engine of growth.

Similarities and Differences Between Internal and International Trade

In this section similarities and differences between the internal and international trade are focused. The general procedure, mechanism and operations are similar to both internal trade and international trade. The following are the basic similarities between the two.

1. **Satisfaction of Consumer:** Both in domestic trade and in international trade, success depends upon effectively satisfying the basic requirements of the consumers.

2. **Goodwill Creation:** It is necessary to build goodwill both in the domestic market as well as in the international market. If a firm is able to develop goodwill of the consumers, its task will be much simpler than the one, which is not able to build up its own reputation. In both the cases, the seller should take all positive measures to gain the confidence of the consumers in his product.

3. **Market Research:** The marketing programme should be formulated after a careful market research and survey. This proposition shall hold good in both the cases. Failure to assess the target market shall ultimately bring failure in the task of marketing.

4. **Product Planning and Development:** Research and development with a view to product improvement and adaptation is necessary in both internal and international trade. Particularly. The marketer should keep a constant watch over the market situation and the changes occurring in the consumer's tastes and the preferences and develop or modify his product to suit the needs of his customers.

However, there are certain special features, which differentiate internal trade from international trade. They are explained as following manner:

1. **Demand and Supply:** Demand and supply cannot work out their full effects where foreign trade is concerned. Where as such factors can work out their full efforts in the case of internal trade.

2. **Physical Obstacle to Commerce:** Where international trade is carried on, a far greater degree of inequality between conditions of production in different countries is necessary to stimulate trade when the countries are widely separated than when they are adjoining.

3. **Artificial Barriers to Trade:** The natural difficulties may be increased by artificial barriers to trade, either through prohibitive laws as in war time of through customs duties or protective tariffs in the context of international trade.

4. **Obstacles to Migration of Labour:** Serious obstacles to the migration of labour from country to country such as language differences are often prohibitive, while feelings of patriotism help to keep men in their own country. According to Briggs "For every man who will so change his habits as to go to work abroad, there are a hundred who will move from district to district within a country." Even, though a relatively small migration is necessary to equalise the conditions in two countries neighbouring states may persist for generations is standards of life which are markedly different.

5. **Obstacles of Mobility of Capital:** Men who refuse to leave their own land may invest capital abroad, but a home investment is usually preferred to a foreign. A foreign loan must offer a much higher rate of interest than a home loan. Not only is there a real risk of loss of interest and even capital, but an investor feels a sense of insecurity when money is invested abroad.

6. **Differences in Economic Environment from country to country:** Different countries have different facilities in carrying out their productive activities. Differences in system of national and local taxation, regulations for health, sanitation, factory organisation, education and insurance, policy regarding the transport and public utilities, laws relating to industrial combinations and trade, etc., do exist as between countries. These differences bring about a difference in the costs of production between them.

7. **Currency differences** are still more important because of the fact that exchange is thereby hampered. For instance, if an Indian manufacturer wishes to sell goods in the U.S.A or English, he must know the value of the U.S.A or England currency units in terms of Indian money. Apart form this, each country is under the control of a separate central bank, each following a separate monetary policy which may greatly affect the foreign trade of the country.

8. **The geographical and climatic conditions** may give rise to territorial division of labour and localization of industries. Some countries may have natural resources is abundance such as iron ore, coal, etc., whereas in some other countries climatic conditions give advantages to them.

9. **Long-distance:** International trade is predominantly long-distance. This may affect the transport costs and the mobility of the different factors of production.

10. **Preference**: Preference for home and the prejudice against foreigners remain as one of the major factors that would explain as to why the rates of earning of the different of equal efficiency would not be equalized between different countries.

Gains from International Trade

In this section the various gains of international trade can be listed as follows:

International Specialisation

International trade enables to specialize in the production of those goods in which each country has special advantages. Each country or region is endowed with certain special facilities in the form of natural resources, capital and equipment and efficiency of human powder. Some countries are rich in minerals and in hydroelectric power. Some are blessed with extensive land but have very little population. Some others possess advanced techniques of manufacturing, a very efficient and hard working populations and plenty of capital equipment. In the absence of trade, every country will be forced to produce all types of goods, even those for which they have no facilities for production, International trade, on the other hand, will enable each country to specialize in the commodities in which it has absolute or comparative advantages. Thus, international trade brings about international specialisation and also all other advantages associated with such specialization.

Increased Production and Higher Standard of Living

It is well known that specialization leads to the following:

1. Best utilization of the available resources.
2. Concentration on the production of those goods in which there are advantages.
3. Saving of time and energy in production and perfecting of skills in production.
4. Inventing and using new techniques of production.

All these indicate one basis advantage viz., increased production. Increased production will also mean higher standard of living for people in both the countries. Thus, due to international trade there is a gain for both the countries.

Availability of Scarce Materials

International trade is the only method by which a country can supplement its storage of resources or certain essential materials. There is no country in the world including the U.S.A and the U.K, which has all the resources it requires. At the same time, there are some countries like Indonesia, which have been blessed by nature with some rare materials like rubber and tin. International trade ensures equal access to raw materials for all countries.

Equalisation of Prices between Countries

An important gain of international trade or the effect of it is the tendency of internationally traded goods to have the same price everywhere. A commodity is cheap or costly depending upon its supply. It will be cheap in a country where it is produced with excessive supply of some essential factors; it will be expensive in that country where it cannot be produced or where it can be produced only at a higher cost. Through international trade, supply is increased in the importing country and thereby the price is reduced. In this way there is a tendency for equalisation of prices of all internationally traded goods.

Evolution of Modern Industrial Society

The modern industrial society is based on extensive specialization and large-scale production. Both are based on the size of the market. The larger and more extensive the market for the products, the greater is the degree of specialization and large-scale production. It is for this reason Adam smith started that the division of the labour is limited by the extent of the market. It is through international trade that the markets for products have been expanded to cover the entire world. Hence it is perfectly true to say that the modern industrial society could not have been developed in the absence of international trade.

Adam Smith's Theory of Absolute Differences in Cost

Adam Smith strongly opposed the mercantilism and advocated cause of free trade. He argued that free trade gives the advantage of division of labour and specialization in the international trade. It is the central point of absolute cost advantage theory. Adam Smith says that trade between two nations is based on absolute advantage. When one nation is more efficient than another in the production of one commodity but is less efficient than the other nation in producing a second commodity, then both nations can gain by each specializing in the production of its absolute advantage and exchanging part of its output with the other nation for the commodity of its absolute disadvantage. This process helps in utilizing the resources in the most efficient way and the output of both products will rise. Such an increase in the output measures the gains from specialization in production available to be shared between the two nations through trade.

Let us take an example. Country A is efficient in producing product X but inefficient in producing product Y whereas country B is efficient in production of product Y but inefficient in producing product X. Hence country A has an absolute advantage over country B in the production of product X but as absolute disadvantage in the production of Y. This position is just opposite for country B. Under these circumstances, both countries would gain if each specialized in the production of product of its absolute advantage and traded with the other country. As a result both the products would be produced and consumed in more quantities and both the nations would benefit.

In this respect, nations behave like an individual who produce only that commodity which he can produce most efficiently and exchanges part of his commodity for other commodities he needs. This way, total output and welfare of the individuals are maximized. From the above discussion, it is clear that though mercantilists believed that one nation could benefit only at the expense of another nation Adam Smith believed that all nations would gain from free trade and strongly advocated a policy of laissez-faire i.e. free trade.

Illustration of Absolute Advantage

We shall now look at a numerical example of absolute advantage. Suppose one hour of labour produces five units of product X in India but only tow units in Srilanka. On the other hand, one hour of labour produces six units of product Y in Srilanka but only 3 units in India. It is clearly expressed in Table. It is clear from the above illustration that India is more efficient in the production of product X than Srilanka and Srilanka is more efficient or has an absolute advantage over India in the production of product Y. Hence India would specialize in the production of X and exchange part of if for product Y of Srilanka and vice versa.

Absolute Advantage

Product	No. of Units Produced per Labour Hour		Domestic Exchange Ratio
	India	Srilanka	
X	5	2	5: 2
Y	3	6	3: 6 or 1: 2

Criticisms of Adam Smith's Theory

Simple theory of absolute cost advantage is based on labour theory of value which is unrealistic. It is based on perfectly mobile, homogeneous units of labour between different lines of production. It cannot explain how trade takes place even when one of the trading countries does not have absolute cost advantage in both the commodities compared to the other country. This was taken up by David Ricardo who gave the principle of comparative cost advantage as the basis for trade.

David Ricardo's Theory of Comparative Cost

Comparative cost advantage theory of international trade was developed by the British economics in the early 19th century. In the year 1817 David Ricardo published his 'Political Economy and Taxation' in which he presented the Law of Comparative cost Advantage. As in the absolute cost advantage theory, this theory also says that international trade is solely due to differences in the productivity of labour in different countries. Absolute cost advantage theory can explain only a very small part of world trade such as trade between tropical zone and temperate zone or between developed countries and developing countries.

Most of the world trade is between developed countries that are similar with respect to their resources and development which is not explained by absolute cost advantage. The basis for such trade can be explained by the law of comparative advantage. In the following subsection, assumptions and illustrations of Ricardian Theory is explained.

Assumption of the Ricardian Theory

We can begin the analysis by listing the number of assumptions required to build the theory

1. Each country has a fixed endowment of resources and all units of each particular resource are identical.
2. The factors of production are perfectly mobile between alternative productions within a country. This assumption implies that the prices of factors of production are also the same among alternative uses.
3. Factors of production are completely immobile between countries.
4. Labour theory of value is employed in the model. The relative value of a commodity is measured solely by its relative labour content.
5. Countries use fixed technology though there may be different technologies in different countries.
6. The simple model assumes that production is under constant cost conditions regardless of the quantity produced. Hence the supply curve for any goods is horizontal.
7. There is full employment in the macro-economy.
8. The economy is characterized by perfect competition in the product and market.

9. There is no governmental intervention in the form of restriction to free trade.

10. In the basic model, transport costs are zero.

11. It is a two-country, two-commodity model.

Ricardian theory can be explained using an example. Let us suppose that there are two countries A and B producing cloth and wine. Table gives labour hours required for the production of one unit of two commodities in the two countries.

Illustration of Comparative Cost Advantage

Country	Cloth	Wine	Price Ratios
Country A	1 hour per unit	3 hours per unit	1 unit of wine: 3 units of cloth
Country B	2 hours per unit	4 hours per unit	1 unit of wine: 2 units of cloth

Table shows that country A has absolute cost advantage in the production of both the commodities. This is shown by lesser labour hours required in the production of cloth and wine which is 1 hour per unit of cloth and 3 hours per unit of wine. This is lesser than 2 hours per unit of cloth and 4 hours per unit of wine as required in country B. Even then trade between the two countries can be mutually advantageous so long as the difference in comparative advantage exists between the productions of two commodities. The example shows that country A is twice as productive as country B in cloth production whereas in wine production it is only 4/3 times as productive as the country B. Hence country A has higher comparative advantage in cloth production. Country B has comparative advantage in wine because its relative inefficiency is lesser in wine. It is half as productive in cloth while in wine the difference in labour productivity is only 1/3 minus 1/4, which is much less than ½

International trade is mutually profitable even when one of the countries can produce every commodity more cheaply than the other. Each country should specialize in the product in which it has a comparative advantage that is greatest relative efficiency. When trade takes place between the two countries, the terms of trade will be within the limits set by the internal price ratio before trade. For both countries to gain, the terms of trade should be somewhere between the two countries internal price ratios before trade.

Country A gains by getting more than one unit of wine for every 3 units of cloth and country B gains by getting something more than 2 units of cloth for every one unit of wine. The actual terms of trade will depend upon comparative strength of elasticity of demand of each country for the others product.

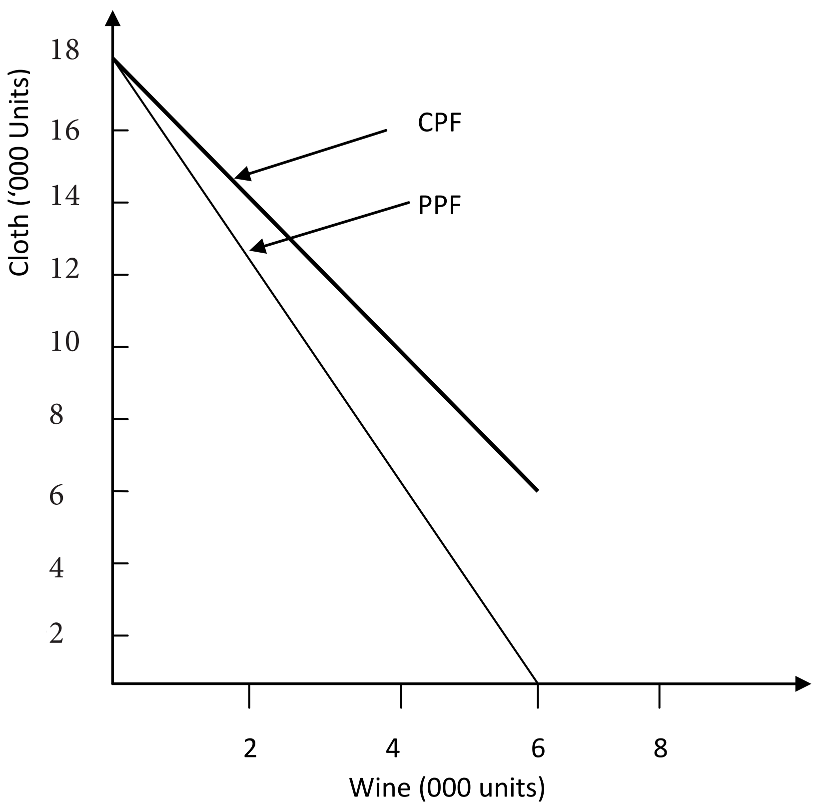
Illustration of Ricardian Theory with Production Possibility Frontiers

Production Possibility Frontier (PPF) reflects all combination of the two products that the country can produce under certain conditions. These conditions are:

1. The total resources are finite and known.
2. The resources are fully employed.
3. The technology is given.
4. The production is economically efficient, that is with the least cost combination of inputs.
5. The costs are constant implying opportunity cost is the same at various level of production. PPF is hence a straight line whose slope is given by opportunity cost of one product in terms of the other.

Country A's resources are given at 18,000 labour hours with price ratio of 1 unit wine: 3 units of cloth. Country A can produce either 18,000 units of cloth and 0 units of wine or 6,000 units of wine and 0 units of cloth.

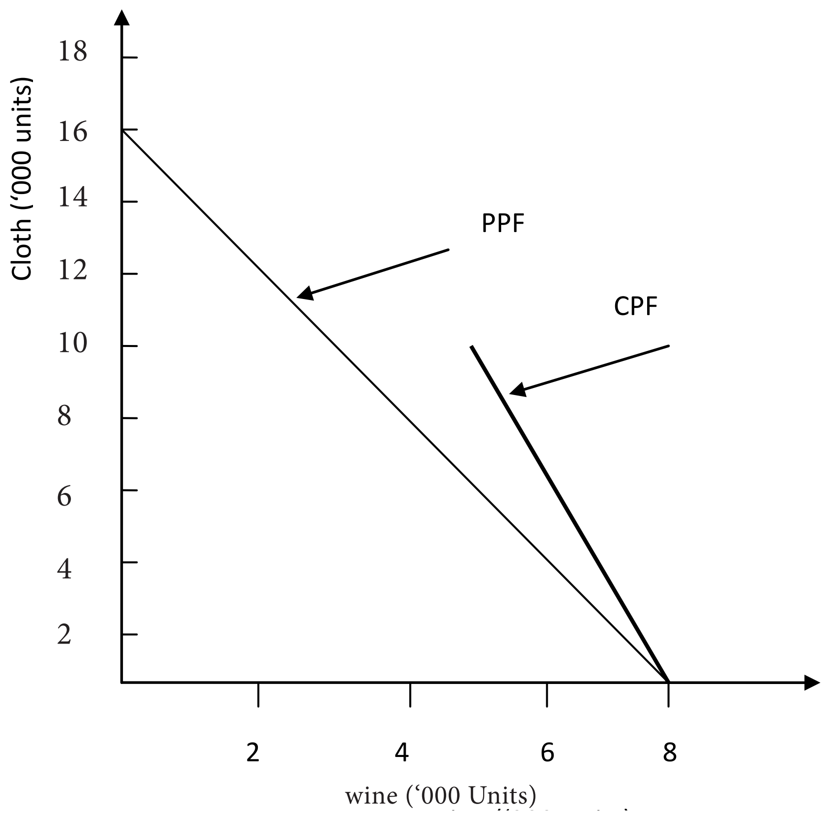
Production Possibility Frontier for Country A



Country A	
Units of cloth	Units of wine
18,000	0
12,000	2,000
9,000	3,000
6,000	4,000
3,000	5,000
0	6,000

Country B has resource constraint to the extent of 32,000 labour hours and the price ratio is 1 unit of wine: 2 units of cloth. It can produce 16,000 units of cloth and 0 units of wine or 8,000 units of wine and 0 unit of cloth

Production Possibility Frontier for Country B



The extent to which the citizens of the country can consume in aggregate is given by the consumption possibility frontier. When the countries do not involve in trade they can consume what are produced in the country. Therefore the consumption possibility frontier overlies the production possibility frontier. When the countries are exposed to international trade, country A can specialize in the production of cloth and export it for wine at the rate of say 1 unit of wine: 2.5 units of cloth which means it will get more than 1 unit of wine for

3 units of cloth that it has to give. This expands its consumption possibility frontier beyond its production possibility frontier. Country B can specialize in the production of wine and exchange 1 unit of wine for something more than 2 units of cloth that it gets internally.

Country B	
Units of cloth	Units of wine
16,000	0
14,000	1,000
12,000	2,000
10,000	3,000
8,000	4,000
6,000	5,000
4,000	6,000
2000	7,000
0	8,000

Under the assumed trade price ratio of 1: 2.5 between wine and cloth, the toral gain is 400 units of wine for country A and 3,000 units of cloth for country B. The gain for individual countries will differ depending upon the trade price ratio. However, the point remains that both the countries gain from trade.

Gains from Trade with Terms of Trade

(After trade price ratio 1 wine: 2.5 cloth)

		Cloth (Units)	Wine (Units)
Country A			
Before trade	Production	12,000	2,000
	Consumption	12,000	2,000
After trade	Production	18,000	0
	Consumption	12,000	2,400
Country B			
Before trade	Production	12,000	2,000
	Consumption	12,000	2,000
After trade	Production	0	8,000
	Consumption	15,000	2,000

Evaluation

Evaluation of the theory of comparative advantage can be made on two ground-one with regard to the assumptions made by the model and the other with respect to empirical evidence available in support of the theory.

Criticisms of the Assumptions

1. **Two × Two model:** Ricardian theory of comparative advantage is based on the assumptions of two commodities and two countries. This is not a serious limitation and is made purely for simplifying the exposition of the theory. The principle behind the theory holds good even when more than two countries and more than two commodities are involved. However generalizing the analysis to cover many countries and many commodities at the same will make the treatment cumbersome and difficult.

2. **Constant costs:** Assumption regarding constat cost conditions will lead to complete specialization. When this is released to consider increasing cost conditions, the principle of comparative advantage may not lead to complete specialization but to a situation of partial specialization. In that case countries will specialize in the commodity in which they have a comparative advantage but nevertheless will produce the other commodity also.

3. **No transport cost:** Absense of transport cost in determining comparative advantage is again not a crucial assumption. Even when this assumption is released the theory will hold good. The costs can be redefined to include transport cost and comparative advantage can be assessed on the basis of such costs. Of course this will reduce the scope for the presence of comparative advantage in many commodities for many countries and this explains why every country has a lot of non-traded commodities.

4. **Trade Restrictions:** Though in the real world absence of government intervention in the form of protective tariff on quota is hard to find, such restrictions definitely reduce scope for free trade on the basis of comparative advantage.

5. **Labour theory of value:** Ricardian theory is basically criticized for one main reason-that it is based on labour theory of value. This limitation has been removed by later theories of international trade. For example, Haberier uses the concept of opportunity cost and shows how difference in opportunity cost in production between countries forms the basis of international trade.

6. **Emphasis on supply:** Ricardian theory clearly shows that free trade results in mutual benefit for the trading countries. However, it does not show the exact terms of trade between the two commodities traded which will determine the extent of the respective gains from trade.

7. **Changes in tastes and differences:** Ricardian theory does not explain the possibility of trade occurring because of differences in tastes and preferences between people in two countries

Haberler's Theory of Opportunity Cost in International Trade

Professor Gottfried Haberier propounded the opportunity cost theory in 1993. According to the opportunity cost theory, the cost of the commodity is the amount of the second commodity that must be given up to release just enough resources to produce one additional unit of the first commodity. Like comparative cost theory, here assumptions like labour is the only factor of production, labour is homogeneous, or cost of commodity depends on its labour content only etc. are not made. As a result, the nation with the lower opportunity cost in the production of commodity has a comparative advantage in that commodity (i.e. comparative disadvantage in the second commodity). Thus the exchange ratio between the two commodities is expressed in terms of their opportunity costs.

Assumptions of Opportunity Cost Theory

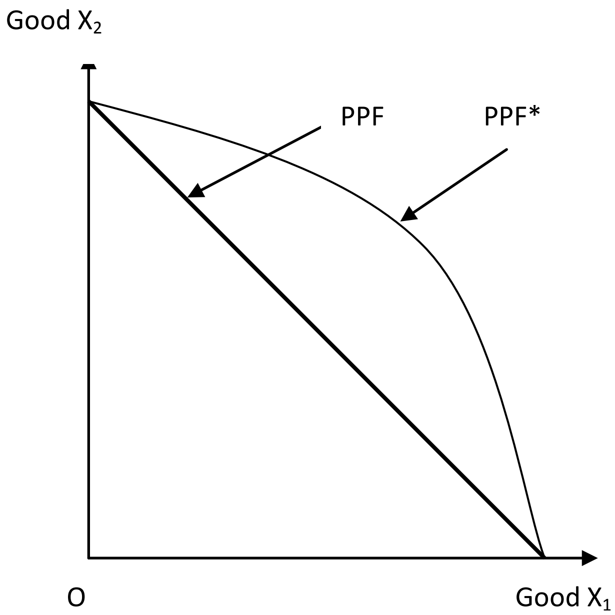
Haberler makes the following assumptions for his theory.

1. There are only two nations.
2. There are only two commodities in both the nations.
3. There are only two factors of production such as labour and capital in both the nations.
4. There is perfect competition in both the factor and commodity markets.
5. The price of each commodity equals its marginal money costs.
6. In each employment, the price of each factor equals its marginal value productivity.
7. Supply of each factor is fixed.
8. In each country there is full employment.
9. No change in technology.
10. Factors are not mobile between two countries.
11. Within countries factors are totally mobile.
12. There is free and unrestricted trade between the two countries.

Haberier demonstrated his theory by constructing a simple diagram that is called Production Possibility Frontier which shows the trade-offs that an economy faces between producing any two products.

The community can produce either one of the goods or some combination of the two. The curve shows the additional amount of one good that can be obtained by foregoing a particular quantity of the other.

Illustration of Opportunity Cost Using PPF



We have drawn two production possibility frontiers-one linear Production possibility frontier, PPF and the other non-linear production possibility frontier, PPF* which is concave. The slope of any production possibility frontier is the opportunity cost of X_1 in terms of X_2.

In the linear case the slope is constant. In case of concave production possibility frontier, the opportunity cost changes as we change the combinations of X_1 and X_2. The concave curve, PPF* shows that the more that is produced of X_1 the more and more we have to give up of X_2. In other words, opportunity cost of X_1 in terms of X_2 increases.

Opportunity Cost

The opportunity cost is defined in terms of the alternative use of the resources. The minimum amount of Good X which has to be given up for producing an additional unit of Good Y is called the opportunity cost of Good Y in that country.

Labour Requirements per Unit of Output

	Country A	Country B
Commodity X	4	6
Commodity Y	2	12

The concept of opportunity cost is explained with hypothetical figures in Table. In country A labour coefficients for commodity X and Commodity Y are 4 and 2 respectively. In country B the corresponding figures are 6 and 12. How many units of commodity X should country A give up in order to produce one more and of commodity Y? It is half a unit of X. This is the opportunity cost of producing Y in terms of X in country A. Compare this with the position in country B. How many units of X should country B give up in order to produce one more unit of Y? The answer is 2 units. Hence the opportunity cost of producing Y in terms of X in country B is 2.

It should be noted here that opportunity cost of X in terms of Y is the reciprocal of opportunity cost of Y in terms of X. For example, in country A opportunity cost of X in terms of Y is 2 and in country B the opportunity cost of X in terms of Y is ½.

Comparative Cost Defined in Terms of Opportunity Costs

It follows that country A has comparative advantage in the production of Y, because opportunity cost of Y in terms of X is lower in country A than in country B. On the other hand, country B has a comparative advantage in the production of X the opportunity cost of X in terms of Y (2 × ½) is lower in country B than in country A.

Once comparative advantage is defined in terms of opportunity cost, It makes no difference whether commodities are actually produced by labour alone. Thus classical conclusion is saved. Hence opportunity cost theory is useful to strengthen Ricardian conclusions.

Critical Appraisal

The critical appraisal of Haberler's opportunity cost theory can be discussed under two heads namely,

1. Superiority over comparative cost theory, and
2. Criticisms.

1. Superiority over Comparative Cost Theory

Haberler's opportunity cost theory is regarded as superior to the comparative cost theory of international trade formulated by the classical economists like Adam Smith and David Ricardo. The arguments put for the superiority are summarized below:

1. **Dispenses with the Unrealistic Assumption of Labour Theory of Value:** The classical theory is based on the unrealistic assumption of labour theory of value. But Haberler's opportunity cost theory dispenses with such unrealistic assumption and is more realistic.
2. **Analyses the Pre-trade and Post-trade situations Completely:** The opportunity cost theory analyses pre-trade post-trade situations under constant, increasing and decreasing opportunity costs, whereas the comparative cost theory is based on the constant cost of production within the country with comparative advantage and disadvantage between the two countries. Hence, Haberler's opportunity cost theory is considered to be more realistic over the classical theory.
3. **Highlights the Importance of Factor Substitution:** The opportunity cost theory highlights the importance of factor substitution in trade theory. It is vital in the production process especially for a growing economy.
4. **Facilitates the Easy Measurement of Opportunity Cost:** The opportunity cost can be measured easily.
5. **Explains the Time, Reason etc. about Trade:** The opportunity cost theory explains why trade takes place or when it should take place, showing how the gains shared between the countries etc.
6. **Explain about the Complete Specialisation:** It explains when complete specialization is possible and when it is not possible etc.

2. Criticisms

Haberler's opportunity cost theory is also not free from criticisms. It has been vehemently criticized by Jacob Viner in his "Studies in the Theory of International Trade (1937)". Some of the important criticisms are listed down below:

1. **Inferior as a Tool of Welfare Evaluation:** Jacob Viner says that opportunity cost approach is inferior as a tool of welfare analysis when compared to classical real cost approach. Further he says that the doctrine of opportunity cost fails to measure real costs in the form of Sacrifices or Disutilities.

2. **Fails to consider Changes in Factor Supplies:** Viner further criticizes that the production possibility curve of opportunity cost theory do not consider changes in the factor supplies.

3. **Fails to consider Preferences for Leisure against Income:** Viner also criticizes the opportunity costs theory on the ground that the production possibility curve does not take into account the preference for leisure against income.

4. **Unrealistic Assumptions:** Haberier's opportunity cost theory is based on many assumption like two countries, two commodities, two factors, perfect competition, perfect factor market, full employment, no technical change etc. All these assumptions are unrealistic because they do not hold in the real word.

Heckscher-Ohlin's Theory or Modern Theory of International Trade

Brtil Ohlin criticized classical theory of international trade. He was discounted with David Ricardo's comparative cost theory. He argued that David Ricardo's comparative and theory is incomplete because David Ricardo fails to explain how the comparative cost difference takes place.

He also accepts that the comparative cost difference is the basis for international trade. So he tried to explain the reason of comparative cost difference through his theory known as "General Equilibrim theory". It is otherwise known as "Modern theory of International Trade".

According to the Heckscher-ohlin theory the main determinant of pattern of production, specialisation and trade among regions is the relative availability of factor endowments and factor prices. Different regions/countries have different factor endowments and factor prices. Some countries have plenty of capital whereas others have plenty of labour.

Heckscher-ohlin theory states "Countries which are rich in labour will export labour intensive goods and countries which have plenty of capital will export capital-intensive goods". Ohlin says that the immediate reason for international trade is always that some goods can be purchased more cheaply from other regions.

While in the same region their production is not possible due to high prices. In other words, the main reason for trade between regions is the difference in the prices of goods based on relative factor endowments and factor prices.

Assumptions of Heckscher-Ohlin Theory

The Heckscher-Ohlin theory makes the following assumption:

1. There are two countries, say A and B.
2. There are two commodities, say X and Y.
3. There are two factors of production such as labour and capital.
4. There is perfect competition in both the commodity as well as factor markets.
5. Country A is labour-abundant and B is capital-rich.
6. There is full employment of resources.
7. There is perfect mobility of factors within the country but between countries they are immobile.
8. There is no change in technology i.e. both the countries use the same technology.
9. The technique used for the production of each commodity is same in both the countries whereas the technique for different commodities is different.
10. There are no transportation costs.
11. There is free and unrestricted trade between the two countries.
12. There are constant returns to the scale.
13. Demand pattern, tastes, preferences etc. of consumers are same in both the countries.
14. International transactions are confined only to commodity trade.
15. There is partial specialization. That is neither country specializes in the production of one commodity.

Explanation of Heckscher-Ohlin Theory

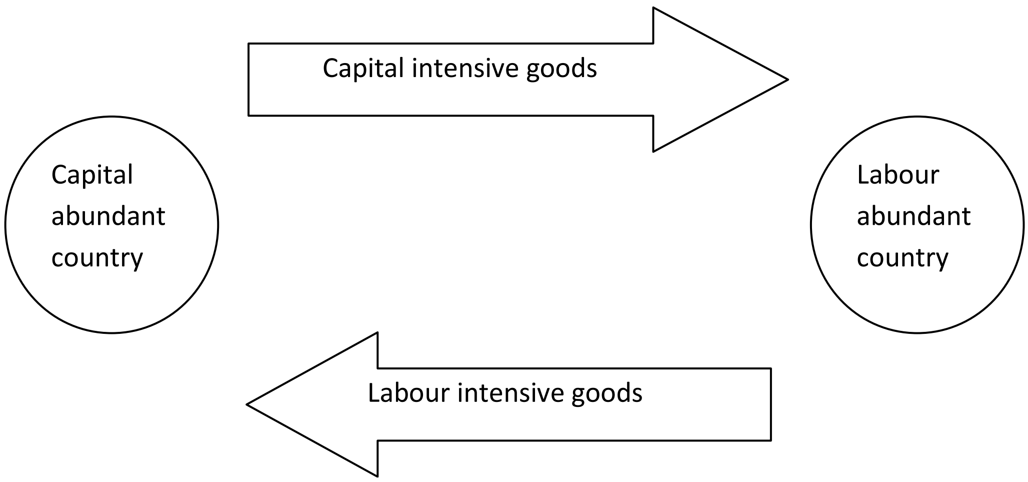
With the above stated assumptions, Heckscher and Ohlin contended that the immediate cause of international trade is the difference in relative commodity price caused by differences in relative demand and supply of factors on account of differences in factor endowments between the two countries. Basically, the relative scarcity of factors i.e. the shortage of supply in relation to demand is essential for trade between two regions. Normally commodities that require large quantities of scarce factors are imported because their prices are high whereas commodities, which use abundant factors, are exported because their prices are less.

The Heckscher-Ohlin theory states that a country will specialize in the production and export of goods whose production requires a relatively large amount of the factor with which the country is relatively well endowed. In the Heckcher-Ohlin model, factors of production are regarded as scarce or abundant in relative terms and not in absolute terms. That is, one factor is regarded as scarce or abundant in relation to the quantum of other factors. Hence, it is quite possible that even if a country has more capital, in absolute terms, than other countries, it could be poor in capital. A country can be regarded as richly endowed with capital only if the ratio of capital to other factors is higher when compared to other countries.

(i) In country A:	Supply of labour	=	25 units
	Supply of Capital	=	20 units
	Capital-labour ratio	=	0.8
(ii) In country B:	Supply of labour	=	12 units
	Supply of capital	=	15 units
	Capital-labour ratio	=	1.25

In the above example, even though country A has more capital in absolute terms, country B is more richly endowed with capital because the ratio of capital to labour in country A (0.8) is less than in country B (1.25).

Pattern of Trade under Heckscher-Ohlin Model



Evaluation of Factor Endowment Theory

1. The Heckscher-Ohlin theory rightly points out that the immediate basis of international trade is the difference in the final price of a commodity between countries, although the actual basis of ultimate cause of trade is comparative cost difference in production. Thus, the Heckscher-Ohlin theory provides a more comprehensive and satisfactory explanation for the existence of international trade.

2. The Heckscher-Ohlin theory is superior to the comparative cost theory in another respect. The Ricardian theory points out that comparative cost difference is the basis of international trade, but it does not explain the reasons for the existence of comparative cost differences between nations. The Heckscher-Ohlin theory explains the reasons for the differences in the cost of production in terms of differences in factor endowments. This is another aspect that makes it superior to the Ricardian analysis.

3. Further, Heckscher and Ohlin make it very clear that "international trade is but a special case of inter-local or inter-regional trade" and hence there is no need for a special theory of international trade. Ohlin states that regions and nations trade with each other for the same reasons that individuals specialize and trade. The comparative cost differences are the basis of all trade – inter-regional as well as international. Nations, according to Ohlin, are only regions distinguished from one another by such obvious marks as national frontiers, tariff barriers and differences in language, customs and monetary systems.

4. The modern theory of trade is also called the General Equilibrium theory of international trade because it points out that the general demand and supply analysis applicable to inter-regional trade can generally be used without substantial changes in dealing with problems of international trade.

5. Another merit of the Heckscher-Ohlin theory is that it indicates the impact of trade on product and factor prices.

6. The Heckscher-Ohlin theory indicates that international trade will ultimately have the following results:

   (1) Equalisation of Commodity Prices: International trade tends to equalize the prices of internationally traded goods in all the regions of the world because trade causes the movement of commodities from area where they are abundant to areas where they are scarce. This would tend to increase commodity due to the redistribution of commodity supply between these two regions as a result of trade, international trade tends to expand up to the point where prices in all regions become equal. But perfect equality of prices can hardly be achieved due to the existence of transport costs and due to the absence of free trade and perfect competition.

   (2) Equalisation of Factor Prices: International trade also tends to equalize factor prices all over the world, International trade increases the demand for abundant factors (leading to an increase in their prices) and decrease the demand for

scarce factors (leading to a fall in their prices) because when nations trade, specialization takes place on the basis of factor endowments. But, in reality, the presence of a number of imperfections make the achievement of perfect equality in factor prices impossible.

Criticisms of the Heckscher-Ohlin Theory

Though the Heckscher-Ohlin theory has been found to be more precise, scientific and superior to the classical theory of international trade, it has also been criticized by many writers on the following grounds.

1. **Over Simplified Assumptions:** The Heckscher-Ohlin theory is based on over simplified assumptions such as perfect competition, full employment of resources, identical production function, constant returns to scale, absence of transportation costs and absence of product differentiations. Hence, it is considered as an unrealistic model.

2. **Static analysis:** The Heckscher-Ohlin theory investigates the pattern of international trade in a static setting. Hence the conclusions arrived at from such analysis will not be relevant to a dynamic economic system.

3. **Assumption of Homogeneous Factors:** The Heckscher-Ohlin theory assumed the existence of homogeneous factors in the two countries which can be measured for calculating factor endowment ratios. It is highly unrealistic because in practice no two factors are homogeneous qualitatively between the countries.

4. **Assumption of Homogeneous Production Techniques:** The Heckscher-Ohlin theory assumed that the production techniques for each commodity in both the countries are similar. This is also highly unrealistic because production techniques are different for the same commodity in the two countries.

5. **Unrealistic Assumption of Identical Tastes and Demand Patterns:** The Heckscher-Ohlin theory unrealistically assumes that the tastes and demand patterns of consumed are the same in both the countries. But in practice it is not true. Tastes and demand patterns of consumers of different income groups are different. Further, due to the inventions taking place in consumer products, changes in tastes and demand patterns of consumers also occur. Hence, tastes are not similar in trading countries.

6. **Assumption of Constant Returns to Scale:** The Heckscher-Ohlin theory unrealistically assumed that the returns to scale are constant because a country

having rich factor endowments often gets the advantages of economics of scale through lesser production and exports. Thus there are increasing returns to scale rather than constant returns.

7. **Ignores Transport Costs: The** Heckscher-Ohlin theory does not take into account transport costs in trade between two countries. This is another unrealistic assumption. When transport costs are included, they lend to difference in price for the same commodity in the two countries, which affect their trade relations.

8. **Neglects Product Differentiation:** The Heckscher-Ohlin theory overlooked the role played by product differentiation in international trade. It related cost to factor prices and neglected the influence of product differentiation on international trade. Hence, Heckscher-Ohlin theory is regarded as faulty.

9. **Assumes Relative Factor Proportions Determine the Specialisation in Exports:** The Heckscher-Ohlin theory states that the relative factor proportions determine the specialization in export of different countries. It says that capital rich countries will export capital-intensive goods and labour rich countries will export labour-intensive goods. But it is not true. In fact, specialisation is governed not only by factor proportions but also by various other factors like cost and price differences, transport costs, economies of scale etc.

10. **Only Part of the Partial Equilibrium Analysis:** Haberler regarded Ohlin's theory as less abstract. But, it has failed to develop a general equilibrium concept. It remains by and large, a part of the partial equilibrium analysis. It tries to explain the pattern of trade only on the basis of factor proportions and factor intensities, and several other influences are totally ignored.

11. **Ignores Factor Mobility:** The Heckscher-Ohlin theory assumed that factors are immobile internationally. This assumption is wrong because, the international mobility of factors of production actually more than the inter-regional mobility within a country.

12. **Vague Theory:** The Heckscher-Ohlin theory depends upon various restrictive and unrealistic assumption. Hence it is considered as a vague and conditional theory. To quote with Haberler, "with many factors of production, some of which are qualitatively incommensurable as between different countries, and with dissimilar production functions in different countries, no sweeping a priori generalization concerning the composition of trade are possible".

Terms of Trade

Terms of trade are an important measure to evaluate gains to individual countries from international trade. In International Economics, terms of trade refer to the ratio index of export prices to import prices, In other words, it is the ratio at which a country's exports are exchanged for imports.

Different Concepts of Terms of Trade

Gerald M. Meier has classified the different concepts of terms of trade into the following three categories:

1. **Those that relate to the ratio of exchange between commodities:**
   (a) Net barter terms of trade
   (b) Gross barter terms of trade, and
   (c) Income terms of trade
2. **Those that relate to the interchange between productive resources:**
   (a) Single factoral terms of trade, and
   (b) Double factoral terms of trade
3. **Those that interpret the gains from trade in terms of utility analysis:**
   (a) Real cost terms of trade, and
   (b) Utility terms of trade.

Net Barter Terms of Trade: Net barter terms of trade, also called the commodity terms of trade, measure the relative changes in the import and export prices and is expressed as,

$$N = Px/Pm$$

Where Px and Pm are price index numbers of exports and imports, respectively.

Gross Barter Terms of Trade: Taussig introduced the concept of gross barter terms of trade to correct the commodity or net barter terms of trade for unilateral transactions, or exports or imports which are surrendered without compensation or received without counter payment, such as tributes and immigrants' remittances. The gross barter terms of trade in the ratio of the physical quantity of imports to physical quantity of exports. It may be expressed as,

$$G = Qm/Qx$$

Where Qm and Qx are the volume index numbers of imports and exports, respectively. A rise in G is regarded as a favourable change in the sense that more imports are received for a given volume of exports than in the base year.

Income Terms of Trade: G.S. Dorrance has modified that net barter terms of trade and presented the income terms of trade. The income terms of trade, which indicate a nation's capacity to import is represented as,

$$l = Px.Qx/Pm$$

It may also expressed as,

$$l = N.Qx \text{ (because } N = Px/Pm)$$

The income terms of trade indicate a nation's capacity to import because when the index of total export earnings (Px × Qx) is divided by the import price index, we get the quantum index of imports that can be made with the export earnings. Therefore, a rise in l indicates that the nation's capacity to import, based on exports has increased, i.e., it can obtain a lager volume of imports from the sale of its exports.

Single and Double Factoral Terms of Trade: Jacob Viner has introduced the concepts of single factoral and double factoral terms of trade to modify the net barter terms of trade so as to reflect changes in productivity. The single factoral terms of trade is the net barter terms of trade adjusted for changes in the efficiency or productivity of a country's factor in its export industries. It may be expressed as,

$$S = N \times Zx$$

where Zx is the export productivity index.

A rise in S implies that a greater quantity of imports can be obtained per unit of factor-input used in the production of exportables. Hence, a rise in N is regarded as a favorable movement. The double factoral terms of trade is the net barter terms of trade corrected for changes in the productivity in producing imports as well as exports. It may be expressed as,

$$D = N \times Zx/Zm$$

where Zm is an import productivity index.

A rise in D is a favourable movement, because it implies that one unit of home factors embodied in exports can now be exchanged for more units of the foreign factors embodied in imports.

Real Cost Terms of Trade: The concept of real cost terms of trade, introduced by Jacob Viner, attempts to measure the gain from international trade in utility terms.

The total amount of gain from trade may be defined in utility terms as the excess of total utility accruing from imports over the total sacrifices of utility involved in the surrender of exports. (Exports result in loss if utility to the exporting country because the resource used for export production could have been utilized for products meant for domestic consumption. Imports, on the other hand, represent gain of utility}.

To find out the real cost terms of trade, we correct the single factoral terms of trade index by multiplying 5 by the reciprocal of an index of the amount of disutility per unit of productive resources used in producing exports. The real cost terms of trade may be represented as,

$$R = N \times Fx \times Rx$$

Where Fx = index of productivity efficiency in export industries and Rx = index of the amount of disutility incurred per unit of productive factors in the export sector.

A rise in R indicated that the amount of imports obtained per unit of real cost is greater, R may rise as result of a change in the methods of producing exports, or a change in factor proportions used in exports.

Utility Terms of Trade: The concept of utility terms of trade, which was also introduced by Jacob Viner, marks an improvement of the real cost terms of trade.

The utility terms of trade may be represented as,

$$U = N \times Fx \times Rx \times Um$$

Where Um = index of relative utility of imports compared to the commodities that could have been produced for internal consumption with those productive factors which are at present devoted to the production of export goods.

Influences on Terms of Trade

The terms of trade of a country depend on a number of factors. The important factors that influence in terms of trade are the following:

1. **Elasticity of Demand and Supply:** The elasticity of demand for exports and imports and the elasticity of supply of exports and imports of a country significantly influence its terms of trade.

2. **Competitive Conditions:** Competitive conditions in the international market are another important influence on the terms of trade. If the country enjoys monopoly or oligopoly power in case of the goods it exports and there are a large number of alternative sources of supply of imports, the country would have a favourable terms of trade.

3. **Tastes and Preferences:** Changes in tastes and preferences may also cause change in the terms of trade. A change in the former in favour of a country's export goods could help improve its terms of trade and vice versa.

4. **Rate of Exchange:** Changes in the rate of exchange of the currency also affect terms of trade. For instance, if a country's currency appreciates, the terms of trade of that country will, ceteris paribus, improve, because the currency appreciation causes an increase in the prices of exports and a decrease in import prices.

5. **Tariffs and Quotas:** The terms of trade of a country may be affected also by tariffs and quotas. The latter, if not retaliated by other countries, may have the effect of improving the terms of trade under certain conditions.

6. **Economic Development:** There are two important effects of economic development to be considered, namely, the demand effect and the supply effect. The demand effect refers to the increase in demand for imports as a result of the increase in income associated with economic development. The supply effect refers to the increase in supply of import competing goods or import substitutes. The net effect on other terms of trade will obviously depend upon the extent of these effects.

Problems of Measurement of Terms of Trade

The use of price indices to measure terms of trade has the following limitations:

1. **Changes in Quality:** Over the years, the quality of internationally trade goods may undergo a change, but the price indices may not reflect this change.

2. **Changes in Composition:** Changes in the composition of the traded goods over a period of time may also not be reflected in the price indices.

3. **Price Differences:** The price indices of import and export goods are usually based on the price declarations made to the customs authorities, which may differ from the actual market selling price of the imports and exports.

4. **Problems of Weightage:** Another problem associated with the price index pertains to that of assigning appropriate weights to various commodities that enter the international trade of the country.

International Trade in Services

International trade in services, which makes up a major share of the invisible account of the Balance of Payments, has been growing fast. It increased from $800 billion in 1990 to about $1435 billion in 2000 and to about $1.8 trillion in 2003. During the 1980's trade in services grew faster than that of the goods increasing its share in the total global trade from 17 per cent in 1980 to 20 per cent in 1990. The share of services in the total global trade remained more or less the same (about one-fifth) since then. In 2003, while the merchandise trade grew by 4 per cent, the services trade increased by 12 per cent. The combined trade in goods ($7.3 trillion) and services ($1.8 trillion) crossed $9 trillion in 2003.

It is pointed out that the "internationalization of services is reflected in the growth of both trade and foreign direct investment flows. Both have been driven by innovation in information and communication technology that allowed increasing specialization. As of early 1990s, about 50 per cent of global stock of FDI was in services activities. The share of annual flows to many countries has been over 65 per cent in recent years." Economic development is, generally, charaterised by an increase of the share of the services in the GDP and total employment. This trend tends to increase the international trade in services.

The services sector which contributes more than 60 per cent of the world GDP is growing fast. It is the largest sector in most of the economies and it is the fastest growing sector in many of them. The development economies are primarily service economies in the sense that the service sector generates bulk of the employment and income. The contribution of services to GDP and employment is substantially high in, particularly, the development economies. Although the share of services in the GDP of developing economies is lower than in the development ones, the service sector has been growing very fast in the developing world. The growing importance of services is reflected in the international trade too. The growth rate of trade in services was faster than that of goods.

As a World Bank report observes, the tremendous growth of trade in services and, more recently, of electronic commerce is part of the new trade pattern. Exports of commercial services have been growing on every continent (particularly Asia) throughout the 1990s. This change has its own special significance, as services are frequently used in the production of goods and even other services. Enhanced international competition in services means reduction in price and improvements in quality that will enhance the competitiveness of downstream industries. Both industrial and developing economies have much to gain by opening their markets. Developing countries would derive large gains from an easing of barriers to agricultural products and to labour-intensive construction and maritime services. Over the longer terms electronic business will loom large as an area where expanding opportunities for trade require an expanding framework of rules.

Major Services

Travel and transportation account for major share of the services trade. In 1997, travel accounted for about one-third and transportation about one-fourth of the services exports. However, trade in other commercial services (particularly financial services – including banking and insurance – construction services, and computer and information services) has been growing faster than these two categories. Travel and transportation account for major share of the services trade.

International trade in many services involves international factor mobility. There are number of international transaction involving temporary factor relocation services such as those requiring temporary residence by foreign labour to execute services transactions.

Major Service Traders

The world trade in service is dominated by the developed economies. In 2002, the three top exporters – USA, UK, and Germany did over 30 per cent of the world total. Seven countries account for about half and 11 countries nearly 60 pre cent of the total service exports. It may be noted that USA which has a huge deficit on the merchandise trade has a huge surplus on the services trade. Some countries like Japan and China which have huge surplus on the goods trade have large deficit on the services account.

With 1.5 per cent share, India's share in global export of services in 2002, India's rank was 19th, compared to 30th rank in merchandise exports and with a 1.4 per cent share of global import of services, its rank was 19, as against 24 in merchandise imports. In recent years India has improved its share and rank in the merchandise trade.

Barriers to Trade in Services

International trade in services, thus, involves intricate issues like right to establish and factor mobility. These are the problems faced in leberalising trade in services as compared to trade in goods. Due to the special characteristics and the socio-economics and political implications of certain services, they are, generally, subject to various types of national restrictions. Tariff as well as non-tariff restrictions are widespread. Protective measures include subsides, tariffs, taxes, quotas, and technical standards, visa requirements, investment regulations, restrictions on repatriation, marketing regulations on the employment of foreigners, compulsion to use local facilities, etc.

Meanings of Balance of Payment

The terms, the balance of international payments, usually referred to as the balance of payments, is a systematic and summary record of a country's economic and financial transactions with the rest of the world, over a period of time.

The IMF publication Balance of Payments Manual describes the concept as follows: "The Balance of Payments is a statistical statement for a given period showing:

1. Transactions in goods and services and income between an economy and the rest of the world;
2. Changes of ownership and other changes in that country's monetary gold, Special Drawing Rights (SDRs) and claims on and liabilities to the rest of the world; and
3. Unrequited transfers and counterpart entries that are needed to balance, in the accounting sense, any entries for the foregoing transactions and changes which are not mutually offsetting."

Structure of Balance of Payments

The format of the balance of payments given below shows the important types of transactions that enter the balance of payments. The various debit and credit entries are generally grouped under the following heads;

(1) Current Account

(2) Capital Account

(3) Unilateral Payments Account

(4) Official Reserves Assets Account.

Current Account

The current account includes all transactions which give rise to or use up national income. The Current Account consists of two major items, namely,

(a) Merchandise exports and imports; and
(b) Invisible exports and imports.

Merchandise exports, i.e., sale of goods abroad, are credit entries because all transactions giving rise to monetary claims on foreigners represent credits. On the other hand, merchandise imports, i.e., purchase of goods from abroad, are debit entries because all transactions giving rise to foreign money claims on the home country represent debits. Merchandise imports and exports form the most import international transactions of most of the countries. Invisible exports, i.e., sale of services, are credit entries and invisible imports, i.e., purchase of services, are debit entries. Important invisible exports include sale abroad of service like transport and insurance, foreign tourist expenditure in the home country and income received on loans and investments abroad (interests or dividends). Purchase of foreign services like transport and insurance, tourist expenditure abroad and income paid on loans and investments (by foreigners) in the home country form the important invisible entries on the debit side. Software exports have emerged as a very important invisible item of India's current account.

Capital Account

The capital account consists of short-term and long-term capital transactions. Capital outflow represents debit and capital inflow represents credit. For instance, if an American firm invests \$100 million in India, this transactions will be represented represented as a debit in the US Balance of Payments and a credit in the Balance of Payments of India. Payment of interest on loans and dividend payments are recorded in the current account, since they are really payments for the services of capital, As has already been mentioned above, interest paid on loans given by foreigners or dividend on foreign investments in the home country are debits for the home country, while, on the other hand, interest received on loans given abroad and dividends on investments abroad are credits.

Unilateral Transfers Account

Unilateral transfers is another terms for gifts, and includes private remittances, government grants, reparations and disaster relief. Unilateral payments received from abroad are credits and those made abroad are debits.

Official Reserves Account

Official reserves represent the holdings by the government of official agencies of the means of payment that are generally accepted for the settlement of international claims.

Balance of Payments Disequilibrium

The balance of payments of a country is said to be in equilibrium when the demand for foreign exchange in exactly equivalent to the supply of it. The balance of payments is regarded as being in disequilibrium when it show either a surplus or a deficit. There will be a deficit in the balance of payments when the demand for foreign exchange exceeds its supply, and three will be a surplus when the supply of foreign exchange exceeds the demand. There are a number of factors that may cause disequilibrium in the balance of payments.

These various causes may be broadly categorized into:

(1) Economic factors,
(2) Political factors and
(3) Sociological factors.

Economic Factors

There are a number of economic factors which may cause disequilibrium in the balance of payments.

Development Disequilibrium

Large scale development expenditures usually increase the purchasing power, aggregate demand and prices, resulting in substantially large imports. Development disequilibrium is common in the case of developing countries, because the above factors and the large scale import of capital goods needed for carrying out the various development programmes give rise to a deficit in their balance of payments.

Cyclical Disequilibrium

Cyclical fluctuations of general business activity is one of the prominent reasons for balance of payments disequilibrium. As Lawrence W. Towle points out, depression always brings about a drastic shrinkage in world trade, while prosperity stimulates it. A country enjoying a boom all by itself will ordinary experience a more repaid growth in its imports than in its exports, while the opposite will be true of other countries, But production in the countries will be activated as a result of the increased exports to the former.

Secular Disequilibrium

Sometimes, the balance of payments disequilibrium persists for long periods due to certain secular trends in the economy. For instance, in a developed country, the disposable income is generally very high and, therefore, so is the aggregate demand. At the same time, the production costs are also very high due to the higher wages. This naturally results in higher prices. These two factors – high aggregate demand and higher domestic prices – may result in the imports being much higher than the exports.

Structural Disequilibrium

Structural changes in the economy may also cause a balance of payments disequilibrium. Such structural changes include development of alternative source of supply, development of better substitutes, exhaustion of productive resources or change in transport routes and costs.

Political Factors

Certain political factors could also produce a balance of payments disequilibrium. For instance, a country plagued with political instability may experience large capital outflow and inadequacy of domestic investment and production. These factors may, sometimes cause a disequilibrium in the balance of payments. Further, factors like war of changes in the world trade routes, could also produce similar difficulties.

Social Factors

Certain social factors also influence balance of payments. For instance, changes in the tastes, preferences and fashions, may affect imports and exports and thereby affect the balance of payments.

Adjustment Mechanism in Balance of Payments

A country may not be bothered about a surplus in the balance of payments but every country strives to remove or at least reduce a balance of payments deficit.

There are a number of adjustment mechanism available for correcting the balance of payments disequilibrium. They fall into two broad group, namely, automatic measures and deliberate measures.

Automatic Correction

This worked well under the gold standard. Today since there is no country on gold standard, it is irrelevant to discuss the mechanism here. The balance of payment disequilibrium may, however, be automatically corrected under the paper currency standard also. The theory of automatic corrections is that if the market forces of demand and supply are allowed to have free play, in course of time, equilibrium will be automatically restored. For example, assume that there is a deficit in the balance of payments.

When there is a deficit, the demand for foreign exchange exceeds its supply and this results in an increase in the exchange rate and a fall in the external value of the domestic currency. This makes the exports of the country cheaper and imports dearer than before. Consequently, the increase in exports and fall in imports restore the balance of payments equilibrium.

Deliberate Measures

As the name indicates, deliberate measures refer to correction of disequilibrium by means of measures taken deliberately with this end in view.

The various deliberate measures may be broadly grouped into (a) monetary measures (b) trade measures and (c) miscellaneous measures.

(a) Monetary Measures: The important monetary measures are outlined below:

1. **Monetary Contraction:** The level of aggregate domestic demand, domestic price level and the demand for imports and exports may be influenced by contraction or expansion of money supply so that a balance of payments disequilibrium may be corrected. For example, assume a situation of balance of payments deficit to correct which a contraction of money supply is required. Constraction of money supply is likely to reduce the purchasing power and thereby, the aggregate demand. It is also likely to reduce domestic prices. The fall in the domestic aggregate demand and domestic prices reduces the demand for imports. The fall in domestic prices is likely to increase exports. Thus, the fall in imports and rise in exports would help correct the disequilibrium.

2. **Devaluation:** Devaluation means the reduction of the official rate at which the currency is exchanged for another currency. A country with fundamental disequilibrium in the balance of payments may devalue to currency in order to stimulate its exports and discourage imports to correct the disequilibrium. Devaluation makes export goods cheaper and imports dearer.

3. **Exchange Control:** Exchange control is a popular method employed to influence the balance of payments positions of a country. Under exchange control, the government of central bank assumed complete control over the foreign exchange reserves and earnings of the country. The recipients of foreign exchange, like exporters, are required to surrender foreign exchange to the government/central bank in exchange for domestic currency. By virtue of its control over the use of foreign exchange, the government can control imports.

(b) Trade Measures: Trade measures include export promotion measures and measures to reduce imports.

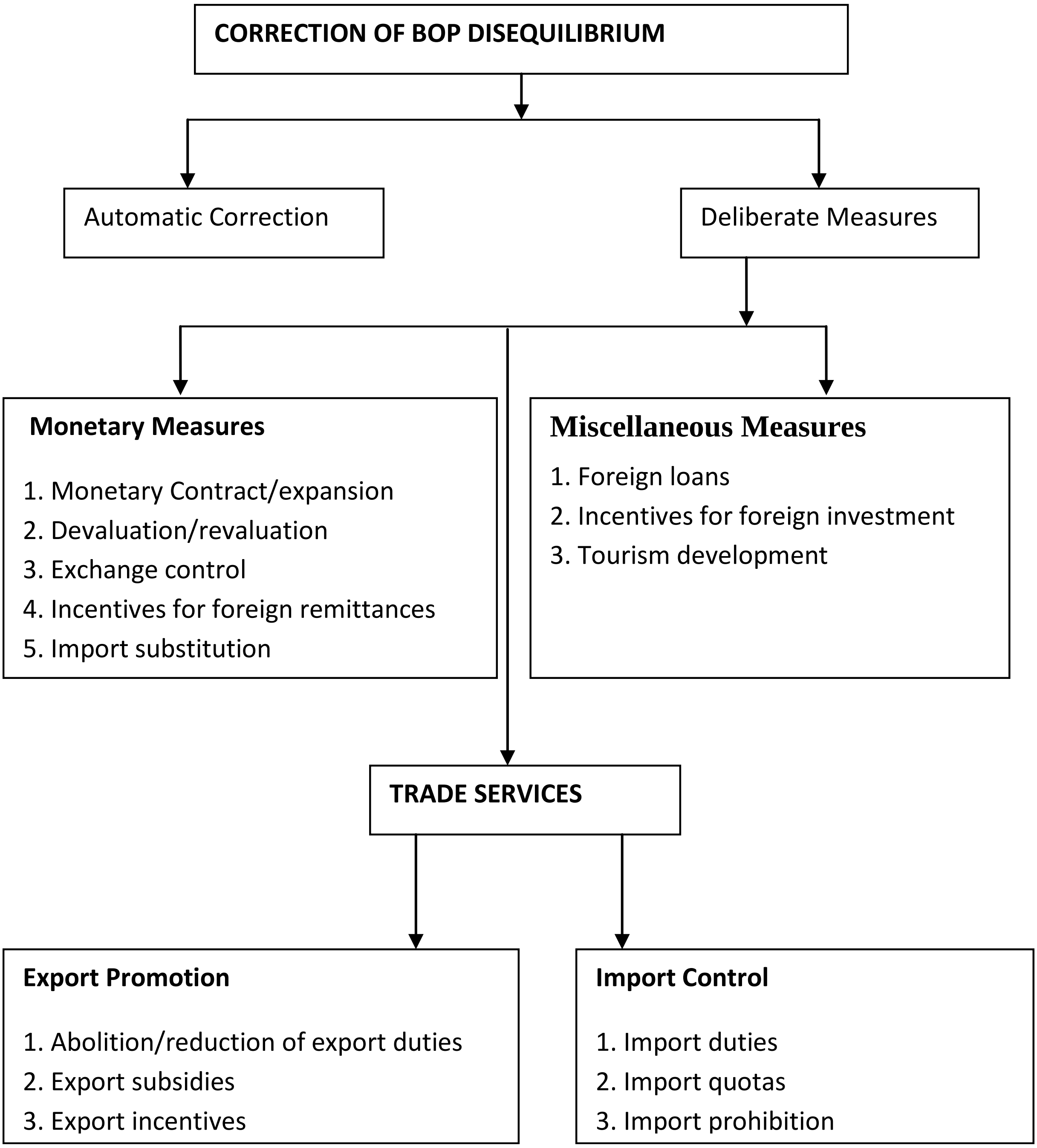
1. **Export Promotion:** Exports may be encouraged by reducing or abolishing export duties, providing export subsidy, encouraging export production and export marketing by giving monetary, fiscal, physical and institutional incentives and facilities.

2. **Import Control:** Imports may be controlled by improving or enhancing import duties, restricting imports through import quotas, licensing and even prohibiting altogether the import of certain inessential items.

(c) Miscellaneous Measures: Apart from the measures mentioned above, there are a number of other measures that can help make the balance of payments position more favourable, like obtaining foreign tourists and providing incentives to enhance inward remittances.

Methods of Correction of BOP Disequilibrium

The following chart may explain the various correction methods normally employed by the government in balance of payment for solving disequilibrium problem.



Summary

There have been a number of theoretical explanations of the bases and pattern of international trade. The oldest of the dominant trade philosophy is known as Mercantilism. The mercantilists argued that Government should do everything possible to maximize exports and minimize imports. Very active State intervention was required to implement the mercantilist philosophy. According to mercantilism, economic activity was a zero-sum game (i.e., one's gain is the loss of another). This view was challenged by Adam Smith and David Ricardo who demonstrated that trade was a positive sum game in which all trading nations can gain even if some benefit more than others.

Adam Smith believed that the basis of international trade was Absolute Cost Advantage. According to his theory, trade between two countries would be mutually beneficial if one country could produce one commodity at an absolute advantage (over the other country) and the other country could, in turn, produce another commodity at an absolute advantage over the first, Smith rightly pointed out that the scope for division of labour (i.e., specialisation) depended on the size of the market. Free international trade, therefore, increases division of labour and economic efficiency and consequently economic welfare.

Challenging the Smithian theory, the famous classical economist David Ricardo has demonstrated that the basis of trade is the comparative cost difference – trade can take place even in the absence of absolute cost difference, provided there is comparative cost difference.

According to the comparative Cost Theory, if trade is left free, each country, in the long run, lends to specialize in the production and export of those commodities in whose production it enjoys a comparative advantage in terms of real costs, and to obtain by importation those commodities which could be produced at home at a comparative disadvantage in terms of real costs, and that such specialization is to the mutual advantage of the countries participating in it.

The Opportunity cost Theory put forward by Gottfried Haberler by displacing one of the main drawbacks of the Ricardian comparative cost theory, vix., labour cost theory of value, gave a new life to the comparative cost theory by restating it in terms of opportunity costs. The opportunity cost of anything is the value of the alternatives or other opportunities which have to be foregone in order to obtain that particular thing.

According to the opportunity cost theory, the basis of international trade is the differences between nations in the opportunity costs of production of commodities. Accordingly, a nation with a lower opportunity cost for a commodity has a comparative advantage in that commodity and a comparative disadvantage in the other commodity.

The Factor Endowment Theory. Developed by Eli Heckscher and Bertil Ohlin, establishes that trade, whether national or international, takes place because of the differences in the factor endowments of the various regions (for example one country may be rich in capital and another in labour) and the differences in the factor intensity of various products (like capital intensive products and labour intensive products) and trade will lead to commodity and eventually factor prices equalization internationally.

The factor endowment theory consists of two important theorems, namely,

(i) Heckscher-Ohlin Theorem which states that a country has comparative advantage in the production of that commodity which uses more intensively the country's more abundant factor, and

(ii) Factor Price Equalisation Theorem which says that free international trade equalizes factor prices between countries, and, thus, serves as a substitute for international factor mobility

Nations can gain very significantly from international trade if trade is fair. The tremendous expansion of international trade is an indication of the gains associated with trade. International trade leads to specialization on a larger scale and, thus, increases the gain from the division of labour. Theoretically, small countries may gain more than large countries from international trade. This is because a small country can sepcialise in production, but if a large country specializes in the production of a single commodity without significantly affecting its prices in the production of a single commodity, the significant increase in its supply would cause a fall in its price, adversely affecting the terms of trade of the large country.

The gains from trade are not equally distributed; international trade sometimes leads to fast exhaustion of non-replenishable resource; trade sometimes ruins domestic industries and competition; international trade sometimes disturbs domestic economic institutions and structures, as well as social political set ups.

Some countries may gain more whereas for others the gain may be relatively less, sometimes even negative. The most important determinant of the distribution of gain is the terms of trade, i.e., the rate at which a country's exports are exchanged for imports. According to Mill's doctrine, the international terms of trade between two commodities will depend upon the strength of the world supply and demand for each of the two commodities. In other words, the terms of trade is determined by reciprocal demand. According to mill, the actual ratio at which goods are traded will depend upon the strength, and elasticity of each country's demand for the other country's product, or upon reciprocal demand.

The terms of trade of a country depend on a number of factors. The important factors that influence the terms of trade are: The elasticity of demand for exports and imports and the elasticity of supply of exports and imports of a country; competitive conditions in the international market; changes in tastes and preferences of people; changes in the rate of exchange of the currency; tariffs and quotas. Further, the terms of trade are affected by economic development.

Self Assessment Questions

1. Distinguish between internal trade and international trade.
2. Critically examine Adam Smith's theory of absolute cost.
3. Discuss the comparative cost theory of David Ricardo.
4. Evaluate the opportunity cost theory of Haberler's.
5. Explain the importance of Heckscher-Ohlin theory of international trade.
6. Examine the salient features and issues of global trade in services.
7. What is meant by balance of payments disequilibrium? Explain the factors which causes balance of payments disequilibrium.
8. Discuss the important methods of correcting balance of payments disequilibrium.

CASE STUDY

By the early 1990s, Italian firms were by far the world leader in the production and export of ceramic roofing and flooring tiles, accounting for over 30% of world production and 60% of world exports.

The rise to global preeminence of the Italian tile industry was based on the superior mechanical and aesthetic qualities of Italian tiles. One reason for the high domestic demand was Italy's Mediterranian climate (ceramic tiles were cool to touch in warm weather). There was also a tradition in Italy for using natural stone materials for flooring as opposed to carpeting a wood.

As a result of booming demand, the number of ceramic tile firms in the Sassuolo region of the Italy grew rapidly. Rivalry between firms was intense. They had to compete vigorously against each other to get access to retail outlets. Retailers demanded high quality, low cost and aesthetically pleasing tiles. Firms constantly sought to gain an edge against each other in technology, design and distributions. Innovations were usually known within a matter of week and quickly copied by rivals.

Firms seeking a leadership position, whether in technology or productive efficiency or design, had to constantly improve their processes and turnover their product line to stay ahead of rivals. One result of competitive process among equipment suppliers in the Sassoulo region was the development of a number of important process innovations that significantly lowered the energy and labour costs of manufacturing ceramic tiles.

The long post war boom in domestic demand was losing steam and excess capacity was beginning to develop among Italian tile firms. They responded to this problem by seeking international markets for their products, with advantages based on higher productivity, lower costs, better design and the Italian regulation for style, against their nearest competitors-the Spanish.

Questions

1. To what extent does the theory of comparative advantage explain the rise of Italian tile firms globally?
2. To what extent the Heckscher-Ohlin theory explain the prominence of Italian tile firms globally?

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UNIT - II

Commercial Policy Instruments

Unit Structure

Lesson 2.1 - Importance of Foreign Trade

Lesson 2.2 - Tariff Quotas and Anti dumping/countervailing Duties

Lesson 2.3 - Technical Standards

Lesson 2.4 - Exchange Controls & Non-Tariff Measures

Lesson 2.1 - Importance of Foreign Trade

Learning Objectives

- To recall the importance of Foreign Trade for the development of a nation.
- To explain the need for policy framework.
- To trace briefly historic perspective of progress of foreign Trade Policy.
- To identify the need for commercial policy Instruments (CPI)
- To describe various commercial Policy Instruments.

Introduction

Trade is an exchange or dealing in goods and services. Any household, village, town, city, state or country cannot have all goods and services required for them. Naturally, there is need for exchanging goods and services and **'Trade'** helped to fulfill the demands of people. When **'wants'** are increasing day-by-day, there is necessity for more trading activities along production.

If the trading is taking place **internally within the political boundaries of a country, it is a domestic trade.** If it takes place **externally with other countries beyond the boundaries of a country, then, it is a foreign trade.** When the trade is taking place between two countries, bilaterally or among several countries, multilaterally, it is considered as **'international trade'**, involving two or more nations. This is a general term for external trade; When the trading activity of our country with other countries are considered, it is termed as **'foreign trade'**, that is, the trade is foreign from the point of view of our country. The term foreign trade is with reference to a particular country.

Foreign trade of a country includes the imports and exports or merchandise and services.

Nature has distributed the factors of production unequally over on the earth. **Countries differ in terms of natural resource endowments, climatic conditions, mineral resources and mines, labour and capital resources, technological capabilities, entrepreneurial and managerial skills** and a whole host of other variables which determine the capacities of countries to produce goods and services.

All these differences in production possibilities lead to situations where some countries can produce some goods and services more efficiently than others; and no country can produce all the goods and services in most efficient manner. Japan, for example, produces automobiles or electronic goods more efficiently than any other country in the world; Malaysia produces rubber and palm oil more efficiently than other countries can do. Their capacity to produce these goods like electronics or rubber is far in excess of their capacity to consume them. Therefore, Japan and Malaysia can export these goods to other countries at relatively lower prices. Thus, international / foreign trade enables people all over the world to get goods and services more efficiently, effectively and economically.

Importance

In the modern economic environment Foreign Trade (FT) is inevitable for a country's **growth and development** for the following reasons:

1. It **earns foreign exchange** required for payment for imports and to pay foreign debts. It reduces the burden for the foreign debts.
2. Export **increases the economic activity** and results in **greater income** and **standard of living.** Increased competition reduces prices. For example TV, computers other electronic goods, cars etc.
3. Contributes to the **national income** of the country.

4. Expands and **widens the market** for domestic products and hence fetches better price and profit.
5. Foreign exchange earned through FT, **generates economic development activities.**
6. People live happily, **gratifying the varied tastes and wants.**
7. It encourages **international specialization** using the special facilities and natural resources, capital efficiency and efficiency of human power.
8. FT provides for **expanding employment opportunities and industrial production.**
9. Helps to **import capital goods and technology** which will modernise the **industrial sector** and increase the efficiency.
10. FT enables to make the best use of all available **resources including human resources.**
11. FT makes available by sharing the scarce resources.
12. FT enables to **equalize the prices** among countries. It moves the commodities where it is available in plenty to countries where it is costly. The vast difference in prices will be reduced in due course by the principle of demand and supply.
13. FT expands market and leads to **large scale production** to achieve the **benefits of economic of scale** and to improve specialization and modernization.
14. Any **invention** in any corner of the country spreads to all countries through International Trade / FT.
15. The whole world makes **best use of scarce resources** including human resources, technology and market and reduces abnormal differences.

Need for Policy Framework

Policy is a Standing Plan

Planning is the first and foremost aspect of efficient and effective management. The success of FT depends on excellent planning. You know well that "failure to plan is planning to fail". Policy is a significant type plan.

Standing Plan

Koontz and O'Donnel define policy as "a general statement of understanding, which guides the thinking and action in decision making.

Whenever certain activities occur repeatedly, a single decision or set of decisions can effectively guide those activities. Once established, *standing plans* allow managers to **conserve** time used for planning and decision making because similar situations are handled in predetermined, consistent manner.

A policy is a general guideline for decision making. It sets up boundaries around decisions, including those that can be made and shutting out those that cannot.

Polices are usually established formally and deliberately at the top level. It will improve the effectiveness of the system. It avoids some conflict or confusion. Foreign Trade being crucial factor in national development formulation of policy framework is essential.

Characteristics of a Good Policy

A good policy should consist of the following characteristics:

- Policies should contribute toward accomplishment of objectives. They should provide broad outlines within which decisions are to be taken to achieve the objectives.
- Policies should be simple and clear and should not give room for misinterpretation.
- Policies of an organization should be consistent.
- Policies should be adequate and sufficient in number to deal with different fields of activities.
- Policies should be flexible in nature, in order to adjust with the changing situations.
- Policies should be in writing in order to ensure uniformity in application.

Merits of Policies

- Policies are guidelines to thinking and action, which provide mangers with the framework within which decisions are to be taken.
- Policies provide uniformity of performance and consistency of action throughout the enterprise.
- Policies ensure promptness of action; they help managers to act confidently without the need for guidance from superiors.
- Policies facilitate effective control; they provide rational means for evaluating the results.

- Policies ensure integration and coordination of action in achieving the organizational goals.
- Policies help to build the confidence of managers, since they provide ready made answers to all problems faced by the organization.

Brief Historic Perspective of Foreign Trade Policy

Necessity

Out of sheer necessity the Foreign Trade Policy (FTP) has been evolved over a period since independence. Policies are framed based on past experience and future needs and when circumstances change, new policies are evolved so that the problems faced could be sorted out and foreign Trade could become an effective source of national development.

Historic Perspective

The first active step was taken in 1970 in the form of a Export Policy Resolution. The major events of chronological progress of the FTP, is indicated as follows:

1970:	Export Policy Resolution passed in the Parliament.
1978:	Export-Import and procedures by Alexander committee.
1980:	Export strategies for eighties by Tandon committee.
1984:	Trade Policies by Abid Hussain committee.
1985:	Exim Policy by Viswanath Pradap Singh Government. (3 year Policy)
1990-93:	3-year Import Export Policy.
1992-97:	Export-Import Policy (to coincide with Plan period)
1997-02:	Eixm Policies with major changes.
2002-02:	Exim Policies
2004-09:	New Foreign Trade Policy (NFTP) was introduced due to change in Government.

Trade and Economic Policy

Until 1990's, India's Trade Policy was mostly influenced by the "Swadeshi" (self sufficiency) feelings and the "licence raj" system of restrictions on production and imports. A first generation of reforms (1991-1996) – aimed at, *inter alia*, liberalizing trade – led to a reduction of import tariffs, elimination of quantitative restrictions, exchange rate reforms and deregulation of industry resulting in yearly growth rates of around 7% (compared with 3% before the reforms).

A second generation of reforms was initiated in 1999 to address issues related to lack of competitiveness, poor infrastructure and overregulation. India has set the ambitious target of an annual 8% sustainable growth besides doubling the per capita income over 10 years.

As you know, India is a member of all major multilateral economic for a, including the International Monetary Fund (IMF), the World Bank and the Asian Development Bank (ADB). India was founding member of both GATT and the World Trade Organisation (WTO).

At regional level, India is member of SAARC, (South Asia Association of Regional Cooperation) of BIMSTEC (Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation) Bangkok Agreement. India has a free trade agreement with Singapore and with the other SAARC countries (SAFTA) and is in the process of negotiating one with Japan, South Korea, GCC and ASEAN.

The details of the NFTP (2004-2009) would be discussed in the relevant unit of this paper. The major objective of the NFTP is to double India's share in world exports from the current 0.82% to nearly 2% by 2010. This provides the much needed boost to Indian exporters. This also reaffirms the fact that trade policy reforms forms the core of the country's economic reform.

Within the broad framework of Foreign Trade Policy, **commercial Policy Instruments** are necessitated to protect indigenous industries as otherwise the indigenous supporting industries may be wiped out by the tornado of developed countries dumping of their products.

Now we will discuss the need for Commercial Policy Instruments.

Check your progress. 1

1. The Export Policy Resolution was passed in the parliament in ____________.
2. Policy is a general guideline for __________________________.
3. Policies provide national means for ______________________ the results.

Need for Commercial Policy Instruments

Tariff and Non Tariff barriers

In order to protect our industries, we have to make use of the Commercial Policy Instruments (CPI). These policy instruments like levying import duty (tariff) as well as other tariffs and adapting other non-tariff barriers like quantitative restrictions enable us to safeguard our industries from these gigantic claws of the developed countries.

It would be very difficult to compete with developed countries with their higher economic status and connected facilities, subsidies and encourage merit in increasing production and reducing their costs. If these products are permitted without restrictions and different forms of tariffs to their prices, our products may not find markers internally or externally.

Under such international trading environment, there is need for developing countries to adopt commercial policy instruments to protect their own industries.

Multilateral Trading System

Understand the international trading environment, has become imperative for the entrepreneurs and the export managers in vie of the growing globalization, liberalization and competition in the world trade. The international trading environment consists of rule-based multilateral trading system, trading blocks, trade agreements and trade policies of individual countries.

The multilateral trading system refers to the system that governs the trading among various countries. This system has been established over the years as a result of the international negotiations among the various countries. These negotiations provide the guidelines to member countries for the formulation of their policies governing international trade. Besides, the emergence of various trading blocks reflecting varying degrees of economic integration and bilateral trade agreements amongst the countries have had a profound impact on course of international trade flows and the state of competition at the global market place.

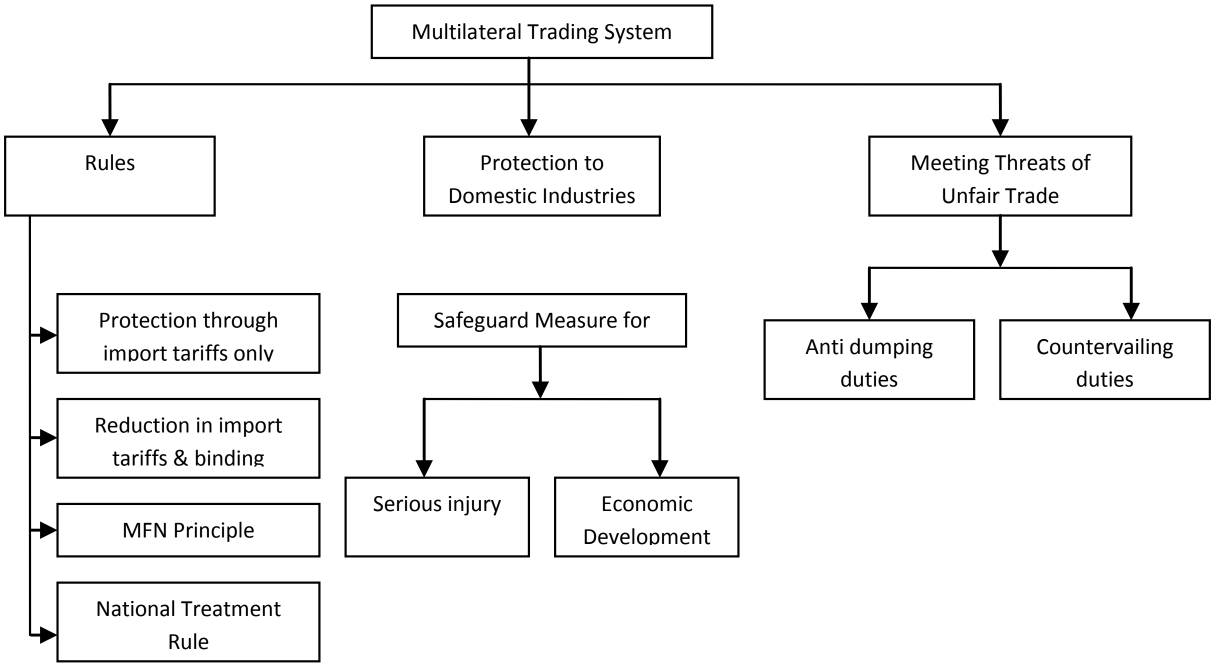
The General Agreement on Tariffs and Trade (GATT) was established in 1948 and the WTO was established in 1955.

The Legal Framework

The Legal framework for the enforcement of the multilateral trading system consists of the following:

- Rules governing international trade
- Agreement on safeguard measures
- Agreements to deal with unfair trade practices namely, Agreements on anti dumping practices and Agreement on subsidies and countervailing measures.

P.K Khurana has analysed the Legal framework further as depicted here:



In this unit we restrict our scope to some of the Commercial Policy Instruments only and discuss their use, and abuse in favour of developed countries and the resultant measures taken in the Institution of Multilateral Trading System – WTO and the effects of such measures.

Various Instruments

Commercial Policy Instruments are evolved over period and it is a continuous process. Its scope is vast and varied. Here we restrict our discussion on various instruments as follows:

- Tariffs and their different types.
- Growth of quota system or quantitative restrictions (QRS) and its removal
- Antidumping / countervailing duties
- Technical standards
- Exchange control measures
- Other non-tariff measures

The details of these instruments are discussed in the ensuing lessons.

Check your progress. 2

4. Commercial policy instrument could be in the form of tariff and ______________ barriers.
5. The multinational organization connected with International Trading is ________________.
6. Anti-dumping / Countervailing duties help to meet the threats of _________________ Competition.

Summary

In this lesson, the importance of foreign trade, the need for policy frame work and the Commercial Policy Instruments and the various kinds of such instruments are discussed.

Keywords

FTP: Foreign Trade Policy.

CPI: Commercial Policy Instruments.

QR: Quantitative Restriction (Quota)

Tariff: Duty Received on imports / exports

(1) 1970 (2) decision making (3) evaluation (4) non-tariff
(5) world Trading Organisation (WTO) (6) Unfair

Self Assessment Questions

1. Explain importance of Foreign Trade
2. What re policies? Why policies are required?
3. Trace the historic evolution of FT policy in India.
4. What are characteristics of a good policy.
5. Mention various forms of Commercial Policy Instruments.

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Lesson 2.2 - Tariffs, Quotas, and Antidumping/Countervailing Duties

Learning Objective

After reading this Lesson you should be able to

- Define the concepts Tariff, Quotas, antidumping/countervailing duties.
- Enumerate various arguments of tariff policy
- Distinguish tariff and non-tariff barriers
- Explain different types of tariffs
- Understand Tariff Schedule
- Describe implications of the rules of GATT 1994 with regard to protection to indigenous industries
- Differentiate various types of Quota systems
- Analyse the impact of removal of QRs
- Distinguish anti-dumping duty and countervailing duty
- Explain the procedures relating to the above two duties

Introduction

Government has to protect the domestic industry from the foreign competition. In order to protect the domestic industries, Government has to announce certain policies protecting and supporting the domestic sector. The term protection refers to a policy introduced to protect the domestic industries from the external forces i.e., foreign competition, compulsions of the International Financial Institutions etc.

The policy governing the support of indigenous industry aims to impose restrictions on the imports of low priced products to support and protect the domestic industries. Imposing high import duties will increase the price of the imported goods.

Quotas and other non-tariff barriers also will protect the domestic industries. The domestic industries may be provided subsidies and concessions to enable them to compete with the foreign competitors producing low priced goods.

The major Commercial Policy Instruments (CPI) governing the support of indigenous industry are as follows:

- Tariff Policy
- Quota Policy
- Anti-dumping duties and
- Subsidies and Concessions

Two Views

In general Trade barriers are classified into two categories. They are tariff barriers and non-tariff barriers. From the point of view of the importing country CPI is a protective instrument from the point of view of exporting country these are barriers.

Tariff Barrier

Tariff refers to duty (tax) imposed on imports and exports. Levying duty and changing duty structure are common on imports. So tariff popularly refers to import duty. Tariff is levied to regulate imports. Tariff increases price of the imported goods and imports become expensive. Tariff is raised for the purpose of primarily protecting domestic industries and to increase revenue of the Government.

Tariff reduces the volume of International trade and prevents the countries from getting gains from trade. Tariff barrier reduces International business relations between countries and it is treated as obstacle in the International trade.

Tariff is classified into three types. They are *specific duty, ad valorem duty* and *compound duty.* Recently Government introduced special additional duty.

Specific duty is a percentage of tariff levied on the value of imports.

Ad valorem duty will be more or less equivalent to the excise duty, levied if the imported goods are produced locally.

Compound duty is a tariff consisting of both a specific and *ad valorem* duty.

Anti-dumping duty is also one of the tariff barriers. This duty is levied to protect the domestic industries from foreign competition. Anti-dumping duty is common not only in developing countries but also in developed countries. Recently India imposed anti-dumping duty for the import of steel, because domestic steel prices are higher than the imported steel. In this situation, imported steel will be dumped into Indian market and domestic steel industries will be affected. So anti-dumping duty is levied on steel import to protect domestic industries.

This duty reduces the volume of International trade. European Union has also levied anti-dumping duty on textile goods imported from India. Developed countries have no exception in levying anti-dumping duty. Robert Cohen, in his paper 'Grumbling over GATT' published in New York Times, September 1, 1993 has stated that "tariffs continue to be one of the most commonly used barriers to trade, despite the fact that they often hurt low-income consumers and have limited, if any, impact on upper-income purchasers."

Tariff Policy Arguments

Terms of Trade Argument

Imposition of tariff on imports increases the rate at which the country's exports are exchanged for imports. Tariff improves the terms of trade.

Bargaining Argument

Tariff imports throws light on negotiations in the international trade. Foreign trade is based on the reciprocal basis. The tariff structure may induce the countries to provide reciprocal concessions to each other.

Anti-Dumping Argument

Dumping will affect the market potentials of the domestic industries. It means selling foreign products at a price less than the price of the domestic industries. To protect and support the indigenous industry anti-dumping duty is levied. This duty will make the foreign goods costlier than the goods produced by the indigenous industry. Thus indigenous industry is protected.

Diversification Argument

The indigenous industry should be diversified to achieve a balanced growth of economy. All the sectors (Agriculture, Industry, Services) of the economy should be developed side by side and the development should go hand in hand. Diversification will contribute to the growth of the indigenous sector.

Infant Industry Argument

Indigenous industries which are at infant stage should be protected from the foreign competition. Industries at infant stage cannot compete with the global competition. Protection should continue till such indigenous industries reaching the growth stage. Protection to the infant industries will contribute to their expansion and reduce the costs and prices, which in turn, advantageous to the industries using the products/services of the protected industries. The industries started in the backward regions are permitted to avail tax holiday and other incentives.

Key Industries Argument

It is the responsibility of the Government to support and protect the key sectors of the economy. Keeping the key industries (agriculture, steel, heavy industries etc) under protective tariff regime is one of the basic objectives of the trade policy.

Employment Argument

The tariff protection will reduce import of manufactured goods and increase the production of the domestic indigenous industries. It is assumed that the tariff protection will contribute to the growth of the indigenous industries. Prof. Haberler has analysed the effects of tariffs on the various types of unemployment. Technological unemployment can be removed by imposing a new tariff duty of imports only in the case of one industry, but not in the case of the entire industrial structure of the economy.

Balance of Trade Argument

The country will have to impose tariff to achieve surplus of exports over imports. Keynes has stated that excess of exports over imports raises employment and income in the country through the expansion of the export sector and the decline in imports by imposing tariffs. Increase in income will increase the availability of funds and will reduce interest rate and encourage investment. The increased investment will help the indigenous industries for growth and development.

Pauper Labour Management

Goods produced by the low wage countries will be cheaper than the goods produced by the high wage countries. If India becomes a high wage country, imports from the low wage countries will affect the indigenous industries. In this situation, tariff protection will protect and support the indigenous sectors.

Keeping Money at Home Argument

When we import goods from the foreign countries we get goods and the foreign countries will receive money. When we purchase manufactured goods from the domestic market we get both the goods and the money. Protected tariff will curtail import and force to buy from the domestic market and the indigenous sector will grow. The growth of indigenous sector will expand the domestic market. When the domestic market is under expansion in the protected tariff regime, the indigenous sector should improve its efficiency to reduce costs of production. Indigenous sector should not pass on the cost of inefficiency to the consumers.

Expanding Home Market Argument

If the imported goods are cheaper than the domestic goods, imported goods will occupy the domestic market and indigenous industries will be affected. In order to protect the indigenous industries, high import duty is imposed on imports. Naturally the home market could be expanded

Equalisation of Costs of Production Argument

If the cost of production of indigenous industry is higher than that of imported goods adding tariff to the imported goods makes its cost either equal or higher than the cost of domestic product. Then people will hesitates to buy the foreign product.

Thus all theses reasons/arguments in support of tariffs indicate how it could be used as a policy instrument to improve our commercial transactions.

From the above discussions, it is revealed that the protected tariff is one of the policies to be taken to support and protect the indigenous industries. Tariff policy is a viable alternative to protect the indigenous industries.

Tariff Schedule

Classification

The Indian classification on tariff items follows the Harmonized Commodity Description and Coding System (Harmonized System or HS). India has fully adopted HS through the Customs Tariff Amendment Act, 1985. There has been some modification of HS as appropriate to the Indian environment concerning excise taxes.

Customs Duties

The Customs Act governs the levying of tariffs on imports and exports and frames the rules for customs valuation. The Customs Tariff Act specifies the tariffs rates and provides for the imposition of anti-dumping and countervailing duties and the like are revised in each annual budget. The April 1993 trade policy merged the auxiliary duty with the present duty. Total duties on imports now consist of basic duty (ranging from zero to 65%) plus additional or countervailing duties (equal to excise duties),. On manufactured "luxury" items, total import taxes can amount to 150%

As import duties are quite product specific and may be altered in mid-year, companies are advised to verify the relevant rates for their products. Rates are published by the Central Board of Customs and Excise within the Ministry of Finance's Department of Revenue. They may be obtained from the public relations officer (Customs House, Indraprastha Estate, New Delhi, 110 002).

GATT Rules

We discussed in the previous lesson, 4 rules formulated by GATT 94 to monitor the use of commercial policy instruments to protect the domestic industry. Let us see some details on these rules.

Protection by Tariffs only (Rule 1)

The GATT '94 has provided that countries may protect their domestic industries from foreign competition, if it is considered necessary by them. But the GATT agreement requires the countries to keep such protection at reasonably low levels and provide them through tariff measures (import duties) only.

The principle of protection by tariffs is further reinforced by provisions of the GATT'94 which prohibit member countries from using quantitative restrictions (QRs) on imports. Thus, the countries cannot make use of non-tariff barriers i.e. quantitative restrictions, to protect their domestic industry. The non-tariff barriers may take the form of import licensing restrictions and / or absolute quantitative restrictions on the import of specified items.

A country may be permitted by WTO to maintain QRs on imports under article XVIII-B (shelter under the Balance of Payment clause) of the GATT'94 in case, it is faced with balance of payment difficulties and has to restrict imports in order to safeguard their external financial position

Reduction in Tariffs and Binding (Rule 2)

The second rule of international trading is that the import tariffs should be reduced and wherever possible, eliminated through negotiations among member countries. The tariffs so reduced should be bound against further increases. The countries have agreed to bind their import tariff rates under GATT'94 and not to increase their rates beyond the specified commitments as given in Schedules of Concessions, appended to the GATT'94

Commitments made by India

As far as India is concerned, India has agreed to undertake the reduction in import tariffs to a ceiling of 40% ad volume on finished goods and 25% on intermediate goods, machinery and equipment during the period from March 1995 to 2005. As far as agricultural goods are concerned, India's bound rates shall range from 100% to 300% and no commitments have been made regarding market access, reduction of subsidies or tariffs." Thus, the Government of India cannot increase the import tariffs beyond the commitments made by it at the Uruguay Round.

The Most Favoured Nation (MFN) Clause (Rule 3)

The third basic rule of international trading is embodied in the famous Most Favoured Nation (MFN) clause. This rule provides that international trade must not be discriminatory, In simple terms, the MFN principle implies that a member country shall apply uniformly and unconditionally the import tariffs and other trade related policy measures in regard to its trade with other member States of WTO.

Accordingly, the normal import tariff rates are known as MFN rates of import tariff. Thus, if a member country grants to another country any tariff or other concession, then it must immediately and unconditionally extend it to the like products of other countries. The MFN principle covers both the imports and exports.

The obligation to provide MFN treatment applies not only to tariffs but it also covers changes method of levying tariffs, Rules and formalities and internal taxes.

There are two exceptions to the MFN rule namely,

a. Regional Preferential Arrangements and
b. One-way Preferential Arrangement

Commitment to the National Treatment (Rule 4)

According to this rule member countries are required to treat imported products on the same footing as similar domestically produced products. Thus, it is not open to a country to levy on an imported product internal taxes(such as a sales tax) at rates that are higher than those applied to comparable domestic products.

Safeguard Measures

Under GATT'94, the Agreement on safeguard measures authorizes importing countries to the impose temporary restrictions on imports under the following conditions:

(i) Imports are causing 'serious injury' to the domestic industry or

(ii) Imports are hampering the economic development of the specified industries

Quota Policy

The quota policy is one of the measures taken to protect the indigenous industries. Under the quota policy a fixed amount of a commodity in volume or value is allowed to be imported into the country during a specified period of time. The basic objective of the import quota is to restrict and regulate imports for the purpose of protecting the indigenous industries from foreign competition. There are *four types of import quotas*. They are, *tariff quota, unilateral quota, bilateral quota and mixing quota.*

Under the *tariff quota* system upto the specified quantity of import, duty will be minimum. Beyond this quantity, high rate of duty will be levied to curtail import above the specified limit.

The *unilateral quota* is fixed by the importing countries without the consent of the other exporting countries. This quota is fixed unilaterally by the importing countries to protect the indigenous industries.

The *bilateral quota* is fixed based on the agreement with one or more countries. It is also called agreed quotas.

Mixing quota is decided based on the proportion of imported material and domestic materials used in the production process and accordingly quota permission is given to import of the required raw materials.

Import licensing system administers the quota policy. The quantity of materials to be imported in a year is decided based on the quota policy. The licensing system administers the import of materials/finished goods by issue of import licenses to the importers. Subsidies and concessions also help to protect domestic industries.

QR Removal

We have seen that Quantitative Restrictions (QR) are limits set by countries to curb imports. Quantitative Restrictions are also called quotas. Ceiling on how much of certain specific products can be imported every year is prescribed under quota.

These ceilings are managed by Central Government which issues licenses that allow the import of specific quantities of goods Quantitative Restrictions can be managed by import canalization also that is allowing a few players to import specific goods from foreign countries.

The Government of India lifted Quantitative Restrictions for the import of 714 items in 2000 and 715 items in 2001. An analysis of QR removal for the year 2001 would indicate the major and minor are as from which QRs have been removed.

The first three categories and the number of items are as follows:

Category	No. of Items
1. Textiles	331
2. Vehicles and floating structures	88
3. Vegetable products, Animal/vegetables fats & oils	82

According to India's original WTO commitments, all quantitative restrictions would have been phased out by 2003, but a dispute with the US has made to advance the removal of QRs by 2001 instead of 2003.

The US had argued at the WTO's dispute settlement board that India's QR removal schedule was too protracted. India lost the case, and in an agreement reached with the US in December 1999 agreed to remove all QRs in two stages by April 1, 2001.

As agreed quantitative restrictions for the import of 1429 items, (714 first phase in 2000 and 715 second phase in 2001) have been and made open for the import. India has become an open economy that does not ban import of any product.

Removing QRs will help all consumers, whether rich or poor, it will make both Indian and foreign companies to bridge the quality gap between products sold in India and abroad.

Impact Study

Dr TR Gurumoorthy made an Impact study and analysed the effects of removal of QRs. For example the review for Textiles is as shown below.

Sector/Type of Goods

- Textiles

Import Cost and Conditions

- Custom Duty 35%

Impact

- Non-branded garments of foreign countries will occupy Indian market. Branded garments are costly. There was no heavy import of branded garments.

Impact

International brands for cosmetics, food beverages, appliances, clothing, automobiles etc are produced and marketed in India. So there is no need to import such items. Hence there was no surge in imports after removing QRs

In Indian import basket, there was an increasing trend in annual growth rate of POL import. It was 64.1 percent in 1999-00 and 74.7 percent in 2000-01 (7 months).

The percentage growth of total imports in 2000-01 (April-Feb) compared to the previous year 1999-2000 was 6.65 percent only. It was more than this level in the years before 1999-2000. So removal of QR has not created any surge in imports.

The gap between value of imports and forex reserve was narrowed over a period of time and removal of QR may not create any adverse impact in India's BOP position. The gap between value of imports and forex reserve was 41% in 1996, 32% in 1997, 23% in 1999, 10% in 2000 and 2% in 2001 (31^{st} January).

After removing QRs in first phase 714 items in April 2000, it was predicted that imports will increase heavily. But import growth is reduced. Foreign trade statistics shows that trade deficit in 2000-01 (April-Jan) was US$6.2 billion. But in pre-removal of QR in 1997-98, 1998-99 and 1999-2000 trade deficits were at US $6.4 billion, US $9.1 billion and US $9.6billion respectively.

There was no danger of hefty rise in the import bill on account of removal of QRs.

Safeguards

Import duty was raised to curb imports. The Union Budget (2000-2001) provided adequate protection in terms of tariffs on most of the newly deregulated imports. The import duties on agriculture consumer goods like tea, coffee, edible oils, sugar etc. were increased to 70% to 80% against 35% in the previous budget.

Import duty for second hand car import is 180%. Import of cars older than three years has been scotched. Foreign goods can be imported only through state trading corporations. Import of all food products would be subject to biological and genetic norms and rules.

A *standing group* was constituted to suggest suitable measures to protect the domestic industry if there is surge in imports of sensitive items. The Government has also taken measures to ensure that imports comply with standards imposed by the Bureau of Indian Standards on all domestic items.

Check Your Progress. I

1. The two types of barriers are (a) ________________ (b) _______________
2. The thing major types of tariffs are (a) ____________________ (b)___________ _______________ (c)______________________
3. The four types of quota system are:
   (a) ___________________________ (b) __________________________
   (c) ___________________________ (d) _________________________
4. The number of QRs removed in 2001 is ____________________________

Anti-Dumping Practices (ADP); Subsides and Counter Vailing Measures (SCM)

The GATT rules provide for imposition of two different measures for dealing with unfair trade practices which distort conditions of fair trade competition:

(i) The competition may be unfair if the exported goods benefit from subsidies and
(ii) The conditions of competition may be distorted if exported goods are dumped in foreign markets.

Definitions

What is an anti-dumping duty?

An anti-dumping duty is a special duty to offset the margin of dumping on dumped imports that are causing, or threatening to cause, material injury to domestic producers of like products. The margin of dumping is equal to the difference between the normal value of the product (generally the price charged in the exporter's home market or the full cost of production of the product) and the export price of the product. Unlike a countervail investigation, therefore, anti-dumping investigations *focus on the pricing behavior* of individual foreign companies.

What is a countervailing duty?

A countervailing duty is a special duty to offset the amount of subsidy on subsidized imports that are causing, or theaterning to cause, material injury to domestic producers of like products. Subsidizing occurs when foreign producers receive financial contributions from their governments, which enable them to sell at lower prices in the marketplace. Unlike an antidumping investigation, therefore, countervailing duty investigations *focus on the subsidy practices* of foreign governments.

The Agreement on Anti-dumping Practices (ADP) and the Agreement on Subsidies and Countervailing Measures (SCM) enable countries to levy compensatory duties on the imports of products that are benefiting from unfair trade practices. The duties so levied are known as anti-dumping duties and countervailing duties respectively.

Dumping of Goods

Normally it refers to thrusting all low-cost imports as dumping of goods. But the agreement on ADP lays down a strict criterion for the determination of dumping of goods.

According to article 2.1 of the Agreement on ADP, a product is considered to be dumped if its export price is less than the price at which a like product is sold for consumption in the exporting country.

This is done by comparing the export price and the home consumption price in the exporting country. It is found that the later price is higher, the product could be treated as being dumped.

An importing country can levy countervailing duties on *subsidized imports* and anti-dumping duties on dumped imports only if it is established on the basis of *investigations* that such imports are causing "*material injury*" to a *domestic industry*.

The Agreements on ADP and SCM lay down the similar criterion for determining injury and for carrying out investigations on the basis of the petitions for the levy of anti-dumping and countervailing duties.

The two agreements referred to above have laid down an important principle that the compensatory duties in the form of countervailing duties on subsidized imports and anti-dumping duties on dumped imports cannot be levied solely on the ground that the product has benefited from subsidy or that it is being dumped.

They can be levied only if it is established after an investigation, which must normally be initiated on the request of a domestic industry, that dumped or subsidized imports are causing "material injury" to that industry.

Request for Investigation

The investigating authorities should initiate action for investigations only if the application is supported by the requisite number of producers.

These articles lay down two complementary criteria for this purpose namely,

(a) The producers supporting the application must account for over 50% of the production of the producers who express an opinion either in support of, or against, the petition.

(b) The producers supporting the application should account for at least 25% of the industry's total production.

Determination of Material Injury

The Agreement on ADP and the Agreement on SCM state that injury to the domestic industry is caused if it is established on the basis of the investigations that:

(a) There has been a significant increase in dumped or subsidized imports, either in absolute terms or relative to production or consumption; or

(b) The prices of such imports have undercut those of the like domestic product, have depressed the price of the like product or have prevented that price from increasing; and

(c) As a result, injury is caused to the domestic industry or there is a threat of injury to the domestic industry of the importing country.

Factors Determining Injury

More injury to the domestic industry is not enough; there must be the causal link between dumped, subsidized imports and injury to the domestic industry. This should be established after taking into account the impact of various economic factors having a direct bearing on the state of the industry. These factors, as stated in the two agreements, are as follows:

(a) Actual or potential decline in output, sales, market share, profits, productivity, return on investments, or utilization of capacity;

(b) Effects on domestic prices;

(c) Actual or potential effects on cash flow, inventories, employment, wages, and growth, ability to raise capital or investments.

In the case of anti-dumping investigations, one of the other factors to be taken into account is the magnitude of the margin of dumping. Likewise in investigations for the levy of countervailing duties on imports of agricultural products, an additional factor to be taken into account is whether there has been an increased burden on government support programmes.

Countervailing or anti-dumping duties should not be levied, if the main factors responsible for the difficulties of the industry are factors *other than subsidized or dumped imports.*

It is obligatory under the agreements on ADP and SCM that the investigating authorities in the importing country provide opportunity to the exporting firms, the concerned trade or business association, and the government of the country of export to defend their interests.

The exporting firms are required to provide the information on the cost of production and other matters on the basis of a questionnaire sent by the investigating authorities.

The Government of India has established a Directorate of Anti-dumping Duties headed by a Director General under the Ministry of Commerce to look into the complaints of the industry for the levy of Anti-dumping duties and Countervailing duties.

Check Your Progress: 2

5. Anti-dumping investigations focus on ______________________
6. Countervailing investigations focus on ______________________
7. ____________________ looks after complaints on Anti-dumping and Countervailing duties.

Summary

The definitions the concepts of Tariff, Quotas, Anti-dumping/Countervailing duties were explained The need and procedures for all these commercial policy Instruments were discussed. An impact study on removal of QR was analysed. The difference between antidumping duty and countervailing duty was also discussed. The procedures for investigations on these two issues were described You may refer to websites, especially FAQS to get details and more information

Answers

(1) (a) Tariff (h) Non-tariff

(2) (a) specific duty (b) ad valorem duty (c) Compound duty.

(3) (a) Tariff quota (b) unilateral quota (c) bilateral quota (d) mixing quota

(4) 715,

(5) Pricing behaviour,

(6) Subsidy practices,

(7) Directorate of Anti-dumping duties

Keywords

GATT:	General Agreement on Tariff and Trade
Tariff:	Duty on imports and exports
Quota:	Fixing the amount of commodity in volume or value
Dumping:	Thrusting low cost goods

Self Assessment Questions

1. Define: Tariff, Quota, anti-dumping duty, Countervailing duty.
2. Explain various arguments for tariff.
3. Distinguish tariff and non tariff barriers
4. What are different types of tariffs? Explain
5. Describe 4 rules of GATT 1994.
6. What are the different types of Quota systems?
7. Analyse the impact of removal of QRs.
8. Differentiate Anti-dumping duty from Countervailing duty.
9. Describe the procedures adopted before imposing Anti-dumping/Countervailing duties.
10. Analyse application of the Commercial Policy Instruments by Developed Countries like USA.

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Lesson 2.3 - Technical Standards

Learning Objectives

After reading this Unit you should be able to:

- Understand the techniques of labelling, packaging, packing and marking.
- Explain the pre-shipment Inspection formalities and its need.
- Comprehend the quality management techniques and the ISO 9000: 2000 standards.

Introduction

Among various Commercial Policy Instruments (CPI), Technical Standards would play a significant role in exporting products. The major aspects of Technical Standards are

(a) Labelling, packaging, packing and marking
(b) Pre-shipment Inspection and
(c) Quality Management System like ISO:9000, by the (International organization for standards)

In fact, the application of these three must be in the reverse order of action. That is, first, we must know all details about producing our commodities in conformity with national / international standards.

Then, to confirm that they are according to the Technical Standards, pre-shipment Inspections (PSI) is essential.

Once the products are ready to be exported, we should adopt the principles of labelling, packaging, packing and marking. This part of the work is the starting point o f satisfying the importers.

If the external technical standards in packaging, packing etc., are not followed, there would be rejection of the products, as they might get damaged and dissatisfy the importers.

Thus, if we sincerely and strictly adopt these technical standards, they become export promoting commercial other Instruments.

If we are not adopting, them, then the standards become non-tariff barriers and hinder export.

All these three areas have more specific and minute details to be followed. In this lesson, we will discuss important and major measures from the point of view of them, as Commercial Policy Instruments. More practical information could be obtained from specific topical books and visits to export industries.

Labelling, Packaging, Packing and Marking

Labelling

Labelling is the act of fixing labels on the export product. Its main purpose is to inform the consumer essential details in respect of the product as regards its quantity, quality, how to use and maintain it. Many a time, the foreign buyers demand a particular type of label to comply with the regulations of their countries. Different countries have different regulations as regards labeling of the product. One of the most common regulations is in respect of origin of the goods i.e. a product must carry the label to indicate the country in which it has been manufactured.

Information on a Label

Every label should contain the following information:

- Information to satisfy the legal requirements of a particular country.
- Instructions for taking care of the product.
- Dimensions of the product i.e., size weight, thickness etc.
- Inputs used i.e., the contents of the materials use in the manufacture of the product.
- Instructions of the use of the product.
- Country of origin.
- Name and address of the manufacturer.
- Lot number of the consignment.
- Date of manufacture and date of its expiry.
- Brief information about those who made it. It is particularly relevant in the case of items of handicrafts or other creative items.

Forms of Labels

Form of Label could be: Strip of cloth, Card label, Adhesive sticker, User's manual.

A good quality label has the following features:

- It includes all the relevant information.
- It is printed in the language of the importer's country.
- It is appropriate to the product. For instance, a label in the form of adhesive sticker on a leather purse or on a wooden article would not be appropriate as it would damage the product.
- It should be developed taking into consideration the colour and shape preferences of the prospective buyers.

E.g.: Black makes negative impact on Singapore, Japan etc. Green is welcomed by Muslim countries, red has negative impact on Africans. Japans consider 1, 3, 5 and 8 as having positive effect; Triangle package is not liked by Korea.

You would have seen GINETEX (International Association for Textile Care) Labels on imported garments with standard symbols.

Packaging and Packing

Packaging refers to a container in which the product reaches the end use *consumer.* It is a part of the presentation of the product and stays right till the customer takes it from the retail store. It should not he confused with packing. *Packing refers to the external protective covering use for the safe transportation* of the goods to the importer.

For example, plastic box used to pack a set of embroidered handkerchiefs is an example of packaging. On the other hand, the corrugated fiber board boxes which are used for packing the plastic boxes for their safe transportation to the importer in the foreign country would represent packing.

Packaging Functions

Packaging of goods for exports performs the following functions:

- The product is broken down into saleable units in terms of size or weight or any other dimension relevant to that product.

- It protects the product during transportation, storage, display and use.
- It conveys a message about handling of the product to the transporter / buyer / consumer during transport, storage, display and use.

Packaging Design

The design of the packaging should be developed very carefully to ensure that:

- The product is environment friendly to produce and dispose off.
- It is safe to handle during transportation.
- It is economical to produce, handle and store.
- It is very attractive when displayed.
- It is convenient and safe to use in compliance with the relevant standards of the target export market.

Packaging Materials

There are various types of materials available for packaging of the goods. Broadly, the selection of the packaging materials would depend upon the following factors:

- Product characteristics.
- Transportation and storage methods.
- Climate and culture.
- Standards and environmental considerations.
- Market position.

Kinds of Packaging

Plastic packaging, Paper based packaging, combined plastic and card board packaging, Miscellaneous packaging could be done according to the nature and needs of the products package.

Packaging Needs

The packing arises due to the fact that there are many stress and risks involved during the transportation of goods from the exporter to the importer.

- Stacking and storage of goods in the factory while waiting for loading on the truck or freight container.
- The boxes are loaded onto the truck and are transported by road to the nearest airport / sea port.
- The boxes are unloaded and are stored at the airport / sea port.
- The goods are packed into the freight container or loaded on the plane / ship.
- Sailing of the ship to the port of destination.
- Unloading of the containers at the port of discharge.
- The palletized goods are transferred with a forklift truck to a warehouse.

Packing Functions

The various functions of packing are as follows:

1. It holds the product for the total duration of the transport and distribution chain.
2. It protects the product from getting broken or being otherwise spoilt.
3. It makes the transport and handling of the product as easy as possible.
4. It informs various people in the transport a distribution chain.
5. It is also the task of the packing to make the transport and distribution of the product economical.

Types of Packing Boxes

Depending on the use of materials, the export boxes can be classified into the following:

- Corrugated fiberboard boxes
- Wooden boxes and crates
- Miscellaneous boxes such as gunny bags or steel drums
- Proper containers should be used, cushioning materials should be used.

All special type of packing should be done to avoid mould, mildew and corrosion. Packaging and Packing materials should also meet environmental requirements as insisted by importing countries.

Marking on the Export Boxes

The exporters should properly mark the export boxes in order to ensure their proper identification, correct handling and delivery to the consignee. You would have seen symbols to indicate top of the parcel, to keep dry (umbrella) etc.

Types of Marking

There are three different types of markings namely:

1. Shipping marks
2. Information marks
3. Handling marks

According to nature and need, proper markings must be made.

Check your Progress-1

Packaging and Packing are same. True ☐ False ☐

Black colour is considered to have negative impact in Japan. True ☐ False ☐

There are —— types of marking.

Pre-Shipment Inspection

Need

Pre-shipment Inspection and ISO: 9000 are discussed in detail in the other paper on Exim Financing and Documentation. Here we consider salient features of these two policy instruments.

What is Quality?

Quality of a product is defined as a set of attributes or specifications including packaging specifications in relation to a given product. It is the manufacturer who first decides the quality of a product before introducing it in the market. This may be done keeping in view the national or the international standards of quality as laid down by the respective national or international standards bodies.

The goods should be properly inspected to ensure that the quality of the export goods is maintained as desired by the buyers. Goods of poor quality spoil not only their own market but also bring bad name to the image of the country itself. It is, thus, in the business interest of the exporter to send shipment of the right quality to the buyer. This would also facilitate effective penetration.

The Government of India had recognized the need for effective pre-shipment inspection in 1963 itself when the Export (Quality Control and Inspection) Act, 1963 was enacted to provide for sound development of the export trade through quality control and pre-shipment inspection.

Types of Pre-Shipment Inspection

There are primarily two different types of pre-shipment inspection namely:

1. Voluntary Inspection
2. Compulsory Inspection

Voluntary Inspection

The following are the different forms of voluntary pre-shipment inspection:

- By the exporter himself
- By the buyer's representative
- By the buying agent in the exporter's country
- By the inspection agencies in the private sector

Compulsory Inspection

Compulsory pre-shipment inspection is conducted by the following agencies of the Government of India:

- Export Inspection Council through its Export Inspection Agencies
- Textile committee
- Development Commissioner (Handicrafts)
- Central Silk Board

Requisites for PSI

An effective system for the inspection of quality should provide for the following:

- Standards for quality of export product.
- Testing facilities and
- Procedural details

PSF by EIA

Products for compulsory PSI

The Government of India has notified 1057 items for compulsory pre-shipment inspection. These items relate to the product groups of:

- Engineering products.
- Chemicals and allied products.
- Food and agriculture products.
- Jute and jute products.
- Coir and coir products.
- Footwear and footwear components.
- Cashew.
- Fish and fish products.
- Miscellaneous products.

Inspection System

The Inspection Agency EIA provides for pre-shipment inspection under the following three different systems of inspection:

- Consignment-wise Inspection
- In-Process Quality Control (IPQC)
- Self-Certificate Scheme.

In-Process Quality Control (IPQC) System

The controls to ensure quality are exercised in relation to the following stages under this system:

- Raw materials and bought out components control
- Production process control
- Finished product control
- Metrological control
- Preservation control
- Packing control

Self Certification System

Under the system of Self Certification, the manufacturing units which have proven record of maintenance of quality are given the facility of self certification so that they can issue pre-shipment inspection certificate themselves. The unit should be well equipped with testing facilities and the required quality control systems.

- Product quality
- Design and development
- Raw materials/bought out components
- Organization and personal for quality control
- Process control
- Laboratory for control
- Metrology
- Quality audit
- Packaging
- After sales service
- House keeping and maintenance

Exemptions from Pre-Shipment Inspection

Units / products exempt from the requirement of compulsory pre-shipment inspection are as follows:

- Export House, Trading House, Star Trading House and the Super Star Trading House
- 100 % Export Oriented Units and the units set up in the Expoert Processing Zones or Free Trade Zones
- Items notified under the Export (Quality Control & Inspection) Act, 1963.
- Products bearing ISI mark or the AGMARK for exports.

Pre-Shipment Inspection by Textile Committee

The Government of India has set up the Textile Committee under the Textile Committee Act, 1963 to provide for sound development of the export of ready made garments and other textile products like yarn, fabrics, made ups etc., through quality control and pre-shipment inspection.

The head office of the Textile Committee is located at Mumbai with its regional offices in different parts of India.

Pre-Shipment Inspection by Development Commissioner (Handicrafts)

Development Commissioner (Handicrafts), Ministry of Textiles conducts pre-shipment inspection in respect of the export of India Items as provided under the Multi fiber Arrangement (MFA).

PSI by the Central Silk Board

There is a requirement of the pre-shipment inspection in those cases where the inputs had been imported for the export product under the Duty Exemption Scheme. The system of inspection is the same as followed by the Export Inspection Agency.

The export firm should have the Registration cum Membership Certificate (RCMC) from, the Indian Silk Export Promotion Council before approaching the Central Silk Board for the issue of pre-shipment inspection certificate.

Fumigation

The export of goods prone to insect infestation in storage and transit are subjected to compulsory fumigation to ensure that the goods reach their destination in safe condition. Such goods include de-oiled rice bran, crashed bones, hooves and horns.

Quality Systems

Need and Benefit of Quality System

The intense competition at the market place has brought into sharper focus the need for gaining the confidence of the customer in the firm and its products. The confidence (of the customer) in the firm as a reliable supplier of goods can be gained by providing him consistently with better quality products.

The introduction of quality system in an enterprise can be used as a marketing tool to generate customer satisfaction. Other benefits are:

- Competitive edge in the domestic as well as foreign markets.
- Can save resources as the quality systems ensure efficient and sound procedures.
- Reduction in the wastage of resources and the time consumed in rework and repairs. This results in increasing the amount of profits for the enterprise.
- Efficient tool to achieve and ensure consistent quality improvement.
- Confidence to the consumers as regards quality of the goods.
- Reduce the cost of production and offer the goods at low prices.

Quality Management System Standard: ISO 9000:2000

The international Organisation for Standardization (ISO) had developed in 1987 a series of international quality systems standards popularly known as ISO 9000 series of standards to provide the framework for the third party certification of the quality systems. These systems were revised in 1994.

The Bureau of Indian Standards (BIS) had also launched the Third Party Certification Scheme of Quality System known as IS:14000 later changed to (ISO:IS:9000) series of standards in India. This series of standards provide an assurance that the quality system installed and operated conform to the international standards and will generate the confidence of the customer in the quality offered by the firm.

The ISO 9000 series of standards were first published in India by BIS in 1988 and subsequently revised in 1994 as IS/ISO 9000 series of standards (IS/ISO 9001, 9002, 9003 etc.) with totally identical text as published by International Organisation for Standardisation.

Features of ISO 9000:2000 Standards

The essential features of the ISO-9000:2000 series of standards are as follows:

- They call for integration of all the activities which have a direct or indirect effect on the quality of a product or service.
- They tell suppliers and manufacturers as to what is expected of them in respect of a quality-oriented working system
- These standards define the basic concepts and specify the procedures and criteria to ensure that the final product meets the customer's requirements.
- These standards are designed to be user-friendly and are applicable to every product and service.
- These standards call for verification of quality system by the customer which gives him the confidence that the organization is capable of delivering the products of services of desired quality.

Elements of Quality Management System

The following are the elements:

- Documentation
- Management responsibility
- Responsibility, Authority and Communication
- Management review
- Resource management
- Product realization
- Customer-related processes
- Review of requirements related to the product
- Customer communication
- Design and dev elopement
- Purchasing
- Production and service provision
- Control of monitoring and measuring devices
- Measurement, Analysis and Improvement
- Corrective action
- Preventive action

Certification Procedures in India

Any business enterprise desirous of obtaining certification under ISO-9000 series of standards can apply to the Bureau of Indian Standards (BIS), Bahadur Shah Zafar Marg, New Delhi.

The Process of Certification

The following steps should be followed:

- Adequacy audit
- Preliminary visit
- Assessment fee
- Assessment
- Opening meeting

Conditions for the Grant of Licence

The licence is granted subject to the following conditions:

- The licence is granted for a period of there years.
- Grant of licence is followed by surveillance visits once in six months by the Auditor(s) of BIS to verify the effective implementation and maintenance of the quality system established by the firm.
- During the operation of licence, when a licensee fails to observe the conditions, licence is liable for suspension.

Check your Progress: 2

1. There are primarily ________________ types of PSI.
2. Cashew comes under Compulsory PSI ☐ True ☐ false
3. BIS stands for ____________________.

Summary

The first impression is the best impression. In this respect labeling, packaging and packing play a vital role in impressing the consumer and importer. Further, it enhances the value of the product and exporter by protecting the products using proper labels and packing materials. Marking helps safe handling of the packs / boxes.

Strict quality control alone can keep high the image of India when India products are exported. In order to ensure this, Pre shipment Inspection is useful. The types of PSI and produces were discussed.

Pre shipment inspection and quality management systems are connected to each other ISO: 9000:2000 helps as a bench mark of International guidelines for maintaining quality. PSI helps to implement these guidelines in practice. The combination helps to provide quality products and promote exports and given quality products to the importer. Both are satisfied.

Key Words

Packaging : The 'Container' in which the product purchase the end use consumer.

Packing : External protective covering used for safe transportation like big boxes cartons, bags, etc.

Marking : Indications marked on the external packing to keep them safe. to handle with care (fragile), keep dry, etc.

IPQC : In process quality control.

TQM : Total Quality Management.

PSI : Pre Shipment Inspection.

ISO : International Organisation for Standards.
(International Standards Organisation)

BIS : Bureau of Indian Standards.

Answers

(1) False (2) True (3) 3 (4) 2 (5) True
(6) Bureau of Indian Standards.

Self Assessment Questions

1. Define the following concepts
   (a) Labelling
   (b) Packaging
   (c) Packing
   (d) Marking
   (e) PSI
   (f) ISO: 9000
2. Explain the need for labeling, Packaging, packing and marking in International Trade.
3. How the packaging should be designed.
4. What are packaging functions.
5. What are different types of PSI?
6. List out the product groups for compulsory PSI.
7. What are the aspects to be considered for self certification?

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Lesson 2.4 - Exchange Controls and Non-Tariff Measures

Learning Objectives

After reading this Unit you should be able to:

- Comprehend the concepts of exchange control, exchange rate.
- Understand the objectives, methods and administrative procedures for exchange control.
- Examine the organizational flow of control with regard to exchange control.
- Know control of exchange rate measures
- Differentiate various types of non-tariff barriers.

Introduction

Need

Exchange control means controlling foreign exchange transaction in India. It is a system of conserving national wealth or increasing it. Our stability in the international market, and the respect which the currency of a country will command depend on the soundness of the exchange control. This also acts as a commercial policy instrument and affects free trade and acts as a barrier.

Historic Perspective

The patterns of world trade and global economics have undergone tremendous changes just like national frontiers after the two wars.

In India, Exchange control was introduced on the outbreak of the Second World War. On September 3, 1939, exchange control originated in India with provisions of Defense of India Act 1939, to help the U.K.'s war efforts and it was relating to transactions between India and then non-sterling area countries. The huge sterling balance accumulated on India's account in London during the war years were frozen by U.K. Government at the end of the war. After independence, India needed foreign exchange mostly to meet the requirements of her developing economy. But the freezing by UK affected this. The country's sources of foreign exchange earnings were limited to the exports of a few traditional commodities like tea, jute, etc. Thus, the freezing of the sterling balance and the needed imports of plant and machinery, raw materials, foodstuff, etc., led to large deficits in India's balance of payments, even when the country's foreign balances were supplemented by borrowing from abroad.

In order to conserve the country's scarce foreign exchange resources for use to the best national advantage according to a scheme of priorities and to correct the balance of payments deficits, the war-time measure was continued, taking advantage of the provisions of Article XIV of the IMF Agreement, as a peace-time control system under the Foreign Exchange Regulation Act, 1947, effective from March 25, 1945. This Act has since been replaced by the Foreign Exchange Regulation Act, 1973. The operations of the Exchange Control system have now come to encompass transactions with all countries outside India excepting Nepal and Bhutan.

Exchange Control

Definition

Exchange Control means official interference in the foreign exchange dealings of a country. The control may extend over a wide area, covering the import and export of goods and services, remittances from the country, inflow and outflow of capital, rate of exchange, methods of payment, maintenance of balance in foreign centers, acquisition and holding of foreign securities, financial relationship between residents and non-residents, etc.

Exchange control, in short, involves a rationing of foreign exchange among various competing demand for it, and is effected through control of receipts, or of payments, or of both as in India. The control of receipts is intended to centralize the country's means of external payments in a common pool in the hands of its monetary authorities to facilitate use thereof, and the control of payments is intended to restrain the demand for foreign exchange to protect the national interests within the limits of available resources.

Objectives

The main objects of exchange control are to maintain the value of the country's currency in terms of other currencies and to bring about and maintain equilibrium in the country's balance of payments, as far as possible.

Methods

Besides the control on the import and export of goods, the other methods, used for exchange control are:

a) Control of the exchange rate, i.e., fixing the exchange rate of the country's currency in terms of other currencies, exchange pegging, etc.

b) Fixing currency areas, which means, fixing the currencies in which payments for imports and exports should be made and received, to and from specified countries. Such fixing, by restricting the convertibility of home currency in terms of other currencies, help the growth of foreign exchange resources in approved currencies considered necessary in the national interest.

c) Bilateral agreements, which means, trade agreements between two countries contracted principally for the purpose of avoiding the balance of payments deficits.

Administration

The Exchange Control policy is determined by the Ministry of Foreign Trade, Government of India, on the basis of the Foreign Exchange Regulation Act, 1973, as amended by FERA 1993, while the day-to-day administration thereof is given to the Reserve Bank. This act has been modified as Foreign Exchange Management Act (FEMA) 1995. You will be studying in detail about Exchange control measures in Forex management paper. In order to achieve the objectives of the Control, the Exchange Control Department works in Coordination with the Trade control authorities who control the import and export of goods.

Various types of transactions which are affected by the Foreign Exchange Regulation Act are:

- Purchases and sales of and other dealing in foreign exchange and maintenance of balances at foreign centres.
- Export and Import of currency, Cheques, Drafts, travellers cheques and other financial instruments, securities, jewellery etc.
- Import formalities and procedure for realization of exports
- Transfer of securities between residents and non-residents and acquisition and holding of foreign securities and
- Payments to non-residents or to their accounts in India

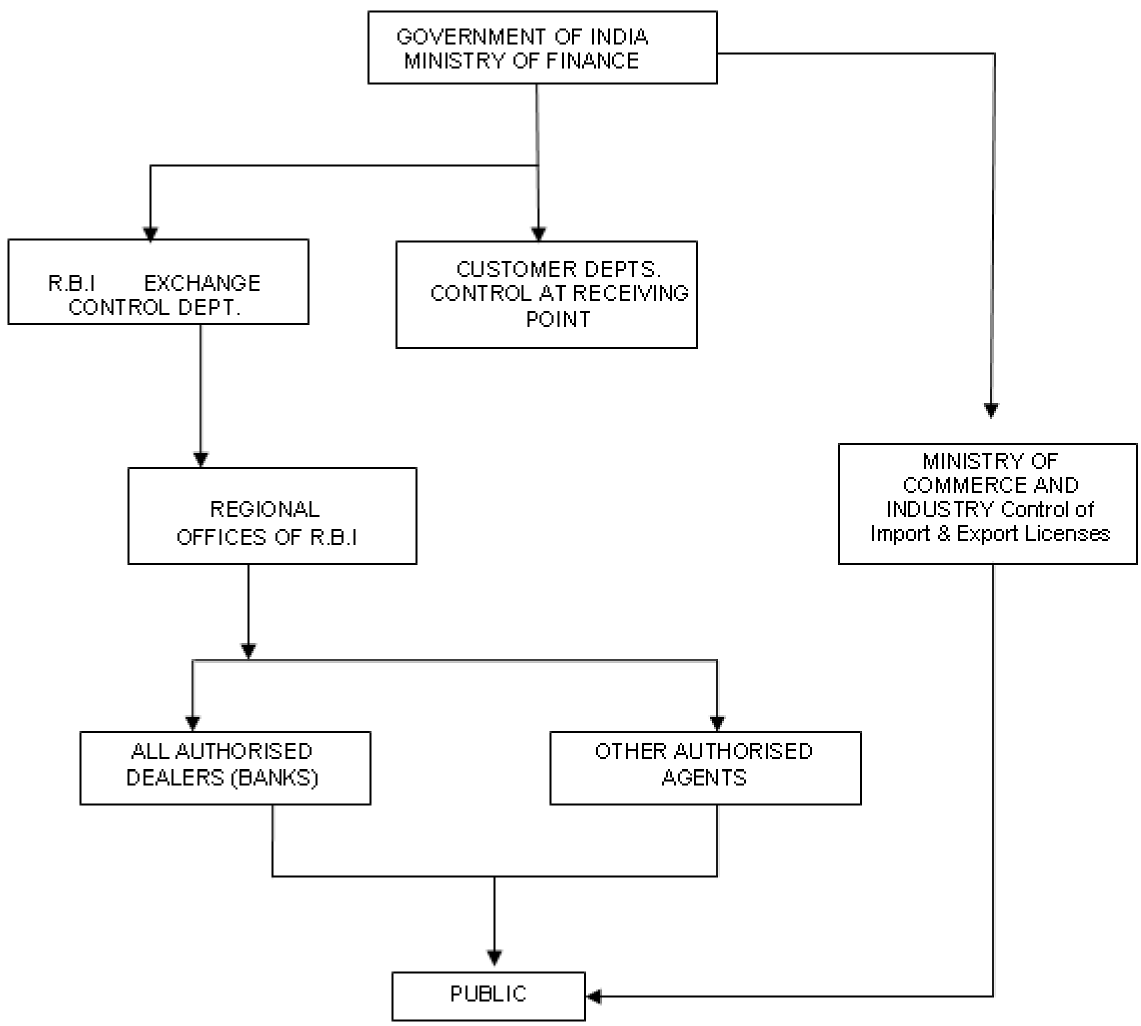
- Foreign travel with exchange
- Branches of foreign firm, FDI, foreign agents, joint ventures/subsidiaries
- Foreign nationals
- Acquisition of property outside India by Indians

The exchanges Regulations Control have two major channels of control

(1) Statutory

(2) Statistical

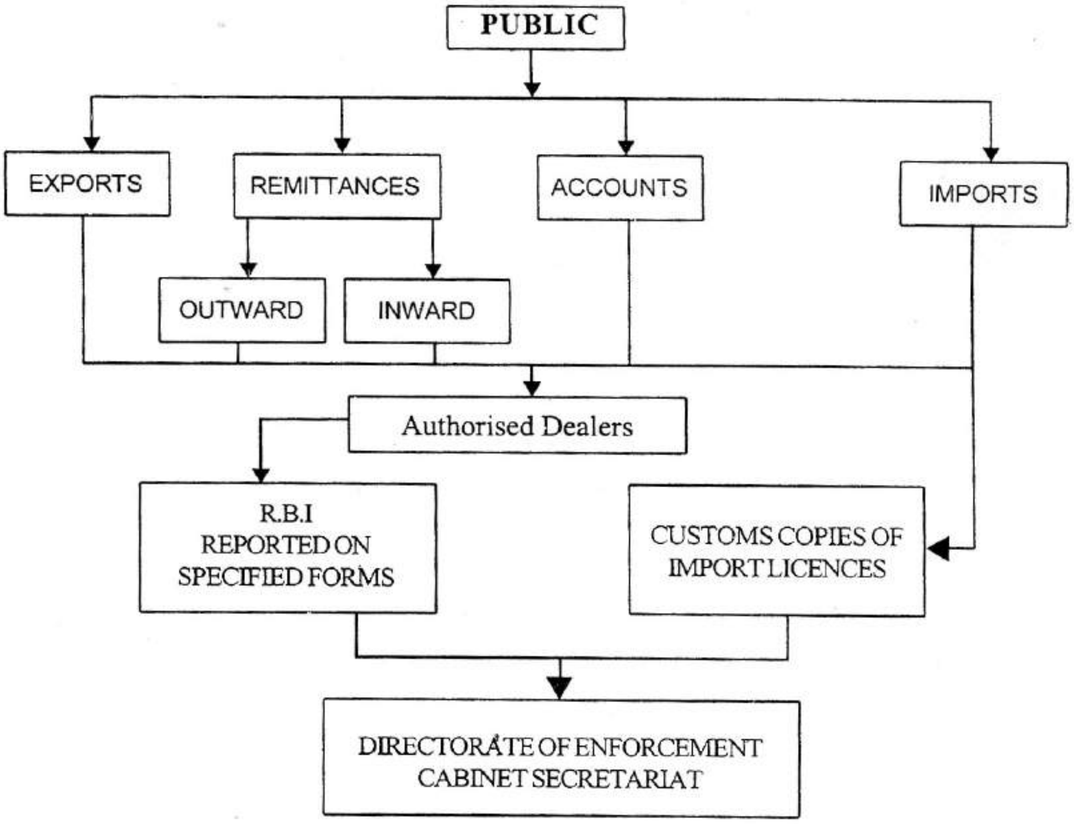
The Act lays down certain rules to be strictly followed namely the Do's and Don'ts of the law, laid down the Reserve Bank of India in consultation with the Government of India. Periodical notifications are issued regarding the amendments.



The regulations regarding Import and Export, although the basic statutory aspect is contained in the Exchange Control Manual, certain larger principles are controlled and monitored by the Controller of Imports and Exports and are kept periodically reviewed each year. These are contained in the Handbook of Import procedures and its enclosures published every year by the Government of India.

The exchange Control Manual is the bible for the ADs, ADs have to keep themselves abreast of the amendments to the statutory points furnished to them by the Reserve Bank of India in the form of A.D. circulars.

The chart shows how the exchange control is enforced practically and the various agencies involved.



A heavy responsibility rests on the Ads in not only interpreting the Rules laid down but to ensure that they (Bank) are thoroughly satisfied regarding (a) correctness of the statements made on the forms and (b) bonafides of the application. The Ads are expected to ensure that Exchange Control regulations are observed by themselves and their constituents both in letter and spirit.

The Directorate of Enforcement is the apex authority for adjudications and prosecutions for infringements of the Foreign Exchange Regulation Act and for a proper functioning of this Department and also to enable the Government to formulate its policies for subsequent periods, the statistical information conveyed by the public, through the ADs in various forms which are further codified as Returns by the Banks, is thus of vital importance. The information part should be given its due importance. The statistical feedback is the backbone for the effective operation of exchange control especially in the context of the fastly changing economy in the country and in the world. With the information supplied by the Banks, those in authority not only draw up the Balance of Trade for the country as a whole but also the Balance of payments in respect of each country and are called upon to take vital decisions regarding rates, quantum of trade and patterns of trade for the future.

Banks should pay equal attention to both the statutory and statistical angles of exchange control. It should also report to the Reserve Bank of India any case which may come to their notice of evasion of, or attempts, either direct or indirect of the Foreign Exchange Regulation Act.

Control of Exchange Earning

(a) Every person, firm, company or authority in India earning foreign exchange expressed in any currency other than the currency of Nepal and Bhutan by the export of goods or services or in any other way is required to surrender the foreign exchange to an AD and obtain payment in rupees within 3 months from the date of acquisition. This will help controlling forex.

(b) By its notification No. FERA 47/77-RB and FERA 48/77-RB of 24th November 1977, under Sections 8 and 9 of the FERA 1973, respectively, the Reserve Bank has made it obligatory for any person acquiring foreign exchange by way of income on assets held outside India, inheritance, settlement, gift, remuneration for services or by way of payments made on behalf of persons resident outside India, or any foreign exchange sent to or brought into India- to offer the same for sale to an AD within seven days from the date of receipt in or being brought to India.

Exceptions

Foreign exchange held by ADs, RBI authorized forex, NRI's lawful income outside India, coins, for numismatic purpose ($500), and forex for personal purpose ($500).

(c) The export of goods other than those essentially needed for use within the country as listed in Schedule 1 to the Export (Control) Order, 1968, or under deferred payment arrangements is free, which means it may be made without any permit or license. But the exporters are required to declare the export value of the goods before they are shipped and to lodge the shipping document for the collection of the export proceeds with an AD. The AD, in his turn, has to report the collection or non-collection, to the Reserve Bank in due course.

(d) The reserve Bank has listed the currencies in which payment for exports can be received. Thus, the export of goods from shipment till receiving of payment as well as the currency in which such payments can be received is under control.

Control Over Expenditure

(a) The spending of foreign exchange is almost fully controlled. Except for the few items listed in the Open General Licence (OGL) in operation for the time being, goods can be imported from outside India only against a licence. Such licences are issued by the Import Trade Control authorities (Chief Controller of Imports and Exports). The receipt into India of goods of a value equivalent to the amount of foreign currency paid out abroad is looked after by the Reserve Bank.

The import policy is framed by the Central Government, and the import licence, granted by the Import Trade Control authorities, permitting import of goods, carries with it permission to pay for them, while the Reserve Bank prescribes the currencies as well as the manner in which payment should be made.

(b) The licensing authority for the import of services, or for remittances otherwise than in payment of imported goods, or for the foreign exchange required for foreign travel, is the Reserve Bank and in some cases, the Government of India. The control is exercised through permits granted by the Reserve Bank against an application on a prescribed form.

(c) The issue of forex in any form, such as travelers cheques, notes coins etc, the persons resident in India even under instructions from an overseas branch/correspondent of an A.D requires prior permission of RBI.

Control of Exchange Rate

Exchange rates were controlled by RBI. On March 1, 1992 Liberalised Exchange Rate Management System (LERMS) was announced. US dollar was adopted as intervention currency. Dual exchange rate system was adopted: 60% forex earnings were converted at market rate and 40% were converted at official rate quoted by RBI.

This was abolished from March 1993 and the rupee was allowed to float relatively. The external value of rupee was determined entirely by the forces of demand and supply in the market. The official rate was abolished.

Check your Progress: 1

1. Exchange control originated in India with the provisions of__________
2. The Act which is relating to foreign exchange control is_____________
3. The official exchange rate was abolished from 1993 ☐ True ☐ False

Non-Tariff Barriers

Tariff barriers are visible barriers to trade and non-tariff barriers are hidden or invisible barriers to trade. Non-tariff barriers are prominent in recent years and they play active role in movement of goods and services in the world market. Countries have resorted to non-tariff barriers more frequently for protection. Rugman and Hodgetts have stated that "non-tariff barriers are imposed by nations to interfere deliberately with trade. Sometimes they arise out of domestic policy and economic management".

Objectives

Rugman and Hodgetts have discussed the objectives of trade barriers. They are given below:

- Protect local jobs by shielding home country business from foreign competition.
- Encourage local production to replace imports.
- Protect infant industries that are just getting started.
- Reduce reliance on foreign suppliers.
- Encourage local and foreign direct investments.
- Reduce balance of payment problems.
- Promote export activity
- Prevent foreign firms from dumping viz., selling goods below cost in order to achieve market share.

Here, we discuss all non-tariff barriers in a nut-shell including those discussed separately in detail, so that it could provide a total comprehensive picture of the non-tariff barriers.

Alan. M. Rugman and Richard.M. Hodgett's analysed Non-tariff barriers as follows:

Specific Limitation	Customs Administration Rules	Government Participation	Import Charges
Quotas (including Voluntary) Import Licences Supplementary Incentives Minimum Import Limits Embargoes Sectoral, Bilateral Agreements Orderly Marketing Agreements.	Valuation Systems Anti-dumping Rules Tariff Classification Documentation Needed Fees Disparities in Quality and Testing Standards. Packaging, Labelling and Marking Standards	Procurement Policies Export Subsidies and incentives Countervailing Duties Domestic Assistance Programme Trade Diverting	Import Deposits Supplementary Duties Import Credits Variable Levies Border Levies

Import Policy Barriers

Quota system which we discussed in lesson 2 is one such barrier. One of the most commonly known tariff barrier is the prohibition or restrictions on imports maintained through the **import licensing requirements.** Article XI of the GATT Agreement requires Members not to impose any prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures. Any form of import licensing (other than an automatic license) is, therefore, to be considered as an import restriction.

Certain restrictions on imports can be imposed in accordance with various provisions of the GATT. These include restrictions on grounds of s**afety, security, health, public morals** etc. (Article XX of GATT)**.**

These are however subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade. Similarly Article XXI of the GATT Agreement provides for certain security exceptions.

Import restrictions on some items on grounds of safety and security are being maintained generally by all the countries, and perhaps these cannot be considered as non-tariff barriers looking to the purpose for which the restrictions are imposed. The GATT allows import restriction to be maintained on grounds of '**Balance of Payment (BOP)** problems (XVIII B). Presently only seven countries maintain import restrictions on account of BOP problem. India is one of them. The others are: Bangladesh, Nigeria, Pakistan, the Philippines, Sri Lanka and Tunisia.

Apart from the import licensing, import charges other than the customs tariffs and **quantitative restrictions, (Quota)** are the other forms in which import restrictions can be imposed through the import policy.

Textiles is the most important commodity on which Indian exports fact quantitative restrictions in the form of MFA (Multi Fiber Arrangement) quotas in the main markets. MFA quotas have been in force for about a quarter of century (since 1972). In the USA, one of the main markets for Indian textiles exports, more and more items have been incorporated in the MFA quotas. So much so that since 1986, within six years the MFA quota coverage has expanded six times from 16% to 95% by the year 1992.

Quotas may provide some satisfaction to the exporters by way of ensured markets, but, these operate more dangerously to **prevent growth of exports** beyond quotas and the importing countries conveniently use them as an effective tool to protect their domestic industry.

Another related issue in the context of MFA quotas is the new US **Rules of Origin** which have resulted in some textile – visas being granted to non-originating goods.

Some agricultural products also suffer from quota regimes. Thailand maintains quota regime on imports of Soyabean which has adversely affected India's exports of oil meals which is a major export to Thailand. Similarly Canada also maintains quantitative restrictions and import licensing requirements for a variety of food and agricultural items.

Recovery of excessive service charges, disproportionate to the services rendered by the port or customs authorities also fall in this category. Notably Japan is one such case where Japanese Customs charge small packaging carriers unreasonable fees for customs clearances of high volume and low value shipments on the weekends and in the evenings.

Standards, Testing, Labelling & Certification Requirements

Standards, Testing, Labelling and Certification requirements are insisted upon for ensuring quality of goods seeking an access into the domestic markets but many countries use them as protectionist measures. The impact of these requirements is felt more by the purpose and the way in which these are used to regulate the trade.

Two of the covered agreements under the WTO namely, the Agreement on the Application of Sanitary & Phytosanitary Measures (SPM) and the Agreement on **Technical Barriers to Trade** (TBT), specifically deal with the trade related measures necessary to protect human, animal or plant life or health, to protect environment and to ensure quality of goods.

The SPM Agreement gives a right to take sanitary and phytosanitary measures necessary for the protection of human, animal or plant life or health provided:

- Such measures are not inconsistent with the provisions of the Agreement;
- They are applied only to the extent necessary;
- They are **based on scientific principles** and are not maintained without sufficient scientific evidence;
- They do not arbitrarily or unjustifiably discriminate between Members where identical or similar conditions prevail including between their own territory and that of other Members, and
- They are not applied in manner which would constitute a restriction on international trade.

It permits introduction or maintenance of sanitary and phytosanitary measures resulting in higher level of sanitary and phytosanitary protection that would be achieved by measures based on the relevant international standards, guidelines or recommendations only if there is a scientific justification. If a notice needs to be published at an early stage and a notification is required to be made of the products to be covered with an indication of the objective and rationale of the proposed regulation. The TBT Agreement also contains similar provisions with regard to preparation, adoption and application of technical regulations for human, animal or plant safety, protection of environment and to ensure quality of goods.

Both the Agreements also envisage special and differential treatment to the developing country Members taking into account their special needs. However, the **trade of developing country Members has often faced more restrictive treatment in the developed countries who have often raised barriers against developing countries on one pretext or the other.**

The Consumer Product Safety Commission (CPSC) and the Food and Drug Authority (FDA) in USA are responsible for ensuring quality of goods that enter the USA. Some of the instances of restrictions imposed by them include:

- Recall of Indian made ghagras (Skirts) on grounds of non-conformity to inflammability standards. This item was ultimately brought under MFA quota regime.
- Targetting of Indian rayon scarves on similar grounds of non-conformity to inflammability standards.
- Automatic import alert in respect of Indian fresh and frozen shrimps on grounds of filth, decomposition and presence of Samonella. This was extended even to cooked shrimps in early 1995 by the FDA.
- Targetting of Indian mangoes on the ground of presence of fruit fly and weevils.

In the case of the European Union (EU) reducing packaging waste and its impact on environment is an important concern. The EU have issued a directive in December 1994 requiring packaging materials to meet some technical standards, designed and produced in such a way to promote their reuse, recycling and energy recovery and at the same time minimizing their impact of environment.

In Germany, however the existing laws are still stricter which puts the **onus of disposal of waste on the wholesale distributors**. All these measures definitely have a great economic impact on developing countries exports to the EU Member countries.

Some of the other non-tariff barriers failing in this category are ban on import of goods (textiles and leather) treated with azo-dyes and pentachlorophenol, ban on use of all hormones, natural and synthetic in livestock production for export of meat and meat products, stipulation regarding pesticides and chemical residues in tea, rice and wheat etc., and requirement of on-board cold treatment for fruits and vegetables exported to Japan.

Anti-Dumping & Countervailing Measures

Anti-dumping and countervailing measures are permitted to be taken by the WTO Agreements in specified situations to protect the domestic industry from serious injury arising from dumped or subsidized imports. The way these measures are used may, however, have a great impact on the exports from the targeted countries. If used as protectionist measures, they may act as some of the most effective non-tariff barriers.

The number of anti-dumping investigations in the recent past has increased manifolds. Not every investigation results in the finding of dumping and / or injury to the domestic industry. But the period for which the investigations are on, and this period may be up to 18 months, the exports from the country investigated suffer severely. Anti-dumping and countervailing duties being product specific and source specific the importers well prefer switching over to other sources of supply.

Govt. of India issues notification on list of products and the names of countries for which Anti-dumping duties are applicable.

In some cases, the investigations, are prolonged or closing one, they short another investigation. The duty should be just adequate to remove the injury but USA, Canada apply full duty rule without considering the “rule of injury”.

Export Subsidies & Domestic Support

Generally the developing countries can hardly find resources to grant subsidies or domestic support. But developed countries like the members of the European Union and Japan have been heavily subsidizing their agricultural sector through schemes like export refunds, production support system and other intervention measures.

Under the Common Agricultural Policy, the EU subsidises European farmers up to $4bn every year, which end up mostly into the pockets of rich land lords who really do not need it. In 1992, Ray MacSharry, EU’s agriculture commissioner, calculated that 80% of the subsidies went to the richest 20% of farmers. For example, Queen Elizabeth receive annually $352,000, Saudi Prince Khalid Abdullah al Saud Claimed $192,000. Just imagine the result of such subsidies as the price of goods exported!

Procurement

Government procurement and bulk procurement policies followed by some of the countries act as a non-tariff barrier. Japan follows peculiar purchasing practices in the Government sector which are neither transparent nor uniform. Similarly the UAE and Saudi Arabia maintain preferential but-national policies giving a preference to local products in the governmental purchases or insist on a certain percentage of sub-contracting in favour of locally owned firms.

Services Barriers

Some of the measures which fall in this category include restrictive visa regime maintained by the USA which act as a severe restriction to India’s services exports, the local sponsorship requirement for visas for Saudi Arabia, the special measures Law concerning the handling of legal business by foreign retainers in Japan and restriction on issue of licences to the foreign professionals in service areas like accounting, architecture, engineering and legal services, etc., in Thailand.

Lack of Adequate Protection to Intellectual Property Rights

Lack of adequate protection to Intellectual Property Rights in some countries hurts the exports of other countries. For example, piracy of motion pictures, video cassettes, computer software etc., is widely practiced in some of the Gulf Countries, which affects Indian exports of these items.

Other Barriers

Some of the other main non-tariff barriers are discriminatory on account of use of **Child Labour, investment barriers, language barriers,** supply and Special 301 measures under the Omnibus Trade Act by the USA etc., use of child labour is increasingly growing as a serious concern in many countries. Carpets and sports goods have often faced criticism mostly from the non-governmental organisations for use of child labour. Various aspects of child labour the problems faced by poor children should all be considered in applying this barrier blind folded. Foreign exchange control is yet another form of barrier.

Conclusion

While tariffs having been already brought down substantially in the Uruguay Round, the future efforts are more likely to concentrate on the non-tariff issues.

It is not true that the non-tariff measures are entirely unnecessary. The WTO Agreements permit the Members to take measures to product human, animal or plant life or health, to conserve natural resources or to ensure the quality of goods finding an access in their markets. Members can also in certain circumstances take specified action to protect their domestic industry. **The non-tariff measures act as barrier if they are applied as protectionist measures in a disguise.** The non-tariff measures need, therefore, to be examined for their consistency with the WTO disciplines and whether they are applied as a protectionist measures in a **disguised form** or manner. Any problem faced could be taken to the WTO for better solution. Some of the non tariff barriers can be tackled by the exporters themselves by ensuring that they adhere to quality and standards requirements of the importing countries. For this purpose they need to plan production and packaging methods specially for the export markets, knowing fully the regulations in the importing countries.

Since any dispute in the WTO can be raised by the Governments only, the exporters will do well to fully cooperate with their Government and to provide it with all the necessary information through their association etc.

Check your progress: 2

4. GATT allows import restrictions to be maintained on grounds of BOP.

   ☐ True ☐ False

5. Anti-dumping duty and countervailing duty are different names for same.

   ☐ True ☐ False

6. Ghagras (Skirts) were recalled on grounds of non-conformity__________ Standards.

Summary

The development of exchange control system in India is traced from the war time efforts. The objectives, methods of exchange control are briefly narrated. The organization chart of the administrative system is described. The exchange rate control modification is also discussed.

Different categories of non-tariff barriers are discussed elaborately.

Key Words

Exchange Control	: Intervention of Govt. of India in foreign exchange dealings.
Authorised Dealer (AD)	: Bank authorized by RBI for dealing in foreign exchange.
FEDAI	: Foreign Exchange Dealer Association of India.
LERMS	: Liberalised Exchange Rate Management System.
Countervail	: Counter balancing the effect of Subsidy by addition duty.

Answers

(1) Defence of India Act 1939 (2) FEMA (3) True
(4) True (5) False (6) inflammability.

Self Assessment Questions

1. 'Exchange Control could also function as commercial policy Instrument' – Discuss
2. What are the objectives of exchange control?
3. Explain Methods of exchange control
4. Draw a flow chat to explain how exchange control is monitored in India.
5. Describe the objectives of trade barriers?
6. Classify different types of non-tariff barriers.
7. Write short notes on the following:
   (a) Import Policy barriers
   (b) Standards testing, labeling
   (c) Anti-dumping and countervailing measures.
   (d) Import Subsides and domestic support
   (e) Procurement by Govt.
   (f) Service barriers
   (g) Exchange control as a barrier.

CASE STUDY

"To keep pace with Industrial development, foreign investment must not be rigidly handled". Explain in the context of a developing country like India.

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UNIT – III

India's Foreign Trade and Policy

Learning Objectives

Objective of this lesson is to help students to understand.

- Export – Import Policy
- Deemed Exports
- Project and Consultancy Exports
- Direction and Composition of India's foreign trade
- Export Promotion and Institutional Setup
- Indian Joint Venture Abroad and
- Rupee Convertibility

EXIM Policy 1997-2000

The objectives and salient features of EXIM policy 1997-2000 and recent EXIM policy (2004-2009) are given below.

Objectives

The principal objectives of this Policy are: (i) To accelerate the country' s transition to a globally oriented vibrant economy with a view to derive maximum benefits from expanding global market opportunities, (ii) To stimulate sustained economic growth by providing access to essential raw materials, intermediates, components, consumables and capital goods required for augmenting production, (iii) To enhance the technological strength and efficiency of Indian agriculture, industry and services, thereby improving their competitive strength while generating new employment opportunities, and encourage the attainment of internationally accepted standards of quality, (iv) To provide consumers with good quality products at reasonable prices.

The objectives will be achieved through the coordinated efforts of all the departments of the government in general and the Ministry of Commerce and the Directorate General of Foreign Trade and its network of regional offices in particular, with a shared vision and commitment and in the best spirit of facilitation in the interest of export promotion.

Measures announced in the annual EXIM Policy

- Removal of Quantitative restrictions. Import of 894 items made licence free and another 414 items can be imported against Special Import Licence.
- Incorporation of a new chapter on policy to boost export of services.
- Free Trade Zones (FTZ) to replace export processing zones and these are to be treated as outside the country's customs territory.
- Duty Exemption Scheme has been made more flexible. Annual Advance Licence system introduced to take care of the entire Import needs of exporters. Other facilities include issuance of licence, where norms are not fixed, on the basis of self certification.
- Zero Duty export promotion capital goods scheme (EPCG) with lower threshold limit of ₹ crore extended to chemicals and textiles.
- Institution of Ombudsman for faster resolution of exporters' problems.
- Green card for exporters exporting 50 percent of their production. Green card will entitle them to various facilities announced by the Government from time to time.
- No additional customs duty on import of capital goods under zero duty EPCG scheme in marine and software sectors.
- Duty free import of consumables up to certain limits for gems and jewellery, handicrafts and leather sectors.
- Value addition for rupee exports to Russia reduced from 100 percent to 33 percent.
- Extension of the period for fulfillment of past export obligations in respect of advance licence and EPCG schemes.
- Entitlement of domestic tariff area sales for Export Oriented Units (EOUs) and EPZs increased to 50% of f.o.b value of previous year.
- Net foreign exchange earnings as a percentage of exports made uniform at 20% for both EOUs and EPZs.

- Golden status certificate for Export and Trading Houses, which means that an exporter who has been a status holder for three terms, will acquire this status permanently.
- Pre-export Duty Entitlement Pass Book Scheme (DEPB) credit entitlement increased from 5 to 10 per cent of previous year's performance.
- New thrust for jewellery and studded jewellery sector through various relaxations like permission for import of jewellery for re-export after repairs/ remaking, export of jeweliery through courier, personal carriage of jewellery and incorporation of a new concept of diamond imprest licence.
- Import of second hand goods of all kinds have been restricted and import of second hand capital goods under the EPCG scheme disallowed with the objective to provide level playing field to the domestic capital goods industry in light of the recent slowdown,

III. Other Measures

- Fresh Duty drawback rates announced w.e.f. 1 June, 1999. The new rates, which incorporate changes in customs duty and inclusion of surcharge, imply a rate hike for 155 items, rationalisation of rates for 489 items and maintainence of existing rates on 193 items.
- The facility for prepayment of external commercial borrowings up to 10 percent of the outstanding and a doubling of the eligibility to borrow for exporters (and long term borrowers) from $100 million to $ 200 million has been restored.
- To encourage trade with SAARC countries, wide ranging concessions on preferential basis In customs duties on imports from these countries have been effected by the Ministry of Finance.
- In order to reduce financing cost of imports and to provide credit at reasonable terms, the monetary and credit policy announced by the RBI in October, 1999, has withdrawn the interest rate surcharge of 30% on import finance. Also, the maximum interest rate of 20 per cent on overdue export bills has been withdrawn.

Foreign Trade Policy 2004 – 09

The annual supplement to the foreign trade policy for 2004-09, announced by Union Commerce and Industry Minister Kamal Nath on April 7, 2006 has addressed the longstanding demand of exporters to cut down transaction costs of exports. Apart from providing a slew of new export incentives, the policy has promised to beef up the electronic data inter-change (EDI) system for online filing of advance license, license under Export Promotion Capital Goods (EPCG) scheme and refund under duty entitlement pass book (DEPB) scheme.

Paying heed to exporters' demand in expediting and simplifying procedures for filing applications and obtaining licenses on various counts, the ministry has now assured exporters that, henceforth, all applications submitted on online EDI will be processed within one working day.

Exporters will not be required' to submit applications and supporting documents manually. Instead, they can file all applications relating to advance license, EPCG license and refund on DEPB to the DGFT website with a digital signature and can pay licence fee through electronic fund transfer mode.

The government has targeted a 20% increase in merchandise exports over 2005-06's achievements. The Minister of Commerce and Industry Mr.Kamal Nath explained that with each passing year the export base was increasing. So, in real terms, a 20% growth would be higher than the 25% growth in 2005-06.

In the year ending March, 2006, the value of merchandise exports touched the "auspicious figure" of $ 101 billion, registering a 2 5 % growth over the previous year. "This year's export figures are unprecedented. Merchandise exports have crossed the magic figure of $100 billion, "Minister of Commerce and Industry Mr.Kamal Nath said, while announcing the annual supplement to the foreign trade policy 2004-2009.

However, this increase was also accompanied by a 32% increase in imports, which stands at $140 billion. Trade deficit for the year 2005-06 is $39 billion, up from $25 billion in the previous year. The Minister of Commerce and Industry said: "Our imports have grown 32%, and stand at $ 140 billion, but $43 billion is our oil bill. Thus, our non-oil imports are $97 billion, a full $4 billion lower than our exports. On the non-oil front, therefore, we have a positive balance of trade."

What is worrisome is that India's oil import bill increased from close to $29 billion in 2004-05 to $43 billion in 2005 -06, largely on account of high global oil prices. India imports nearly 73% of its crude oil requirement and also sources petroleum products like LPG from abroad. This accounts nearly 30% of the country's import bill. Nonetheless, the minister said exports could touch $165 billion by 2009/10. This is without taking into account trade in services, which constitutes 52% of GDP, export-import in services exceeded $ 100 billion in 2005-06.

Exports from many sectors surpassed expectations. "Project goods exports grew at the rate of 173%. Exports of non-ferrous metals, guar gum meal, computer software in physical form, rice, pulses, dairy products, all recorded a growth surpassing 50%. Commodities like man-made staple fibres, cosmetics and toiletries, iron-ore, coffee, processed food and transport equipment grew at the rate above the average, that is more than 2 5 % during this period".

"India is steadily increasing its share in important markets. Growth in exports to UK has been 30%, to Singapore (with which we implemented the CECA) 54%. India's exports to South Africa grew at 44% while for China the growth rate is 35%," the minister said. The government proposes to bring out a detailed ready reckoner in May, 2006 showing India's increasing share in important markets.

New Steps to Replace Target Plus

Scrapping of the Target Plus scheme has left exporters fretting, but companies focusing on emerging markets, or rural products, are on a better wicket than others. Companies with buyers in Africa, CIS countries and Latin America stand to gain on all the products they export to these regions. The annual supplement to the Foreign Trade Policy promises 2.5 % additional import entitlement on their export turnover, irrespective of the product they export.

The move is aimed at encouraging exporters to tap non-traditional markets more aggressively. The list of countries that would be eligible to be covered under the 'Focus Market' scheme is yet to be finalised, government officials said. However, they feel Africa, CIS countries and Latin America would definitely be included in the scheme.

The Focus Products scheme promises 2.5% additional import entitlement for exporters shipping value-added fish, leather products, stationary, handlooms and handicraft items. However, the entitlement in this case would be only on 50% of their export turnover.

Together the two schemes are expected to result in duly exemption valued at around ₹ 2,500 crore. This is no compensation for the ₹ 8,000 crore worth of duty-free import, entitlement taken away by scrapping Target Plus, exporters feel. 0 P Garg, president of the Federation of Indian Export Organisations (FIEO), said the Target Plus Scheme *was* the only benefit available lo large exporters.

This category of exporters have not been provided any new facility though they contribute 60% of India's exports, he added. Interestingly, even small exporters do not seem to be too happy with the policy. "What's there in the policy for exporters?" quipped S P Agarwal, President of Delhi Exporters Association. Revenue notifications for the new schemes should be issued without delay, he said.

Scrapping of Target Plus could be an indication that the government is moving away from fiscal incentives for boosting exports. Instead, the emphasis is on facilitation and reduction of transaction cost.

While the 'Focus Market' scheme is aimed at enhancing India's export competitiveness in emerging markets, the 'Focus Products' scheme is aimed at compensating exporters for infrastructure inadequacies.

Though the commerce department is bullish on the job creation potential of new measures, especially the boost of select products, there are concerns that the schemes may be labeled as not compatible with World Trade Organisation (WTO) norms.

EOUs receive more words than matter

The policy has enabled fast-track clearance for disposal of left-over material. Units having a turnover of ₹ 15 crore, or more, will be allowed the facility of submitting consolidated procurement certificate and pre-authenticated procurement certificates. It has also been decided that interest would be paid on delayed payment of refunds to ensure accountability and cut delays.

The policy stated that that the new units, which are involved in export of agriculture, horticulture and aquaculture products, will now be allowed to take capital goods out of their premises. This can be done by producing bank guarantee equivalent to the duty forgone on the capital goods proposed lo be taken out. EOUs can use this provision to take their equipment to farms, for example.

The export promotion council for EOUs and SEZs said that the idea of fixing time limits for finalising the decision on matters related to EOUs would help this sector.

Export Obligation Extended by 2 Years

While the industry's demand for a duty-free import of machinery has been rejected, the government has decided to give greater flexibility to exporters under the Export Promotion Capital Goods (EPCG) scheme.

It has decided to extend the export obligation period by another two years for those exporters that are unable to meet their obligation on time. However, such an extension will be allowed only on the payment of 50% of the duties payable in proportion to the unfulfilled export obligation.

The EPCG scheme allows imports of capital goods at 5 % customs duty subject to the fulfilment of export obligations which could range from six-to-eight times of the duty saved on capital goods imported under the scheme.

This export obligation has to be met over a period of time, depending on the category of the industry seeking exemption under the scheme. For instance, in the case of agro units, the exemption is allowed subject to fulfilment of the export obligation equivalent to six times the duty saved over a period of 12 years from the date of issue of authorisation.

Thus, all units seeking exemption under the scheme are required to maintain the level of their base export performance and undertake additional export obligation for availing the facility of importing capital goods at reduced custom duty.

However, in a number of situations exporters find it difficult to maintain average export performance, owing to reasons such as sickness of the unit and international market dynamics among others.

In all such cases, the exporter approaches the government for an extension of the time period permitted for such exports.

Such cases are now being considered by the government on a case-by-case basis.

Moreover, obligations to meet a base level of exports every year have also been streamlined to give exporters the flexibility to cover up for lack of exports in one year in subsequent years.

BOOSTER DOSE FOR SERVICES

A special thrust on increasing exports of services is evident in the annual supplement to the foreign trade policy which was unveiled on 7TH April, 2006. Hotels now count payments received from foreign tourists in rupees for obtaining export incentives. Commerce & Industry Minister Mr.Kamal Nath has also expanded the Served from India' scheme to allow more flexibility to service exports. *The* measures announced by the government are with a view to bring service export norms in line with recent Reserve Bank guidelines.

Services account for 52% of GDP, and trade in services in 2005-06 exceeded $100 billion. The supplement to the foreign trade policy makes service exports in Indian rupees, which are otherwise considered as having been paid for in free foreign exchange by RBI, will now qualify for benefits under the 'Served from India' Scheme.

In addition, the foreign exchange earned through International Credit Cards and other instruments as permitted by RBI for rendering of service by the service providers shall be taken into account for the purposes of computerisation of entitlement under the Scheme.

Benefits of the Scheme eamed by one service provider of a group company can now be utilised by other service providers of the same group company including managed hotels. The measure aims at supporting the group service companies not earning foreign exchange in getting access to the international quality products at competitive prices.

This new initiative allows transfer of both the scrip and the imported input to the Group Service Company, whereas the earlier provision allowed transfer of imported material only.

Stand-alone restaurants will now be eligible for benefits under 'Served from India' Scheme at the rate of 10% of FOB value of exports (instead of the earlier 20%). (Source: The Economic Times, 8th April, 2006).

Exemption From Service Tax & FBT

This should come as a major relief to exporters who have been paying service tax and fringe benefit tax on exports. The government has decided that-exemption from these taxes is necessary to make sure that taxes are not exported.

The finance minister had introduced services taxes on a host of services including customs house agents and freight forwarders who are hired by exporters regularly. Imposing such levies on exports was counterproductive to the government's moves to boost export earnings. There was strong lobbying by the exporters to do away with these taxes.

Although official figures were not available, studies done by Chambers of Commerce indicated that the taxes paid on this account would be in the range of around 1 % on the FOB value of exports. "It could differ from sector to sector depending on the exports and value addition".

Direction of India's Exports

Kindle Bergar defines balance of payments as, 'a systematic record of all economic transactions between the residents of the reporting country and residents of foreign countries during a given period of time'.

It is a statement of systematic record of all economic transactions between one country and the rest of the world. In contains two sets of accounts. They are capital account and current account.

A modest attempt has been made to analyse balance of payments position of Government of India and composition of exports and imports. Balance of payments is analysed for the period 1990-91 to 2004-05 and composition of exports and imports for the two years, 2002-03 and 2003-04. Indicators of India's external sector are also analysed in this paper. The data required for the above analysis are gathered from the various issues of Economic Survey, Government of India.

Balance of Payments

Trends in exports, imports, trade balance, invisibles, current account balance and capital account are analysed for the period 1990-91 to 2004-05. The following table shows balance of payments position during the review period 1990-91 to 2004-05.

Balance of Payments

(US $ million)

S.No.	Year	Exports	Imports	Trade Balance	Invisibles (net)	Current account balance	Capital account balance
1	1990-91	18477	27915	-9438	-242	-9680	8402
2	1997-98	35680	51187	-15507	10007	-5500	9393
3	1998-99	34298	47544	-13246	9208	-4038	7867
4	1999-00	37542	55383	-17841	13143	-4698	10840
5	2000-01	45452	57912	-12460	9794	-2666	8508
6	2001-02	44703	56277	-11574	14974	3400	8357
7	2002-03	53774	64464	-10690	17035	6345	10640
8	2003-04	64723	80177	-15454	26015	10561	20860
9	2004-05 (April to September)	34451	51892	-17441	14182	-3259	10149

Table reveals that India's export in the year 1997-98 was US $ 35680 million and it has increased to US $ 37542 million in 1999-00, US $ 44703 million in 2001-02 and US $ 64723 million in 2003-04, showing the percentage increase of 81 per cent during the period 1997-98 to 2003-04. In the year 2004-05, for the period April to September, export remains at US $ 34451 million.

India's major trading partners are USA, UK, Belgium, Germany, Japan, Switzerland, Hongkong, UAE, China, Singapore and Malaysia.

The Economic Survey, Government of India, 2004-05, reveals that exports registered an increase of 25.6 percent in US dollar terms in April – January 2004-05, substantially higher than the annual target of 16 percent as well as the rise of 11.7 percent recorded in the corresponding period of the previous year. In the foreign trade policy 2004-09, Government 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 percent, thus doubling the share of India in global exports to 1.5 per cent.

India's import in the year 1997-98 was US $ 51187 million and it has increased to US $ 55383 million in 1999-00, US $ 56277 million and US $ 80177 in the year 2003-04, recording the percentage increase of 57 percent during the period 1997-98 to 2003-04. In the year 2004-05, for the period April to September, import remains at US $ 51892 million.

It is also attempted to compute Karl Pearson Coefficient of Correlation between exports and imports during the period 1992-93 to 2004-05. Correlation shows relationship between exports and imports. Correlation between India's exports and imports during the period 1992-93 to 2004-05 is +0.962. It shows that there is a perfect positive correlation between India's exports and imports.

Export-import ratio is also computed to assess what is imported for every one rupee of export? The following table shows export-import ratio for the period 1997-98 to 2004-05.

Export-Import Ratio

Year	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
Import for one rupee of export (₹)	1.46	1.38	1.45	1.27	1.27	1.19	1.23	1.53

Table shows for every one rupee of export, import was 1.46 in 1997-98, 1.38 in 1998-99 and 1.45 in 1999-04. After 1999-00, this ratio is on declining trend. It shows that the magnitude of gap between export and import is getting narrowed. The ratio was 1.27 in the year 2000-01 and 2001-02, 1.19 in 2002-03 and 1.23 in 2003-04.

Trade balance is on increasing trend during the review period 1997-98 to 2004-05. It was US $ 15507 million in 1997-98 and increased to US $ 17841 million in 1999-00. It remains at US $ 15454 million in 2003-04. The trade deficit is decreased by one percent during the period 1997-98 to 2003-04.

Invisibles play a vital role in determining balance of payments in India. Invisibles (net) is on increasing trend after liberalization. Invisibles (net) was US $ 10007 million in 1997-98 and it has increased to US $ 13143 in 1999-00. US $ 14974 million in 2001-02 and US $ 26015 in 2003-04 recording the percentage increase of 160 per cent during the review period 1997-98 to 2003-04. Invisibles (net) during the period April to September, 2004-05 remains at US $ 14182 million. Invisibles receipts for the year 2001-02, 2002-03 and 2003-04 are more than trade deficit. So current account balance remains at surplus during the three years.

The current account balance was negative in the year 1997-98, 1998-99, 1999-00 and 2000-01, current account had a surplus in the year 2001-02, 2002-03 and 2003-04. In the year 2004-05, April to September, current account deficit remains at US $ 3259 million. The Economic Survey, Government of India 2004-05 reveals that the current account surpluses during the current decade are largely attributable to the buoyant inflows of invisible receipts. As a proportion of GDP, the invisibles balance increased by 1.2 percentage points from 3.1 per cent in 2001-02 to 4.3 per cent in 2003-04. The increase was particularly sharp in 2003-04, when net invisibles inflows increased by more than 50 per cent from US$17 billion in 2002-03 to US$26 billion in 2003-04. Non-factor services and private transfers comprised more than 90 per cent of total invisible receipts in 2003-04, with their individual shares in total receipts at 47.1 per cent and 43.7 per cent, respectively.

The steady growth of non-factor services receipts, and the concomitant strengthening of the invisibles balance, can be, inter alia, attributed to the rapid rise in software services exports. From a relatively low share of only 10.2 per cent in 1995-96, exports of software services came to occupy 48.9 per cent of India's total services exports in 2003-04, highlighting the country's growing comparative advantage in production and export of such services. The growth in information technology IT-enabled services (ITES) and business process outsourcing (BPO) has been very satisfactory, with such exports experiencing more than six-fold increase between 1999-00 (US$565 million) and 2003-04 (US$3.6 billion). The year

2003-04 was also characterized by a turnaround in travel receipts, which increased by more than US$800 million compared to 2002-03. This turnaround not only bolstered overall invisible inflows, but also underlined a sharp revival in tourism interest in India. Besides software services and travel, transportation receipts increased by nearly US$700 million in 2003-04, primarily on account of higher earnings by the Indian shipping industry. The year experienced net positive transportation earnings (almost US$ 1 billion) after almost two decades.

Apart from software services, growing volume of private transfers, driven essentially by workers remittances, have been one of the main reasons behind the expanding surpluses in the current account. Private transfer inflows increased by around US$6 billion in 2003-04, up nearly 35 per cent over the previous year. Remittances from overseas Indians constituted 83 per cent of these transfers. As a proportion of GDP, workers remittances have increased from 0.7 per cent in 1990-91 (US$2.1 billion) to 3.2 per cent in 2003-04 (US$19.2 billion), making India one of the largest global recipients of such inflows. Source-wise, remittances from Indians in advanced economies (mainly the US and Europe) now form the bulk of such transfers, as compared to those from the Gulf countries in the past.

By growing faster than merchandise trade, services trade is increasingly becoming of paramount importance in the global trade matrix. Services trade has special relevance to India, a country with a good potential in many services.

While the first quarter of the current fiscal witnessed buoyant invisibles inflows (net), the second quarter, in a sharp reversal of the trend, experienced a fairly significant drop in the volume of invisibles (net). As a result, the trade deficit of US$12.3 billion during the second quarter was left uncovered by US$6.4 billion, which resulted in not only a current account deficit of an equivalent amount for the quarter, but also a current account deficit for the first half of the current year. Receipts of both non-factor services and private transfers dropped during the second quarter, by US$1 billion and US$1.7 billion, respectively, compared to the first quarter of the current fiscal.

Among non-factor services, transportation earnings recorded net outflows (US$90 million) during the second quarter, as against net inflows (US$339 million) during the first quarter, largely on account of higher transportation expenses arising from growing domestic demand for imports. Software service exports, however, continued to remain buoyant, registering an increase of 28.7 per cent in April-September 2004 over April-September 2003. The invisibles balance for the first half however was significantly, affected by the sharp decline in workers remittances.

Capital account balance was US $ 9393 million in 1997-98 and it has increased to US $ 10840 million in 1999-00 and US $ 20860 million in 2003-04. The India, external trade transactions are more than external investment transactions. So current account is given greater importance than capital account in balance of payments. If a country receives more and more external loans, it may add capital account inflow, but it will create heavy outflow in current account in the form of debt service. Capital account surplus which is created by foreign / international loans may contribute to current account deficit.

Indicators of External Sector

S. No.	Year	Exports	imports	Trade Balance	Invisible Balance	Current Account Balance	External Debt	Import cover of forex reserve in months
1.	1990-91	5.8	8.8	-3.0	0.01	-3.1	28.7	2.5
2	1997-98	8.3	11.5	3.2	2.2	-1.0	23.6	8.2
3	1999-00	8.4	12.4	-4.0	2.9	-1.0	22.1	8.2
4	2000-01	9.9	12.7	-2.7	2.2	-0.5	22.6	8.8
5	2001-02	9.4	11.8	-2.4	3.1	0.7	21.2	11.5
6	2002-03	10.6	12.7	-2.1	3.3	1.2	20.3	14.2
7	2003-04	10.8	13.3	-2.5	4.3	1.8	17.8	16.9

Table shows that in the year 1998-99, India's export was 8.3 percent of GDP and it has slowly increased to 9.9 per cent in 2000-01, and 10.8 percent in 2003-04. Similarly imports 11.5 per cent of GDP in 1998-99, 12.7 percent in 2000-01 and 13.3 per cent in 2003-04. India's foreign exchange reserve position is comfortable. Import cover of foreign exchange reserve was 8.2 months in 1998-99 and it has increased to 14.2 months in 2002-03 and 16.9 months in 2003-04.

External Trade

India's total external trade, including goods and services, grew by 44.2 per cent to |JS$268 billion in 2004-05. Growth was 41.5 per cent in the first half of 2005-06, with value of such trade at US$163 billion. Trade in services has been growing faster than merchandise trade-for example, in 2004-05, growth in services trade was 78.6 per cent, compared to 33.6 per cent in merchandise trade. The share of services in total trade increased from 23.5 per cent in 2003-04 to 29.1 per cent in 2004-05 and further to 34.4 per cent in the first half of 2005-06.

Merchandise Trade

India's merchandise exports (in dollar terms and customs basis), by continuing to grow at over 20 per cent per year in the last 3 years since 2002-03, have surpassed targets. In 2004-05, export growth was a record of 26,2 per cent, the highest since 1975-76 and the second highest since 1950-51. Supported by a buoyant world economy (5.1 per cent) and import volume (10 per cent) growth in 2004, there was an upswing in India's exports of primary commodities and manufactures, and Indian exports crossed US$80 billion in 2004-05. The good performance of exports (growth of 18.9 per cent) continued in April-January 2005-06, despite the slightly subdued growth of global demand, and floods and transport disruptions in the export nerve centres of Mumbai and Chennai.

Performance of the Foreign Trade Sector
(Annual percentage change)

Year	Export Growth			Import Growth			Terms of Trade	
	Value (in US Dollar terms)	Volume	Unit value	Value (in US Dollar terms)	Volume	Unit value	Net	Income
1990-00	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
1999-00	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	27	0.3	19.4	9.5	10.7	-9.4	10.3
2003-04	21.1	6.0	8.5	27.3	20.9	-0.1	8.6	15.1
2004-05	26.2	13.2	8.9	39.7	8.8	25.7	-13.0	-2.0
2005-06*	18.9			26.7				

While volume growth dominated export performance till 2002-03, there is an increasing contribution of higher unit values in recent years (Table). This change, evident in the last two years, coincided with a rising share of high value gems and jewellery items, gradual shift to garments from fibres and fabrics, and the sharp rise in prices of non-fuel primary items like ores and minerals, iron and steel and non ferrous metals. The net terms of trade which have been witnessing a continuous decline since 1999-00, showed a sharp rise in 2003-04 mainly due to the rising export unit values. Growth of exports in dollar terms was faster than the same in rupee terms with the continued appreciation of the rupee between 2003-04 and early 2005. Export volume growth, which was subdued in 2003-04, picked up in 2004-05. With a rise in both export volume and unit value, export's purchasing power to import measured by the income terms of trade, which has been improving consistently during the 1990s (except 1996-97) improved further in 2003-04. However, in 2004-05, there was a sharp deterioration in both net and income terms of trade mainly due to the sharp rise in import unit value of crude petroleum, gold and other primary commodities.

India moved one notch up the rankings in both exports and imports in 2004 to become the 30th leading merchandise exporter and 23rd leading merchandise importer of the world. The momentum 'n export growth continued, though at a decelerated pace, in 2005-06. After a fall in November 2005, export growth rebounded in December 2005. Overall exports in April-January 2005-06 was US$ 74,9 billion, vis-a-vis the target of US$ 92 billion for 2005-06 as a whole.

Both external and domestic factors have contributed to the satisfactory performance of exports since 2002-03. While improved global growth and recovery in world trade aided the strengthening of Indian exports, firming up of domestic economic activity, especially in the manufacturing sector, also provided a supporting base for strong sector-specific exports. Various policy initiatives for export promotion and market diversification seem to have contributed as well. The opening up of the economy and corporate restructuring have enhanced the competitiveness of Indian industry. India's impressive export growth has exceeded world export growth in most of the years since 1995; but, since 2003, it has lagged behind the export growth of developing countries taken together, mainly because of China's explosive export growth. India's share in world merchandise exports, after rising from 0.5 per cent in 1990 to 0.8 per cent in 2003, has been stagnating at that level since then with marginal variation at the second decimal place (Table). This is a cause for concern. Foreign Trade Policy (FTP) 2004-09 envisages a doubling of India's share in world exports from 0.75 per cent to 1.5 per cent by 2009. To achieve this target, Indian exports may need to exceed US$150 billion by 2009 as world exports are also growing fast.

Export growth and share in world exports of selected countries

Country	Percentage growth rate				Share in world exports				Value (US$ billion) 2004
	1995- 01	2003	2004	2005*	2001	2003	2004	2005*	
1. China	12.4	34.5	35.4	32.1	4.3	5.9	6.6	7.2	593.0
2. Hong Kong	3.6	11.9	15.6	11.4	3.1	3.0	2.9	2.8	259.0
3. Malaysia	6.6	6.5	26.5	12.1	1.4	1.3	1.4	1.4	125.7
4. Indonesia	5.7	5.1	11.2	44.6	0.9	0.9	0.8	0.8	71.3
5. Singapore	4.1	15.2	24.5	14.8	2.0	1.9	2.0	2.0	179.6
6. Thailand	5.9	17.1	20.0	12.9	1.1	1.1	1.1	1.1	96.0

7. India	8.5	15.8	25.7	21.0	0.7	0.8	0.8	0.8	71.8
8. Korea	7.4	19.3	30.9	18.1	2.5	2.6	2.8	2.8	254.0
9. Developing countries	7.9	18.4	27.1	21.2	36.8	38.8	40.7	42.4	3685.1
10. World	5.5	15.9	21.2	14.9	100.0	100.0	100.0	100.0	9049.8

Source: IPS statistics, IMF. * January-August, 2005

The world economy in 2004 had recorded its strongest growth in more than a decade, providing the foundations for a volume expansion of world exports and imports by 9 per cent and 10 per cent, respectively, powered by the growth in trade of manufactures at 10 per cent. The strong growth in world trade in 2004 was more in nominal terms, with value of world merchandise growth registering a rise of 21 per cent. This was mainly due to the price increase in primary commodities following a sharp rise in demand particularly for fuels and other mining products, and a rise in Europe's dollar prices and nominal trade values from the depreciation of the US dollar by 9 per cent vis-a-vis a basket of European currencies. After the estimated markedly lower expansion of 6.5 per cent for 2005, according to the WTO, with a moderate recovery of the world economy in 2006, volume of world merchandise trade is likely to accelerate to 7 per cent in 2006.

While high growth in global output and demand, especially in the major trading partners of India, helped, it was the pick up in domestic economic activity, especially the consistent near double-digit growth in manufacturing, that constituted the main driver of the recent export surge. In 2004-05, India's manufacturing exports grew by 21 per cent and had a share of around 74 percent in total exports. Vis-a-vis the US dollar, the Indian rupee, which had started strengthening from June 2002 onwards, appreciated by around 2.2 per cent on an annual average basis in 2004-55. As per the revised Real Effective Exchange Rate (REER) of the RBI, which is currency-trade-based-weights index providing a better reflection of India's trade competitiveness, rupee appreciated by 2.5 per cent in 2004-05, on an annual basis. While the appreciation of the rupee remained around the benchmark over the long horizon and orderly and smooth, the adjustment cost to industry appears to have been limited with productivity gains. Furthermore, in more recent times, though the REER (six currency index) for November 2005 reflects an appreciation of above 7 per cent, the rupee started to depreciate in nominal terms from August 2005.

Further productivity gains in the export sector require a deepening of domestic reforms, and an accelerated removal of infrastructure bottlenecks, including export infrastructure. Infrastructure remains the single most important constraint to export growth. -Achievement of the ambitious export target set in Foreign Trade Policy (2004-09) requires a projected augmentation of the installed capacity of ports by 140 per cent. Indian ports, which handle over 70 per cent of India's foreign trade even in value terms, have a turn-around time of 3-5 days as against only 4-6 hours at international ports like Singapore and Hong Kong. As for internal transport, while there has been a perceptible improvement in the national highways, secondary roads need to be improved and the issue of delays caused at inter-state check points need to be addressed.

As trade grows and the number of consignments increases, there is a need not only for improved trade infrastructure, but also for streamlining trade data infrastructure to remove any data anomalies and provide the basis for appropriate policy formulation. 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 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.

Growth in India's merchandise imports in 2004-05 at 40 per cent in dollar terms was the highest since 1980-81. This surge in growth in 2004-05 was mainly due to the steep rise in price of crude petroleum and other commodities with value of POL imports increasing by 45.1 per cent. While volume growth in import of POL was subdued at 6.4 per cent, largely in response to the price increase, larger imports filled the gap between growing demand and stagnant domestic crude oil production. In 2004-05, lower tariffs, a cheaper US dollar, a buoyant manufacturing sector and high export growth boosted non-oil imports by 39 per cent, particularly capital goods, intermediates, raw materials and imports needed for exports.

Buoyant growth of imports of capital goods at 21 per cent, on top of the 40 per cent growth in 2003-04, reflected the higher domestic investment and firming up of manufacturing growth. A significant contributor to the rise in non-POL imports was the 59.6 per cent growth of gold and silver on the back of a 59.9 per cent growth in 2003-04, due to the high international gold prices. The duty reduction on important gold from ₹ 250 to ₹ 100 per 10 gram and liberalization of such imports as per trade facilitation measures announced in January 2004 could also have provided a fillip. Non oil non bullion imports increased by 31 percent in 2004-05, compared to a rise of 28.5 per cent in 2003-04.

In the current year, imports continue togrow, though at a decelerated pace. The 26.67 per cent growth in imports in April January 2005-06 was contributed by that growth in POL imports of 46.91 per cent. This was mainly due to the rise in prices, by quantity growth was only 1.6 per cent in April - November 2005. While non-oil imports increased by 18.81 per cent in April-January 2005-06, non-oil non-bullion imports increased by 30.8

per cent in April-October 2005-06 (on top of a 29.9 per cent increase in the corresponding period of the previous year indicating the economy's growing absorped capacity for imports. Gold and silver import growth accelerated during the same period. Owing to the firming up of international gold prices which reached a high of US$510 per troy ounce in December 2005. Gold prices rose further to US$570.9 per troy ounce on February 2, 2006.

Unlike in 2003-04, the surge in PCL imports in 2004-05 and 2005-06 (April-November) was dominated by the price import (Figure). International crude oil (Brent variety, per barrel) prices, trending upwards since 2002, on average, rose from US$27.6 in 2002-03 to US$28.9 in 2003-04, US$ 42.1 in 2004-05, and further to US$56.64 per barrel in April-November 2005 with a peak of US$67.33 on August 12, 2005. The stiffering of global crude oil prices was contributed by a combination of heightened demand, limited spare capacity and geopolitical threats to the existing capacity. Crude oil prices have since moderated and was ruling at US$60.76 per barrel as on February 9, 2006.

The surge in crude oil prices has sharpened the focus on the adverse impact of such volatility on domestic prices and the need to minimize such 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 geopolitically sensitive regions. 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.

With a widening trend in recent years, the trade deficit reached a high of US$28.6 billion (as per customs data) in 2004-05, and this high was surpassed by a record US$33.8 billion in April-January 2005-06 itself. While this is a cause for concern, it may reflect a lag between export growth and growth in import of capital, intermediate and basic goods. With a slowdown in imports in November, December, 2005 and January 2006, growth in trade deficit has decelerated from 71 per cent in April-September 2005 to 69 percent in April-November 2005 and further to 54 per cent in April-December 2005 and 48 per cent in April-January 2005-06. One notable feature in the recent past is the deficit in non-oil balance; in surplus in 2003-04, it turned negative with a deficit of US$5.6 billion in 2004-05 and US$5.8 billion in April-October, 2005, considerably higher than the deficit of US$1.1 billion in April-October, 2004. This may again reflect the growing industrial and export demand, which will materialize only with a lag.

Composition of Merchandise Trade

Export growth in 2004-05 continued to be broad-based with good performance in most of the sectors. Manufactured exports, with a share of 73.7 per cent in total merchandise exports, continued to grow at 21 per cent. The most notable feature was the 91 per cent growth in exports of petroleum products, with a perceptible increase in its share in total exports. It reflected not only the rise in POL prices, but also India's enhanced refining capacity developed with a supportive tariff structure [Table]. Exports of primary products grew by 29.4 per cent with rapid growth in exports of ores & minerals, induced by strong international demand and higher prices.

Commodity composition of Exports, April – October 2004-05

Commodity Group	Percentage share				Growth Rate*			
			April – October				April – October	
	2003-04	2004-05	2004	2005	2003-04	2004-05	2004	2005
I. Primary products	16.4	16.8	14.8	16.1	17.3	29.4	39.7	17.0
Agriculture & allied	12.4	10.5	11.2	9.9	11.9	7.4	27.0	8.8
Ores & minerals	4.0	6.3	4.9	5.4	18.2	97.1	81.1	36.9
II. Manufactured goods	76.9	73.7	74.1	72.4	20.0	20.8	20.2	20.5
Textiles including ready made garments	16.6	12.1	13.2	11.8	21.5	-2.2	9.3	10.5
Gems & jewellery	18.6	17.1	17.4	17.9	16.8	29.9	20.8	26.9
Engineering goods	19.3	20.6	20.2	20.1	30.2	31.8	36.6	23.1
Chemical & related products	11.9	12.1	11.8	11.1	22.7	25.1	30.1	15.9
Leather & manufactures	2.3	1.9	2.1	1.7	15.7	6.1	16.9	6.3
Handicrafts	0.8	0.5	0.5	0.5	-4.8	-26.4	-19.6	1.6
III. Petroleum crude & products	5.6	8.4	8.7	11.1	38.1	90.5	89.4	57.7
Total Exports (I+II+III)	100.0	100.0	100.0	100.0	21.1	26.2	28.3	23.5

Source: DGCI&S, Kolkata * In US$ terms;

Within manufacturing, high performers were: engineering goods (mainly manufactures of metals, machinery and instruments, transport equipment and primary, semi-finished iron & steel and non-ferrous metals); gems and jewellery; and chemicals and related products (including basic chemicals, pharmaceuticals and cosmetics, plastics and linoleum, rubber, glass and other products and residual chemicals and allied products). Despite the new opportunities that opened up with the phasing out of textiles quotas, textiles exports showed a disappointing negative growth. In agriculture exports, besides traditional items like cereals, cashew nuts, spices and rice and pulses, non-traditional items like poultry and dairy products and fruits and vegetable seeds registered high growth.

Export performance in April-October 2005 continued to be broad-based, with manufactures in the lead, and engineering goods, gems and jewellery, and chemicals and related products registering good performance. The growth of petroleum products, though impressive, was slightly subdued possibly due to the fire at Mumbai High and transport disruptions due to floods, Primary products growth moderated somewhat due to slowdown in demand from China for ores and minerals, though its growth was still impressive. One notable feature was the growth in project goods by more than 200 per cent.

In textiles, with the quota regime giving way to free market at the global level at the beginning of 2005, there is a lot of expectation from the Indian textile industry. So far, while China's performance exceeded expectations, India's performance has not been satisfactory. Following the supportive measures announced in Budget 2005-06 textiles exports showed a revival with a growth of 10.5 per cent in April-October, 2005.

Bull China's growth of textiles exports was double at 21 per cent in the comparable period April-November, 2005. While export growth was somewhat better in readymade garments (16 per cent) and to the US (25 per cent in April-November, 2005), it was far below the corresponding growth of Chinese export to the US of 51 per cent. The low scale intensity of textiles manufacturing has deprived India the opportunity to make the best of her comparative advantage in labour. Some of the major problems plaguing the sector, like reservation for the small scale sector, have been addressed. Nevertheless, substantial investment, both domestic and foreign, is needed to achieve a quantum jump in textiles exports.

Growth of exports of gems and jewellery, a major contributor to India's exports, accelerated in April-October 2005, with USA the largest market accounting for 25 per cent of such exports from India. While exports of engineering goods, comprising transport equipment, machinery and parts and manufactures of metals, remained key drivers, there was a significant loss of growth momentum compared to the previous year.

Among engineering exports, there was a sharp deceleration in primary and semi-finished iron and steel, with strong domestic demand and a slowdown in demand from countries like Germany and UAE, though demand from China continued to be strong. With buoyant Japanese demand, there was a turnaround in marine product exports with growth of 16 per cent compared to the decline a year ago. Among agricultural items, export growth was impressive in items like rice and pulses and in non-traditional items like poultry and dairy products, meat and preparations, and fruits and vegetable seeds. Exports of coffee grew satisfactorily, while that of raw cotton grew at over 187 per cent.

Share of Major Exports of India in World Exports

(Items with one per cent share and above)

HS rev.1	Product	2000	2004
03	Fish crustaceans molluscs aquatic invertebrates nes	3.4	2.4
05	Products of animal origin nes	1.2	1.4
07	Edible vegetables and certain roots and tubers	1.3	1.1
08	Edible fruit nuts peel of citrus fruit melons	2.1	**1.4**
09	Coffee tea mate and spices	**5.8**	**4.7**
10	Cereals	2.3	**3.1**
12	Oil seed oleagic fruits grain seed fruit etc nes	1.7	1.5
13	Lac gums resins vegetable saps and extracts nes	11.9	8.0
14	Vegetable plaiting materials vegetable products nes	4.4	6.1
15	Animal.vegetable fats and oils cleavage products etc	1.2	1.2
23	Residues wastes of food industry animal fodder	2.4	3.1
25	Salt sulphur earth stone plaster lime and cement	**2.7**	3.3
26	Ores slag and ash	1.9	10.7
28	Inorganic chemicals precious metal compound isotopes	0.6	1.0
29	Organic chemicals	1.2	1.7
32	Tanning dyeing extracts tannins derivatives pigments etc	1.5	1.6
41	Raw hides and skins (other than furskins) and leather	**1.8**	2.4
42	Articles of leather animal gut harness travel goods	4.1	3.5
46	Manufactures of plaiting material basketwork etc.	0.1	2.0
50	Silk	11.3	11.1
52	Cotton	0.**6**	4.9
53	Vegetable textile fibres nes paper yarn woven fabric	**4.5**	3.5
55	Manmade staple fibres	**2.0**	2.4
57	Carpets and other textile floor coverings	7.5	10.7
58	Special woven or tufted fabric lace tapestry etc	**2.4**	1.4

61	Articles of apparel accessories knit or crochet	2.1	2.3
62	Articles of apparel accessories not knit or crochet	3.6	2.9
63	Other made textile articles sets worn clothing etc	6.3	7.0
64	Footwear gaiters and the like parts thereof	1.4	1.7
67	Bird skin feathers artificial flowers human hairm	1.7	3.0
68	Stone plaster cement asbestos mica etc articles	1.9	2.7
71	Pearls precious stones metals coins etc	6.5	7.4
72	Iron and steel	0.9	1.3
73	Articles of iron or steel	1.2	1.0
83	Miscellaneous articles of base metal	0.5	1.0

***Source:* NCTI based on UN-ITC Trade Map data.**

Efforts at export diversification continued. However, India has a share of one per cent and above in world exports in only 35 out of a total of 99 commodity categories at the two digit (Harmonised System (HS) Revision 1) level, with a reasonable share in only a few items (Table). Recently, world exports of items like scientific instruments have increased tremendously to equal the value of textiles exports, but in these new areas, India's export contribution continues to be low.

Among the top 150 items of world exports at the four digit level, in 2004, India had significant shares only in four items, and a share of more than one per cent in only 28 items. The items with large potential, in which India has not yet made a mark while China has already established itself, include many electronic and electrical items, processed food items, scientific instruments and apparatus, toilet papers and handkerchiefs, electro-medical appliances, furniture and toys.

Manufacturing constitutes around 74 per cent of India's merchandise exports;-and there is enormous scope for accelerating such exports. Export of manufactures played a crucial role in the export performance of most of the emerging market economies. Between 1965 and 1985, exports of manufactures from the Republic of Korea grew at an average annual rate of around 35 per cent, which was more than double the pace of growth in world exports of manufactures.

Bringing manufacturing to the central stage can help in increasing merchandise exports at rates substantially above the world average, to reach a higher share in world exports. The setting up of the National Manufacturing Competitiveness Council (NMCC) to prepare a strategy for the revival of the manufacturing sector should help in accelerating the export of manufactured items.

With high value added 'the quality of India's exports was somewhat different from that of China, which continued to include a large portion of imported inputs, the so called exports from China to China as per the UNCTAD Trade & Development Report, 2005. India's share in world agricultural exports continued to be low at 1.1 per cent in 2004. India, which has been spearheading the WTO negotiations on agriculture on behalf of the developing countries, needs to quickly take steps to increase supply of agricultural items for world market to make use of the possible opportunities, as a result of WTO negotiations. A three-pronged approach covering more and concerted initiatives to review and implement the relevant standards domestically; recourse to bilateral and multilateral avenues to remove barriers to agricultural exports; and expanding the supply base of exportable agricultural items can help. The Integrated Food Law which is in the offing may be a good step forward.

Imports of principal commodities

Commodity Group	Percentage share				Growth Rate*			
			April – October				April – October	
	2003-04	2004-05	2004	2005	2003-04	2004-05	2004	2005
POL	26.3	27.3	30.2	31.8	16.6	45.1	56.8	41.4
Pearl precious & semi-precious stones	9.1	8.6	7.9	8.1	17.6	32.1	12.6	36.4
Capital goods	12.7	11.5	9.6	10.3	40.3	20.9	23.3	44.2
Electronic goods	9.6	8.9	9.3	8.2	34.0	30.0	33.3	17.9
Gold& silver	8.8	10.0	9.4	9.0	59.9	59.6	31.5	34.1
Chemicals	7.4	6.0	6.2	5.6	39.9	31.7	31.9	19.7
Edible oils	3.2	2.1	2.6	1.6	40.1	-8.1	-11.9	-15.3
Coke coal and briquettes	1.8	2.6	2.8	2.0	13.7	97.5	99.5	-3.2
Metaliferrous ores & metal scrap	**1.7**	**2.2**	**2.2**	**2.6**	**24.9**	**84.8**	**72.1**	**57.0**
Professional instruments and optical goods	1.6	1.4	1.4	1.3	8.6	21.0	15.2	26.8
Total imports	**100.0**	**100.0**	**100.0**	**100.0**	**27.3**	**39.7**	**36.9**	**34.3**

The consistent rise in imports, in both 2004-05 and April-October, 2005, is attributable to not only the over 40 per cent growth of POL imports with a share of around 30 per cent in India's import basket, but also to other items like gold and silver, capital goods and export related items. While the increase in the price of the Indian basket, for example, by over 44 per cent in April-November 2005, contributed to the growth in POL imports, and the rising international bullion prices contributed to the growth in gold and silver imports, the rise in imports of capital goods and export related imports was due to the rising industrial demand and exports, which was also reflected in the high growth of capital goods production.

***ln US Dollar terms**

Non-electrical machinery, transport equipment, manufactures of metals and machine tools were the main contributors of the rise in capital goods imports. After five successive years of decline, project goods imports, which reflect the technological maturity and industrial capabilities of a country, made a rebound in 2004-05, with the growth accelerating in the current year. This augurs well for the industrial sector and infrastructure sectors of the economy. Among bulk goods, imports of fertilizer, metallic ferrous ores and scraps, and iron and steel registered steep rise during April-October 2005. Fertiliser import growth, which witnessed a turnaround in 2003-04 after three years of decline, accelerated further in 2004-05 and April-October, 2005. While the turnaround in 2003-04 in fertilizer imports was due to price increases, the increase in 2004-05 and April-October, 2005 was caused by higher volumes induced by falling prices, and reflected robust demand by the agriculture sector. Import of food and allied products declined with a fall in imports of edible oils, in both value and volume terms, in 2004-05 and April-October, 2005, with higher domestic output. The very high growth in iron and steel imports — due to both volume and price increase in 2004-05, and mainly due to volume increase in the current year with.a fall in international steel prices in the last few months — reflected rising demand in a buoyant economy.

Direction of Trade

India's major trading partners, 2000-2005

(Percentage share in total trade (exports+imports)

Country	2000-01	2002-03	2003-04	2003-04	2004	2005
					April – October	
USA	13.0	13.4	11.6	10.3	11.1	10.0
UK	5.7	4.6	4.4	3.7	3.6	3.7
Belgium	4.6	4.7	4.1	3.7	3.7	3.4
Germany	3.9	4.0	3.8	3.5	3.5	3.6
Japan	3.8	3.2	3.1	2.7	2.6	2.4

Switzerland	3.8	2.4	2.6	3.3	3.2	3.3
Hong Kong	3.7	3.1	3.3	2.8	2.8	3.0
UAE	3.4	3.8	5.1	6.2	5.6	5.4
China	2.5	4.2	4.9	6.4	5.6	6.4
Singapore	2.5	2.5	3.0	3.4	3.3	3.7
Malaysia	1.9	1.9	2.1	1.7	1.9	1.4
Total (1 to 11)	**48.8**	**47.9**	**48.1**	**48.0**	**46.8**	**46.4**

Source: DGCI&S, Kolkata

"The share of the 11 major trading partners of India, accounting for a share of around 48 per cent in India's trade, has not changed much since 2000-01 (Table). While USA continues to be the single largest trading partner of India, its share has fallen in 20Q4-05 and April-October, 2005. China emerged as the second major trading partner in 2005-06 and the share of combined China- Hong Kong at 9.4 per cent was close to that of l.8%. The impressive growth in trade with China was contributed by ores, slag, ash, iron and steel and organic chemicals on the export sideband by electrical machinery, other machinery and organic chemicals on the of imports and exports, another important country, whose share has been increasing steadily, is Singapore, with which India has recently signed a Comprehensive Economic Cooperation Agreement (CECA). In the case of India-Singapore trade, precious stones, metals, mineral fuel, oil, ships and boats and other machinery were the major contributors in exports, and other machinery, electrical machinery, organic chemicals, books, newspapers and manuscript, and aircraft & spacecraft in imports.

Region-wise, in 2004-05, India's exports to Asia and Oceania, (with a share of 47.4 per cent) registered a robust growth of 27 per cent. This was powered by the high growth of exports to China, Singapore, UAE and the Republic of Korea. The other two respectively) registered growth of around 20 percent. Exports to Africa and Latin American countries were also impressive (Appendix Table B). In April-October, 2005, while performance was similar to that in 2004-05, growth of exports to EU 25 accelerated, and exports to China-Hong Kong, Singapore and Korea continued to be impressive. Significant growth was also seen in trade with Sri Lanka and Thailand, with which India has a Free Trade Agreement (FTA). The growing importance of Asia in India's exports indicates that the regional trading arrangements (RTAs) strategy is bearing fruit (Box 6.6). Framework Agreements on economic cooperation have also been entered into with MERCOSUR and Chile. India is also engaged with Gulf Cooperation Council and Mauritius for FTA / Comprehensive Economic Cooperation Partnership Agreement. India-Israel and India, Brazil, South Africa (IBSA) joint Study Groups have also been set up.

In 2004-05, India's imports from Asia and Oceania, accounting for 35.4 per cent of total imports, was buoyant with growth of 40 per cent. Import growth from EU 25 (with a share of 16.9 per cent) at 20 per cent and that from America (with a share of 8.4 per cent and 29 per cent were also impressive. In America, US was the major source of import, and Belgium, Germany and the UK were the major import sources in EU 25.

In Asia, import growth from major sources like China and Singapore and, within SAARC, growth in imports from Sri Lanka and Pakistan, were impressive. In April-October, 2005, there was an acceleration of growth in imports from EU 25, and growth in imports from Asia and Oceania, and from America continued to be impressive, despite a moderation. While the country-wise performance was almost similar to that in 2004-05, within SAARC, besides Sri Lanka and Pakistan, imports from Bangladesh witnessed an impressive rebound in growth in the first seven months of 2005-06, after a decline in 2004-05.

Services Exports

Services exports grew by 71 per cent in 2004-05 to US$46 billion, and 75 per cent to US$32.8 billion in April-September, 2005. In 2004-05, software service exports grew by 34.4 per cent to US$17.2 billion and by 32 per cent to US$10.3 billion inthefirsthalfof2005-06. India's share in the world market for IT software and services (including BPO) increased from around 1.7 per cent in 2003-04 to 2.3 per cent in 2004-05 and an estimated 2.8 per cent in 2005-06.

A new development in services exports is the explosive growth of business services, including professional services. This is reflected in the growth of miscellaneous services excluding software, which grew by 216 per cent to US$16.3 billion in 2004-05, and 181 per cent in the first half of the current year to reach a level of US$15.4 billion and surpass even the value of software services exports. The enormous opportunities for further growth of these services make WTO negotiations in services all the more important for India.

While India is negotiating for greater market access in developed country markets, domestic regulations create barriers for Indian service providers even when trading partners have taken firm commitments. Quick domestic policy reforms are needed, especially in qualification and licensing requirements and procedures, to impart effective market access for our service providers. Some of the ways of promoting services could include facilitation to become known suppliers of quality services, providing relevant export market information, providing appropriate export financing with reduced transaction costs by reviewing the common practice of collateral backing, good marketing of services by energizing Indian embassies and industry associations, anchoring brand ambassadors for promoting services, and leveraging the country's potential services purchasing power in multilateral and bilateral negotiations and in the CECA's. [Source: Economic Survey, Government of India, 2004-05].

Deemed Exports

Definition

"Deemed Exports" refers to those transactions in which the goods supplied do not leave the country and the payment for such goods are made in India, by the recipient of goods?

Categories of Supply

The following categories of supply of goods by the main /sub-contractors shall be regards as "Deemed Exports" under this Policy, provided the goods are manufactured in India:.

(a) Supply of goods against duty free licences issued under the Duty Exemption Scheme;

(b) Supply of goods to Export Oriented Units (EOUs) or units located in Export Processing Zones (EPZs) or Software Technology Parks (STPs) or to Electronic Hardware Technology Parks (EHTPs); |

(c) Supply of capital goods to holders of licences under the Export Promotion Capital Goods (EPCG) scheme subject to the condition that such supplies will be eligible for benefits stated in paragraph 6.9 of the Policy; |

(d) Supply of goods to projects financed by multilateral or bilateral agencies/Funds as notified by the Department of Economic Affairs. Ministry of Finance under International competitive bidding or under limited tender system in accordance with the procedures of those agencies/Funds, where the legal agreements provide for tender evaluation without including the customs duty;

(e) Supply of capital goods and spares to the extent of 10% •of the FOR value for fertilizer plants if the supply is made under the procedure of international competitive bidding;

(f) Supply of goods to any project or purpose in respect of which the Ministry of Finance, by a notification, permits the import of such goods at zero customs duty coupled with the extension of benefits under this Chapter to domestic supplies; and

(g) Supply of goods to the Power, Oil and Gas sectors in respect of which a notification duly approved by Ministry of Finance, extends the benefit under this Chapter to domestic supplies.

Benefits for Deemed Exports

Deemed exports shall be eligible for following benefits in respect of manufacture and supply of goods qualifying as deemed exports:

(a) Special Imprest Licence/Advance Intermediate Licence;
(b) Deemed Exports Drawback Scheme;
(c) Refund of terminal excise duty; and
(d) Special Import Licence at the rate of 6 per cent of the FOR value (excluding all taxes and levies).

Project Exports From India

Performance and Potential

From a modest beginning in the late 1970s, project exports have evolved over the years to reflect the country's technological maturity and industrial capabilities; give visibility to Indian technical expertise and project execution capability; and create entry points for other Indian firms for supplies, consultancy and manpower exports. Exports of projects and services including construction and industrial turnkey projects and consultancy services increased from US$629 million in 1998-99 to US$911 million in 2004-05, and crossed US$956 million in April-October, 2005 itself.

Destination of project exports has undergone a change between 1999-00 and 2004-05, with the share of West Asia (mainly Oman, UAE and Iraq) increasing from 28.4 per cent to 63.9 per cent, North Africa (mainly Sudan) increasing from 9.1 per cent to 28.5 per cent, South Asia falling from 41.5 per cent to 5.7 per cent, and South East Asia falling from 15.8 per cent to 0.9 per cent. In 2004-05, turnkey contracts had the major share (57.2 per cent), followed by construction contracts (36.4 per cent), and consultancy contracts (6.4 per cent).

There is a growing realisation across Asia and Africa that the experience of Indian companies is more appropriate to their project needs, especially in hydro-power, irrigation, transportation and water supply systems. Indian exporters need to make inroads into the lucrative markets in West Asia, including Iraq and Libya, which are showing signs of revival.

There is need to obtain a major share of all funded projects in SAARC region through intensive marketing; to forge strategic alliances with leading European companies to target multilaterally funded projects in CIS countries, and with companies in Latin America to participate in projects funded by Inter-American Development Bank (IADB); to use the Comprehensive Economic Cooperation Agreements (CECAs) to promote such exports; and to secure sub-contracts from major European/American/Japanese companies.

The challenges for Indian project exports include: relatively lower ability to compete with many other countries, including developed ones and China, in the absence of competitive credit; lack of experience in handling barter deals and counter-trade practices; and low levels of effective and strategic tie-ups with reputed international consultancy firms and quality accreditation.

Some important initiatives have been taken to promote project exports. Government of India (GoI) Lines of Credit, since 2003 routed through Exim Bank, and with GoI guarantee for repayment of principal and payment of interest, facilitate offer of competitive credit. Bid Intervention Service by Exim Bank, on behalf of Indian companies, seeks redressal in case of discriminiation against Indian companies in multilateral tenders. Exim Bank has so far intervened in 32 bid intervention cases, of which 19 were successful with contracts ultimately going in favour of Indian companies. [Source: Economic Survey, Government of India, 2004-05]

Export Promotion and Institutional Set Up

The Government of India has created a number of service organisations for export promotion and assistance and to meet the challenges in the changing environment in industry and trade. The export houses should ascertain market potential for their products in the overseas market.

They have to organise trade fairs and exhibitions for wider publicity of their products. They have to collect and process and interpret the data on exports (countrywise and commoditywise) to judge the trend in the export market. Conducting marketing research and training the executives engaged in export-import business are difficult tasks to the individual exporters.

In order to assist the individual exporters for conducting market surveys, organizing trade fairs and exhibitions, collecting data on recent trends in the global market, training the executives who are involved in foreign trade, arranging buyers-sellers meet etc, the Government of India has established the following service organisations.

Service Organisations

Name of the service organizations and the services rendered by them are given below:

S.No.	Name of the Service Organisation	Services Rendered
1	Commodity boards [7 community boards] (Silk, coffee, coir, rubber, spices, tea, tobacco)	Take care of the entire range of problems of production, marketing, promotion, competition etc. in respect of the commodities concerned
2	Export Promotion Councils [20 export promotion councils] (apparel, chemicals, carpet, cashew, pharmaceuticals, cotton, leather, electronics, engineering, handicrafts, handlooms, silk, construction plastics, powerloom, shellac, sports, goods, rayon textiles, woolen)	Providing a forum between government and exporters to discuss export related issues; sponsoring trade delegations; arranging buyers-sellers meet; publicity of Indian products in the overseas market; allocation of export quota etc.
3.	Trade Development Authority	Arranging import licenses and customs clearance; conducting market surveys for exploring export potentials; product promotion and publicity; consultancy services; supply of information on trends in the foreign trade etc.
4.	Directorate general of commercial intelligence and statistics	Compilation and dissemination of statistical information on India's foreign trade; publication of periodicals in foreign trade of India.
5.	Government Trade Representatives Abroad Visiting foreign countries Products in foreign market	Supply of information in foreign market; assisting Indian trade delegations and organisign trade fairs in foreign countries; conducting market survey for Indian
6.	Federation of Indian Export Organisations	Providing common services for the benefit of exporters; collecting and forwarding important market information; sponsoring and conducting market surveys; sponsoring trade delegations; coordinating the export promotion activities etc.
7.	Indian Institute of Foreign Trade	Offering training progrmame in international business; conducting market surveys; offering diploma courses and master's programme on international business; publication of periodicals and occasional papers on foreign trade and various aspects of liberalization.

A detailed description of the services rendered by the above services organisations are given in the following pages;

Export Promotion Councils

The Export Promotion Councils are established under the Companies Act 1956 to provide direct institutional support to the Indian exporters. The Government of India has created a separate export promotion council for every industry. Export Promotion Councils are the representative bodies of the various exporting industries. They serve as a bridge between the Government and exporters for export promotion and development.

The exporters should register themselves with the respective export promotion councils and become the member of the councils. A nominal fee is charged by the export promotion | council to issue membership certificate. This certificate is called Registration-cum-Membership Certificate (RCMC). This certificate is issued in terms of the EXIM policy. Export Promotion council helps the member-exporters on technical matters, export marketing strategies and export promotion.

Experts are appointed in various working committees of the export promotion councils in order to help the exporters to solve various issues relating to international trade. The offices of the Indian Export Promotion Councils are established in foreign countries for the benefit of the Indian exporters. The export promotion council perform both advisory and executive functions.

The name and address of the Export Promotion Councils and the products covered are listed below:

1	Apparel Export Promotion Council 15, NBCC Tower, Bhikaji Cama Place, New Delhi – 110 066.	Ready made garments (excluding woollen, leather, silk, jute products)
2.	Basic Chemicals, Pharmaceuticals and Cosmetics Export Promotion Council 7, Cooperage Road Jhansi Castle (4th Floor) Mumbai – 400 001	Drugs, pharmaceuticals, fine chemicals, dyes, intermediates, alcohol, organic chemicals, agro chemicals, glycerine, soaps, detergents, cosmetics, toiletries, agrobatis, essential oils dehydrated culture media and crude drugs
3.	Carpet Export Promotion Council Flat No. 110-A/1, Krishna Nagar Street No.5, Safdarjung Enclave New Delhi – 110 029	Handmade / Woollen / synthetic carpets, rugs, drug gets and namdhas including handmade silk carpets

4.	Cashew Export Promotion Road Chitoor Ernakulam South Cochin – 600 016	Cashew products
5.	Chemicals and Allied Products Export Promotion Council World Trade Centre 14/1B, Ezra Street (II Floor) Calcutta – 700 001.	Chemicals and allied products (glass and glasswares, ceramics, paints, rubber products, paper and paper products, cement and cement products, safety matches, fire works, wood products, mica and mica based products, granites, phototype set films and micro films
6.	Cotton Textile Export Promotion Council Engineering Centre, 5 Mathew Road Mumbai – 400 004.	
7.	Council for Leather Exports Leather Centre 53, Sydemhams Road, Periamet Chennai – 600 003	Cotton textiles
8.	Electronics and Computer Software Export Promotion Council PMD House, Hauz Khas New Delhi – 110 016.	Finished leather and leather goods, chrome tanned blue hides and skins, crane tanned crust leather, E.I tanned hides and skins and EI crust leather
9.	Engineering Export Promotion Council World Trade Centre 14/1B, Ezra Street, Calcutta – 700 001.	Electronic Goods, computer software and related services
10.	Export Promotion Council for Handicrafts 6 Community Centre Basant Lok, Vasant Vihar, New Delhi – 110 057.	Engineering goods, stainless steel products
11.	Gems and Jewellery Export Promotion Council Diamond Plaza (V Floor) 391A, Dr. Dadasaheb Ambedkar Marg, Bombay – 400 004.	Handicrafts

12.	Handloom Exports Promotion Council, 18, Cathedral Garden Road, Numgambakkam Chennai – 600 034.	Gems and Jewellery
13.	The Indian Silk Export Promotion Council 62, Mittal Chambers, Nariman Point Bombay – 400 021.	Handloom products
14.	Overseas Construction Council of India Commerce Centre, 7th Floor, J. Dedaji Road, Tardeo, Bombay – 400 037	All natural silk fabrics, made-ups, garments and machine made carpets
15.	Plastic and Linoleum Export Promotion Council Centre 1, 11th Floor, Unit No.1 World Trade Centre Cuffe Parade Bombay – 400 005.	Overseas construction and civil engineering products
16.	Powerloom Development Export Promotion Council Cecil Court B Wing, 4th Floor, Mahakavi Bhusan Marg Colaba Mumbai – 400 039.	Plastics, toys, polyester film and Unit No.1, allied products, human hair and human hair products
17.	Shellac Export Promotion Council, World Trade Centre 4th Floor, 14/1B Ezra Street, Calcutta – 700 001.	Powerloom cotton textiles
18.	Sports Goods Export Promotion Council 1E/6, Swami Ram Tirath Nagar, New Delhi – 110 055.	Lac in all forms

19.	The Synthetic and Rayon Textiles Export Promotion Council Resham Bhavan 78, Veer Nariman Road, Mumbai – 400 020.	Sports goods, non-cellulosic products, cellulosic products, nylon polyester fibre or yarn acrylic knitwear
20.	Wool and Woollen Export Promotion Council 612/714, Ashoka Estate, 24, Barakhamba Road New Delhi – 110 001.	Woollen textiles, hosiery, knitwear and other woollen products

Functions of the Export Promotion Councils

The important functions of the Export Promotion Councils are given below:

- Providing a forum between the Government and the members of the export promotion councils for consideration and early implementation of the export promotion schemes Sponsoring and inviting trade delegations and study teams for exploring export markets for the Indian industries
- Making arrangements for the distribution of scarce materials for export production
- Allocation of export quota for the export products like textiles
- Arranging Buyer-Seller Meets and trade fairs/exhibitions in India and abroad
- Foreign publicity for Indian products in overseas markets through the scheme like Joint Foreign Publicity
- Recommending the Government regarding the formulation and implementation of export incentive schemes like fixation of drawback rates, market development assistance etc.
- Creating export consciousness among the exporters
- Collecting and disseminating statistical information and market intelligence about the export opportunities through various media including newsletters, bulletins and other periodicals
- Coordinating with the export inspection council on quality control and preshipment inspection

- Speedy disposal of export assistance applications and assisting small scale units to export their products
- Helping the member exporters in claiming various types of incentives from the Government and
- Keeping the member exporters informed with regard to trade enquiries and opportunities

Commodity Boards

Commodity Boards are established by the Government of India in order to help the organisation of industry and trade. The Boards take care of the entire range of problems of production, marketing, promotion, competition, etc in respect of the commodities concerned. The Commodity Boards ‘are statutory bodies taking steps for the development of cultivation, increased productivity, processing, marketing and research and development. Offices of the Commodity Boards are established in foreign countries for increasing the exports of the commodities concerned. The Boards for the respective commodities arrange trade fairs and exhibitions, sponsor trade delegations and conduct market surveys for the purpose of promoting exports. All the Commodity Boards except Central Silk Board are the registering authority and pro vide Registration-cum-Membership Certificate (RCMC) to the member exporters in terms of the Export-Import Policy. Commodity Boards are established in India for the commodities such as silk, coffee, coir, rubber, spices, tea and tobacco.

The name, address and products of the Commodity Boards functioning in India are given below:

Sl.No.	Name of the Commodity Board	Products
1	Central Silk board United Mansions Building (II Floor) 39, Mahatma Gandhi Road Bangalore – 560 001	Silk
2	Coffee Board No.1, Ambedkar Road Bangalore – 560 001	Coffee
3	Coir Board Ernakulam South Cochin – 682 016	Coir

4	Rubber Board Shastri Road Kottayam – 686 001 Kerala	Natural rubber
5	Spices Board Sygandh Bhavan Near Ernakulam Medical Centre Cochin – 682 025	Curry powder and paste, spices, spices oil, oleoresins
6	Tea Board 14, Biplabi Trailokya Maharaj Sarani Brabourne Road Cochin – 700 001	Tea
7	Tobacco Board Srinivasa Rao Thota G.T.Road, Guntur – 522 004	Tobacco and tobacco products

Trade Development Authority (TDA)

The Trade Development Authority was established in the year 1970 under the Societies Registration Act 1860. It is a non-profit service organisation functioning under the Ministry of Commerce, Government of India. The Director is the executive head of the organization and he is guided and assisted by a high powered committee consists of officials of the Government and experts in the field of foreign trade. The Secretary of the Foreign Trade department is the Chairman of the Organisation. The Trade Development Authority has created three important divisions to execute its functions effectively. The three divisions are, (i) Merchandising (ii) Research and Analysis and (iii) Information.

The Merchandising division concentrates on ways and means to increase Indian exports in the overseas market. This division identifies the emerging market to penetrate Indian exports in the foreign countries in the year to come. This division attempts to promote India's foreign trade by assisting the exporters to plan marketing strategy, product development and capacity expansion.

The Research and Analysis division attempts to conduct marketing research to assess the market potentials for the Indian products in the domestic as well as overseas market. This division helps the exporters to raise their export capabilities.

The Information division collects the relevant data regarding the global exports countrywise and commoditywise, trend in Indian exports and opportunities for the Indian products in the overseas market. The collected data are processed and supplied to the exporters to plan their export strategies and to maximise their exports.)

Package Services

The Trade Development Authority of India offers the following package services for the benefit of the exporters:

(i) Product Development
(ii) Capacity Expansion
(iii) Information Supply
(iv) Promotion and Publicity
(v) Consultancy Services and other Services

Product Development

Under the product development package TDA helps the exporters to improve the quality of their products at par with the international standard, TDA gets specifications and samples for the products from the foreign countries and suggests the clients-exporters to develop their products at par with the specifications and samples. TDA arranges import licenses and customs clearance for the benefit of exporters to import the required raw materials and other components.

It identifies what is required and demanded in the overseas market, based on that suggests the client-exporters to modify their production schedule. TDA attempts to identify technically and commercially viable export units for providing necessary inputs to expand their exports. The Trade Development Authority takes steps to display the Indian products in the departmental stores of the foreign countries. This service is done under the special product development programme.

Capacity Expansion

The TDA helps the client-exporters for their capacity expansion. The clients of the TDA are given priority for capacity expansion over other industrial units. The TDA assists the client-exporters to obtain industrial license and foreign exchange and to import capital goods. It conducts feasibility studies for the expansion ofthe export oriented units.

Information Supply

The TDA has created 'Trade Information Centre' for collecting and disseminating the data required by the exporters. The TDA has established overseas offices in FGR, USA, Japan, Sweden and Libya. These offices gather the trade related information and supply to the 'Trade Information Centre'. This centre furnishes the uptodate information relating to export credit, shipping, insurance, licenses and product development and promotion. It conducts certain research study to ascertain the competitiveness of the Indian export units, the findings of such research study are sent to the export units to improve their competitiveness in exports.

The Trade Information Centre furnishes the export related information through its periodicals, reports and brochures. This centre tries to explore export potentials for the Indian products in the overseas market by undertaking marketing research and prepares action plan for the promotion of Indian exports. The weekly bulletin brought out by the TDA furnishes the trade related information such as, import policies and tariff, trade fairs and exhibitions, addresses of the foreign buyers and agents, import-export procedure and trend in the export market, for the benefit of the exporters.

Promotion and Publicity

Promotion and publicity is another service extended by the TDA for the benefit of exporters. Under the promotion and publicity service, TDA has organised a number of trade fairs, exhibitions and buyer-seller meets to expose the Indian products to the prospective buyers and to increase Indian exports.

Consultancy Services

Consultancy services provided by the TDA is highly useful to its clients-exporters. It extends the consultancy services for maintaining and improving quality, export pricing, project expansion, ascertaining credit worthiness of the importers, entering into new overseas market, shipping, import of raw materials etc.

Other Services

The Trade Development Authority extends its services as and when the client-exporters approach to solve issues in the export trade. The services needed for export maximization are provided by the TDA promptly to the client-exporters.

Directorate General of Commercial Intelligence and Statistics (DGCf&S)

The Office of the Directorate General of Commercial Intelligence and Statistics is situated at Calcutta. It is functioning under Ministry of Commerce, Government of India.

The important functions of the DGCI&S are listed below:

- Collection, compilation and dissemination of commercial information on India's Trade
- It acts as a mediator in settling commercial disputes through the Indian Commercial representatives abroad between Indian and foreign firms
- Publishing 'Directory of Exporters' of Indian products and manufacturers
- Publishing Indian Trade Journal (weekly) and monthly statistics of Foreign Trade of India for disseminating the information relating to India's Foreign Trade and
- Publishing periodical reports received from the Trade representatives of the Indian
- Government stationed in abroad. This report reveals the trade prospects and opportunities of the Indian products in the overseas market.

Publication of the DGCI&S

(i) Monthly Statistics of Foreign Trade of India

Vol I - Exports and Reexports
Vol II-Imports

(ii) Monthly Press Note on Foreign Trade

It is published within 30-35 days from the end of the reference month. It reveals aggregate figures on India's exports and imports,

(iii) Monthly Brochure titles 'Foreign Trade Statistics of India (Principal Commodities and Countries)

This brochure reveals the export and import of principal commodities in India. The details are given in countrywise and commoditywise also.

(iv) Indian Trade Classification based on Harmonised Commodity Description and Coding System

This publication shows the code number of any individual commodity or product exported or imported. These codes are to be compulsorily quoted both in export transaction and import transaction.

(v) Indian Trade Journal

It is a weekly journal and contains the reports of Indian Commercial Representatives abroad. This journal highlights export opportunities for Indian products, foreign tender notices, freight rates etc.

(vi) Other Publications

(1) Directory of Exporters-both nomenclature as well as commoditywise

(2) Ancillary Trade Statistics viz.,

    (a) Trade Statistics on mter-State Movement of goods by Rail, River and Air

    (b) Statistics on Customs and Excise Revenue Collections according to different tariff heads

    (c) Shipping Statistics of the Foreign and Coastal Cargo Movement of India

(3) Index Number of Unit Value and Quantum of Export and Import in India

The DGCI&S has established a Commercial Library in its office at Calcutta. This library is the best source for collecting the data relating to foreign trade. The. relevant and uptodate books and periodicals on foreign trade are available in this library.

Federation of Indian Export Organisation (FIEO)

The Federation of Indian Export Organisation was established in the year 1965. It is a non-profit service organisation. It is located at New Delhi. It coordinates the various export organisations such as Export Promotion Councils, Commodity Boards, Indian Trade Promotion Organisation and other service organisations for deciding the policies on export promotion. It is an advisory body to the Central and State Government for export promotion and development. It is authorised to disburse grants under Market Development Scheme to the exporters for the specified activities.

The important objectives of the FIEO are given below:

- Promotion and development of Exports in lndia
- Coordinating the Export promotion activities
- Sponsoring Indian trade delegations to abroad and inviting trade deligations from abroad
- Sponsoring and conducting commodity and market surveys
- Establishing trade centre, design centre and show rooms and opening offices abroad
- Creating common services for the benefit of exporters and export organisations
- Establishing warehouses for highly demanded Indian products in the emerging overseas market for facilitating export
- Organising trade fairs and exhibitions and publicity programmes for Indian products
- Publishing periodical reports on achievements in foreign trade, facilities and infrastructure required for foreign trade, review ofEXIM Policy, sectorwise growth in exports, Government policies on foreign trade etc and
- Organising seminars and conferences to gather the recommendations and suggestions for the promotion of exports and to disseminate the policies announced by the Government for the cause of exports.

Indian Institute of Foreign Trade

The Indian Institute of Foreign Trade was established in the year 1964. It is an autonomous body registered under Societies Registration Act. It is located at New Delhi. It is functioning under the Ministry of Commerce, Government of India. It is a pioneering institute offers training programmes on International Trade Procedure and Documentation, Export Management, Logistics Management, Foreign Exchange Management to the executives if export houses. Government departments and trade organisations and other export organisations. Training Programme on Human Resource Development in International Business is also organised by the Institute periodically. The basic objectives of this Institute are to provide training facilities to the executives involved in foreign trade, to conduct marketing research in India and abroad and commodity surveys to identify new market and market potentials for Indian products, to collect, process and disseminate export market information to the exporters and to undertake consultancy services to the export houses.

It undertakes a number of research studies on various subjects in the field of foreign trade and International business. This Institute offers a two year Post Graduate Diploma (full time) in International Trade and a one year Master's Programme in International Business. It also offers a four months certificate course (evening programme) to the executives who are already engaged in export-import business.

The Indian Institute of Foreign Trade publishes two periodicals viz.. Foreign Trade Review (quarterly) and Foreign Trade Trends & Tidings (monthly) in order to highlight the latest trends and development in the global trade scenario and to meet the felt needs of Indian Trade and Industry.

The Institute has published a number of books en foreign trade and undertaken overseas market surveys/country studies and functional Research Studies. The occasional papers published by this Institute on various aspects of Liberalisation are very popular and used as study materials in many academic institutions.

Government Trade Representatives Abroad

Government trade representatives stationed in abroad play a vital role in boosting Indian 'exports. They supply periodical reports containing the demand and supply of various products in the foreign markets, market surveys for Indian products, market potential for Indian markets, new products introduced in the foreign market and their demand, import tariff structure in overseas market, political, social, cultural, technological and economic environment in the foreign market etc. These reports help the Indian Government to devise suitable strategies to tap the global market and to increase exports. Indian Government Trade Representatives in abroad help the Indian Trade delegations to visit the foreign countries, to meet the industrialists and foreign Government officials for getting collaborations in trade and industry. They assist to organise trade fairs and exhibitions in foreign countries sponsored by the Indian agencies. Of late. Ministry of Commerce, Government of India has created a separate office in the Indian embassies abroad for ascertaining opportunities for Indian products in the foreign market and strengthening Indian brands in the overseas market.

Trade Fairs Organised by Indian Trade Promotion Organisation (ITPO)

In the year 1996-97, ITPO has organised 30 fairs. Out of this 15 were general fairs, 12 specialised commodity fairs and 3 exclusive Indian Exhibitions. Indian exhibitions were organised in Almaty (Kazakhstan), Sao Paulo (Brazil) and Kathmandu (Nepal). The ITPO has provided budgetary support for 12 fairs and 18 fairs were organised on self-financing basis. The exclusive Indian Exhibition organised by ITPO in Kathmandu during March 14 to 21,1997 was the largest exhibition in Kathmandu so far.

The Trade and Merchandising Department of ITPO has organised six Buyers – Seller Meets, seven contact promotion programme, seven specialised trade fairs abroad and one specialised trade fair in India.

No. of Buyer-Seller Meets	Place	Products
3	Osaka Japan	Home furnishings Garments Fashion Accessories Building Materials
1	Buenos Aires Argentina	Variety of products
1	Cape Town South Africa	Textile and Garments
1	Dubai	Engineering and Consumer Sector

Contact Promotion Programme Organised

Products	Country
Dyes and Intermediaries	France Germany Italy
Hardware	Germany UK
Medical and Hospital Equipment	Kenya Egypt
Home Furnishings	USA Canada
Household and Kitchenware	South Africa Botswana Swasiland
Power Equipments and Accessories	UAE Oman Bahrain Saudi Arabia
Forgings	France Germany

Given below is the specialised Trade Fairs organised by the Trade Development and Merchandising Department of ITPO during 1996-97.

- Four specialised trade fairs were organised in Japan. They are listed below:
- Osaka International Trade Fair
- Osaka West Japan Import Fair
- Kitaueyushu Asia Auto Business Fair
- Foodexl997

One trade fair was organised in Germany. (Auto Mechanika 96, Frankfurt)

The trade fairs were organised in USA. They are, Big-I/ APPAA' 96, Las Vegas and mterbike '96 at Anaheim, for bicycles.

During the year 1996-97, ITPO has organised eleven fairs in India. Out of these, seven were specialised fairs. These were Shoe Fair Shoecomp Fair, AHARA, International Leather Goods Fair, India International Leather Fair, Mystique India and Book Fair. The number of exhibitions in the India International Trade Fair was approximately 3 000 including those participated through the State pavilions and pavilions of Ministries.

Apparel Export Promotion Council (AEPC) is also actively involved in organising trade fairs both national and international for the benefit of the Indian exporters. Buyer-Seller Meets are also organised by the AEPC as one of its activities of export promotion.

The following Buyer-Seller Meets were organised by the Apparel Export Promotion Council during the year 1997-98.

1. Buyer-SeUerMeetinBrazil^hileandArgentmay^May, 1997)
2. Buyer-Seller Meet in South Africa (5-14 February 1998)
3. Buyer-Seller Meet in Australia and New Zealand (9-18 February 1998)
4. Buyer-SeUerMeetmMexico,ColumbiaandChile(3-18Marchl998)

The Apparel Export Promotion Council with the assistance of other leading associations representing Apparel Exporters organised the following fairs during the year 1997-98.

1. 19th India International Garment Fair (II GF), 18-21 July l997 at New Delhi.
2. 20th India International Garment Fair, 29-31January l998 at New Delhi

The Apparel Export Promotion Council and Timpur Exporters Association jointly organised the following fairs during the year 1997-98.

1. 3rd India Knit Fair (IKF), 29th April to 1st May,1997 at Tirupur
2. 4th India Knit Fair (IKF), 27 - 29 November, 1997; at Tirupur

The Apparel Export Promotion Council in collaboration with the Apparel Exporters and Manufacturers Association (AEMA), New Delhi, Apparel and Handloom Exporters Association (AHEA), Chennai, Clothing Manufacturers Association of India (CMA1), Mumbai and Garment Exporters Association (GEA), New Delhi, is organising India International Garment Fair twice a year. It has become one of the leading international fail for foreign buyers and their buying agents in India to source high fashions garments from India The fair provides excellent opportunities to the garment exporters to enter into the international market extensively and to increase their market share in the overseas market.

Trade Fairs organised in India

The following information shows the details of Trade Fairs/Exhibitions organised in India during the year 1997-98.

Fair	**Month & Year**	**Place**	**Scope**
Garmentech	29th 0ct to 1st Nov 1998	Pragati Maiden New Delhi	Sewing Machines Knitting Machine Embroidery Machine Sewingrelated equipments Facilities & equipment for apparal manufacturer CAD/ CAM systems Packaging Trimming Embellishments Trade Publications Turnkey Projects Software Auxil- haries Support Service etc.
Textile'99 World Expo	10th to 12th Feb 1999	Chennai	
Gartex	March/April 1999	Pragati Maidan New Delhi	Garment Machinery Fabrics & Ac- cessories
India International Garments	29th Jan to 4th Feb 1999	Pragati Maidan New Delhi	High Fashion Garments
Tex Styles India '99	1st to 4th Feb 1999	Pragati Maidan New Delhi	Fabrics Yams Threads Textiles Fur- nishing Made-ups Accessories Em- bellishments
India Knit Fair Spring Summer	May 1999	Tirupur Tamil Nadu	Sportwear Swimwear nightwear lin- geries T-Shirts Polo Shorts Collec- tion Blouses Jacketies Shorts Bermu- das Kids-wear & other knitwear.
Indian Handicrafts & Gifts Fair Autumn'98	10th to 13th Oct '98	Pragati Maidan New Delhi	All Handicrafts and gifts item.
Spring'99	26th to 28th Feb.'99		
Sajavat'99	August 1999	Pragati Maidan New Delhi	Giftwear Artificial Plants Flowers Leather Goods Toys Home Appli- ances Electrical Goods.

Indian International Leather Fair ’99	31^{st} Jan to 4^{th} Feb ’99	Chennai	Leather products & Accessories Leather Machinery & Equipments.
Indian International Leather Fair ’99	March 1999 4^{th} Feb ’99	Calcutta	Leather Goods & Products.
Delhi International Shoe Fair ’99	July’99	Pragati Maidan New Delhi	Footwear Dress Shoes for Men Women and Children
Shoecomp’99	July’99	Pragati Maidan New Delhi	Shoe components Accessories & Manufacturing aids.
5^{th} Indian Knit Fair	28^{th} to 30^{th} May 1998	Tirupur	Sports wear Swim wear Night wear Lingeries T-Shirts Polo Shirts Blouses Jacketies Shorts Bermudas Kids Wear & Other Knit wears
Health & Medicare India ’98	24^{th} to 26^{th} June 1998	Mumbai	Medical & Hospital Equipment & Supplies Re-habilitation Health Care Products in conjunction with 6^{th} International Multifaculty Medical conference.
Shoe Comp ’98	2^{nd} to 4^{th} July 1998	Pragati Maidan New Delhi	Components accessories and manufacturing aids like soles insoles toe-puffs counters diking knives tacks heals straps adhesives chemicals etc.
Delhi Intl. Shoe Fair	2nd to 5^{th} July 1998	Pragati Maidan New Delhi	Footwear for men women and children dress shoes for men and women horachi shoes and sandels Kothapur chappals ballerines sandels etc.
Sajavat	8th to 16^{th} August 1998	Pragati Maidan New Delhi	Giftware artificial plants and flowers crockery and cutlery leather goods toys home appliances food processing equipment electrical goods etc.
Mystique India	7^{th} to 15^{th} Oct 1998	Pragati Maidan New Delhi	Aayurveda Siddha Unam Homeopathy and Naturopathy systems medicine acupunture and acupressure alternative therapies anit aids cancer polio remedies and heart care programme Yoga Mediation Astrologer Palmistry Numerology and Vastu Health food products and nature cure equipment etc.

3rd Delhi International Jewellery & Watch '98	9th to 12th Oct 1998	Pragati Maidan New Delhi	Jewellery of Diamond platinum Gold Silver Gemset Jewellery Pearls Corals & Jade Machinery & Equps packaging & publications Jewellery watches Precious & Semi-precious stone
Indian Handicrafts & Gifts Fair	10th to 13th Oct 1998	Pragati Maidan New Delhi	All Handicrafts and Gifts item

Trade Fair Authority of India (TFAI)

Trade Fair Authority of India is one of the service institution functioning under the Ministry of Commerce, Government of India for the purpose of promoting exports. It was established in December, 1976 under the Companies Act, 1956. It was established by amalgamating the two service institutions, viz., Directorate of Exhibitions and Commercial Publicity and India International Trade Fair Organisation. TFAI started functioning from March, 1977. It has become a nodel agency for organising trade fairs and exhibitions in India and foreign countries.

The important objectives of the Trade Fair Authority of India are given below:

- To undertake promotion of exports and to explore new markets for traditional items of export by organising trade fairs and exhibitions in India and abroad
- To establish show-rooms for the Indian products in India and abroad
- To publicise the ensuing trade fairs and exhibitions in India and abroad
- To extend infrastructural support to the interested organisations for holding fairs and exhibitions in India and abroad
- To identify emerging markets for diversification and expansion of Indian exports
- To take steps for projecting India's progress and achievements in industrial and technological development in various fields through trade promotion and development

The Trade Fair Authority of India has organised trade fairs and exhibitions throughout he world and created awareness about the Indian products in the global market by displaying Indian quality products in the overseas markets. TFAI has successfully organised trade fairs and exhibitions in engineering goods, publishing industries, power, mining and machinery engineering. Pragati Maidan situated at New Delhi is a permanent venue for organizing national and international trade, trade fairs and exhibitions. It is a permanent exhibition complex and equipped with all infrastructural facilities required for organising trade fairs and exhibitions such as, spacious place to cover several halls and pavilions, warehousing facilities, banking, post and telegraph office, control room, fire station, hospital, electricity, drinking water, conference hall, auditorium, restaurant, etc. Many foreign countries participate in the International Trade Fairs organised in India. It helps to identify the products to be imported and find out buyers to export our products and to observe the recent sophisticated technology in diverse fields of agriculture, industry and services sector. The Trade Fair Authority of India has organised seminars and conferences to create awareness about the i trade fairs and exhibitions among the Indian exporters.

The Trade Fair Authority of India has participated in many international trade fairs in foreign countries and projected India's progress and achievement in various sectors of the economy. It has coordinated with the Indian Mission abroad, Ministry of Commerce and Ministry of External Affairs, Government of India for organising multinational trade fairs and exhibitions. It brought out three journals for disseminating the market potential for Indian products in the overseas market. The three journals are, Udyog Vyapar Patrika, Indian Export Bulletin and Economic and Commercial News. These journals published the authentic information about the country's progress in business, trade and industry.

Special Economic Zones in India

A policy was introduced in the Exim Policy effective from 1.4.2000 for setting up of Special Economic Zones in the country with a view to provide an internationally competitive and hassle free environment for exports. Units may be set up in SEZ for manufacture, of goods and rendering of services. All the import/export operations of the SEZ units will be on self-certification basis. The units in the zone have to be a net foreign exchange earner but they shall not be subjected to any pre-determined value addition or minimum export performance requirements. Sales in the Domestic Tariff Area by SEZ units shall be subject to payment of full Custom Duty and Import Policy in force.

The policy provides for setting up of SEZs in the public, private joint sector or by State Governments. It was also envisaged that some of the existing export processing zones would be converted into Special Economic Zones. Accordingly, the Government has converted Export Processing zones located at Kandla and Surat (Gujara), Cochin (Kerala), Santa Cruz (Mumbai-Maharashtra), Falta (West Bengal), Madras (Tamilnadu), Visakhapatnam (Andhra Pradesh) and Noida (Uttar Pradesh) into a Special Economic Zones.

Salient Features

- A designated duty free enclave and to be treated as foreign territory for trade operations and duties and tariffs.
- No licence required for import.
- Manufacturing, trading or service activity allowed.
- SEZ unit to be positive net foreign exchange earner within three years.
- Performance of the units to be monitored by a committee headed by Development Commissioner and consisting of customs.
- No fixed wastage norms.
- Full freedom for subcontracting including subcontracting abroad.
- Duty free goods to be utilized in 5 years.
- Job work on behalf of domestic exporters for direct exports allowed.
- Contract farming allowed agriculture/horticulture units.
- No routine examination by customs of export and import cargo.
- No separate documentation required for customs and exim policy.
- In house customs clearance.
- Support services like banking, post office, clearing agents etc. provided in zone complex.
- Developed plots and ready to use built up space.

Policy for Development of Special Economic Zone

With a view to augmenting infrastructure facilities for export production it has been decided to permit the setting up of Special Economic Zones (SEZs) in the public, private, joint sector or by the State Governments. The minimum size of the Special Economic Zone shall not be less than 1000 hectares. Minimum area requirement shall, however, not be applicable to product-specific and port/air-port based SEZs. This measure is expected to promote self-contained areas supported by world-class infrastructure oriented towards export production.

Who Can Set Up?

Any private/public/joint sector or state government or its agencies can set up Special Economic Zone (SEZ).

How to Apply?

15 copies of application, indicating name and address of the applicant, status of the promoter along with a project report covering the following particulars may be submitted to the Chief Secretary of the state:

- Location of the proposed zone with details of existing infrastructure and that proposed to be established.
- Its area, distance from the nearest sea port/airport/rail/road head etc.
- Financial details, including investing proposed, mode of financing and viability of the project.
- Details of foreign equity and repatriation of dividends etc., if any
- Whether the zone will allow only certain specific industries or will be a multiple-product zone.

The state government shall, forward it along with their commitment to the following to the Department of Commerce, Government of India:

- That area incorporated in the proposed Special Economic Zone is free from environmental restrictions.
- That water, electricity and other services would be provided as required.
- That the units would be given full exemption in electricity duty and tax on sale of electricity for self generated and purchased power.
- To allow generation, transmission and distribution of power within SEZ.
- To exempt from state sales tax, octroi, mandi tax, turnover tax and any other duty/ cess or levies on the supply of goods from Domestic Tariff area to SEZ units.
- That for units inside the zone, the powers under the Industrial Disputes Act and other related labour Acts would be delegated to the Development Commissioner and that the units will be declared as a Public Utility Service under Industrial Disputes Act.
- The single point clearances system and minimum inspections requirements under state law / rules would be provided. The proposal incorporating the commitments of the state government will be considered by an inter-Ministerial Committee in the Department of Commerce. On acceptance of the proposal, a letter of permission will be issued to the applicant.

Are There any Terms and Conditions?

- Only units approved under SEZ scheme would be permitted to be located in SEZ.
- The SEZ units shall abide by local laws, rules, regulations or bye-laws in regard to area planning, sewerage disposal, pollution control and the like. They shall also comply with industrial and labour laws as may be locally applicable.
- Such SEZ shall make security arrangement to fulfill all the requirements of the laws, rules and procedures applicable to such SEZ.
- The SEZ should have a minimum area of 1000 hectares and at least 25% of the area is to be earmarked for developing industrial area for setting up of units.
- Minimum area of 1000 hectares will not be applicable to product specific and air-port based SEZs.
- Wherever the SEZs are landlocked, an inland container depot (ICD) will be an integral part of SEZs.

Facilities to SEZ Developer

- 100% FDI allowed for; (a) townships with residential educational and recreational facilities on a case to case basis, (b) franchise for basic telephone service in SEZ.
- Income tax benefit under (80 1A) to developers for any block of 10 years in 15 years.
- Duty free import/domestic procurement of goods for development, operation and maintenance of SEZs.
- Exemption from service tax.
- Income of infrastructure capital fund/company from investment in SEZ exempt from investment in SEZ exempt from income tax.
- Investment made by individuals etc. in a SEZ company also eligible for exemption u/s 88 of IT Act.
- Developer permitted to transfer infrastructure facility for operation and maintenance.
- Generation, transmission and distribution of power in SEZs allowed full freedom in allocation of space and built up area to approved SEZ units on commercial basis.
- Authorized to provide and maintain service like water, electricity, security, restaurants and recreation centres on commercial lines.

How to Set Up a Unit in SEZ?

For setting up a manufacturing, trading or service units in SEZ, 3 copies of project proposal in the format prescribed at Appendix 14-1A of the Handbook of Procedures, vol.1 to be submitted to the Development Commissioner of the SEZ.

What is the Approval Mechanism?

All approval to be given by the unit approval committee headed by the Development Commissioner, Clearance from the Department of Policy and Promotion / Board of Approvals, wherever required will be obtained by the Development Commissioner, before the Letter of intent is issued.

What is the Obligation of the Unit Under the Scheme?

- SEZ units have to achieve positive net foreign exchange earning as per the formula given in paragraph appendix 14-11 (para 12.1) of Handbook of procedures, Vol.1. For this purpose, a legal undertaking is required to be executed by the unit with the Development Commissioner.
- The units have to provide periodic reports to the Development Commissioner and zone customs as provided in Appendix 14-1F of the handbook of procedures, vol.1.
- The units are also to execute a bond with the zone customs for their operation in the SEZ.

Faciliteis to SEZ Enterprises

Customs and Excise

- SEZ units may import or procure from the domestic sources, duty free, all their requirements of capital goods, raw materials, consumables, spares, packing materials, office equipment, DG sets etc. for implementation of their project in the zone without any licnese or specific approval.
- Duty free import/domestic procurement of goods for development, operation and maintenance of SEZ units.
- Goods imported/procured locally duty free could be utilized over the approval period of 5 years.
- Domestic sales by SEZ units will now be exempt from SAD.

Income Tax

- 100% income-tax exemption (10A) for first 5 years and 50% for 2 years thereafter.

Foreign Direct Investment

- 100% foreign direct investment is freely allowed in manufacturing sector in SEZ units under automatic route, except arms and ammunition, explosive, atomic substance, narcotics and hazardous chemicals, distillation and brewing of alcoholic drinks and cigarettes, cigars and manufactured tobacco substitutes.
- No cap on foreign investments for SSI reserved items.

Off-Shore Banking (OBUs)

- Setting up of off-shore banking units allowed in SEZs.
- OBUs entitled for 100% income-tax exemption for 3 years & 50% for next 2 years.

Banking / External Commercial Borrowings

- External commercial borrowings by units up to $ 500 million a year allowed without any maturity restrictions.
- Freedom to bring in export proceeds without any time limit.
- Flexibility to keep 100% of export proceeds in EEFC account. Freedom to make overseas investment from it.
- Commodity hedging permitted.
- Exemption from interest rate surcharge on import finance.
- SEZ units allowed to 'write-off' unrealized export bills.
- Exemption from interest rate surcharge on import finance.

General Sales Tax Act

- Exemption to sales made from Domestic Tariff Area to SEZ units.

Service Tax

- Exemption from service tax to SEZ units.

Environment

- SEZs permitted to have non-polluting industries in IT, and recreational facilities like golf courses, desalination plants, hotels and non-polluting service industries in the coastal regulation zone area.
- Exemption from public hearing under environment impact assessment notification.

Companies Act

- Enhanced limit of ₹ 2.4 crore per annum allowed for managerial remuneration.
- Regional office of Register of Companies in SEZs
- Exemption from requirement of domicile in India for 12 months prior to appointment as Director.

Drugs and Cosmetics

- Exemption from port restriction under Drugs & Cosmetics Rules.

Sub-Contracting / Contract Framing

- SEZ units may sub-contract part of production or production process through units in the Domestic Tariff Area or through other EOU/SEZ units.
- SEZ units may also sub-contract part of their production process abroad.
- Agriculture/Horticulture processing SEZ units allowed to provide inputs and equipments to contract farmers in DTA to promote production of goods as per the requirement of importing countries.

Are there any Relaxation in Labour Laws for SEZ Units?

The labour laws of the land will apply to all units inside the zone. However, the respective state governments may declare units within the SEZ as public utilities and may delegate the powers of the labour commissioner to the Development Commissioner of the SEZ.

Facilities for Domestic Suppliers to Special Economic Zone

- Supplies from Domestic Tariff Area (DTA) to SEZ to be treated as physical export. DTA supplier would be entitled to:

- Drawback/DEPB
- CST Exemption
- Exemption from state levies
- Discharge of EP if any on the suppliers
- Income-tax exemption under section 80-HHC

What is the Policy Frame for Sezs?

The policy frame work of SEZ units and SEZ developer is contained in the following:

- Chapter 7 of Export and Import policy
- Appendix 14-II of Handbook of Procedures, vol.1
- All relevant notifications and information is available at website www.sezindia.nic.in

List of Functional Special Economic Zone

S.No.	Location	Address
1	SEEPZ (Mumbai)	Development Commissioner, SEEPZ Special Economic Zone, Andheri (East) Mumbai – 400 096. Tel: 91-22-28290046, 28292147, 28292144 Fax: 91-22-28291385, 2829175 E-mail: dcseepz@vsnl.com Website: www.seepz.com
2	Kandla (Gujarat)	Development Commissioner, Kandla Special Economic Zone, Gandhidham – Kachchh, Tel: 91-2836-252194, 252475, 253300, 252281 Fax: 91-2836-252250 E-mail: ksez@sancharnet.in Website: www.kandlasez.com

3.	Cochin (Kerala)	Development Commissioner, Cochin Special Economic Zone, Kakkanmad, Cochin – 682 030. Tel: 91-484-2413111, 2413234 Fax: 91-484-2413074 E-mail: mail@cepz.com Website: www.csez.com
4.	Madras (Chennai)	Development Commissioner, Madras Special Economic Zone, National Highways 45, Tambaram, Chennai – 600 045. MEPZ CHENNAI Fax: 91-44-2628218 E-mail: mepz@vsnl.com mepz@md5-vsnl.net.in
5.	Visakhapatnam (Andhra Pradesh)	Development Commissioner, Visakhapatnam Special Economic Zone, Duvvada, Visakhapatnam – 530 046. Tel: 91-891-2587555, 2587352 Fax: 91-891-2587352 E-mail: dc@vepz.com
6.	Falta (West Bengal)	Development Commissioner, Falta Special Economic Zone, M.S.O.Building 4th Floor, Nizam Palace, Koltaka – 700 020. Tel: 91-33-22472263, 22477923, 22404092 Fax: 91-33-22477923 E-mail: fepz@wb.nic.in

7.	Noida (Uttar Pradesh)	Development Commissioner, Noida Export Processing Zone, Noida Dadri Road, Phase-II, Noida District Gautam Budh Nagar – 201305 (U.P) Tel: From Delhi: 91-120-2567270-73 From outside delhi: 91-120-2567270-3 Fax: 91-120-2562314, 91-2567276 E-mail: dcnepz@nda.vsnl.net.in
8.	Surat (Gujarat)	Surat Special Economic Zone, Diamond Park, Sachin Surat – 394 230 Tel: 91-261-2372733, 2372734 E-mail: maria@bom3.vsnl.net.in
9.	Indore SEZ (Madhya Pradesh)	Indore Special Economic Zone, 3/54, Press Complex, Free Press Home, H.B.Road, Indore – 452 008. Tel: 91-731-257229 E-mail: md@sezindore.com Website: www.sezindore.com

List of Approved SEZ

Name of the SEZ	Name of Promoter	Telephone (Office)
Navi Mumbai SEZ (Mharashtra)	Voice Chairman and Managing Director City & Industrial Development Corporation of Maharashtra Ltd. Nirmal, 2nd floor, Nariman Point, Mumbai – 400 021.	91-22-2026665 91-22-2021155 Fax: 91-22-2757-1066 E-mail:cidsys@giasbm01.vsnl.net.in

Positra SEZ (Gujarat)	Gujarat Postra Port Infrastructure Ltd. Pipavav House, 209 Bank St., Cross Lane, Off. Shahid Bhagat Singh Road, Fort, Mumbai – 400 023.	91-22-2270 3031 Fax: 91-22-2269 6021
Nanguneri SEZ (Tamil Nadu)	Chairman cum Managing Director Tamil Nadu & Industrial Development Corporation, Lakshimipathy Road, Chennai – 600 008.	91-44-28554421 Fax: 044-8553729
Bhadohi SEZ Kanpur SEZ Moredabad SEZ (Uttar Pradesh)	Managing Director, UP State Industrial Development Corporation Ltd., UPSIDC Complex, A-1/4, Lakhanpur, Kanpur – 208 024.	91-512-2582851-53 Fax: 91-512-2380797 E-mail:feedback@upsidcltd.com
Greater Noida (U.P)	Greater Noida Development Authority, Greater Noida, UP	
Visakhapatanum SEZ (Andhra Pradesh)	A.P. Industrial Infrastructure Corporation Ltd., Parisrama Bhavanam 6th Floor, 5-8-58/B, Fateh Maidan Road, Hyderabad – 500 004.	91-40-23233596 91-40-23230234 Fax: 91-40-232340205
Kakinada SEZ (Andhra Pradesh)	Kakinada Sea Port Ltd., 2nd Floor, Post Administrative Building Beach Road, kakinada – 533 007.	91-884-2365089, 2365889 Fax: 91-884-2365989 E-mail:kakinadaport@vsnl.net
Paradeep SEZ Gopalpur SEZ (Orissa)	Managing Director, Industrial Development Corporation of Orissa (IDCO), IDCO Tower, Janpath, Bhuvaneshwar, Bhuvaneshwar – 751 001.	91-674-2542784, 2540820 Fax: 91-674-2542956 E-mail: md@idcoindia.com
Sah Lake SEZ Kulpi SEZ (West Bengal)	West Bengal Industrial Development Corporation Ld., 5, Council House Street, Kolkata – 700 001.	91-33-22486583, 22101536/62/63/64/65 Fax: 91-33-2248-3737 E-mail: mdbidc@vsnl.com

Sitapura SEZ Jaipur (Rajasthan)	Managing Director, Rajasthan State Industrial, Development & Investment, Corporation Ltd. (RIICO) Udyaog Bhawan, Tilak Marg, Jaipur – 302 005.	91-141-2380751, 2413201 Fax: 91-141-2404804 E-mail: riico@riico.com
Maha Mumbai SEZ (Maharashtra)	Gujarat Posita Port Infrastructure Ltd., Pipavav House, 209 Bank Street, Cross lane, off. Shahid Bhagat E-mail: riico@riico.com Singh Road, Fort, Mumbai – 400 023.	91-22-2270-30311 Fax: 91-22-2269-6021
Vallarpadam/ Puthuvypeen (Kerala)	Cochin Port Trust Willington Island, Cochin Ltd., Pipavav House, 209 Bank St., Cross Lane, off. Shahid Bhagat E-mail: riico@riico.com Singh Road, Fort, Mumbai – 400 023.	91-484-2669200, 2668566 Fax: 91-484-2668163
Hassan SEZ (Karnataka)	Principal Secretary, Infrastructure Development Department, Government of Karnataka, 5th Stage, M.S. Building, Dr.Ambedkar Veedi, Bangalore – 560 001.	91-80-22280605, 22092397 Fax: 91-80-22280605 E-mail:psecinfra@ secretariat2.kar.nic.in

Source: Special Economic Zones in India, Investor's Guide, Ministry of Commerce and Industry, Department of Commerce, Government of India.

Are Special Economic Zones Too Costly?

The logic of creating a special economic zone is to offer infrastructure and other facilities that cannot be provided quite so easily across the country as a whole. The objective is to create islands of world-class infrastructure to reduce the cost of doing business and make industry globally competitive. This would mean assured electricity availability at competitive rates, availability of capital at internationally benchmarked rates, good transport links to reduce shipment time and delays, and flexible labour laws. In India, SEZs are being developed by the private sector or public sector or through private-public partnership. Since SEZs require massive investments and have relatively longer gestation period, proper mix of stable SEZ policy coupled with fiscal benefits need to be extended to the zones.

The fiscal concessions has made it possible for private players to look at SEZs as a profitable and new business opportunity. This has also helped provide infrastructure and other facilities to units in SEZs at substantially lower cost. Laying a kilometre of road costs ₹ 5 crore in our country, of which 30% goes to taxes. The exemption given to developer will ultimately percolate to units. In many states, industry pays as high as ₹ 7 for a unit of power where as all the large SEZs in the world provide electricity at ₹ 2. The removal of electricity duty will help in providing electricity at internationally benchmarked rates. Banks in SEZs are exempted from SLR and CRR requirements and also enjoy income tax concession. Thus the capital cost is lower for these banks which they will pass on to their customers.

A narrow view is being taken by interpreting SEZs as a loss making venture from revenue point of view as it may lead to revenue loss of about ₹ 90,000 crore over a period of time. This fear is base-less as SEZs can be a pivot for attracting FDI both in manufacturing and retail trade. It can provide flexibility to global major players to tap the Asean and Gulf markets. It may be emphasised that no government should provide primacy to revenue considerations over employment, exports and infrastructure development. (Source: The Economic Times, 14th April, 2006).

SEZs may Become a Burden on Taxpayers

By offering privileged trading terms for export-oriented units, SEZs are expected to attract investment and foreign exchange, spur employment and boost the development of improved technologies and infrastructure. These zones are designated duty-free enclaves, and are deemed foreign territories for the purpose of trade operations, duties and tariffs. Indian SEZs have more than 800 units, employing 1 lakh people with export growth of 32% in 2004-05 (around ₹ 18,000 crore) covering sectors like gems and jewellery, textiles, software, leather and chemicals.

Despite their appeal, many economists feel that SEZs attract investment only by offering distortionary incentives rather than building underlying competitive conditions. It is difficult to achieve 'comparative advantage' only by setting up SEZs. The success of any SEZ depends on conditions such as proper location, right kind of incentives, product specific policies, linkage between domestic sector and SEZ, financing issues and availability of sufficient trained human capital, etc. Along with the supply side conditions, identification of markets, multi-market strategy, brand development and so on are equally important for which strategies are quite independent of location of firms (inside or outside of SEZs).

Many critics feel that SEZs could be the victim of 'allocative inefficiency'. As the policy inside the zone is quite attractive in terms of facilities and fiscal incentives, many investors may blindly relocate their operations inside the zone without giving due consideration to investment decisions in other areas. Hence, the incentives to firms may create a fiscal burden on the taxpayer and sometimes hurt environmental and labour standards. In addition, the direct and indirect costs of maintaining zone privileges lead to enclaves of prosperity and does not benefit the economy in the true sense. The success of SEZs depends on government's strategy to promote private sector-led growth. Active linkage programmes, adequate social and environmental safeguards, and private sector involvement in zone development and operation can go a long way in ensuring that the benefits of SEZs are maximised. (Source: The Economic Times, 14th April, 2006)

Joint Ventures

Liberalisation has created new avenues for foreign investment, technology collaboration and joint ventures. Among these three, joint venture is the easy way to enter into the business by the domestic industries and the foreign counterparts. Joint ventures benefit the investing firm, investing country and the host country. Joint venture aims to achieve collective self-reliance and mutual cooperation among the developing countries. The basic objectives of the joint venture are summarised below:

- To increase export of capital goods, spare parts and components from India
- To increase the export of technical knowhow and consultancy services
- To project India's image abroad as a supplier of capital goods and updated technology to the global market
- To utilise the idle capacity in the capital goods sector in particular and industrial sector in general

Foreign countries prefer to enter into joint venture with the Indian industries, because the labour intensive nature of the Indian industries is suited to fulfil the requirements of the foreign counterparts. While Indian companies enter into joint venture with the developed countries, Indian companies are getting the opportunities to avail the technology of the industries are also expected to invest in the foreign countries and enter into foreign market rough joint ventures.

Requirements for Indian Direct Investment in Joint Ventures Abroad

Transparent policy is required to enable Indian industries to plan their business activity and to negotiate with the potential foreign counterparts for collaboration. Financial support of the financial institutions and banks are also required for entering into joint venture with the collaborator outside the country.

Many developing countries offer incentives such as tax holiday, export incentives, guarantee against expropriation, freedom to remit profits and repatriate capital and protective tariff to encourage joint ventures by foreign collaboration in their country. The developing countries prefer joint ventures from India. Because the labour intensity of the Indian industries is suited to the requirements of the developing nations. The developing countries having limited domestic market may not be in aposition to absorb the capital intensive technology provided by the developed countries. So they prefer medium scale technology with labour intensive developed by India.

Varshenoy and Bhattacharya in their book. International Marketing have pointed out some factors influencing the selection of a country for the establishment of joint ventures. The factors are given below:

(1) Market for the products concerned	a. Size of the market b. Market growth c. Existing competition local and foreign
(2) G**overnment Regulations**	a. Tax concessions and incentives b. Price controls and their severity c. Local content requirements d. Export obligations e. Extents of equity holding permitted f. Degree and nature of protection g. Repatriation of capital and profits
(3) **Economic Stability**	a. Economy and its management b. Fiscal Policies c. Growth Rate d. Degree of Inflation e. Trade balance and balance of payments f. Balance of indebtedness g. Import and debt service cover

(4) **Political Stability institutions**	a. Sound political b. Mechanism for orderly transfer of power c. Acceptance of the obligations of the previous Government d. Political relations with India

joint Ventures Abroad

Many Indian companies have entered into joint ventures abroad. There were 524 joint ventures as on 31 st December 1994, Out of the 524 joint ventures, 177 were in operation and the remaining 347 were at different stages of implementation. The Government of India has approved 216 joint ventures in 1995 and 255 in 1996. The total Indian equity in the 177 joint ventures in operation abroad was at ₹ 179.04 crore and the approved equity for joint ventures under various stages of implementation is amounted to ₹ 1398.96 crore. Of the 177 joint ventures which are in operation, 99 (56%) are in the field of manufacturing and the remaining 78 (44%) are sanctioning in the non-manufacturing sector. Indian equity in joint venture has been mainly through export of machinery and equipment/technology/or capitalisation of earnings of the Indian company through provision of technical know how or other services..

The scale of operations of the Indian joint ventures abroad is generally small. The shareholding of the Indian joint venture is less than ₹ 50 lakhs in most of the operating joint ventures. Of late, projects under joint venture with large equity base are coming up. The Governmental policies and guidelines for joint venture encourage Indian joint venture abroad with large equity base and insist the Indian enterprises to carefully select the economically viable projects capable of not only coming higher returns but also projecting better image of Indian expertise and technology in the overseas market.

Indian joint ventures abroad are engaged in the manufacturing and non-manufacturing sectors. The mdianjoint ventures are functioning in the manufacturing sectors such as, light engineering, textiles, chemicals, pharmaceuticals, food products, leather and rubber products, iron and steel, commercial vehicles, pulp and paper and cement products etc. The non-manufacturing sectors are hotels and restaurants, trading and marketing, consultancy, engineering and construction. Indian joint ventures are in operation in the UK, Malaysia, the USA, UAE, Singapore, Srilanka, Russia, Nepal, Thailand, Mauritius, Nigeria, Indonesia and Hong Kong. Majority of the Indian joint ventures are in operation in the East Asia region followed by Europe-America region, Africa region. South Asia region and West Asia region.

The earnings of the Indian joint ventures abroad are in the form of dividends and other entitlements of the Indian promoters such as fee for the technical know how, engineering services, management services, consultancy and royalty. Substantial foreign exchange could be earned by exporting machineries and other inputs to joint ventures. The Indian promoters are getting bonus shares also when the joint ventures declare bonus shares. This enables the Indian promoters to raise their equity and to earn higher dividends.

Indian joint ventures are facing many problems in the initial stage, implementation Stage and operational stage.

Following are the reasons identified for the problems faced by the Indian joint ventures abroad:

- Inability to assess the market prospects
- Failure to identify the right foreign counterpart
- Non-approval of technology sought to be supplied by Indian partners
- Inability of the Indian companies to adjust themselves in the new environment and (no sheltered market in the overseas market)
- Price competition

Definitions

(a) **Direct Investment** shall mean investment by an Indian party in the equity share capital of a foreign concern with a view to acquiring a long term interest in that concern. Besides the equity stake, such long term interest may be reflected through representation on the Board of Directors of the foreign concern and in the supply of technical know-how, capital goods, components, raw materials, etc. and managerial personnel to the foreign concern.

(b) **Host Country** shall mean the country in which the foreign concern receiving the direct investment is formed, registered or incorporated.

(c) **Indian party** shall mean a private or public limited company incorporated in accordance with the laws of India. When more than one Indian body corporate make a direct investment in a foreign concern, all the bodies corporate shall together constitute the "Indian party".

(d) **Joint Venture** shall mean a foreign concern formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian party makes a direct investment, whether such investment amounts to a majority or minority shareholding.

(e) **Wholly Owned Subsidiary** shall mean foreign concern formed, registered or incorporated in accordance with the laws and regulations of the host country whose entire equity share capital is owned by the Indian party.

Automatic Approval

An application for direct investment in aj oint venture/wholly owned subsidiary abroad from a Private/Public Ltd. Co. will be eligible for automatic approval by R.B.I. provided:

(i) The total value of the investment by the Indian party does not exceed US $4 (four) million,

(ii) The amount of investment is upto 25% of annual average export earnings of the company in the preceding three years and

(iii) The amount of investment should be repatriated in full by way of dividends, royalty, technical services fee etc. within a period of five years investment.

The investment may, besides cash remittance at the discretion of the Indian party, be contributed by the capitalisation in full or in part of

(a) Indian made plant, machinery, equipment and components supplied to the foreign concern;

(b) The proceeds of goods exported by the Indian party to the foreign concern;

(c) Fees, royalties, commissions or other entitlements from the foreign concern for the supply of technical know-how, consultancy, managerial or other services.

Within the overall limit ofUS $4 million the Indian party, may opt for:

(1) Cash remittance;

(2) Capitalisation of export proceeds towards equity; or

(3) Giving loans or corporate guarantees to/on behalf of Indian JVs/WOSs.

For loans/Guarantees from banks/financial institutions from India to/on behalf of Indian JVs/WOSs abroad requisite clearances from commercial banking angle for loans and guarantees as required would need to be taken as normally prescribed.

Where R.B.I. in its judgment, feels that a proposal under automatic route is predominantly real estate-oriented, such proposals shall be remitted to the High Level Committee.

Time Limit

All implications under the automatic route will be eligible for approval within 21 days of receipt of complete application by RBI, which shall include abroad feasibility study, a statement of credit-worthiness from a bank, and statement from a Chartered Accountant verifying the ratios, projections made, etc.

In case the application is for takeover of participation in an existing unit, the basis of share valuation shall be certified by a Chartered Accountant.

This facility of automatic approval will be available to the Indian party in respect of the same JV/WOs only once in a block of three financial years including the financial year in which the investment is made. However, within the overall limit of US $4 million the Indian party may be permitted to invest equity/provide guarantee etc. on the automatic route on more than one occasion. However, non-automatic route may be availed of without these restrictions.

Special Committee

All applications involving investment beyond US $4 million but not exceeding US $15 million or those not qualifying for fast track clearance on the basis of the applicable criteria outlined above, and all applications where RBI feels that the proposal imder automatic route is predominantly real estate-oriented, will be processed in the RBI through a Special Committee appointed by RBI in consultation'with Government and chaired by the Commerce Secretary with the Deputy Governor, R.B.I., as the Alternate Chairman. The Committee shall have as members representative of the Ministry of Commerce, Ministry of Finance, Ministry of External Affairs and the RBI. The Committee shall co-opt as members other Secretaries/Institutions dealing with the Sector to which the case before the Committee relates.

A recommendation will be made within 60 days of receipt of the complete application and RBI will grant of refuse permission on the basis of the recommendations. Such proposals should be accompanied by a technical appraisal by any of the designated agencies (currently they are IDBI, ICICI, Exim Bank and SBI) to be arranged for by the applicant. The Committee will, inter alia, review the criteria for and progress of all overseas investments under these guidelines and evolve its own procedures for consultations and approvals.

Criteria

In considering an application under category “B”, the Committee shall, inter alia, have due regard to the following:

(a) The financial position, standing and business track record of the Indian and foreign parties.

(b) Experience and track record of the Indian party in exports and its external orientation.

(c) Quantum of the proposed investment and the size of the overseas venture in the context of the resources, net worth and scale of operations of the Indian party; and

(d) Repatriation by way of dividends, fees, royalties, commissions or other entitlements from the foreign concerns for supply of technical know-how, consultancy, managerial or other services in five years w.e.f. the date of approval of investments.

(e) Benefits to the country in terms of foreign exchange earnings, two way trade generation, technology transfer, access to raw materials, intermediates or final products not available in lndia.

(f) Prima facie viability of the proposed investment.

Indian financial and banking institutions considering to support the venture will examine independently the commercial viability of the proposal.

Post Approval Changes

In the case of a joint venture in which the Indian party has a minority equity shareholding, the Indian party shall report to the Ministry of Commerce and the Reserve Bank of India the details of following decisions taken by the joint venture within 30 days of the approval of these decisions by the shareholders/promoters/Directors of the joint venture in terms of the local laws of the host country:

(i) Undertake any activity different from the activity originally approved by the R.B.I/ Government of India for the direct investment;

(ii) Participate in the equity capital of another concern;

(iii) Promote a subsidiary or a wholly owned subsidiary as a second generation foreign concern;

(iv) After its share capital structure, authorised or issued, or its shareholding pattern.

  (i) Undertake any activity different from the activity originally approved for the direct investment;

  (ii) Participation in the equity capital of another concern;

  (iii) Promote a subsidiary or a wholly owned subsidiary as a second generation concern;

  (iv) After its share capital structure, authorised or issued, or its shareholding pattern.

Provided, the following conditions are fulfilled;

(a) The Indian party has repatriated all entitlements due to it from the foreign concern, including dividends, fees and royalties and this is duly certified by a Chartered Accountant;

(b) The Indian party has no overdues older than 180 days from the foreign concern in respect of its exports to the latter;

(c) The Indian party does not seek any cash remittance from India; and

(d) The percentage of equity shareholding of the Indian party in the first generation joint venture or wholly owned subsidiary is not reduced, unless it is pursued to the laws of the host country.

The Indian party shall report to Ministry of Commerce and the Reserve Bank of India the details of the decisions taken by the joint venture or wholly owned subsidiary within 30 days of the approval of those decisions by the shareholders/promoters/ Directors in terms of the local laws of the host country, together with a statement on the fulfilment of the conditions mentioned above.

In the case of subscription by an Indian party to its entitlement of equity shares issued by a joint venture on Rights basis, or in the case of subscription by an Indian party to the issue of additional share capital by a joint venture or a wholly owned. Subsidiary, prior approval of the R.B.I shall be taken for such subscription.

Large Investments

Investment proposals in excess of US $ 15.00 million will be considered if the required resources beyond US $15.00 million are raised through the GDR route. Upto 50% of resources raised may be invested as equity in overseas joint ventures subject to specific approvals of the Government. Applications for investments beyond US $ 15.00 million would be received in the RBI and transmitted to Ministry of Finance for examination with the recommendation of the Special Committee. Each case would, with due regard to the criteria outlined above, be subject to rigorous scrutiny to determine its overall benefit. Investments beyond US $ 15.00 million without GDR resources will be considered only in very exceptional circumstances where a company has a strong track record of exports. All proposals under this category should be accompanied by the documentation as detailed above.

Foreign Exchange

(i) Indian parties intending to conduct preliminary study with regard to feasibility, viability, assessment of fair price of the assets of the existing/proposed overseas concern, identification of foreign collaborators, etc. before deciding to set up/ acquire an overseas concern/bid for the same, may approach the concerned Regional Office of Reserve Bank for prior approval for availing the services of overseas consultants/merchant bankers involving remittance towards payment of fees, incidental charges, etc.

(ii) For release of exchange of meeting preliminary/pre-operative expenses in connection with joint venture/subsidiary abroad approved by Government of India/ Reserve Bank of India, applications should be made to the concerned Regional Office of Reserve Bank, Reserve Bank will consider releasing exchange keeping in view, inter alia, the nature of the proj ect, total proj ect cost, need for meeting such expenses from India, etc. subj ect to such conditions as deemed necessary including repatriation of amounts so released. Remittance towards recurring expenses for the upkeep of the joint venture/ subsidiary abroad will, however, not be permitted.

The foreign exchange needed for overseas investment may be drawn after the approval is granted, either from an authorised dealer or by utilising the balance available in the EEFC account of the Indian party or by any other means specified in the letter of approval.

Acquisition of Shares and Issue of Holding Licence

Where equity contribution are made by way of cash remittance or capitalisation of royalty, technical know-how fees, etc., Indian promoter companies are required to receive share certificates of equivalent value from the overseas concern within three months from the date of effecting such cash remittance or Mthe date on which the royalty, fees, etc. become due for payment. As soon as shares are acquired from the overseas concern, Indian companies should apply in form FAD 2 to the concerned office of Reserve bank for obtaining necessary licence to hold such foreign security as required under Section 19(i)(e) of FERA,1973

Acceptance of Directorship of Overseas Companies and Acquisition of Qualification Shares

Persons resident in India are free to accept appointments as directors on the board of the overseas companies. However, they will require permission from Reserve Bank for any remittance toward acquisition of qualification shares, if any, of the overseas companies for which application in form A2 together with an offer letter of the overseas company should be made to the concerned Regional Office of Reserve Bank through an authorised dealer.

In receipt of shares from the foreign concern, an application in form FAD 2 should be made to the concerned office of the Reserve Bank for issue of necessary holding licence. Such directors are also required to repatriate to India promptly, remuneration, if any, received by way of sitting fees, etc. through nominal banking channels.

Export of Goods

Both under Category “A” and Category “B” above, secondhand or reconditioned indigenous machinery may be supplied by the Indian party towards its contribution to the direct investment in the foreign concern.

Agency Commission

No agency commission shall be payable to ajointventure/wholly owned subsidiary against the exports made by the Indian party towards its equity investment. Similarly, no agency commission shall be payable to a trading joint venture/wholly owned subsidiary if the Indian party makes an outright sale to it.

Remittance towards equity, loans and invoked guarantees

i) Where the Indian promoter companies have been permitted to make equity contribution by way of cash remittance, they should apply for release of foreign exchange to the concerned Regional Office of Reserve Bank in form A2, in duplicate, through their authorised dealer. In case theremittance is to be effected out of the funds held in their EEFC account, prior permission from Reserve Bank will, however, not be necessary. In both the cases, after affecting the remittance, the particulars thereof, along with the certificate of the authorised dealer concerned, should be reported by the Indian company to the concerned Regional Office of Reserve Bank positively within 15 days from the date of such remittance.

ii) In case of remittance of loan amount, if specifically approved by Reserve Bank, the aforesaid procedure should be followed and particulars of remittance should be reported to the concerned Regional Office of Reserve Bank within 15 days from the date of such remittance. Where issue of guarantee by the Indian company has been specifically approved by Reserve Bank, a certified copy of such guarantee should be submitted to the concerned Regional Office of Reserve Bank within 15 days from the date of issue of such guarantee to/on behalf of the overseas concern. If and when such guarantee is invoked, the Indian company should approach the concerned Regional Office of Reserve Bank through their authorised dealer for effecting remittance towards the invoked guarantee. After effecting the remittance, the particulars thereof should be reported to Reserve Bank as in the case of remittances made for.equity and for loan. (Source: Exports, What, Where, How - Paras Ram).

Rupee Convertibility

Rupee convertibility is an important reform in foreign exchange transactions after liberalization. Foreign currency earners (exporters) can convert their foreign currency into Indian rupee with valid documents. They can utilize the services of banks and other authorized money changers for conversion.

Similarly foreign currency spenders (importers) can convert their Indian rupee in to foreign currency with valid documents for paying imports. Before introducing rupee convertibility policy, foreign currency earners and foreign currency spenders approached the Reserve Bank of India for currency conversion and it was made based on the directions and policies of the Reserve Bank of India. Exchange rate was decided by the Reserve Bank of India. Foreign currency earners and spenders were not allowed to open bank accounts in foreign currency.

There are two accounts in Balance of Payments. They are (i) current account and (ii) capital accounts. Rupee convertibility is fully exercised in current account. At present convertibility is not applied in capital account

Current account is otherwise called trade account. Current account deals with transactions related to merchandise export, merchandise import, invisible export and invisible import and private remittances. Foreign exchange involved in these transactions is freely convertible in to Indian rupee at the prevailing exchange rate. It is known as trade account convertibility or current account convertibility.

Those who want to visit abroad as tourist can get foreign currency with authorized dealers by submitting valid documents. Similarly those who go abroad for higher studies and medical treatment can get foreign currency by submitting required documents.

Foreign currency earners can open foreign currency account in banks. The account is called "Exchange Earners Foreign Currency Account". They can draw foreign currency from this account to meet their foreign currency requirements.

Rupee Convertibility is not in practice in Capital Account of Balance of Payments. Foreign exchange involved in capital account is not freely convertible. The Government of India has formed a committee under the chairmanship of Mr. S.S.Tarapore, Deputy Governor, Reserve Bank of India to suggest policy measures for capital account convertibility in India.

Capital Account Convertibility

It implies the freedom to convert domestic financial assets into overseas financial assets at market determined rates.

It can also imply conversion of overseas financial assets into domestic financial assets. Freedom for firms and residents to freely buy into overseas assets such as equity, bonds, property and acquire ownership of overseas firms besides free repatriation of proceeds by foreign investors.

Once a country eases capital controls, typically there is a surge of capital flows. For countries which face constraints on savings and capital can utilize such flows to finance their investment, which in turn create economic growth. Local residents will be in a position to diversity their portfolio of assets, which helps them insulate themselves better from the consequences of any shocks in the domestic market. For global investors, capital account convertibility helps them to seek higher returns by sharing of risks. It offers countries better access to global markets besides resulting in the emergence of deeper and more liquid markets. It is stated to bring it greater discipline on the part of governments in terms of reducing excess borrowings and rendering fiscal discipline.

Prospects of outflow of what is termed as speculative short-term flows. Denomination of a substantial part of local assets in foreign currencies poses the threat of outward flows and higher interest rates which could destabilize economies. The volatility in exchange and interest rates in the wake of capital flows can lead to unsound funding and large unhedged foreign liabilities. This is especially so for economies which go in for a free float without following prudent macro economic policies, and ensuring financial reforms.

Capital account convertibility is in vogue in terms of freedom to take out proceeds relating to foreign direct investment, portfolio investment for overseas investors and non-resident Indians besides lee-way for forms to invest abroad in joint ventures or acquisition of assets and for residents and mutual funds to invest abroad in stocks and bonds with some restrictions.

S.S. Tarapore Report on Capital Account Convertibility (Report was released on 01.09.2006)

Important Highlights

Ban on participatory notes

Participatory notes are instruments that overseas entities, which are not registered with SEBI, buy from foreign security houses to invest in India. NRI will stop enjoying tax exemptions on the interest on bank deposits.

RBI has allowed relaxations in foreign exchange transactions, Basic travel quota is liberalized. International credit cards were allowed to fund ed;ucation and medical treatment were raised.

Phase I 2006-07 - for individuals- Indians can freely remit $50,000 in the first phase and $2,00,000 in the final phase.

Mutual funds can invest $ 3 billion in phase I and $ 5 billion in phase II in overseas markets.

Portfolio Management Schemes (PMS) to be allowed to invest overseas. Indian can have foreign currency accounts in overseas banks. Foreign individuals can invest in stocks through PMS and Mutual Funds.

Companies can raise External Commercial Borrowings up to $ 1 billion in phase III without permission.

No ceiling on long-term or rupee denominated External Commercial Borrowings.

Companies can invest up to four times their capital in overseas subsidiaries/joint ventures.

Banks can eventually raise up to 100% of their capital through overseas borrowing in Phase III

Foreign companies can raise rupee loans and bonds in India. Mauritius will no longer be a tax haven.

Self Assessment Questions

1) What are the objectives of Export – Import Policy?
2) What do you understand by Deemed Exports?
3) Write a short note on 'Project and Consultancy Exports'.
4) Elaborately Explain the Direction of India's Foreign Trade
5) Explain the composition of India's Foreign Trade.
6) What are the objectives of Export Promotion Councils?
7) What are commodity Boards? Explain their functions.
8) What is SEZ? Explain its salient features.
9) Discuss the salient features of the recent foreign trade policy.
10) Write a short note on 'Rupee Convertibility'.

CASE STUDY

Foreign Trade – Driving the growth of India

The shares of the services sector has increased to a large extent matched by a corresponding declines in the share of agriculture. However, the industrial share of GDP does not show a significant improvement and is low in India compared to the developed nations. Since 1999, the share of agriculture in the GDP has declined from 26.2% to 21.2% in 2006. Further decline in the share of the agriculture in the GDP is likely in the future. Since the majority of the people derived their livelihood from agricultural directly or indirectly there is a need to absorb surplus agricultural labour in other sectors of the economy specially in industry. It is expected that the rapid growth of agro-processed industries like the food processing can provide immediate employment to many people without moving from rural to urban areas. Further, investment in rural infrastructure, irrigation, reforms in legislation, strengthening agri-research and development and upgrading post-harvest management technologies are needed to give impetus to Indian agriculture.

There has been a modest increase in the share of the industry from 25.9% in 1999 to 27% in 2006. One of the factors responsible for the rapid growth of GDP is the revival of manufacturing sector due to major reforms by the Govt. in the form of relaxing restrictions and opening new sectors for Foreign Direct Investment. As a result the net inflow of FDI has increased from $2.26 bn in 1999 to more than $100 bn.

Questions

1. What are the prospects of Agro-Exports of India in Future?
2. Foreign Direct Investment is acting of late, as an engine of growth for India. Discuss.

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UNIT – IV

Unit Structure

Lesson 4.1 - Instruments of Export Promotion

Learning Objectives

After studying this lesson you should be able:

- To understand the export import policy
- To understand the export assistance provided by the government
- To learn about infrastructural and promotion measures
- To understand incentives provide for EDI applications

Introduction

Trade is not an end in itself, but a means to economic growth and national development. The primary purpose is not the mere earning of foreign exchange, but the stimulation of greater economic activity. The Foreign Trade Policy 2004-09 is rooted in this belief and built around two major objectives. These are:

(i) To double our percentage share of global merchandise trade within the next five years; and

(ii) To act as an effective instrument of economic growth by giving a thrust to employment generation.

The new Policy envisages merchant exporters and manufacturer exporters, business and industry as partners of Government in the achievement of its stated objectives and goals. Prolonged and unnecessary litigation vitiates the premise of partnership.

In order to obviate the need for litigation and nurture a constructive and conducive atmosphere, a suitable Grievance Redressal Mechanism will be established which, it is hoped, would substantially reduce litigation and further a relationship of partnership.

Instruments of Export Promotion

The initiatives taken by government of India for strengthening the exports are multifaced. It offers various incentives and facilities to the exporters to help them improve their competitiveness in the foreign markets.

These schemes can be named as instruments of export promotion are given below.

1. Export assistance and promotional measures
2. Import facilities under EPCG scheme Duty exemption schemes
3. Fiscal incentives like Duty drawback and Tax concessions
4. Marketing assistance under MDA scheme
5. Recognition of Export houses, Trading houses
6. Support provided by State Trading Organisations
7. Establishment of EPZs and SEZs

Export Assistance and Promotional Measures

Export assistance is provide from the entry level organisations to large business houses through different organisations such as Export promotion councils, commodity boards etc.. Exports and imports are free unless regulated. Generally there are various bottlenecks that are faced by exporters in actual trade. The following steps were taken in the latest policy to enhancement of export trade.

Exports and Imports free unless regulated. Exports and Imports shall be free, except in cases where they regulated by the provisions of this Policy or any other law for the time being in force. The item wise export and import policy shall be, as specified in ITC(HS) published and notified by Director General of Foreign Trade, as amended from time to time.

Export Promotion Councils/ Commodity Boards

The basic objective of Export Promotion Councils is to promote and develop the exports of the country. Each Council is responsible for the promotion of a particular group of products, projects and services.

Registration-cum-Membership Certificate (RCMC)

Any person, applying for

(i) A license/ certificate/ permission to import/ export, [except items listed as restricted items in Import Tariff Code (ITC)] or

(ii) Any other benefit or concession under this policy shall be required to furnish Registration-cum-Membership Certificate (RCMC) granted by the competent authority unless specifically exempted under the Policy.

An exporter desiring to obtain a Registration-cum-Membership Certificate (RCMC) shall declare his main line of business in the application, which shall be made to the Export Promotion Council (EPC) relating to that line of business. However, a status holder has the option to obtain RCMC from Federation of Indian Exporters Organization (FIEO).

Example

Exporters of Drugs & Pharmaceuticals shall obtain RCMC from Pharmexcil only. Further, exporters of minor forest produce and their value added products shall obtain RCMC from Shellac Export Promotion Council.

The service exporters (except software service exporters) shall be required to obtain RCMC from FIEO.

In addition, an exporter has the option to obtain an RCMC from FIEO or any other relevant EPC if the products exported by him relate to those EPC's.

Validity Period of RCMC

The RCMC shall be deemed to be valid from 1st April of the licensing year in which it was issued and shall be valid for five years ending 31st March of the licensing year, unless otherwise specified.

Directives of DGFT

The Director General of Foreign Trade may direct any registering authority to register or de-register an exporter or otherwise issue such other directions to them consistent with and in order to implement the provisions of the Act, the Rules and Orders made there under, the Policy or this Handbook.

Infrastructure Initiatives

Assistance to States for Infrastructure Development of Exports (ASIDE)

The State Governments shall be encouraged to participate in promoting exports from their respective States. For this purpose, Department of Commerce has formulated a scheme called ASIDE. Suitable provision has been made in the Annual Plan of the Department of Commerce for allocation of funds to the States on the twin criteria of gross exports and the rate of growth of exports.

The States shall utilise this amount for developing infrastructure such as roads, connecting production centers with the ports, setting up of Inland Container Depots and Container Freight Stations, creation of new State level export promotion industrial parks/zones, augmenting common facilities in the existing zones, equity participation in infrastructure projects, development of minor ports and jetties, assistance in setting up of common effluent treatment facilities, stabilizing power supply and any other activity as may be notified by Department of Commerce from time to time.

Identifying Towns of Export Excellence

A number of towns in specific geographical locations have emerged as dynamic industrial clusters contributing handsomely to India's exports. It is necessary to grant recognition to these industrial clusters with a view to maximizing their potential and enabling them to move higher in the value chain and tap new markets.

Selected towns producing goods of ₹ 1000 crore or more will be notified as Towns of Exports Excellence on the basis of potential for growth in exports. However for the Towns of Export Excellence in the Handloom, Handicraft, Agriculture and Fisheries sector, the threshold limit would be ₹ 250 crores.

Common service providers in these areas shall be entitled for the facility of the EPCG scheme. The recognized associations of units will be able to access the funds under the Market Access Initiative scheme for creating focused technological services. Further such areas will receive priority for assistance for rectifying identified critical infrastructure gaps from the ASIDE scheme.

Market Related Initiatives:

Market Access Initiative (MAI)

The Market Access Initiative (MAI) scheme is intended to provide financial assistance for medium term export promotion efforts with a sharp focus on a country and product.

The financial assistance is available for Export Promotion Councils, Industry and Trade Associations, Agencies of State Governments, Indian Commercial Missions abroad and other eligible entities as may be notified from time to time. A whole range of activities can be funded under the MAI scheme.

These include market studies, setting up of showroom/ warehouse, sales promotion campaigns, international departmental stores, publicity campaigns, participation in international trade fairs, brand promotion, registration charges for pharmaceuticals and testing charges for engineering products etc. Each of these export promotion activities can receive financial assistance from the Government ranging from 25% to 100% of the total cost depending upon the activity and the implementing agency.

Marketing Development Assistance (MDA)

The Marketing Development Assistance (MDA) Scheme is intended to provide financial assistance for a range of export promotion activities implemented by export promotion councils, industry and trade associations on a regular basis every year. As per the revised MDA guidelines, assistance under MDA is available for exporters with annual export turnover upto ₹ 10 crores.

These include participation in Trade Fairs and Buyer Seller meets abroad or in India, export promotion seminars etc. Further, assistance for participation in Trade Fairs abroad and travel grant is available to such exporters if they travel to countries in one of the four Focus Areas, such as, Latin America, Africa, CIS Region, ASEAN countries, Australia and New Zealand. For participation in trade fairs etc., in other areas financial assistance without travel grant is available.

Focus Market Scheme and Focus Product Scheme

Under the above schemes the exporter was allowed for claiming duty and shall submit the application within a period of six months from the end of the period of the application or within a period of six months ofthe date of realization of the last export covered by the said application, which ever is later.

Special Focus Initiatives

With a view to doubling our percentage share of global trade within 5 years and expanding employment opportunities, especially in semi urban and rural areas, certain special focus initiatives have been identified for the **agriculture, handlooms, handicraft, gems & jewellery, leather and Marine sectors.** Government of India making concerted efforts to promote exports in these sectors by specific sectoral strategies that shall be notified from time to time.

Vishesh Krishi and Gram Udyog Yojana (Special Agriculture and Village Industry Scheme)

The objective of Vishesh Krishi and Gram Udyog Yojana (Erstwhile Vishesh Krishi Upaj Yojana) is to promote export of Fruits, Vegetables, Flowers, Minor Forest produce, Dairy, Poultry and their value added products, and Gram Udyog products by incentivising exporters of such products.

Exports of Fruits, Vegetables, Flowers, Minor Forest Produce, Dairy, Poultry and their value added products shall be entitled for duty credit scrip equivalent to 5% of the FOB value of exports. Gram Udyog products as listed in Appendix 37A of the Handbook of Procedures (Vol. I) shall be entitled for duty credit scrip equivalent to 5% of the FOB value of exports in respect of the exports made on or after 1st April 2006. The scrip and the items imported against it shall be freely transferable.

Following exports shall not be taken into account for duty credit entitlement under the scheme:

(a) Export of imported goods covered under para 2.35 of the Foreign Trade Policy or exports made through transshipment.

(b) Deemed Exports.

(c) Exports made by SEZs units and EOUs units.

The Duty Credit may be used for import of inputs or goods, which are otherwise freely importable under ITC (HS) Classifications of Export and Import Items, Imports from a port other than the port of export shall be allowed under TRA facility as per the terms and conditions of the notification issued by Department of Revenue.

Additional customs duty/excise duty paid in cash or through debit under Vishesh Krishi and Gram Udyog Yojana shall be **adjusted as CENVAT Credit or Duty Drawback** as per rules framed by the Department of Revenue.

Brand Promotion and Quality

The Central Government aims to encourage manufacturers and exporters to attain internationally accepted standards of quality for their products. The Central Government will extend support and assistance to Trade and Industry to launch a nationwide programme on quality awareness and to promote the concept of total quality management.

Trade Facilitation through EDI Initiatives

It is endeavor of the Government to work towards greater simplification, standardization and harmonization of trade documents using international best practices.

As a step in this direction DGFT shall move towards an automated environment for electronic filing, retrieval and authentication of documents based on agreed protocols and message exchange with other community partners including Customs and Banks.

DGCI&S Commercial Trade Data

To enable the users to make commercial decisions in a more professional manner, DGCI&S trade data shall be made available with a minimum time lag in a query based structured format on a commercial criteria.

Fiscal Incentives to promote EDI Initiatives adoption

With a view to promote the use of Information Technology, DGFT will provide fiscal incentives to the user community.

The following deductions in Application Fee would be admissible for applications signed digitally or/ and where application fee is paid electronically through EFT (electronic fund transfer).

Sr.No	Mode of Application	Fee Deduction (as a % of normal applicationfee)
1	Digitally signed	25%
2	Application fee payment vide EFT	25%
3	Both digitally signed as well as use of EFT for payment of application fee	50%

The facility will reduce unnecessary physical interface with DGFT. It will enable faster processing, speedier communication of deficiencies, if any, and on-line availability of application processing status.

Trade Related Initiatives

Export Promotion Council for Services

Service exporters are required to register themselves with the Federation of Indian Exporters Organisation. However, software exporters shall register themselves with Electronic and Software Export Promotion Council. In order to give proper direction, guidance and encouragement to the Services Sector, an exclusive Export Promotion Council for Services shall be set up.

The Services Export Promotion Council shall:

(i) Map opportunities for key services in key markets and develop strategic market access programmes for each component of the matrix.

(ii) Co-ordinate with sectoral players in undertaking intensive brand building and marketing programmes in target markets.

(iii) Make necessary interventions with regard to policies, procedures and bilateral/ multilateral issues, in co-ordination with recognised nodal bodies of the services industry.

Recognition of Star Export House

Merchant as well as Manufacturer Exporters, Service Providers, Export Oriented Units (EOUs) and Units located in Special Economic Zones (SEZs), Agri Export Zone (AEZ's), Electronic Hardware Technology Parks (EHTPs), Software Technology Parks (STPs) and Bio Technology Parks (BTPs) shall be eligible for applying for status as Star Export Houses. Plenty of advantages were provided to these houses. This topic will be discussed in the following lesson.

Test Houses

The Central Government will assist in the modernisation and upgradation of test houses and laboratories in order to bring them at par with international standards.

Grievance Redressal DGFT As A Facilitator Of Exports/ Imports

DGFT has a commitment to function as a facilitator of exports and imports. Our focus is on good governance, which depends on clean, transparent and accountable delivery systems.

Grievance Redressal Mechanism

In order to facilitate speedy redressal of grievances of trade and industry, a new grievance redressal mechanism has been put in place by a Government resolution. The Government is committed to resolving all outstanding problems and disputes pertaining to the past policy periods through the Grievance Redressal Committee for condoning delays, regularizing breaches by exporters in bonafide cases, resolving disputes over entitlements, granting extensions for utilization of licences etc.

Meeting Legal Expenses for Trade Related Matters

Financial assistance would be provided to deserving exporters on the recommendation of Export Promotion Councils for meeting the cost of legal expenses relating to trade related matters.

Summary

Foreign trade policy aims at providing wider support to the industry in manufacture and service sector. Registration-cum-Membership Certificate (RCMC) will be issued by Export promotion councils (EPCs) or by Federation of Indian Exporters Organization (FIEO). Benefits provided by government will be availed through EPCs. Infrastructural support will be provided under ASIDE and identifying town with large turnovers. Exports are encouraged under special schemes like Focus Market Scheme, Focus Product. Market development assistance will be provided for various activities under taken by EPCs and others. Trade is facilitated through EDI (electronic data interchange) and fiscal incentives are provided for those who are filing their applications through EDI. Grievance system was simplified and focussed to settle past policy linked grievances

Glossary

Registration-cum-Membership Certificate (RCMC): The certificate required for availing the incentives provided by the government through EPC and others.

FIEO: Federation of Indian Exporters Organization

DGFT: Director General of Foreign Trade

Marketing Development Assistance (MDA): Assistance provided for undertaking study tour, Participation in Trade Fairs and Buyer Seller meets abroad or in India, export promotion seminars etc.

EDI: Electronic Data Interchange.

Self Assessment Questions

1. Explain briefly the focus of the foreign trade policy 2004-2009.
2. Explain the importance of RCMC certificate.
3. List market related initiatives taken for improvement of exports..
4. What are the major advantages of EDI initiatives?
5. Explain various trade related initiatives taken for export promotion.

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Lesson 4.2 - Import Schemes and Incentives

Learning Objectives

After studying this lesson you should be able:

- To understand the purpose of EPCG scheme
- To learn import facilities under the Duty exemption/remission schemes
- To know the procedure in Duty drawback scheme
- To learn about Tax concessions provided for exporters

Foreign trade policy facilitates import of goods under the following schemes.

Export Promotion Capital Goods Scheme (EPCG)

An importer of capital goods has to pay the applicable import duty. If exporter imports capital goods against payment of import duty, then the cost of capital goods will certainly increase by the amount of import duty and it would result in the increase in the cost of production.

As a consequence, the cost competitiveness of the export products would be adversely affected. Though it is the primary responsibility of the exporter to ensure cost effectiveness yet the Government of India in the Export-Import Policy 1997-2002 has introduced **Export Promotion Capital Goods Scheme** to promote cost competitiveness of India's exports.

The term 'capital goods' includes computer software systems and jigs, dies fixtures, moulds and spares, Second hand capital goods without any restriction on age may also be imported under the EPCG scheme.

However, import of motor cars, sports utility vehicles/all purpose vehicles shall be allowed only to hotels, travel agents, tour operators or tour transport operators and companies owning/operating golf resorts are allowed subjected to fullfilment of export obligation. Import of capital goods shall be **subject to Actual User condition** till the export obligation is completed

Main Features of the EPCG Scheme

The main features of the EPCG scheme are as follows:

a. Eligibility for Import

Under this scheme, manufacturer exporters, merchant exporters tied to supporting manufacturer(s) and service providers are eligible to import capital goods. The capital goods imported by the licence holder shall be installed at the factory of the licence holder or the supporting manufacturer(s). The import of capital goods is allowed subject to the actual user condition only till the export obligation stipulated under this scheme is completed.

b. Adjustment in the Value of EPCG Licence

The value of an EPCG licence can be adjusted plus/minus 10% of the CIF value of the licence.

c. Amount of Export Obligation

The scheme allows import of capital goods for pre production, production and post production (including CKD/SKD thereof as well as computer software systems) at 5% Customs duty subject to an export obligation. equivalent to 8 times of duty saved amount for the CIF value saved on capital goods imported under EPCG scheme to be fulfilled over a period of 8 years and for agro units 6 times the duty saved (on capital goods imported under the Scheme) over a period of 12 years from the date of issue of Authorisation.

d. Fulfillment of Export Obligation

The Authorisation holder under the EPCG scheme shall fulfill the export obligation over the specified period in the following proportions:

Period from the date of issue of Authorisation	Minimum export obligation to be fulfilled
Block of 1st to 6th year	**50%**
Block of 7th and 8th year	50%
If the value of duty saved is ₹100 crore or more	
Block of 1st to 10th year	50%
Block of 11th and 12th year	50%

e. Extension of Period

The concerned Regional authority, may consider one or more request for grant of extension in export obligation period for a period of 2 years, on payment of a composition fee of 2% of the total duty saved under the Authorisation or an enhancement in export obligation imposed to the extent of 10% of the total export obligation imposed under the Authorisation, as the case may be, at the choice of the exporter, for each year of extension sought.

Application Form

An application for the grant of an Authorisation may be made to the Regional authority concerned in the form given in 'Aayaat Niryaat Form' along with documents prescribed therein.

The applicant may apply for EPCG Authorisation wherein duty saved amount is ₹ 50 crores, to the Regional Authority along with a certificate from the independent chartered engineer on the proforma annexed to 'Aayaat Niryaat Form' certifying the end use of capital goods sought for import for its use at pre production, production or post production stage for the product undertaken for export obligation.

For the cases wherein duty saved amount is above ₹ 50 crores, the applicant may apply to DGFT Headquarters directly with a copy endorsed to the concerned Regional Authority. In such cases, based on the recommendations of Headquarters EPCG Committee/ approval of competent authority the concerned Regional Authorities will issue the EPCG Authorisation accordingly.

General view of Duty Exemption/Remission Schemes

The Export-Import Policy has introduced Duty Exemption / Remission Scheme, in addition to the EPCG scheme, to promote the competitiveness of India's exports. The basic aim of the Duty Exemption scheme is to enable the exporters to import 'Duty Free' inputs required for the manufacture of products for export.

Duty Exemption Scheme consists of

(a) Advance Authorisation Scheme and

(b) Duty Free Import Authorisation Scheme (DFIA).

A Duty Remission Scheme enables post export replenishment/ remission of duty on inputs used in the export product.

Duty remission schemes consist of

(a) DFRC (Duty Free Replenishment Certificate),

(b) DEPB (Duty Entitlement Passbook Scheme) and

(c) DBK (Duty Drawback Scheme).

Goods exported under Advance Authorisation/DFIA / DFRC/ DEPB may be re-imported in the same or substantially the/ same form subject to such conditions as may be specified by the Department of Revenue from time to time.

Value Addition

The value addition for the purposes of the schemes listed above (Except for the Gems and Jewellery) shall be: -

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$$V.A = (A - B) / B * 100$$

V.A. Value Addition

A FOB value of the export realised / FOR value of supply received.

B CIF value of the imported inputs covered by the authorisation, plus any other imported materials used on which the benefit of duty drawback is being claimed.

Main Features of Duty Exemption Scheme

Under the Duty Exemption Scheme, an exporter is allowed to make duty free import of inputs that are physically used in the export product at the pre-shipment stage.

The Handbook of Procedures (Volume II) gives details of the inputs used in the export products defined as **standard input-output norms (SION).** The quantity of inputs can be increased by the amount of normal wastage in the course of production.

'Duty Free' import of inputs implies that the import of inputs under this scheme shall be allowed without payment of Basic Custom Duty, Surcharge, Additional Customs Duty, Anti-Dumping Duty and Safeguard Duty, if any.

Advance Authorisation Scheme (Erstwhile Advance Licence Scheme)

Advance Authorisation can be issued either to a manufacturer exporter or merchant exporter tied to supporting manufacturer(s):

a) For Physical exports
b) For Intermediate supplies
c) For Deemed exports.

In addition, fuel, oil, energy, catalysts etc. which are consumed/ utilised in the course of their use to obtain the export product, may also be allowed under the scheme. supply of stores on board of the foreign going vessel/aircraft subject to the condition that there is specific SION in respect of the item(s) supplied.

Export Obligation Period and its Extension

The period of fulfillment of export obligation under an Advance Authorisation shall commence from the date of issuance of authorisation. The export obligation shall be fulfilled within a period of 24 months except in the case of supplies to the projects/turnkey projects in India/abroad under deemed exports category where the export obligation must be fulfilled during the contracted duration of execution of the project/ turnkey project.

Duty Free Import Authorisation (DFIA)

A Duty Free Import Authorisation is issued to allow duty free import of inputs which are used in the manufacture of the export product (making normal allowance for wastage), and fuel, energy, catalyst etc. which are consumed or utilised in the course of their use to obtain the export product. However, the Director General of Foreign Trade, by means of Public Notice, may in public interest, exclude any product(s) from the purview of this scheme. This scheme came into force from 1st May, 2006.

Export Obligation Period and its Extension

The period of fulfillment of export obligation is 24 months. However, any extension beyond 36 months from the date of issuance of the authorisation shall not be allowed. Re-export of goods imported under DFIA Scheme Goods imported against transferable DFIA, which are found defective or unfit for use, may be re-exported, as per the guidelines issued by the Department of Revenue.

DFIA against Physical Exports

DFIA against physical exports can be issued under the following two conditions:

(a) Against an export order and
(b) On the basis of annual requirement in respect of export product.

This licence can be issued in all cases irrespective of whether the standard input-output norms have been determined or not. In cases where input-output norms have not been fixed, the licence is issued on the basis of adhoc quantities and the norms are finally fixed.

Duty Free Replenishment Certificate (DFRC)

Duty Free Replenishment Certificate is issued to a merchant-exporter or manufacturer-exporter for the import of inputs used in the manufacture of goods without payment of Basic Customs Duty, Surcharge and Special Additional Duty.

However, such inputs shall be subject to the payment of Additional Customs Duty equal to the Excise Duty at the time of import. Duty Free Replenishment Certificate shall be issued only in respect of export products covered under the SIONs as notified by DGFT.

Duty Free Replenishment Certificate shall be issued for import of inputs, as per SION, having same quality, technical characteristics and specifications as those used in the end product and as indicated in the shipping bills. The validity of such licences shall be 12 months. DFRC and or the material imported against it shall be freely transferable.

DFRC shall be issued on minimum value addition of 25% except for items in gems and jewellery sector for which higher value addition is prescribed under Advance Authorisation Scheme shall be applicable.

The exporter shall be entitled for drawback benefits in respect of any of the duty paid materials, whether imported or indigenous, used in the export product as per the drawback rate fixed by Directorate of Drawback (Ministry of Finance).

The drawback shall however be restricted to the duty paid materials not covered under SION. The export under deffered payment scheme to Russia is also allowed for issuance of DFRC.

Application for DFRC

The application for the grant of DFRC should be submitted to the regional licensing authority having jurisdiction over the firm in the prescribed form along with the following documents.

1. Bank draft for payment of application fee
2. Export promotion copy of the shipping bill
3. Bank certificate of export and realisation
4. A statement of export giving separately each shipping bill number and date, FOB value in Indian rupees as per shipping bill and the description of the result product.

The exporter can file the application within a period of 90 days from the date of realisation of the export proceeds. The period of 90 days is increased to 180 days in case of shipments sent under irrevocable letter of credit.

Duty Entitlement Passbook (DEPB) Scheme

For exporters not desirous of going through the licensing route, an optional facility is given under DEPB. The objective of Duty Entitlement Passbook Scheme is to neutralise the incidence of Customs duty on the import content of the export product. The neutralisation shall be provided by way of grant of duty credit against the export product.

Under the Duty Entitlement Passbook Scheme (DEPB), an exporter may apply for credit, as a specified percentage of FOB value of exports, made in freely convertible currency or the payment made from the Foreign Currency Account of the SEZ unit in case of supply by DTA to SEZ unit.

The credit shall be available against such export products and at such rates as may be specified by the Director General of Foreign Trade by way of public notice issued in this behalf, for import of raw materials, intermediates, components, parts, packaging material etc.

The holder of Duty Entitlement Passbook Scheme (DEPB) shall have the option to pay additional customs duty, if any, in cash as well. Under the scheme Exporters are granted duty credits on the basis of pre notified entitlement rates which will allow them to import input duty free. The exporter can export any product under this scheme provided the same is covered by SION. Goods in the negative list of exim policy cannot be exported under this scheme.

Application for the Grant of Import Duty Credit under DEPB

An application for grant of import duty credit under DEPB should be made to the licencing authority concerned along with the following documents:

1. **Demand draft for the amount prescribed application fee.**
2. Export promotion Copy of the DEPB shipping bill
3. Bank Certificate of Exports and Realisation
4. Self addressed Copy of valid RCMC

The application may file one or more applications subject to the condition that each application contain not more than 25 shipping bills.

All the shipping bills in any one application must relate to exports made from one Custom House only. The DEPB shall be issued with single port of registration, which will be port from where the exports have been effected.

Monitoring of Export Obligation

The Regional Authority, with whom the undertaking is executed by the DFIA holder, shall maintain a proper record in a master register indicating the starting and closing dates of obligation period and other particulars to monitor the export obligation.

Within two months from the date of expiry of the period of obligation, the certificate holder shall submit requisite evidence in discharge of the export obligation in accordance with procedure laid down..

However, in respect of shipments where six months period (one year in case of status certificate holder) for realisation of foreign exchange has not become due, the Regional Authority shall not take action for non submission of bank certificate of exports and realisation provided the other document(s) substantiating fulfillment of Export Obligation have been furnished.

In case the Authorisation holder fails to complete the export obligation or fails to submit the relevant information/ documents, the Regional Authority shall take action by refusing further authorisations, enforce the condition of the authorisation and undertaking and also initiate penal action as per law.

Duty Draw Back Scheme

It is an internationally accepted principle that goods exported out of a country are relieved of the duties borne by them at various stages of their manufacture so that they become competitive in the world markets.

As defined in the Drawback Rules (see under 'definition' later), drawback in relation to any goods manufactured, or processed or on which any operation has been carried out in India and exported, means the rebate of duty chargeable on any imported materials or excisable materials used in the manufacture of such goods in India. Hence, drawback is-

(i) A refund of excise or import (customs) duty paid on indigenous or imported inputs (raw materials, components, parts, packing materials, etc) used in export products.

(ii) A refund of duty of customs or excise paid on production inputs and not refund of duty paid on finished products.

An exporter is entitled to claim the amount of duty draw back as soon as export of goods takes place. Drawback under Section 19 bis of the Customs Act (No.9) B.E. 2482 means the refund of import duty already paid on imported goods which have undergone production, mixing, assembling, or packing and then exported within one year from the date of importation. The importer may place a bank guarantee or a guarantee issued by the Ministry of Finance in lieu of the payment of import duty. The refund is administered after the exportation or destruction of either the imported/substituted product or article that has been manufactured from the imported/substituted product.

Criteria and Conditions for Drawback

- The claim for drawback on the imports must not be prohibited by the Ministerial Regulations;
- The quantity of the imports used in producing, mixing, assembling, or packing exports shall be in compliance with the criteria approved or notified by Customs;
- The imports are exported through a port or place of exit designated for a drawback scheme;
- The imports are exported within 1 year from the date of importation of the goods used in producing, mixing, assembling the exports or packing the exports into the country;

- A claim for drawback must be made within 6 months from the date of exportation of goods, unless the time limits for exportation are extended as the reasons are deemed by Customs to be valid.

Procedure for Drawback

The importer submits a letter of intent for drawback under Section 19 bis (Customs Form No. 29) to the Customs office at the port where the drawback is to be taking place, together with 2 certified copies of the following documents:

1. Value-added tax registration document;
2. Juristic person registration or commercial registration documents;
3. A certification of the Ministry of Commerce indicating the purpose of the authorized juristic person, and company's address; and
4. A valid factory operation permit.

Submission of Production Formula

Production formula means a document detailing quantity of raw materials used for producing or manufacturing goods which are used in calculating raw material stock account for drawback.

To submit the production formula, the following rules and conditions must be observed:

- The production formula is to be used by entrepreneurs or drawback claimers;
- Prior to the exportation, the importer is required to submit, to the Drawback Unit of a relevant Customs office, an application for production formula (Customs Form No. 96) with the lists of raw materials; lists of products or manufactured goods; production process; the quantity of raw materials to be used, including wastes (if any); samples of raw materials; samples of finished products;
- In case where it is necessary to examine a production process at a manufacture site, the importer must allow Customs officers to visit the site as appointed; and
- Approval of the application for production formula will be obtained within 30 working days from the date of receiving all documents required by the drawback law and regulation.

Exportation of Goods

The imported goods under a drawback scheme must be exported within 1 year from the date of importation of raw materials. In addition to the documents required for normal export processes, the exporter under the drawback scheme is required to submit the documents and follow the instructions listed below:

- Attachment to the Export Declaration Form (Customs Form No.113) declaring all required particulars;
- A packing list;
- An invoice;
- Check the box indicating "Drawback under Section 19 bis";
- Declare the name of Customs office/house where the drawback is taking place;
- In case where Customs does not required samples of finished products, the exporter must check the box indicating "Exempted from Submission of Samples"

Claim for Drawback or Withdrawal of Bank Guarantee

A drawback claim or withdrawal of bank guarantee must be submitted to the Drawback Unit within 6 months from the date of exportation. The documents required are as follows:

- A Drawback Application under Section 19 bis (Customs Form No. 111) and its Attachment indicating the numbers of both the Import and Export Declaration Forms;
- A valid specimen signature card of the owner or manager issued by Customs;
- A valid specimen signature card of the authorized person issued by Customs;
- A registration certificate of the Ministry of Commerce, detailing and indicating the purpose of the juristic person; and
- A Value-Added Tax Registration.

Additional documents are also required in checking raw material inventory for the drawback claim as specified.

Distinction between Drawback and Excise Rebate

No Drawback is admissible on finished products on which either excise duty or export duty is paid. Because the finished excisable goods can be exported either under ‘bond’ or under ‘Claim of rebate’. Hence, the finished excisable goods need not suffer any duty as the same is either refunded or need not be paid under the Scheme of export under excise bond. In case any export duty is paid, no drawback or refund thereof is admissible. Besides, drawback is also admissible under Deemed Export Policy.

Tax Concessions

The exporters are eligible for fiscal incentives as detailed below:

1. Sales Tax Exemption
2. Income Tax Exemption
3. Service Tax Remission/Exemption

Sales Tax Exemption

Exporters are eligible to claim exemption from the levy of sales tax on the supplies taken by them for manufacture of goods meant for production of export product or supplies of goods for exports against specific export orders. This facility is available to the exporters both under the Central Sales Tax Act 1956 and under the Local Sales Tax Acts of the specific states. The exporters are required to give Form H to the suppliers of goods/materials from another State and the exemption form prescribed by the Sales Tax Department of the State concerned in case of supplies procured from within the State.

The 100% export oriented units and the units in export processing zones, electronic hardware technology park and software technology park are entitled to full reimbursement of Central Sales Tax paid by them on the purchases made by them from within the State in which they are located, for the purpose of production of goods meant for exports.

Income Tax Exemption

The export firms are eligible for deduction under Section 80 HHC in respect of income from export turnover.

Extent of Deduction u/s 80HHC in case of manufacturer exporter is determined in the following manner:

=30% of (Profit of business *export turnover/Total turnover) +

(90% of Export incentives* Export turnover/ Total turnover)

Deduction is available to the units engaged in the export of computer software (to include customized electronic data or any other product or service of a similar nature as may be notified by the Central Board of Direct Taxes) under Section 80 HH E. It is calculated as below:

= 30% of (Profit of business *export turnover/Total turnover)

Under Section 10 A, Tax holiday has been provided for 10 years beginning assessment year 2000-2001 for the newly established industrial undertakings in free trade zones, electronic hardware technology park or software technology park as well as 100% export oriented units. One of the basic conditions is that the export proceeds must be realised in free foreign exchange i.e., freely convertible foreign currency.

Service Tax Remission/Exemption in DTA and SEZ

For all goods and services, which are exported from units in Domestic Tariff Area (DTA) and units in EOU/EHTP/STP/BTP, remission of service tax levied shall be allowed. Units in SEZ shall be exempted from service tax.

Summary

To be competitive in the international markets, the exporter need cost effective raw materials, consumables. At the same time he require latest equipment to produce high quality products. FTP allows companies to import Machinery, Software under EPCG and raw materials, consumables etc. under Duty Exemption Schemes. Repayment of duties which are exempted under the policy will be remissioned through Duty Draw back scheme. At the same time tax concessions were provided to strengthen the fiscal muscle of the exporters.

Glossary

Aayaat Niryaat Form: It provides information about prescribed form number against a specific application.

Duty Remission Scheme: It enables post export replenishment/ remission of duty on inputs used in the export product.

Duty Entitlement Passbook Scheme: It neutralises the incidence of Customs duty on the import content of the export product.

Drawback: The rebate of duty chargeable on any imported materials or excisable materials used in the manufacture of such goods in India.

Drawback Year. It is from 1st June to 31st May (of the following year) as against the financial year (April-March) and calendar year (January-December).

Self Assessment Questions

1. Explain the benefits of EPCG scheme.
2. List various options of importing goods under duty exemption scheme.
3. Differentiate DFIA, DFRC and DEPS
4. What is Duty Drawback? List the conditions and formalities.
5. Explain the Tax concessions provided for exporters.

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Lesson 4.3 - Market Development Assistance and Role of Export Houses

Learning Objectives

After studying this lesson you should be able:

- To know activities supported through Market Development Assistance
- To understand the limits of assistance provided to eligible companies.
- To know the organisations who receive assistance
- To understand the concept of Export Houses
- To learn the role of state trading corporation and other organisations

Marketing Development Assistance Scheme

Export promotion continues to be a major thrust area for the Government in view of the prevailing macro economic situation with emphasis on exports and to facilitate various measures being undertaken to stimulate and diversify the country's export trade, Marketing Development Assistance (MDA) scheme (revised guidelines w.e.f. 1.4.2004) is under operation through the Department of Commerce to support the under mentioned activities:

- Assist exporters for export promotion activities abroad.
- Assist Export Promotion Councils (EPCs) to undertake export promotion activities for their product(s) and commodities.
- Assist approved organizations/trade bodies in undertaking exclusive non-recurring innovative activities connected with export promotion efforts for their members.
- Assist EPCs to contest Countervailing Duty/Anti Dumping cases initiated abroad.
- Assist Focus export promotion programs in specific regions abroad like FOCUS (LAC), Focus (Africa), Focus (CIS) and Focus (ASEAN + 2) programs.
- Residual essential activities connected with marketing promotion efforts abroad.

The utilization of scheme is administered by the E&MDA Division in the Department of Commerce, Government of India, Udyog Bhavan, New Delhi-110 011.

Who are Eligible

Assistance to individual exporters for export promotion activities abroad – Participation in EPC etc. led Trade Delegations/BSMs/Trade Fairs/ Exhibitions:

Allowing participation of exporting companies in fairs/exhibition abroad will be allowed “either directly” OR “through the EPCs/ITPO lead activities” as per details mentioned in MDA guidelines

However, for Buyer Seller Meet and Trade Delegations, no direct participation has been allowed and these are to be allowed only for EPCs/ITPO led activities.

i. Exporting companies with an f.o.b. value of exports of upto ₹ 5.00 crore in the preceding year will be eligible for MDA assistance for participation in EPC etc. led trade delegations/BSMs/fairs/exhibitions abroad to explore new markets for export of their specific product(s) and commodities from India in the initial phase and exporting companies with an f.o.b. value of export upto ₹ 10.00 crores in the preceding year will be eligible for MDA assistance.

ii. Assistance would be permissible on travel expenses assistance would be permissible on travel expenses by air, in economy excursion class fair and/or charges of the built up furnished stall, @ 90% for exporters having valid SSI registration certification and @ 75% for others including merchant exporters. This would, however, be subject to an upper ceiling mentioned in the Table per tour.

S. No.	Area/ Sector	No. of visits eligible	Maximum Financial ceiling per event		
			BSM/Trade Fair/ Delegations/ Exhibition etc. abroad (in ₹) (Travel grant)	Trade Fair/ Exhibition abroad (in ₹) (Stall charges)	**Total (in ₹)**
			(A)	(B)	**(A + B)**
1	Focus LAC	1	90,000/-	50,000/-	1,40,000/-
2	Focus Africa	1	60,000/-	50,000/-	1,10,000/-
	(including WANA countries				

3	Focus CIS	1	60,000/-	50,000/-	1,10,000/-
4	Focus ASEAN	1	60,000/-	50,000/-	1,10,000/-
5	General Areas	1	Nil	50,000/-	50,000/-
	TOTAL	5			

The participation of individual companies in the above activities shall be subject to the following conditions:

For EPC etc. led Trade Delegations/BSMs only air-fare by economy excursion class as indicated above shall be permissible. For participation in Trade Fairs/Exhibitions stall charges in addition to travel expenditure shall also be permissible subject to ceilings mentioned in the above table.

Maximum number of permissible participations shall be five in a financial year as indicated in above table (No travel grant is permissible for one visit to General Areas)

Assistance shall be permissible to one regular employee/director/partner/ proprietor of the company Assistance would not be available to exporter of foreign nationality or holding foreign passport.

Intimation application must be received in the concerned EPC etc. with a minimum of 14 days clear advance notice excluding the date of receipt of application in the office of the concerned organization and the date of departures from the country.

The company shall not be under investigation/charged/prosecuted/ debarred/black listed under EXIM Policy of India or any others law relating to export and import business.

Maximum MDA assistance shall be inclusive of MDA assistance received from all Govt. bodies/FIEO/EPCs/Commodity Boards/ Export Development Authorities/ITPO etc.

Assistance to Export Promotion Councils

Export Promotion Councils (EPCs) are autonomous in administrative matters and no financial assistance is provided to them from MDA from administrative expenditure. The EPCs can, however, be considered for one time assistance for computerization for data collection, analysis, dissemination under MDA Maintenance and updating of systems shall be the responsibility of the EPCs.

Role of EPCs shall be diversify the export promotion activities to new emerging potential markets wherein the participation by the Indian companies is yet to be established. The trade fairs/exhibitions organized and participated by the EPCs on three or more occasions shall be left to the exporters for participation individually. For such established trade fairs/exhibitions, EPC shall organize booking of the space/ stalls for its members based on the pre-accessed requirement, construction/furnishing of stalls, publicity for the event etc.

Member exporters of the council shall participate individually in the space/stall allotted to them by the EPC. MDA assistance to the EPC shall be available for a particular fair/exhibition upto a maximum of three participations and thereafter, participation in such established fairs/exhibitions shall be on self-financial basis.

Focus Area Programmes

At present 4 Focus Area programmes viz Focus (LAC), Focus (Africa), Focus (CIS) and Focus (ASEAN + 2) are under operation in the Department. In addition to activities in non focus areas, special provision has been made under Reverse Trade Visits for visits of prominent delegates and buyers (one person from each organization) from these Focus Area Regions for participation in buyer cum seller meets, exhibitions etc., in India. The foreign delegates/buyers/journalists would be assisted in meeting their return air travel expenses in economy excursion class upto the entry point in India. Activities which are eligible under Focus Area Programmes and assistance are mentioned in the Table.

For Activities Under The Focus-Area Programmes		
S.No.	**Permissible Items of expenditure under MDA**	**Percentage of funding under MDA**
1	(i) Participation in International Fairs/Exhibitions organized by EPCs etc. (ii) Sponsoring BSMs/Trade delegation abroad by EPCs etc.	As applicable in non-focus area with ceiling of ₹ 10 lakh.
2	Reverse Trade visits of prominent foreign buyers/ delegates/journalists to India for participation in BSMs/ exhibition etc.:	
	(i) Return air-fare travel expenses in economy excursion class upto the entry point in India MDA grant shall be considered for return air fare (in economy excursion class) and hotel charges etc. with ceiling of ₹ 90,000/-(for LAC) and ₹ 60,000/- (for other focus areas) per buyers.	(i) 100% (subject to a ceiling of ₹ 90,000/- for LAC and ₹ 60,000/- for other Focus areas)

	(ii) Venue charges	(ii) & (iii) As applicable in non-focus area with ceiling of ₹ 10 lakh
	(iii) All other organizing expenditure	
	All other expenses relating to stay, per diem allowance, local travel etc. of delegates invited from abroad are to be met by the EPC or by sharing between the organizers and delegates	
3	Translation facilities in foreign languages and vice versa.	60%
4	Product catalogue in CD ROM	60%
When EPC conduct an event abroad in more than one country during the same tour, additional event cost shall be allowed @ ₹ 10.00 lakh per country subject to 60% reimbursement.		

Non-Focus Areas

For activities in Non-Focus areas details of funding are given below.

For Participation in Fairs / Exhibitions abroad by EPCs etc. And For EPC sponsored Buyer Seller Meets/Trade Delegations abroad:

i) Central stall of council 60% of Council rent and other organising expenditure (subject to a ceiling of ₹ 10 lakh per event)
ii) 100% funding for one official of EPC towards air fare, DA, Hotel stay expenses
iii) Entertainment expenses upto a ceiling of $ 500.

For organising Promotional Activities like seminars, workshops etc., on quality upgradation, awareness creation etc., with focus on export promotion within India by EPCs etc

i) 60% Venue Cost and other organising expenditure (subject to a ceiling of ₹ 10 lakh per event)

ii) 100% funding for one official of EPC towards air fare,DA, Hotel stay expences

iii) 60% of net approved expenditure after accounting for the revenue generated through the sales, advt. etc. for Publicity/publicity with focus on export promotion and brought out for circulation/use of overseas buyers/organizations and advertisement abroad

Financial Assistance to contest Countervailing Duty/ Anti Dumping cases initiated abroad

No distinction need be made between CVD and AD investigations since both types of cases have intended to involve various export incentives granted by the Government e.g. income tax concessions, export credit concessions, advance licensing, drawback etc.

Pattern of assistance to Grantee/Approved Other Organizations

FIEO

MDA assistance to FIEO will be on the lines as applicable to EPCs, with the condition that export promotion activities by FIEO should be for multi-products/sectors or products/services not covered by any other EPCs or to a country where EPC is not in a position to participate.

FIEO can also sponsor requests of its members exports for participationin fairs/ exhibitions/BSMs/Trade delegations led by FIEO for MDA assistance.

ITPO

Allocation for ITPO from MDA would be kept to the minimum and confined to the special fairs to meet deficit as approved by the Exhibition Advisory Committee in the Department of Commerce. ITPO should cross subsidize other events from surpluses in other fairs.

IIFT, IIP, IDI and ICA

MDA assistance to IIFT, IIP, IDI and ICA for various activities on an annual basis would not be provided. However, specific development activities directed towards export growth of Indian products and Commodities would be considered by the Govt. (E&MDA Division in the Department of Commerce) for part financing.

To other approved trade bodies

On receipt of specific development and export promotion project(s) from the approved trade bodies such as ASSOCHAM, CII, FICCI etc. (other than IIFT, IIP, IDI, ICA and ITPO), E&MDA Division may consider financing one or two special specific non-recurring activities with 60% financial assistance of the net expenditure on approved items from MDA subject to maximum MDA assistance of ₹ 10 lakh for each focus area programme + ₹ 10 lakhs for general areas. As such the total MDA grant to such approved trade bodies would not be more than ₹ 50 lakhs in a financial year to a particular approved trade body.

Adhoc Grant-in-Aid

Residual essential activities or proposals connected with the export effort, which qualify for the grant-in-aid but not covered by this Code will also be considered on merits for assisting from the Marketing Development Assistance scheme.

Star Export Houses

Commerce ministry recognising organisations whose export performance above the specified value as star export houses and providing certain privileges to them. The reason behind recognising the trade houses is recognise their continuous efforts in trade and to create a hassle free environment to them. The incentives will provide better fiscal strength as well as better marketing abilities. These facilities make their focus continuously on export markets. They also bacome a channel for exporting the products produced from small scale industries.

Merchant as well as Manufacturer Exporters, Service Providers, Export Oriented Units (EOUs) and Units located in Special Economic Zones (SEZs), Agri Export Zone (AEZ's), Electronic Hardware Technology Parks (EHTPs), Software Technology Parks (STPs) and Bio Technology Parks (BTPs) shall be eligible for applying for status as Star Export Houses.

Status Category

The applicant shall be categorized depending on his total FOB/FOR export performance during the current plus the previous three years:

Category	Performance (Rupees in Crores)
One Star Export House	15
Two Star Export House	100
Three Star Export House	500
Four Star Export House	1500
Five Star Export House	5000

More weightage is given to manufacturer exporters in the Small Scale Industry/ Tiny Sector/Cottage Sector, Units registered with KVICs/KVIBs, Units located in North Eastern States, Sikkim and J&K, Units exporting handloom/ handicrafts/hand knotted or silk carpets, etc in granting star export status.

Privileges

A Star Export House shall be eligible for the following facilities:

i) Licence/certificate/permissions and Customs clearances for both imports and exports on self-declaration basis;

ii) Fixation of Input-Output norms on priority within 60 days;

iii) Exemption from compulsory negotiation of documents through banks. The remittance, however, would continue to be received through banking channels;

iv) 100% retention of foreign exchange in EEFC account;

v) Enhancement in normal repatriation period from 180 days to 360 days.

vi) Entitlement for consideration under the Target Plus Scheme; and

vii) Exemption from furnishing of Bank Guarantee in Schemes under this Policy.

Validity Period

All status certificates issued or renewed on or after 01.09.2004 shall be valid from 1st April of the licensing year during which the application for the grant of such recognition is made upto 31st March, 2009, unless otherwise specified.

Assistance from State Organisations

Export Credit Guarantee Corporation of India Limited (ECGC)

Export Credit Guarantee Corporation of India Limited, was established in the year 1957 by the Government of India to strengthen the export promotion drive by covering the risk of exporting on credit.

ECGC provides a range of credit risk insurance covers to exporters against loss in export of goods and services, and also offers guarantees to banks and financial institutions to enable exporters obtain better facilities from them. Exporters have a lot to benefit from ECGC as it provides —

1. Insurance protection to exporters against payment risks
2. Provides information on credit-worthiness of overseas buyers
3. Provides information on about 180 countries with its own credit ratings
4. Guidance in export related activities
5. Makes it easy to obtain export finance from banks/financial institutions
6. Assists exporters in recovering bad debts

Export Inspection Council, New Delhi (EIC)

The EIC, an autonomous body, is responsible for the enforcement of quality standards and compulsory **pre-shipment inspection** of the various commodities meant for export and notified under the Export (Quality Control & Inspection) Act, 1963. It was set up under Section (3) of the Export (Inspection and Quality Control) Act, 1963. It is headed by a Director. EIC is assisted in its functions by the Export Inspection Agencies (EIAs) located at Chennai, Delhi, Kochi, Kolkata and Mumbai along with a network of 42 sub-offices and laboratories to back up the pre-shipment inspection and certification activities.

National Centre for Trade Information (NCTI).

National Centre for Trade Information(NCTI) is a joint venture of India Trade Promotion Organisation (ITPO) and National Informatics Centre (NIC) under the aegis of Ministry of Commerce. It has been incorporated and registered as a company under Section 25 of Indian Companies Act, 1956. The company has a Board of Directors for administration of its affairs, which include representatives from National Informatics Centre, India Trade Promotion Organisation, Apex chamber of Commerce/ Industry/ Trade, Export Promotion Councils and Commodity Boards etc.. NCTI is setup to synergise the efforts of different organisations engaged in collection, processing and dissemination of trade and investment information.

India Trade Promotion Organisation (ITPO)

Indian Trade Promotion Organisation (ITPO), New Delhi, is the premier trade promotion agency of India and provides a broad spectrum of services to trade and industry so as to promote export. With Headquarters at Pragati Maidan, a modern exhibition complex spread over 150 acres in New Delhi and regional offices at Bangalore, Chennai, Kolkata and Mumbai, ITPO ensures a representative participation of trade and industry from different regions of the country at its events in India and abroad.

State Trading Corporation (STC)

The State Trading Corporation of India Ltd. (STC) is a premier international trading house owned by the Government of India. Having been set up in 1956, the Corporation has developed vast expertise in handling bulk international trade. Though, dealing largely with the East European countries during the early years of its formation, today it trades with almost all the countries of the world.

By virtue of infrastructure and experience possessed by the Corporation, it plays an important role in arranging import of essential items into India and developing exports of a large number of items from India. It exports a large number of items ranging from agricultural commodities to manufactured products from India to all parts of the world.

Because of Corporation's in depth knowledge about the Indian market, STC is able to supply quality products at most competitive prices and ensure that the goods reach the foreign buyer within the prescribed delivery schedule. It also imports bulk commodities for Indian consumer as per demand in the domestic market.

The eventful track record of more than 50 years has helped STC to gear itself to face the fierce competitive challenges, seize business initiatives and build on its core competencies.

Services provide by STC

While undertaking import and export operations, the Corporation renders following services

To the Overseas Buyer

STC acts as an expert guide for buyers interested in Indian goods. For them, STC finds the best Indian manufacturers, undertakes negotiations, fixes delivery schedules, oversees quality control - all the way to the final shipment to the entire satisfaction of the buyer.

To the Indian Industry

The Indian manufacturers, whose products sail the seas via STC, benefit a lot from its expertise. STC helps thousands of Indian manufacturers to find markets abroad for their products. STC assists the manufacturers to use the best raw materials, guides and helps them manufacture products that will attract buyers abroad. Some of the other services offered by STC to the Indian manufacturers include:

- Financial assistance to exporters on easy terms.
- Taking products of small scale manufacturers to international trade fairs and exhibitions.
- Import of machinery and raw material for export production.
- Assistance in the areas of marketing, technical know-how, quality control, packaging, documentation, etc.
- Supply of imported goods in small quantities as per convenience of buyers.
- Market intervention on behalf of the Government.

To the Indian Consumer

The Indian consumers also benefit from STC's expertise and infrastructure. STC imports essential commodities for them to cover shortfalls arising in the domestic market. During the last one decade, STC imported sugar, wheat and pulses to meet domestic requirements at a very short notice.

Summary

Marketing Development Assistance (MDA) is under operation through the Department of Commerce to Assist exporters for export promotion activities abroad., Assist Export Promotion Councils (EPCs) to undertake export promotion activities for their product(s) and commodities and to Assist approved organizations/trade bodies in undertaking exclusive non-recurring innovative activities connected with export promotion efforts for their members. Export houses are recognised based on their export performance and provided god number of privilises. Manufactures, traders and units in export zones are eligible for this facilities. Government providing various services through state run organisations like ECGC, EIC, NCTI, ITPO, STC etc. The ultimate aim is build Dynamic Organisations and to have a good share in the international trade.

Glossary

Marketing Development Assistance (MDA): It is an operation through which the financial assistance provided to exporters for export promotion activities in India and abroad.

Focus Area: Promising markets, which are presently under target

Pre-shipment Inspection: Certification of goods by authorised agencies that the goods are as per specification. It is desirable before shipping.

Self Assessment Questions

1. List the activities that are supported by MDA.
2. Explain the role of EPCs in export promotion and financial support extended to these activities.
3. Explain the role of Export houses and privileges received by them.
4. List a few state organisations that support international trade.

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Lesson 4.4 - Special Economic Zones

Learning Objectives

After studying this lesson you should be able:

- To learn the concept of SEZs
- To understand the terms and conditions for setting up SEZs
- To learn the incentive/facilities available for SEZ units
- To know the facilities for Domestic suppliers to SEZ

Introduction

Special Economic Zone (SEZ) is a specifically delineated duty free enclave and shall be deemed to be foreign territory for the purposes of trade operations and duties and tariffs.

Usually the goal is an increase in foreign investment. Special Economic Zones have been established in several countries, including the People's Republic of China, India, Iran, Jordan, Poland, Kazakhstan, the Philippines and Russia. North Korea has also attempted this to a degree, but failed. Currently, Puno, Peru has been slated to become a "Zona Ecomomica" by its president Alan Garcia. In the United States, SEZ are referred to as "Urban Enterprise Zones"

The policy provides for setting up of SEZ's in the public, private, joint sector or by State Governments or its agencies. Even foreign companies can set up Special Economic Zone (SEZ).

Conversion of EPZs into SEZs

It was also envisaged that some of the existing Export Processing Zones would be converted into Special Economic Zones. Accordingly, the Government has converted Export Processing Zones located at Kandla and Surat (Gujarat), Cochin (Kerala), Santa Cruz (Mumbai-Maharashtra), Falta (West Bengal), Madras (Tamil Nadu), Visakhapatnam (Andhra Pradesh) and Noida (Uttar Pradesh) into a Special Economic Zones.

In addition, 3 new Special Economic Zones approved for establishment at Indore (Madhya Pradesh), Manikanchan – Salt Lake (Kolkata) and Jaipur have since commended operations. Currently, India has 15 SEZs, each an average size of 200 acres. The government has approved as many as 164 or more SEZs.

Distinguishing Features

Indian SEZ policy has following distinguishing features:

a) The zones are proposed to setup by private sector or by state Govt. in association with Private sector. Private sector is also invited to develop infrastructure facilities in the existing SEZs

b) State Government have a lead role in the setting up of SEZ.

c) A framework is being developed, by creating special window under existing rules and regulations of the Central Govt. and State Govt. for SEZ.

The State Government Commitment Towards SEZs

- That area incorporated in the proposed Special Economic Zone is free from environmental restrictions;
- That water, electricity and other services would be provided as required;
- That the units would be given full exemption in electricity duty and tax on sale of electricity for self generated and purchased power;
- To allow generation, transmission and distribution of power within SEZ;
- To exempt from State sales tax, octroi, mandi tax, turnover tax and any other duty/ cess or levies on the supply of goods from Domestic Tariff Area to SEZ units;
- That for units inside the Zone, the powers under the Industrial Disputes Act and other related labour Acts would be delegated to the Development Commissioner and that the units will be declared as a Public Utility Service under Industrial Disputes Act.
- That single point clearances system and minimum inspections requirement under State Laws/Rules would be provided.

Terms & Conditions for Setting up of SEZ

Only units approved under SEZ scheme would be permitted to be located in SEZ. The SEZ units shall abide by local laws, rules, regulations or bye-laws in regard to area planning, sewerage disposal, pollution control and the like. They shall also comply with industrial and labour laws as may be locally applicable.

Such SEZ shall make security arrangements to fulfill all the requirements of the laws, rules and procedures applicable to such SEZ. The SEZ should have a minimum area of 1000 hectares and at least 25 % of the area is to be earmarked for developing industrial area for setting up of units. Minimum area of 1000 hectares will not be applicable to product specific and port/airport based SEZs. Wherever the SEZs are landlocked, an Inland Container Depot (ICD) will be an integral part of SEZs.

Incentive/ Facilities to SEZ Developer

The following incentives/facilities are provided to SEZ developer.

- 100% FDI allowed for:
  - (a) Townships with residential, educational and recreational facilities on a case to case basis,
  - (b) Franchise for basic telephone service in SEZ.
- Income Tax benefit under (80 IA) to developers for any block of 10 years in 15 years.
- Duty free import/domestic procurement of goods for development, operation and maintenance of SEZs
- Exemption from Service Tax /CST.
- Income of infrastructure capital fund/co. from investment in SEZ exempt from Income Tax
- Investment made by individuals etc in a SEZ co also eligible for exemption u/s 88 of IT Act
- Developer permitted to transfer infrastructure facility for operation and maintenance.
- Generation, transmission and distribution of power in SEZs allowed
- Full freedom in allocation of space and built up area to approved SEZ units on commercial basis.
- Authorised to provide and maintain service like water, electricity, security, restaurants and recreation centres on commercial lines.

Obligation of the Unit under the Scheme

SEZ units have to achieve positive net foreign exchange earning as per the formula given in paragraph Appendix 14-II (para 12.1) of Handbook of Procedures, Vol.1. For this purpose, a Legal Undertaking is required to be executed by the unit with the Development Commissioner.

The units are also to execute a bond with the Zone Customs for their operation in the SEZ. Any company set up with FDI has to be incorporated under the Indian Companies Act with the Registrar of Companies for undertaking Indian operations.

The incentive/Facilities Available for SEZ Units

The following incentive/ facilities are provided to SEZ enterprises.

Customs and Excise

SEZ units may import or procure from the domestic sources, duty free, all their requirements of capital goods, raw materials, consumables, spares, packing materials, office equipment, DG sets etc. for implementation of their project in the Zone without any licence or specific approval.

Duty free import / domestic procurement of goods for setting up of SEZ units are allowed. Goods imported/procured locally duty free could be utilised over the approval period of 5 years. No License is required for imports, including second hand machinery.

Domestic sales by SEZ units will now be exempt from SAD. Domestic sale of finished products, by-products on payment of applicable Custom duty. Domestic sale rejects and waste and scrap on payment of applicable Custom duty on the transaction value.

Income tax for Physical Export Benefit

100% IT exemption (10A) for first 5 years and 50% for 2 years thereafter. Reinvestment allowance to the extend of 50% of ploughed back profits Carry forward of losses

Foreign Direct Investment

100% foreign direct investment is under the automatic route is allowed in manufacturing sector in SEZ units except arms and ammunition, explosive, atomic substance, narcotics and hazardous chemicals, distillation and brewing of alcoholic drinks and cigarettes, cigars and manufactured tobacco substitutes. No cap on foreign investments for SSI reserved items.

Banking / Insurance/External Commercial Borrowings

Setting up Offshore Banking Units (OBU) allowed in SEZs. OBU's allowed 100% Income Tax exemption on profit for 3 years and 50 % for next two years. External commercial borrowings by units up to $ 500 million a year allowed without any maturity restrictions. Freedom to bring in export proceeds without any time limit.

Flexibility to keep 100% of export proceeds in EEFC account. Freedom to make overseas investment from it. Commodity hedging permitted. Exemption from interest rate surcharge on import finance. SEZ units allowed to 'write-off' unrealized export bills.

Central Sales Tax Act

Exemption to sales made from Domestic Tariff Area to SEZ units. Income Tax Act:

Service Tax

Exemption from Service Tax to SEZ units

Environment

SEZs permitted to have non-polluting industries in IT and facilities like golf courses, desalination plants, hotels and non-polluting service industries in the Coastal Regulation Zone area. Exemption from public hearing under Environment Impact Assessment Notification

Companies Act

Enhanced limit of ₹ 2.4 crores per annum allowed for managerial remuneration Agreement to opening of Regional office of Registrar of Companies in SEZs. Exemption from requirement of domicile in India for 12 months prior to appointment as Director.

Drugs and Cosmetics

Exemption from port restriction under Drugs & Cosmetics Rules.

Sub-Contracting/Contract Farming

SEZ units may sub-contract part of production or production process through units in the Domestic Traiff Area or through other EOU/SEZ units SEZ units may also sub-contract part of their production process abroad.

Agriculture/Horticulture processing SEZ units allowed to provide inputs and equipments to contract farmers in DTA to promote production of goods as per the requirement of importing countries.

Labour laws in SEZs

Normal Labour Laws are applicable to SEZs, which are enforced by the respective state Governments. The state Government have been requested to simplify the procedures/ returns and for introduction of a single window clearance mechanism by delegating appropriate powers to Development Commissioners of SEZs.

The Facilities for Domestic Suppliers to Special Economic Zone

Supplies from Domestic Tariff Area (DTA) to SEZ to be treated as physical export. DTA supplier would be entitled to:

- Drawback/DEPB
- CST Exemption
- Exemption from State Levies
- Discharge of EP if any on the suppliers
- Income Tax benefits as applicable to physical export under section 80 HHC of the Income Tax Act.

Other Features

State has exempted the sales from DTA to SEZ from local levies and taxes. Customs examination is to the bear minimum.

SEZ units function on self-certification basis. Inter Unit Sales are permitted as per the Policy. Buyer procuring from another unit pays in Foreign Exchange.

Export Oriented Units

The Export Processing Zones (EPZs) were introduced in 1960s to accelerate the growth of exports of the country by providing conducive environment to the enterprises to concentrate on their export activities. EPZs did not succeed due to location disadvantage therefore in 1980s the Export Oriented Unit (EOU) was introduced and it was extended to the development of specific sectors like granite, textile, food processing, coffee, chemicals, pharmaceutical, engineering, electrical and electronics etc., As on 2011 around 2446 EOUs were established out of which Karnataka had 463 units followed by Tamil Nadu (427) and Maharashtra (395).

The major objectives of the EOU Scheme are to increase exports, earn foreign exchange to the country, transfer of latest technology, and stimulate direct foreign investment and to generate additional employment.

EOU is an individual manufacturing unit which is allowed the facility of duty free import on its undertaking to export its entire production; but it is located in the Domestic Tariff Area (DTA). Units located in EOUs are allowed to import capital goods and raw materials free of customs duty subject to the condition that they export their entire production. A small percentage of the production including rejects is allowed to be sold to DTA the rest of India which is subject to the duty regime, subject to certain terms and conditions.

Units undertaking to export their entire production of goods and services may be set up under the EOU scheme. For setting up of an EOU, three copies of the application in the prescribed form are required to be submitted to the Development Commissioner. In certain cases, approval of the Board of Approval is required.

EOUs are given approval for manufacturing of goods and services. Trading by EOUs is not permitted. Minimum investment for approval as an EOU should be ₹ 10 million in plant and machinery. Licenses are required for manufacturing arms and ammunition, atomic substances, narcotics and tobacco productions established in city limits.

To run manufacturing activities foreign companies need to set up an Indian company. It should have independent legal status, distinct from the parent foreign company. The company may be a fully owned subsidiary or a Joint venture in financial collaboration with an Indian company in India. A company registered in India can start an EOU unit without starting a new legal entity, separate accounts suffice. Existing Indian entities can open a new EOU under the same legal entity. DTA units can also convert to EOU scheme.

Investment Criteria

Only projects having a minimum investment of ₹ 1 Crore in plant and machinery shall be considered for establishment as EOUs. 100% FDI in manufacturing EOUs is permitted under the automatic route of the RBI. External commercial borrowing are allowed up to US $ 50 million with maturities of 3 years or more, for funding and running the unit.

Export and Import

An EOU unit may export all kinds of goods and services except prohibited in ITC. And may import and process for DTA or bonded warehouse in DTA, international exhibition held in India, without payment of duty. Second hand capital goods, without any age limit may also be imported duty free. Even the goods appearing in the restricted list of the foreign trade policy are permitted to be imported.

However, the goods prohibited for import are not permitted. An EOU may export goods manufactured / soft ware developed by it through another exporter or any other EOU subject to conditions. Supplies from Indian manufacturing to EOUs are classified as deemed exports and the suppliers are eligible for Deemed export duty drawback, discharge of export performance obligations on the suppliers.

DTA Sale

The EOUs are allowed to sell goods including rejects and byproducts manufactured by them in DTA up to 50% of FOB value of exports on payment of concessional duty subject to achievement of prescribed NFE (Net Foreign Exchange).

However, the DTA sale facility is not available for certain products such as motor car, alcoholic liquor, tea, books etc. A concessional duty has been prescribed for goods sold in DTA which are manufactured entirely out of indigenous materials.

Sale of Surplus/ Unutilized Goods

The EOUs are allowed to sell surplus and unutilized goods, imported or procured duty free in DTA on payment of duty on the value at the time of import/procurement and at rates in force on the date of payment of such duty, in case the unit is unable for valid reasons to utilize the goods.

Customs Bonding of EOUs

EOUs have to get their premises bonded by the local customs / central excise department, and function under their supervision. One single multi- purpose bond with the customs/ central excise department, called the B 17 Bond, suffices for all operation.

B17 Bond

All the EOUs are required to execute a single all purpose bond covering liability both of central excise and customs. The bond is executed with the jurisdictional assistant commissioner of customs/central excise in charge of the unit.

However, it does not cover the differential duty amount against advance DTA sale for which a separate bond is to be executed. The bond is taken for an amount of equal to 25% of the duty forgone on the sanctioned requirement of capital goods plus the duty forgone on raw materials required for 3 months. Surety or security equivalent 5% of the bond amount in the form of bank guarantee is required to be given by the EOUs.

EEFC Account

EOUs are allowed to retain 100% of its export earnings in EFFC a/c and will not be required to furnish back guarantee at the time of import or going for job work in DTA. EOUs need to bring export proceeds to India only within 360 days of export even up to 100% may be retained in foreign currency in the units of EEFC account.

Access to Indian Market

EOUs can sell duty free to other EOU/SEZ/STP etc., EOUs can sell on full duty in the DTA against foreign currency, from EEFC a/c or from abroad. They can sell up to 50% of FOB value of physical exports to the DTA at concessional duties. EOU can sell over and above that at full duties, subject to NFE being positive.

Subcontracting and Inter unit transfer

Up to 50% of overall production of previous year in value terms in DTA is allowed to subcontract with permission of customs authority to the units in the EOU or Indian manufacturers. They can subcontract to units abroad, can take temporary job workers. EOUs can undertake job work for export on behalf of local manufactures.

Inter unit transfer of manufacturing goods from one EOU to another is allowed with prior intimation to concerned DC and customs authorities and it is treated as imported goods.

Penalty for Non Compliance

Under EOU scheme, the units are required to achieve positive NFE. In case of failure to achieve this, the duty forgone under the EOU scheme along with interest is recoverable from the units.

Repair

The EOUs are permitted to import goods of any origin to carry on reconditioning, repair, testing, calibration, quality improvement, up gradation of technology and reengineering activities for export in freely convertible foreign currency provided such repairs etc. are carried out in customs bonded premises and the final goods are not sold within the country.

Exit Policy (De-Bonding)

With the approval of DC an EOU can opt out of scheme at any time subject to payment of duty on excise and customs and industrial policy. Units can de-bond without paying duties for capital goods they have used for 10 years. Software units can de-bond on duty free basis after 3 years. If the unit has not met positive NFE, de-bonding shall also be subject to payment of penalties under the Foreign Trade Act 1992, and under the customs Act 1960.

Summary

A policy was introduced on 1.4.2000 for setting up of Special Economic Zones in the country with a view to provide an internationally competitive and hassle free environment for exports. Units may be set up in SEZ for manufacture of goods and rendering of services. All the import/export operations of the SEZ units will be on self-certification basis. The units in the Zone have to be a net foreign exchange earner but they shall not be subjected to any pre-determined value addition or minimum export performance requirements. Sales in the Domestic Tariff Area by SEZ units shall be subject to payment of full Custom Duty and import policy in force. Further Offshore banking units may be set up in the SEZs.

The Export Processing Zones (EPZs) were introduced in 1960s to accelerate the growth of exports of the country by providing conducive environment to the enterprises to concentrate on their export activities. EPZs did not succeed due to location disadvantage therefore in 1980s the Export Oriented Unit (EOU) was introduced and it was extended to the development of specific sectors like granite, textile, food processing, coffee, chemicals, pharmaceutical, engineering, electrical and electronics etc. The major objectives of the EOU Scheme are to increase exports, earn foreign exchange to the country, transfer of latest technology, and stimulate direct foreign investment and to generate additional employment.

Self Assessment Questions

1. Explain the reason behind the promotion of SEZs
2. Discuss the assistance provided by the State governments.
3. Explain the benefits provided to SEZ developer.
4. List the advantage of setting up a unit in SEZ.
5. Make a note on the present debate on setting or functioning of SEZs.

CASE STUDY

The Public Sector Indian Oil Corporation (IOC), the major oil refining and marketing company which was also the canalizing agency for oil imports and the only Indian company in the Fortune 500, in terms of sale, planned to make a foray into the foreign market by acquiring a substantial stake in the Balal Oil fields in Iran of the Premier oil. The project was estimated to have recoverable oil reserves of about 11 million tons.

When IOC started talking to the Iranian Company for the acquisition in October 1998, oil prices were at rock bottom ($11 per barrel) and most refining companies were closing shop due to falling margins. Indeed a number of good oil properties in the Middle East were up for sale. Using this opportunity, several developing countries “made a killing by acquiring oil equities abroad.

IOC needed Government’s permission to invest abroad. Application by Indian Company for investing abroad is to be scrutinized by a special committee represented by the RBI and the Finance and Commerce Ministries. By the time, the government gave the clearance for the acquisition in December 1999 (i.e. more than a year after the application was made) the prices had bounced back to $24 per barrel. And the elf of France had virtually took Airway the deal from under IOC’s nose by acquiring the premiere oil.

The RBI which gave IOC the approval for $15 million investment, took more than a year for clearing the deal because the structure for such investments were not in place, it was reported.

Questions:

1. Discuss whether it is the domestic or global environment that hinders the globalization of Indian Business.
2. Even if elf had not acquired premiere oil, what would have been the impact of the delay in the clearance of IOC?
3. What are the lessons of this case?

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UNIT - V

Unit Structure

Lesson 5.1 - Foreign Direct Investment

Lesson 5.2 - Foreign Collaboration and Policy

Lesson 5.3 - Counter Trade Arrangements- Indian Joint Ventures abroad

Lesson 5.4 - Project and Consultancy Exports

Lesson 5.1 - Foreign Direct Investment

Learning Objectives

After reading this lesson you would be able to understand:

- The philosophy of the government towards foreign direct Investment in India
- A paradigm shift towards F.D.I policy in 1991
- The major initiatives of the government towards F.D.I
- Sector wise flow of F.D.I in India
- International comparison

Introduction

A poor country which has faced a colonial rule and exploitation for centuries, must lack capital and thus face poverty, scarcity and unimaginable sufferings of the people. India presents the best example of poverty in the midst of plenty. Nature has provided India with almost all the vital resources for economic development but drainage of the capital made India poor and unable to exploit her own resources for the most required economic development.

Economic condition of India was very pathetic at the time of independence. India inherited an economy where there was no structure of industry, agriculture was in the subsistence stage and one could not imagine about the existence of services sector. In these circumstances if a country wishes to march towards rapid economic development, it will have to import machinery, technical know how, and every other thing for the purpose which can be possible in two ways:-

1. The government has to curtail consumption drastically and export more and cut import substantially. Russia and China chose this method after the establishment of the communist government.

2. The second option to achieve foreign technology and equipment is to depend upon the foreign assistance in some form or the other. Most countries of the world particularly, the democratic countries, which had embarked on the road of economic development, had to depend upon the foreign capital. Therefore, India also chose to depend upon the foreign capital for the economic development. The need for foreign capital for a developing country arises on account of the following reasons:

    i. Since the domestic capital is inadequate for the purpose of economic growth, thus it becomes necessary to invite foreign capital.

    ii. For want of experience, domestic capital and entrepreneurship may not flow into certain lines of production. Foreign capital can show the way for domestic capital.

    iii. There may be potential savings but this may come forward only at a higher level of economic activity. It is, therefore, necessary that foreign capital should help in speeding up economic activity in the initial phase of development.

    iv. It is difficult to mobilize domestic saving in the initial stage for the financing of projects of economic development that are badly needed for economic development. The capital market at this period is itself undeveloped, thus foreign capital is essential as a temporary measure.

    v. Some scarce productive factors such as technical know how, business experience and knowledge which equally essential for economic development, spontaneously come with the foreign capital like the infant and the mother.

Therefore, after independence the pressure of economic development in India necessitated a realistic approach towards foreign capital. The first Prime Minister of India, Pandit Jawahar Lal Nehru, made a statement in April 1949 giving three important assurances to foreign investors:

1. India would not make any discrimination between foreign and local undertakings

1. MNCs
2. Investment by Overseas Corporate Bodies
3. Branches and Subsidiaries of Foreign Companies
4. Foreign Collaboration and Technical Know-how Agreement.

The Importance of F.D.I:

i. Foreign exchange position permitting, reasonable facilities would be given to foreign investors for remittances of profits and repatriation of capital; and

ii. In case of nationalization **o**f the undertaking, fair and equitable compensation would be paid to foreign investors.

The Industrial Policy Resolution of 1948 and 1956 as well as Mr. Nehru's statement on foreign capital were the basis of the Government's policy of foreign capital till 1991 when the New Industrial Policy was announced.

The world financial markets have been continuously opening since 1970's which presents a picture of a dramatic and unprecedentedly experienced situation so far as the world financial system is concerned. This transformation essentially stem from the interrelated factors. Prominent among them are the progressive deregulation of financial markets both internally and externally in leading countries, the internalization of these markets, the introduction of an array of new financial instruments allowing bigger and riskier financial investments, and the emergence and the increasing role of new investors in the markets. Having such a global economy characterized by severe competitive environment, the role of foreign capital in the economic development of a country cannot be ignored. In the present day world, it is very hard to believe that there is a country which has not depended upon foreign capital during the course of its economic development.

There are different ways in which foreign capital can come into a country such as:

1. Foreign Direct Investment (F.D.I)
2. Foreign Collaboration
3. Portfolio Investment
4. Loans from International Institutions
5. Inter-Governmental Loans
6. External Commercial Borrowings.

But we will restrict ourselves to the explanation of the first two i.e. F.D.I and Foreign Collaboration.

Of all these, F.D.I has been the most prominent source as it is instrumental in creating assets in an economy. F.D.I can be made by a multinational corporation or by its subsidiary or by way of joint enterprise involving an MNC and a domestic partner for setting up a plant or a project in a country.

There are different forms of F.DI. They are:

Since early sixties, the developing countries understood it well that without having a substantial share in the world trade, they cannot develop their economies. That is the reason why they gave a slogan **–"Trade No Aid".** For having a success in world trade, their domestic industries must develop to the degree of competing with the industrially developed countries.

Thus they started working on two areas simultaneously- inviting foreign capital and battling for a fair deal at world economic forums like GATT and WTO. By now they left the restrictive or protectionist trade practice and started opening their economies because they understood the importance of the F.D.I as a source of economic development, modernization and employment generation and have liberalized their F.D.I policies to attract investment. The overall benefits of F.D.I for developing economies are well documented. F.D.I triggers technology spillovers, assist human capital formation, contributes to international trade integration, helps to create a more competitive business environment and enhances enterprise development.

These all finally contribute to higher economic growth. F.D.I does not only provide initial macro economic stimulus for actual investment, but it goes beyond it and influences growth by increasing total factor productivity and more generally the efficiency of resource use in the recipient economy. Technology transfers through F.D.I generate positive externalities in the host country.

At the same time one should not forget that F.D.I is like a double edged sword. On one hand it can add to the country's capital resources and help in achieving rapid development, on the other, it can distort the economic properties and cause misallocation of resources, corrupt administrative machinery and promote inappropriate technology. Thus if handled properly, foreign capital does add to the country's investible resources and facilitates rapid development.

FDI Policy before Liberalization

Till 1945-46 in India, it were the industrial and financial fields where the foreign capital was dominating. The foreign trade network, as also part of the internal trade that fed into exports, was controlled by the foreign capital. British companies dominated mining, jute industry, shipping, banking insurance, tea and coffee plantations. British corporations also controlled many Indian owned companies. The large presence of the foreign companies, particularly the British companies before independence, as explained earlier (in introduction part) did not contribute to the growth of income in the country. In fact it was one of the major causes of underdevelopment of the country as these companies were engaged in the production and export of the raw materials and food stuffs. There was practically no transfer of capital to India and India was a net exporter of capital to the U.K. There was no scope of transfer of technology as most of the investment was concentrated in low technology extractive industries.

Against this background, one can easily find the reason why after independence, an important plank of India's development policy was to discourage inflows of foreign capital. Share holding by the foreign companies was also reduced drastically by forced or voluntary transfer of capital into Indian hands. By the beginning of 80's the share of F.D.I in gross capital formation was the lowest for India among all developing countries. The tough and restrictive policy towards foreign equity investment continued without any significant change until 1991. But 1991 is a land mark year for Indian industry and commerce and in general for the whole Indian economy itself. It was 1991 when the rules governing foreign investment were liberalized greatly and it continues till date. And hence, India is once again actively seeking foreign investment. In fact, distinct changes have been observed in thrust and direction of F.D.I policy of the Government. These changes are the result of the development in industrial policies and also foreign exchange situation, from time to time. For the convenience of the study and seeing the thrust and direction of the policies regarding the F.D.I., it would be good if we divide the whole period into different time span and analyze the whole period related to F.D.I. Thus the whole period can be divided into four sub-heads as follows:

1. A friendly atmosphere (1950-1967) the first period,
2. The atmosphere of doubt and thus restrictive in nature (1968-80) the second period,
3. The period of opening up and slow liberalization for F.D.I regulations (1981-90), the third period, and
4. The complete liberalization and attitudinal change (1991) on wards.

Let us now discuss these one by one:

Friendly atmosphere (1950-1967)

This period presents a picture of a plan strategy of import substitution and export promotion adopted by India for its economic development. The rational behind adopting this strategy was that country was short of capital, technology and entrepreneurship required for the ambitious programmes of rapid development. To meet the development requirements of the country, the attitude towards F.D.I was increasingly receptive. Foreign investment was welcomed on mutually advantageous terms, preferably through collaboration and majority local ownership. As foreign investment was considered necessary, foreign investors were assured of non discriminatory treatment on par with domestic enterprises. They were allowed to transfer their profit without any restriction and dividends and assured fair compensation in the event of nationalization.

However, foreign investment was welcomed but the major interest in ownership and effective control would always be in Indian hands. Policies regarding FDI were further liberalized and incentives and concessions were further extended to face exchange rate crisis of 1957-58. Thus FDI policy in this phase can be described as one of cautious but friendly one.

1. The Atmosphere of Doubt and Restriction: (1968—80))

After fifteen year's period of acceptance and importance, from the year 1968 the feeling started changing in India regarding FDI. Though this phase was characterized by considerable investment in various industries, substantial expansion in scientific and technological knowledge, infrastructure development, skill formation, lesser requirements of capital and technology imports. Apart from that, outflow on account of servicing of FDI and technology imports from the earlier period began to rise in the form of dividends, profits, royalties and technical fees etc.

Consequently the Government was forced to adopt a more restrictive attitude towards FDI, following are some of the prominent measures adopted by the Government to restrict the flow of FDI.

1. No FDI without the transfer of the technology was accepted.
2. The renewals of foreign collaboration agreements were restricted.
3. Foreign Exchange Regulation Act (FERA) was passed in 1973 in order to further restrict FDI in certain core or high priority industries.

4. Foreign collaborations required exclusive use of Indian consultancy services wherever available.
5. Foreign investment was prohibited in industries where local capability was available.
6. Equity participation of more than 40% was disallowed.

Therefore, after the above explanation, it can easily be said that the above period (1968-80) was a period of doubt and thereby restriction.

2. The period of Opening up and Slow Liberalization (1981-90)

Since 80's India started facing the problem of foreign exchange because of second oil crisis (1979-80) and failure on the front of the export of the manufactured goods. This necessitated gradual liberalization of FDI policies in the same period. Therefore this period witnessed a gradual but discernible sign of easing of restrictions on foreign investment inflows with the liberalization of industries and policies. Policies were framed to attract more FDI's and foreign collaborations.

They were specially designed to encourage higher foreign equity holding in export oriented units and exemptions from the general ceiling of 40% on foreign equity were allowed on the merit of individual investment proposals. Rules and procedures regarding remittances of profits, dividends, royalties were relaxed and efforts were made to provide a framework for expediting clearances of FDI proposals. The approvals for opening liaison offices by foreign companies in India were liberalized. A fast channel was set up for expediting clearances of FDI proposals from major investing countries viz, Japan, Germany, the US and the UK. Therefore, this phase witnessed concrete efforts for liberalization of FDI policies.

3. The Complete Liberalization and Attitudinal Change (1991) Onwards

The circumstances in 1991 (famine of foreign exchange) compelled the Government to bring a paradigm shift in its economic policy. Industrial Policy being a part of the overall Economic Policy, the Government of India adopted a Policy Statement in July 1991, which automatically brought a shift in the approach, thrust and direction of FDI policy. There were several objectives of the industrial policy statement and one among them was that – foreign investment and technology collaboration would be welcomed to obtain higher technology, to increase exports and to expand the production base. This policy statement followed an 'open door' policy on foreign investment and technology transfer. Transparency and openness have been the most significant features of FDI in this period. During this period, favourable policy environment consisting of liberalization policies on foreign investment, foreign technology collaborations, foreign trade and foreign exchange have been exerting positive influence on foreign firm's decisions on investment and business operations in the country.

This period was significant also because, many concessions were announced for foreign equity capital in 1991-92. Existing companies were allowed to raise foreign equity capital up to51% subject to certain prescribed guidelines. FDI was also allowed in exploration, production and refining of oil and marketing of gas. NRIs and Overseas Corporate Bodies (OCBs) were permitted to invest 100% equity in high priority areas as well as in export houses, trading houses, hotels and tourism related industries. Disinvestment of equity by foreign investors has been allowed at market rates on stock exchange as against the earlier provision of doing so at prices determined by the RBI. Foreign companies were allowed to use their trade mark on domestic sales from May 14, 1992.

Another significant change in this respect was the replacement of FERA (Foreign Exchange Regulation Act of 1973) with FEMA (Foreign Exchange Management Act 1999, became effective from 1 June 2000). The most significant feature of FEMA was that foreign exchange law violators would no longer be treated as criminals but as civil offenders. Contravention of FEMA will now attract only a monetary fine and even too has been reduced to a maximum of three times of the amount involved in contrast to five times prescribed in FERA. The provision of imprisonment has completely been abolished for the FEMA violators.

Except for few things, the Government has permitted access to the automatic route for FDI. Companies with more than 40% of foreign equity are now treated at par with Indian owned companies. New sectors like mining, banking, telecommunications, highways, construction, airports, hotels, tourism, courier services and management have been thrown open for FDI. The most significant feature of these changes was the opening up of the defense industry up to 100% for Indian private sector participation with 26% FDI subject to licensing. Now it is not necessary that FDI must accompany foreign technology agreements. Liberal approach has been followed towards investment by Non Resident Indians.

In the recent years some major initiatives have been taken to attract FDI in India. Important among them are listed below:

1. Cap on foreign investment in the power sector has been removed.
2. 100% FDI has been permitted in the oil refining.
3. FDI up to 26% is eligible under automatic route in the insurance sector.

4. Foreign investors can set up 100% operating subsidiaries without the condition to disinvest a minimum of 25% equities to Indian entities, subject to bringing in US $50million.
5. 100% FDI permitted for B to B e-commerce.
6. Condition of Dividend Balancing on 22 consumer items has been removed.
7. 100% FDI on automatic route in drugs and pharmaceuticals airports, hotels, tourism, mass rapid transport system development of town ship and courier services.
8. FDI up to 49% under automatic route in private public sector, 74 in internet service providers(ISPs), page and to in band width and 26% in defense production which has also been opened up to 100% to the domestic private players
9. 100% FDI under automatic route for all manufacturing activities(with certain exception) in Special Economic Zones (SEZs)
10. FDI up to 100% is allowed with conditions in telecom sector like ISPs not providing gateways, electronic mail, voice mail.
11. The existing upper limit for FDI in projects involving electricity generation, transmission and distribution (other than atomic reactor plants) has been dispensed with.

In fact except for a small negative list consisting of very sensitive sectors, FDI on automatic route has been permitted for all other industries.

In June 2002 Government allowed 100% FDI in tea including plantations in an effort to step up tea cultivation and modernization. This would also include foreign ownership in tea plantation, subject to case by case approvals. Companies opting for this route would have to divert 26% equity to Indian partner or public within five years. This will require the approval of the concerned state government if it results into any change in the present land use. Most significance is the decision by the Government to allow FDI up to 26% in News and current affairs print media. Technical and Medical publications have been allowed a higher FDI of 74% while FDI in banking sector has been revised to 74%. The Government has fixed an annual target of US dollar 7.5 billion FDI for the Tenth Five Year Plan (2002-2007).

In August 2001, the Planning Commission has set up a steering committee, as part of the ongoing process of liberalizing FDI policies for suggesting measures for enhancing FDI inflows in India. Apart from the measures adopted by the Government, and discussed earlier, in 2001-2002 the Government permitted 100% FDI in development of integrated town ship and regional urban infrastructure, tea sector, advertising and films and permission to foreign firms to pay royalty on brand name or trade mark as a percentage of net sales in case of technology transfer.

Let us see now the major recommendations of the Steering Committee headed by S.K.Singh.

1. The committee recommended that a new law should be enacted to incorporate and integrate relevant aspects for promoting FDI.

2. It urges State Governments to enact a special investment law relating to infrastructure for expediting investment in infrastructure and removing hurdles to production in infrastructure.

3. Empower the (FIPB) Foreign Investment Promotion Board for granting initial Central-level registrations and approvals wherever possible, for speeding up the implementation

4. Empower (FIIA) Foreign Investment Implementation Authority for expediting administrative and policy approvals. Disaggregating FDI targets for the tenth Plan in terms of sectors, and relevant administrative ministries/ departments, for increasing accountability.

5. The Committee also suggested reduction of sectoral FDI caps to the minimum and elimination of entry barriers. Caps can be taken off for all manufacturing and mining activities except defense, eliminated in advertising, private banks, and real estate, and hiked in telecom, civil aviation, broadcasting, insurance and plantations (except tea).

6. It recommended overhauling the existing FDI strategy by shifting from a broader macro-emphasis to a targeted sector-specific approach.

7. Informational aspects of the FDI strategy require refinement in the light of India's strengths and weaknesses as an investment destination and should use information technology and modern marketing techniques.

8. The Special Economic Zones (SEZs) should be developed as internationally competitive destinations for export- oriented FDI, by simplifying laws, ruses, and procedures, and reducing bureaucratic rigmarole on the lines of China.

9. The N.K.Singh Committee also recommended that the domestic policy reforms in power, urban infrastructure, and real estate, and de-control/de licensing should be expedited for attracting FDI.

10. The above mentioned recommendations were implemented and some favourable results were also experienced, but they were not sufficient viewing fast changing world scenario. Government having understood these facts, went on continuing the reform process in the FDI sector and brought wide ranging changes whenever required. In the same context the Government has brought some changes in the year 2004-2005 which are discussed below.

Major Steps to Attract Foreign Direct Investment (2004-2005)

As the Government is committed to further facilitate Indian Industry, it has permitted access to FDI through automatic route, except for a small negative list. Latest revision to further liberalise the FDI regime are as explained below:

1. The Government has increased the FDI limits in the Domestic Air Transport Services to the limit of 49% through automatic route and up to 100% by Non Resident Indians (NRIs) through automatic routes. But the Government has restrained the Foreign Airlines to have direct or indirect equity participation in this area.

2. Further reviewing the guidelines pertaining to foreign technical collaborations under automatic route for foreign financial/technical collaborations with previous ventures/ tie-ups in India, it has been decided that new proposals for foreign investment/ technical collaborations would henceforth be allowed under the automatic route, subject to sectoral policies.

In this regard following guidelines were framed

1. Government's prior approval would be required only in cases where the foreign investor has an existing joint venture for technology transfer/trade mark agreement in the same field.

2. Though in the cases where investment to be made by venture capital funds registered with SEBI or where the existing joint venture investments by either of the parties is less than 3 percent or, where the existing venture/collaboration is defunct or sick, the Government's approval would not be required.

3. In so far as joint ventures to be entering after January 12, 2005 are concerned, the joint venture agreement may embody' a conflict of interest clause ' to safeguard the interest of the joint venture partners in the event of one of the partners desiring to set up another joint venture or a wholly owned subsidiary in the 'same' field of economic activity.

4. Foreign investment in the banking sector has been further liberalized by raising FDI limit in private sector banks to 24% under the automatic route including investment by fIIs. The aggregate foreign investment in a private bank from all sources will be a maximum of 74 per cent of the paid up capital of the bank and at all times, at least 26 % of the paid up capital held by residents except in regard to a wholly owned subsidiary of a private bank. Further, the foreign will be permitted to either have branches or supervisory authority in the home country and meeting Reserve Bank's license criteria will be allowed to hold 100% paid up capital to enable them to set up wholly-owned subsidiary in India.

5. Remarkable in this regard was the changes brought in the Telecom sector. In this sector FDI ceiling particularly for basic, public mobile radio trunked services (PMRTS) global mobile personal communication service (GMPCS) and other value added services, has been increased from 49% to 74% in February 2005. The total composite foreign holding including but not limited to investment by FIIs, NRI/OCB, FCCB, ADRs, GDRs, convertible preference shares, proportionate foreign investment in Indian promoters/investment companies including their holding companies etc. will not exceed 74%.

In January 2004 the guidelines for equity cap on DDI, including investment by NRIs and Overseas Corporation Bodies (OCBs) were revised which are listed below:

1. 100% FDI was permitted in printing scientific and technical magazines, periodicals, journals subject to compliance with legal framework and with the prior approval of the Government.
2. 100% FDI was permitted through automatic route for petroleum product marketing subject to existing sectoral policy and regulatory framework.
3. 100% FDI was permitted thorough automatic route in oil exploration in both small and medium sized fields subject to and under the policy of the Government on private participation exploration of oil fields and the discovered fields of national oil companies.
4. !00% FDI was permitted through automatic route for petroleum products pipelines subject to and under the Government policy and regulations thereof.
5. 100% FDI was permitted for Natural Gas/LNG pipelines with prior Government approval.

Inflows of FDI in India

In recent years the FDI inflows have continuously been showing upward trend from 1991 to 1997.The increase in approval of FDI during the period 1995-96 was quite impressive which is clear from the fact that while in 1993-94 it was US$3178million, improved up to US$ 11439 million in 1995-96. During 1998-99 the FDI inflows declined considerably. The Asian crisis and sanctions imposed on India as a consequence of nuclear test were responsible for such downside. But FDI flow again showed increasing trend both in the years 2000 and 2001. But the alarming fact is that there is an enormous gap between FDI approval and flow. For example, if we consider an average covering 12 years, we find that the FDI flow has been only 27.5% of the approved amount. Till the third quarter of 2004-2005 the FDI reached US $ 2.5 billion, which is more than double, compared to the corresponding period last year and is very near to the total FDI inflows in 2003-2004.

Sector wise FDI Inflow

When we look at the sector wise inflow of FDI we find that from August 1991 to November 2004 the highest share of FDI inflows have gone to the data-processing software and consultancy services, followed by pharmaceuticals and automobile industry.

Source of FDI in India

After a close observation of the source of FDI in India, we find that most of the FDI inflows come from Mauritius (around 35%) followed by the USA (17.08%0 and Japan (7.33%). The important fact is that most of FDI flows routed through Mauritius is dominated by the US companies based there in order to take advantage of the tax concession provided to Mauritius companies.

International Comparison

World Investment Report of United Nations Conference on.Trade and Development (UNCTAD) shows that Global FDI inflows have declined significantly from the peak of US $ 1.4 trillion in 2000 to US$ 560 billion in 2003 because of slow down in world economy. But FDI inflow to India has shown a rise, particularly in 2003, to reach US $ 4.27 billion. China is the largest recipient of FDI inflows among the Asian developing countries. The share of developing countries in total FDI inflows has declined from 26.9% in 2001 to 23.2% in 2002 but China's share rose to 7.8% in 2003 from 5.7% in 2001. Out of total FDI inflows of 30.7%of developing countries, China accounted a major share of 9.6% in 2003. In contrast to China, the share of India among the Asian countries has been hovering between 0.4%to 0.8% between 2002 and 2003.

Self Assessment Question

1. Explain FDI and it's need.
2. Examine the importance of FDI in the present context.
3. Explain the FDI policy of the Government of India soon after independence.
4. What are the different ways through which FDI can come? Explain.
5. Examine the FDI policy in India before liberalization.
6. Explain the special features of FDI policy during 1968-80.
7. Comment upon the Opening up period of the FDI policy.
8. Explain the main features of the FDI policy after liberalization.
9. Comment upon the major recommendations of the S.K.Singh Committee.

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Lesson 5.2 - Foreign Collaboration and Policy

Learning Objectives

After reading this lesson you will be able to understand:

- The policies regarding foreign collaboration during post independence period.
- Inflows of foreign capital actual and approvals
- Size, distribution and extent of foreign collaboration
- Financial and technical collaboration
- Takeovers and implementations of foreign collaborations
- FDI and Indian Stock Market
- A complete assessment of the foreign collaboration in India.

Foreign Collaboration in the Post- Independence Period

During the early phase of the planning era, the national policy towards foreign capital did recognize the need for foreign capital, but decided not to permit it a dominant position. Consequently, foreign collaborations had to keep their equity within the ceiling of 49% and allow the Indian counterpart a majority stake.

Moreover, foreign collaborations were to be permitted in priority areas, more especially those in which we had not developed our capabilities. But in an overall sense, our policy towards foreign collaborations remained restrictive and selective. Consequently, during 1961-70,a total of 2,475 foreign collaborations were approved and during the next decade (1971-80) an another 3,041 collaborations were sanctioned.

It was only during the eighties that government relaxed its policy towards foreign collaborations. This was done specifically in respect of investors from Oil Exporting Developing countries with a well-defined package of exemptions.

This was followed by Technology Policy Statement (TPS) in January 1983. The objective of the policy was to acquire imported technology and ensure that it was of the latest type appropriate to the requirement and resources of the country. Under this policy, a number of policy measures were announced liberalizing the licensing provisions. They are listed below:

a. All but 26 industries were exempted from licensing in case of non MRTP and non-FERA companies;
b. Private sector was allowed to participate in the manufacture of telecommunication equipment;
c. A number of electronic items were exempted from MRTP Act;
d. Foreign companies were allowed to manufacture electronic components;
e. MRTP companies were allowed to set up industries in backward areas;
f. A number of new items were added to the list of industries allowed to set up by FERA and MRTP units;
g. Broad banding of a license for a number of industries was allowed; and
h. MRTP companies could commercialize the results of their R&D or of those of national laboratories.

These technical collaborations were allowed on financial criteria i.e., royalty or lump sum payment or a combination of both. These relaxations resulted in a larger inflow of foreign direct investment and consequently, the number of approvals during the decade (1981-90) reached a record figure of 7,436 involving a total investment of ₹ 1, 274 crores. Country wise analysis of foreign collaborations reveals that USA was at the top accounting for nearly ₹ 322.7 crores of investment. This was one-fourth of the total foreign collaboration approvals. This was followed by Federal Republic of Germany (17.2 per cent), Japan, U.K, Italy, France and Switzerland. Five countries i.e. USA, West Germany, Japan, U.K and Italy accounted for nearly 63 per cent of total approved foreign investment. Even Non-Resident Indians (NRIs) contributed about ₹ 113 crores accounting for 8.9 per cent of total investment.

An industry wise analysis of the distribution of foreign collaboration approval reveals that Electricals and Electronics (including telecommunications) accounted for 22per cent of the total approvals, indicating highest priority to this sector, followed by industrial machinery 15.5 per cent. Foreign collaborations in chemicals (other than fertilizers) were third in importance. By and large, it may be stated that the priority sector accounted for about 70 per cent of total approvals. It implies that foreign collaborations approvals were more or less in conformity with the general climate towards foreign capital in the country at that time.

Foreign Investment Approvals and Actual Inflows

The year 1991 will be written in golden letters in Indian history, at least in the Economic history because of its enormous importance in the field of economic Philosophy and Policies. This can be termed as a complete shift from a regulated to a beginning of a deregulated or more aptly to say, free economic system. It saw the announcement of a New Economic Policy: comprising- new Industrial and Trade Polices.

After the announcement of New Industrial Policy (1991), there has been an acceleration in the flow of foreign capital in India. As per data provided by the Government of India, between the period 1991-92 to 2001-2002, total foreign investment flows were of the order of $30.3 billion (50.7 per cent) were in the form of Foreign Direct Investment and the remaining $24.3billion (44.3per cent) were in the form of portfolio investment. This clearly shows that the preference of foreign firms was more in favour of direct investment. Moreover, out of the total direct foreign investment of the order of $30.3 billion, nearly 4.8 per cent ($2.62 billion) was contribution of foreign firms and investment was 51 per cent of total foreign investment flows.

As a response to the polices of liberalization, the foreign investors were very keen to undertake portfolio investment, including GDR(Global Depository Receipts) and investment by Foreign Institutional Investors, Euro equities and other rose sharply from $244 million in 1992-93 to $3,824 million in 1994-95 and declined to $1,828 million in 1997-98. Portfolio investment became negative in 1998-99 but again improved to $2.76 billion in 2000-2001, but again declined to nearly $1 billion in 2002-03.

Total DFI proposals approved since 1991 till 2002 amounted to ₹ 2,90,854 crores against just ₹ 1,274 crores approved during the whole of the previous decade (1981-90). There is no doubt that it takes sometime for all these proposals to fructify into actual inflows. Unfortunately, the actual flows as a proportion of approval were low till 1997, but the situation has shown distinct improvement thereafter. Actual flow during 2002 peaked to ₹ 21,286 crores- a creditable achievement.

Industry-wise approvals of FDI reveal that for the entire period August 1991 to March 2004, basic goods industries accounted for about 45 per cent of FDI. Out of this, the major share was appropriated by power (15.7%) and oil refineries (12.3%). Mining and metallurgy (ferrous and non-ferrous) accounted for 4% and chemicals only 6.2%. The next group in order of importance was that of services accounting for 31.3% of FDI. The share of telecommunications was about 18%. Financial services contributed barely 3.9%. Capital goods and intermediate goods accounted only 10.1% of FDI approvals. Although it is commonly believed that consumer durables are attracting large share of FDI, but the data reveal that they only accounted for 3.0% of FDI approvals. Consumer non-durables shared about 10% FDI (Refer Table).

Analysis of FDI approvals underline the fact that nearly 75% was accounted for by basic goods industries, capital goods and telecommunication and computer software services which are high on our priority list. Since segregated data actual flows industry wise is not available, it is not possible to comment whether the intentions are being realized in practice, or are distorted in the process of implementation.

It is really strange that industrial machinery accounted for only 1.1% of total approved investment. Explaining this situation, ISID study, mentions: "With steep reduction in the customs duties for capital goods sector, foreign investors might be finding it more advantageous to export to India than to manufacture within the country. It has also been observed that this sector has not been receiving much attention even in technical collaborations".

However, the data do not reveal the full story. *Economic survey (1996-97)* estimated the share of consumer goods sector to be 15.3 per cent and that of capital goods and machinery 13.1 per cent and infrastructure 49.1 per cent in FDI approvals during August 1991 to October 1996. It gives an impression that relatively the share of the consumer goods sectors is small, but in reality it is not so. This is due to the fact that although food processing accounted for just 6.5 per cent of total approved investment (₹ 7,500 crores), Coca Cola alone received approvals worth ₹ 2,700 crores and Pepsi ₹ 1,000 crores. But these two soft drink giants since liberalization are dominating the market.

Since a number of consumer goods companies are setting up holding companies and subsidiaries and the investment in them is not included in approved investment, the figure of approved investment understate the potential of these companies to influence market structure. For instance, Hindustan Lever has recently taken over a number of Indian firms (Brook Bond, Lipton), Tata Oil Mills and several other firms and created a subsidiary Unilever. Since investment in subsidiaries is not reflected in approved investment, these figures do not reflect the full potential of these firms to dominate the Indian market structure

Size Distribution of Approvals

Since bulk of the approvals was in power and fuel and infrastructure sectors, this resulted in raising the size of investment approvals. For instance, only 58 proposals (0.8 per cent of total) in the range of over ₹ 500 crores accounted for 38 per cent of total approvals investment. If we add all proposals above ₹ 100 crores, they account for 72 per cent of total approvals. Thus, large size investment proposals are likely to dominate foreign investment and the success of foreign collaborations will be judged on the basis of large size projects.

Extent of Foreign Ownership

Under foreign Exchange regulation Act (FERA), percentage of equity ownership allowed to foreigners was restricted to 40 per cent and this acted as a deterrent to the foreign firms acquiring a dominant position. After the announcement in Industrial Policy of 1991, majority share of foreign companies was permitted upto 51 percent for automatic approvals, but this limit was raised to 74 per cent in January 1997 in case of foreign investors and 100 per cent in case of NRIs (Non-Resident Indians). The government could also permit 100% foreign equity in high technology and export-oriented foreign companies.

Data given in table reveals that:

(i) Prior to liberalization, during 1981-83, the distribution of foreign ownership was overwhelmingly in favour of upto 40 per cent of total ownership was in firms with foreign ownership of less that 40 per cent equity.

(ii) After liberalization, 100 per cent foreign ownership subsidiaries accounted for 37 per cent. Share of less than 40 per cent ownership subsidiaries fell to about 14 per cent and that in the range of 40 to 99.9 per cent improved to 49 per cent. There is, therefore, a structural change in the ownership pattern of foreign subsidiaries. Majority ownership (more that 50 per cent) accounted for 64 per cent of total.

Financial and Technical Collaborations

Foreign collaborations are of two types- (i) technical approvals involving payments for technology, and (ii) financial approvals involving equity capital of an existing or new undertaking. Upto ₹ 600 crores, the Industry Ministry accords approval on the advice of Foreign Investment Promotion Board (FIPB), but larger projects over this limits are approved by Cabinet Committee on Foreign Investment (CCFI).

(i) Financial collaborations were just 20.1 per cent during 1981-85, their share improved to 28.8 per cent during 1985-90, but rose sharply to 72 per cent during 1991-97.

(ii) The amount of approved investment also increased sharply from ₹ 899 crores during 1985-90 to ₹ 1,73,510 crores in August 1998.

Obviously, there is a shift from technical approvals to financial approvals during the post-liberalisation phase. However, Government has been successful in attracting more foreign investment in the post-liberalisation phase as compared to the earlier period.

Countrywise Investment Approvals and Actual Inflows

Although USA was at the top in approvals for the period 1991-204 accounting for 19.9 per cent of total approvals its share in actual inflows was 16.1 per cent. As against it, Mauritius accounted for 12.3 per cent in approvals but its share in actual flows was of the order of 35.5 per cent. This was due to the fact that Mauritius is used as a tax shelter and investors belonging to several countries use it as a conduit to avoid payment of taxes. Next largest contributor of actual inflows was Non-Resident Indians(NRIs) who accounted for 9.7 per cent of total inflows. The other contribution to actual inflows of some significance were Japan, Germany, UK, Netherlands, South Korea, France and Singapore.

So far as proportion of actual inflows to proposals is concerned, NRIs record stands out distinctly superior to all countries accounting for about 91 per cent. Mauritius comes next and actual inflows were 94 per cent of approvals. Next in order was Japan, Netherlands, Germany, France, and Singapore. In case of USA,the situation showed a wide gap and actual inflows were barely 26.4 per cent of approvals. It is vitally necessary to reduce the gap between approvals and actual inflows.

A review of state-wise flow of FDI approvals reveals, that Maharashtra tops the list with ₹ 51,115 crores (17.5%) followed by Delhi ₹ 35,251 crores (12.2%), Tamil Nadu ₹ 25,072 crores (8.6%), Karnataka ₹ 24,138 crores (8.3%),Gujarat ₹ 18,837 crores (6.4%),Andhra Pradesh ₹ 13,745 crores (4.7%), West Bengal ₹ 9,317 crores (3.2%), and Madhya Pradesh ₹ 9,271 crores (3.2%). These eight states taken together, account for 64 percent of total investment approvals. Most of these states with the exception of Madhya Pradesh are industrialized states. Uttar Pradesh accounted for barely 1.7 % and Bihar and Jharkhand together accounted for 0.3 per cent of total FDI approvals. There is a need to alter the flows of FDI in relatively less better-off states.

Takeover and Implementation of Foreign Collaborations

Indian entrepreneur seems to have lost his bargaining power and well-known Indian brands have been taken over by TNCs. It needs to be emphasized that takeover do not add to new production capacities. On the contrary, they are likely to add to higher outflow of foreign exchange.

In foreign collaborations transfer of superior technology has not been the main consideration.

Some Recent Takeovers

- ICI (UK) attempted to takeover Asian Paints.
- Hindustan Lever took over TOMCO.
- Premier Automobiles transferred two of its plants to Peugeot.
- Transfer of Lakme's brand to a 50:50 Joint Venture with the Levers.
- TVS-SUZUKI takes up Hero Honda.
- Whirlpool took over TVS Whirlpool.
- SUZUKI's attempted to gain majority control in Maruti Udyog.
- Bridgstone increasing its stake from 51to74 per cent in Joint Venture with ACC.
- Bausch & Lomb increasing its share in the Indian venture to 69 per cent.
- Henkel increasing its share to 70 per cent.
- Blue Star edged out of Motorola Blur Star and Hewlett Packard India.
- Shiram's share got reduced in Shriram Honda Power.

Once the Indian partners transferred the units, they neither had the money nor the marketing network with them.

FDI and the Indian Stock Market

Stock market is an ideal form of organization which by providing easy liquidity encourages the public to invest and this brings out the latent surplus in the economy. For this purpose, the shares of good promising companies should be listed on the market. During the70's and 80's a good number of blue-chip TNC scrip got listed. Notables among them were: Abbot Labs, Burroughs Welcome, E. Merck, Eskayef, Fulford, Hoechst, May &Baker, Organon, Parke Davis and Wyeth. The chief objective of offering shares to the public by the affiliates could not be to raise fresh capital from the public, but was only a strategy of diluting foreign equity without reducing their foreign parent's quantum of investment.

In the post-liberalization period, the policy was reversed. At the first available opportunity, many foreign affiliates raised foreign equity to majority levels. While rising of foreign equity to majority levels, most TNC's indicates a tendency to avoid the stock market. TNC's are side-stepping the stock market and they sell off the existing units to locals and promote wholly-owned-subsidiaries (WOS) or transfer certain divisions/ products to wholly owned subsidiaries of the parent company.

The number of technical collaborations declined from 629 in 1997-98 to only 299 in 2003-2004. There was a tendency to convert purely technology transfer arrangements later into financial collaborations by buying the equity share of the concerns.

An Assessment of Policies towards Foreign Collaboration

The main arguments put forth by the protagonists of liberalization to permit larger doses of foreign collaboration are: The days of East India Company are over. The inflow of foreign collaborations through Multinational Corporations (MNCs) or their subsidiaries does not imply subjugation. The share of India in direct foreign investment when compared with China, Brazil, Mexico etc. is very low.

Foreign Direct Investment flows have increased from US $51.1 billion in 1992 to about US $ 162.1 billion by 2002 for all developing countries. Data available with the RBI reveal that India's share in Foreign Direct Investment increased from 0.5% in 1992 to 2.1% in 2002. As against it, China's share improved from 21.8% in 1992 to 33% in 2002. IN absolute terms, whereas China's shares were US $52.7 billion in 2002, India share was barely US $ 3.45 billion. Obviously, India has not been able to benefit much from Foreign Direct Investment despite the red carpet spread by it for the foreign investors.

Secondly, transfer of technology can also be effected with more investment being made by technologically advanced MNCs. These gains are not disputed by the critics, but the fact of the matter is that there are aspects of foreign direct investment which seriously impinge on people's welfare and national sovereignty. It is these aspects which need serious consideration

Thirdly, 45 per cent of the Foreign Investment is in the nature of portfolio investment (financial investment) which only strengthens speculative trading in shares. The wisdom of permitting foreign companies to trade in the share market is punctuated by a question mark. This has led to an artificial boom in the share market and the BSE Sensitive Index touched a high mark of 4,282 on 18th June 1994.

Earlier when the share market boom burst, the market came tumbling down and millions of small share-holders who entered the share market to have a quick buck, suffered very heavy losses, but the big gains for them. The securities boom resulted in a scam involving over ₹ 5,000 crore. The critics are of the view that although we feel jubilant over the strengthening of the share market, but we do not realize the fact that we may be sitting on a volcano.

Even during 2001, the activities of MNCs resulted in wild fluctuations in BSE Sensitive Index which came tumbling down after budget 2001-2002 was presented to the parliament. The Government had to intervene so that confidence in the market is revived. This only underlines the fact that MNCs are able to manipulate the stock market to suit their goals.

Fourthly, foreign direct investment catering to the needs of the upper middle and affluent classes, thus concentrating on the 180 million consumers in the Indian economy. In this sense, they feel a new consumer's culture of colas, jams, ice creams, processed foods and the acquisition of durable consumer goods. Consequently, there is an utter neglect of the wage goods sector. During 1993-94 to 2001-02, the output of consumer durables increased at an annual average rate of 12.4 per cent, while that of wage goods was as low as 5.8 per cent. In other words, production instead of benefiting the masses, is only catering to the needs of the upper classes. In this sense, the multinationals by entering into production of goods like potato chips, wafers, bakery products, food processing etc. are rapidly displacing labour working in the small scale sector since such units are faced with the MNCs. Thus both from the point of view of the pattern of production and employments, the unrestricted entry of multinationals in soft areas has dangerous implications.

Fifthly, portfolio investment made in India is in the nature of hot money which may take to flight if the market signals indicate any adverse trends. Thus, it would be a mistake to treat portfolio investment as a stable factor in our growth.

Sixthly, a larger inflow of foreign direct investment, more so in the financial sector, will lead to building of reserves which in turn will expand domestic money supply. Consequently, inflationary tend of prices gets strengthened in the process. Moreover, the country is witnessing the growth of a vast non-banking financial and intermediate sector which may include foreign financial companies and mutual funds. If this sector grows at a very fast rate as is happening in India, it may render any efforts of monetary management by the Reserve Bank of India ineffective.

Seventhly, MNCs after their entry are rapidly increasing their shareholding in Indian companies and are thus swallowing Indian concerns. This has resulted in a number of takeover by the MNCs and thus, the process of Indianisation of the corporate sector initiated by Jawaharlal Nehru has been totally reversed. This has given a serious set back to Indian private sector. This explains the reason why leading industrialists of the Bombay Club or the All India Manufacture Organisation (AIMO) have raised their voice against the "discriminatory" policy of the government to woo foreign capital at the cost of indigenous capital.

Finally, it has recently come to light that multinationals such as Cadbury Schweppes, Gillette, Procter and Gamble, Donone, GEC, Unilever, Ciba-Geigy, Hewlett Packard, Timex, ABB, Unisys and Rhone-Poulenc have decided to expand their business in India by adopting the wholly-owned (100%) subsidiary route at the cost of their established and listed subsidiaries.

Thus thousands, of Indian minority shareholders in the listed affiliate subsidiaries (joint ventures) feel cheated by this move of the multinationals. Earlier, in the last couple of years, most of the MNCs augmented their holdings in listed affiliates by acquiring shares at heavy discounts over market prices through the mechanism of preferential allotment while making demands for preferential allotment of shares, MNCs promised that they would bring fresh capital, introduce latest technologies and marketing skills and help Indian affiliates become more competitive internationally and accelerate their growth. The move to keep Indian affiliates out of their activities on the one hand has hurt Indian interests, but a serious issue is that more attractive and profitable businesses have been transferred to wholly owned and newly created subsidiaries.

Thus a conflict of interests has arisen between a wholly-owned subsidiary and the 51 per cent owned affiliates. But since MNCs have acquired majority stake in the affiliates, the Indian minority investor has been rendered powerless to take any retaliatory action. Indian industrialists feel that the new move is a kind of day-light robbery because the MNCs want to profit on established brand names. Moreover, this will accelerate the process of forex drain from India.

But, the clandestine manner by which the multinationals enhanced their equity at throw-away prices by seeking preferential allotment of shares, is a blatant abuse of the permissive clauses, in Industrial policy (1991). It, is therefore, of urgent necessity that the Government should take remedial steps through SEBI and RBI to plug this abuse. To sum up, while capital inflows by multinationals may be permitted, but this should not be allowed at the cost of Indian national interests. The Government should, therefore, not have an open door policy but should be more selective in its approach.

Self Assessment Questions

1. Explain the meaning of foreign collaboration.
2. State the position of foreign collaboration during post independence period.
3. Bring out a summary of the size and distribution of approvals.
4. What is the extent of foreign ownership? Explain.

5. What is meant by financial and technical collaboration? Give Indian position.
6. Bring an account of country wise investment approvals and actual flows.
7. Explain takeovers and implementation of foreign collaboration.
8. Detail out some recent takeovers.
9. Critically examine the role of F.D.I in Stock Market.
10. Bring an assessment of policies towards foreign collaboraaation.

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Lesson 5.3 - Counter Trade Arrangements-Indian Joint Ventures Abroad

Of late it has been understood by all that foreign exchange cannot only be earned by exporting goods and services. It can be earned by establishing joint ventures in other countries. In these circumstances, corporate houses and companies are called upon to engage in establishing joint ventures in other countries particularly, in developed countries, if possible. It will serve two purposes-(i) Easy transfer of technology and, (ii) Less dependency on import of capital because the companies will earn profit and bring them to the native countries. This philosophy is based on the empirical evidence of the present developed countries which have depended on this and achieved a great success. Thus trade policy should aim at not only increasing and enlarging export of goods and services, but to create an atmosphere where native companies become true multinational companies and earn profit like their counterparts of the other countries.

Present EXIM Policy is designed based n the requirements to facilitate international trade. It aims to increase exports and liberalize imports. Export maximization and import liberalization are he basic objectives if EXIM Policy. It is the known fact that even after hard efforts India's share in the world trade is only 0.8 percent still we are trying or to say our Export Import Policy aims only at increasing it only by increasing export. This is done by solving bottlenecks in the present licensing schemes and shifting more than 500 items from restricted list to special import license and free list. Therefore, the present EXIM Policy has the following objectives:

1. To accelerate the country's transition to a globally oriented vibrant economy with a view to derive maximum benefits from expanding global market opportunities.
2. To stimulate sustained economic growth by providing access to essential raw materials, intermediates, components, consumables and consumer goods required for augmenting production.
3. To enhance the technological strength and efficiency of Indian agriculture, Industry and Services, thereby improving their competitive strength while generating new employment opportunities and encourage the attainment of internationally accepted standards of quality, and
4. To provide consumers with good quality products at reasonable prices.

In order to achieve these objectives, Commerce Ministry has modified Export Promotion of Capital Goods (EPCG)schemes, merged the Quantity Based Advance License and Pass Book Scheme, raised the FOB Criterion for Export Houses, Trading Houses, Star Trading Houses and Superstar Trading Houses, extended Special Limit to ISO9000units, liberalized exports and extended the Special Import License list and free list and introduced Duty Entitlement Pass Book.

India- Joint Ventures Abroad

Proposals from Indian companies for overseas investment in Joint Ventures (JVCs) and Wholly Owned Subsidiaries abroad are considered in terms of the guidelines issued in this regard by the Government from time to time. As per the guidelines issued in the month of August 1995, all applications for grant of approvals for setting up JVs or WOSs abroad are to be made to and processed by the Exchange Control Department of the RBI. The RBI, in pursuance of the above mentioned guidelines, started processing overseas investment proposals with effect from January 1, 1995.

These guidelines were further liberalized or modified by this Ministry (Commerce Ministry) three times during 7th November 1996 to 22nd August 1997. In addition to the existing fast track route operated by the Reserve Bank of India, where the total value of the Indian investment does not exceed US$15 million out of balances held in the Exchange Earners Foreign Currency (EEFC) Account of the Indian promoter company without reference to the RBI. The second permits overseas investment up to a maximum of 50% of GDRs to be raised by the promoter company with the clearance of Ministry of Finance. Apart from these, the RBI operates the normal route where cases are considered by the Special Committee for investments beyond US$ 4 million and up to US $ 15 million, as also cases not qualifying for automatic approval. The Finance Ministry on the recommendation of the Special Committee considers large investments beyond US $ 15 million. At the end of March 1998 there were 1,392 active Indian JVs and WOSs abroad, out of which 541 were in production and 851 were under various stages of implementation. The approved equity of the 1,392 JVCs or WOSs as on 31.3.1998, amounted to US $ 2,205.425 million. The total inflow to the country to date as on 31 December 1997 in the form of dividends, other entitlements repatriated was ₹ 218.32 crores and ₹ 484.46 crores respectively. Apart from this, additional non equity exports to the extent of ₹ 1,847crores have been realized up to 31st December 1997 on account of JVs or WOSs abroad.

Liberalization has created new avenues for foreign investment, technology collaboration and joint ventures. Among these three, joint venture is the easy way to enter into the business by the domestic industries and the foreign counterparts. Joint ventures benefit the investing firm, investing country and the host country. Joint venture aims to achieve collective self-reliance and mutual cooperation among the developing countries. The basic objectives of the joint venture can best be understood by summarizing them in the following manner:

1. Aim to increase export of capital goods, spare parts and components from India
2. Aim to increase the export of technical know how and consultancy services
3. To project India's image abroad as a suppler of capital goods and updated technology to the global market.
4. To utilize the idle capacity in the capital goods sector in particular and industrial sector in general.

India's misfortune in one way is turning favorable to it in other way, because it is mainly the cheap labour force and thus labour intensive technique which attracts the foreign countries to enter in to joint ventures with the Indian industries. On the other hand Indian companies enter in to joint venture with the developed countries to get the opportunities to avail the technology of the developed countries. This will reduce the operational cost and increase productivity. Indian industries are also expected to invest in the foreign countries and enter into foreign market through joint ventures.

Requirement of Policies for Indian Investment in Joint Ventures Abroad.

There is the requirement of a well designed and transparent policy to enable Indian industries to plan their business activity and to negotiate with the potential foreign counterparts for collaboration. Financial support of the financial institutions and banks are also required for entering in to joint venture with the collaborator outside the country.

Incentive Offered by the Developing Countries

Now a days many developing countries offer incentives such as tax holiday, export incentives, guarantee against expropriation, freedom to remit profits and repatriate capital and protective tariff to encourage joint ventures by foreign collaboration in their country. The developing countries prefer joint ventures from India. The main reason being that, the labor intensive technique of the Indian industries is suited to the requirements of the developing nations. The developing countries having limited domestic market may not e in a position to absorb the capital intensive technology provided by the developed countries. Therefore, they prefer medium scale technology with labour intensive developed by India.

Varshenoy and Bhattacharya in their book, International Marketing have pointed out some factors influencing the selection of a country for the establishment of joint ventures. The factors are given below:

1. Market for the products concerned - Size of the market
   - Market growth
   - Existing competition local and foreign
2. Government Regulations
   - Tax concessions and incentives
   - Price controls their severity
   - Local content requirements
   - Export obligations
   - Extents of equity holding permitted
   - Degree and nature of protection
   - Repatriation of capital and profits
3. Economic Stability
   - Economy and its management
   - Fiscal Policies
   - Growth Rate
   - Degree of Inflation
   - Trade balance and balance of payments
   - Balance and indebtedness
   - Import and debt service cover
4. Political stability institutions
   - Sound political
   - Mechanism for orderly transfer of power
   - Acceptance of the obligations of the pervious Government
   - Political relations with India

Joint Ventures Abroad

Many Indian companies have entered into joint ventures abroad. There were 524 joint ventures as on 31st December 1994. Out of the 524 joint ventures, 177 were in operation and the remaining 347 were at different stages of implementation. The Government of India has approved 216 joint ventures in 1995 and 255 in 1996. The total Indian equity in the 177 joint ventures in operation abroad was at ₹ 179.04 crore and the approved equity for joint ventures under various stages of implementation is amounted to ₹ 1398.96 crore. Of the 177 joint ventures which are in operation, 99 (56%) are in the field of manufacturing and the remaining 78 (44%) are sanctioning in the non-manufacturing sector. Indian equity in joint venture has been mainly through export of machinery and equipment/ technology/or capitalization of earnings of the Indian company through provision of technical know how or other services.

The scale of operation of the Indian joint ventures abroad is generally small. The shareholding of the Indian joint venture is less than ₹ 50 lakhs in most of the operating joint ventures. Of late, projects under joint venture with large equity base are coming up. The Governmental policies and guidelines for joint ventures encourage Indian joint ventures abroad with large equity base and insist the Indian enterprises to carefully select the economically viable projects capable of not only coming higher returns but also projecting better image of Indian expertise and technology in the overseas market.

Indian joint ventures abroad are engaged in the manufacturing and non-manufacturing sectors. The Indian joint ventures are functioning in the manufacturing sectors such as, light engineering, textiles, chemicals, pharmaceuticals, food products, leather and rubber products, iron and steel, commercial vehicles, pulp and paper and cement products etc. The non – manufacturing sectors are hotels, and restaurants, trading and marketing, consultancy, engineering and construction. Indian joint ventures are in operation in the UK, Malaysia, the USA, UAE, Singapore, Srilanka, Russia, Nepal, Thailand, Mauritius, Nigeria, Indonesia and Hong kong. Majority of the Indian joint ventures are in operation in the East Asia region followed by Europe-America region, Africa region, South Asia region and West Asia region.

The earnings of the Indian joint ventures abroad are in the form of dividends and other entitlements of the Indian promoters such as fee for the technical known how, engineering services, management services, consultancy and royalty. Substantial foreign exchange could be earned by exporting machineries, and other inputs to joint ventures. The Indian promoters are getting bonus shares also when the joint ventures declare bonus shares. This enables the Indian promoters to raise their equity and to earn higher dividends.

Indian joint ventures are facing many problems by the Indian joint ventures abroad:

- Inability to assess the market prospects
- Failure to identify the right foreign counterpart

- Non-approval of technology sought to be supplied by Indian partners.
- Inability of the Indian companies to adjust themselves in the new environment and (no sheltered market in the overseas market)
- Price competition

Definitions

(a) Direct Investment shall mean investment by an Indian party in the equity share capital of a foreign concern with a view to acquiring a long interest in that concern. Besides the equity stake, such long term interest may be reflected through representation on the Board of Directors of the foreign concern and in the supply of technical know-how, capital goods, components, raw materials, etc. and managerial personnel to the foreign concern.

(b) Host country shall mean the country in which the foreign concern receiving the direct investment is formed, registered or incorporated.

(c) Indian party shall mean a private or public limited company incorporated in accordance with the laws, of India. When more than one Indian body corporate make a direct investment in a foreign concern, all the bodies corporate shall together constitute the "Indian party".

(d) Joint Venture shall mean a foreign concern formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian party makes a direct investments, whether such investment amounts to a majority or minority shareholding.

(e) Wholly Owned Subsidiary shall mean foreign concern formed, registered or incorporated in accordance with the laws and regulations of the host country whose entire equity share capital is owned by the Indian par

Automatic Approval

An application for direct investment in a joint venture/wholly owned subsidiary abroad from a Private/Public Ltd.Co. will be eligible for automatic approval by R.B.I. provided:

a) The total value of the investment by the Indian party does not exceed US $4 (four) million,
b) The amount of investment is upto 25% of annual average export earnings of the company in the preceding three years and

The amount of investment should be repatriated in full by way of dividends, royalty, technical services fee ect with in a period of five years investment.

The investment may, besides cash remittance at the discretion of the Indian party, be contributed by the capitalization in full or in part of

(a) Indian made plant, machinery, equipment and components supplied to the foreign concern;

(b) The proceeds of goods exported by the Indian party to the foreign concern;

(c) Fees, royalties, commissions or other entitlements from the foreign concern for the supply to technical know-how, consultancy, managerial or other services.

Within the overall limit of US$4 million the Indian party, may opt for:

(1) Cash remittance;

(2) Capitalization of export proceeds towards equity; or

(3) Giving loans or corporate guarantees to /on behalf of Indian JVs/WOSs.,

For loans / Guarantees from banks / financial institution from India to/ on behalf of Indian JVs/WOSs abroad requisite clearances from commercial banking angle for loans and guarantees as required would need to be taken as normally prescribed.

Where R.B.I in its judgment, feels that a proposal under automatic route is predominantly real estate-oriented, such proposals shall be remitted to the High Level Committee.

Time Limit. All implication under the automatic route will be eligible for approval within 21 days of receipts of complete application by RBI, which shall include a broad feasibility study, a statement of credit-worthiness from a bank, and statement from a Chartered Accountant verifying the ratios, projections made, etc.

In case the application is for takeover of participation in an existing unit, the basis of share valuation shall be certified by a Chartered Accountant.

This facility of automatic approval will be available to the Indian party in respect of the same JVs/WOs only once in a block of three financial years including the financial year in which the investment is made. However, within the overall limit of US $ 4million the Indian party may be permitted to invest equity/provide guarantee etc.on the automatic route on more than one occasion. However, non-automatic route may be availed of without these restrictions.

Special Committe

All applications involving investment beyond US $4million but not exceeding US$15 million or those not qualifying for fast track clearance on the basis of the applicable criteria outlined, above and all application where RBI feels that the proposal under automatic route is predominantly real estate-oriented, will be processed in the RBI through a Special Committee appointed by RBI in consultation 'with Government and chaired by the Commerce Secretary with the Deputy Governor, RBI., as the Alternate Chairman. The Committee shall have as members representative of the Ministry of Commerce, Ministry of Finance, Ministry of External Affairs and the RBI. The Committee shall co-opt as members other Secretaries/Institutions dealing with the Sector to which the case before the Committee relates.

A recommendation will be made within 60 days of receipt of the complete application and RBI will grant of refuse permission on the basis of the recommendations. Such proposals should be accompanied by a technical appraisal by any of the designated agencies (currently they are IDBI,ICICI, Exim Bank and SBI) to be arranged for by the applicant.

The committee will, inter alia, review the criteria for and progress of all overseas investments under these gudelines and evolve its own procedures for consultations and approvals.

Criteria In considering an application under category "B", the Committee shall, inter alia, have due regard to the following:

(a) The financial position, standing and business track record of the Indian and foreign parites.

(b) Experience and track record of the Indian party in exports and its external orientation.

(c) Quantum of the proposed investment and the size of the overseas venture in the context of the resources, net worth and scale of operations of the Indian party; and

(d) Repatriation by way of dividends, fees, royalties, commissions or other entitlements from the foreign concerns for supply of technical know-how, consultancy, managerial or other services n five years w.e.f. the date of approval of investments.

(e) Benefits to the country in terms of foreign exchange earnings, two way trade generation, technology transfer, access to raw materials, intermediates or final products not available in India.

(f) Pima facie viability of the proposed investment. Indian financial and banking institutions considering to support the venture will examine independently the commercial viability of the proposal.

Post Approval Changes

In the case of a joint venture in which the Indian party has a minority equity shareholding, the Indian party shall report to the Ministry of Commerce and the Reserve Bank of India the details of following decisions taken by the joint venture within 30 days of the approval of these decisions by the shareholders/promoters/Directors of the joint in terms of the local laws of the host country:

(i) Undertake any activity different from the activity originally approved by the R.B.I/ Government of India for the direct investment ;

(ii) Participate in the equity capital of another concern;

(iii) Promote a subsidiary or a wholly owned subsidiary as a second generation foreign concern;

(iv) After its share capital structure, authorities or issued, or its share holding pattern.

(v) After its share capital structure, authorized or issued, or its shareholding pattern.

   (a) Undertake any activity different from the activity originally approved for the direct investment;

   (b) Participation in the equity capital of another concern;

   (c) Promote a subsidiary or a wholly owned subsidiary as a second generation concern;

   (d) After its share capital structure, authorized or issued or its shareholding pattern.

Provided, the following conditions are fulfilled;

(a) The Indian party has repatriated all entitlement due to it from the foreign concern, including dividends, fees and royalities and this is duly certified by a Chartered Accountant ;

(b) The Indian party has no overdues older than 180 days from the foreign concern in respect of its export of its exports to the latter;

(c) The Indian party does not seek any cash remittance from Indian; and

(d) The percentage of equity shareholding of the Indian party in the first generation joint venture or wholly owned subsidiary is not reduced, it is pursued to the laws of the host country.

The Indian party shall report to Ministry of Commerce and the Reserve Bank of India the detail of the decisions taken by the joint venture or wholly owned subsidiary within 30 days of the approval of those decision by the shareholders/promoters/Directors in terms of the local laws of the host country, together with a statement on the fulfillment of the conditions mentioned above.

In the case of subscription by an Indian party to its entitlement of equity shares issued by a joint venture on Right basis, or in the case of subscription by an Indian party to the issue of additional share capital by a joint venture or a wholly owned. Subsidiary, prior approval of the R.B.I shall be taken for such subscription.

Large Investment

Investment proposals in excess of US $15.00 million will be considered if the required resources beyond US $15.00 million are raised through the GDR route. Upto 50% of resources raised may be invested as equity in overseas joint venture subject to specific approvals of the Government. Applications for investment beyond US $ 15.0 million would be recived in the RBI and transmitted to Ministry of Finance for examination with the recommendation of the Special Committee. Each case would, with due regard to the criteria outlined above, be subjected to rigorous scrutiny to determine its overall benefit. Investments beyond US$ 15.00 million without GDR resources will be considered only in very exceptional circumstances where a company has a strong track record of exports. All proposals under this category should be accompanied by the documentation as detailed above.

Foreign Exchange

(i) Indian parities intending to conduct preliminary study with regard to feasibility, viability, assessment of fair price of the assets for the existing /proposed overseas concern, identification of foreign collaborators, etc. before deciding to set up / acquire an overseas concern/bid for the same may approach the concerned Regional Office of Reserve Bank for prior approval for a availing the services of overseas consultants/ merchant bankers involving remittance towards payment of fees, incidental charges, etc.

(ii) For release of exchange of meeting preliminary/ pre-operative expenses in connection with joint venture/ subsidiary abroad approved by Government of India / Reserve Bank o India, applications should be made to the concerned Regional Office of Reserve Bank, Reserve Bank will consider releasing exchange keeping in view, inter alia, the nature of the project total project cost, need for meeting such expenses from India, etc. subject to such condition s as deemed necessary including repatriation of amounts so released. Remittance towards, recurring expenses for the upkeep of the joint venture / subsidiary abroad will, however, not be permitted.

The foreign exchanges needed for overseas investment may be drawn after the approval is granted either from an autyorsied dealer or by utilizing the balance available in the EFFC account of the Indian party or by any other means specified in the letter of approval.

Acquisition of Shares and Issue of Holding Licence

Where equity contribution are made by way of cash remittance or capitalization of royalty, technical know-how fees, etc., Indian promoter companies are requied to receive share certificates of equivalent value from the overseas concern within three months from the date of effecting such cash remittance or Mthe date on which three the royalty, fees, etc. become due for payment. As soon as shares are acquired from the overseas concern, Indian companies should apply in form FAD2 to the concerned office of Reserve bank for obtaining necessary licence to hold such foreign security as required under section 19 (i) (e) of FERA,1973.

Acceptance of Directorship of Overseas Companies and Acquisition of Qualification Shares

Persons resident in Indian are free to accept appointments as directors on the board of the overseas companies. However they will require permission from Reserve Bank for any remittance toward acquisition of qualification shares, if any, of the overseas company for which application in form A2 together with an offer letter of the overseas company should be made to the concerned Regional Office of Reserve Bank through and authorized dealer. On receipt of shares from the foreign concern, applications in form FAD2 should be made to the concerned office of the Reserve Bank for issue of necessary holding licence. Such directors are also required to repatriate to India promptly, remuneration, if any, recived by way of sitting fees, etc. through normal banking channels.

Export of Goods

Both under Category "A" and Category "B" above, secondhand or reconditioned indigenous machinery may be supplied by the Indian party towards its contribution to the direct investment in the foreign concern.

Agency Commission

No agency commission shall be payable to a joint venture / wholly owned subsidiary against the exports made by the Indian party towards its equity investment. Similarly, no agency commission shall be payable to a trading joint venture/wholly owned subsidiary if the Indian party makes an outright sale to it.

Remittance towards equity, loans and invoked guarantees

(i) Where the Indian promoter companies have been permitted to make equity contribution by way of cash remittance they should apply for release of foreign exchange to the concerned Regional Office of Reserve Bank in form A2, in duplicate, through their authorised dealer. In case the remittance to be effected out of the funds held in their EEFC account, prior permission from RBI will, however, not be necessary. In both the cases, after the remittance, the particulars thereof, along with the certificate of the authorized dealer concerned, should be reported by the Indian company to the concerned Regional Office of RBI positively within 15 days from the date of such remittance.

(ii) In case of remittance of loan amount, if specifically approved by RBI, the aforesaid procedure should be followed and particulars of remittance should be reported to the concerned Regional Office of RBI within 15 days from the date of such remittance. Where issue of guarantee by the Indian company has been specifically approved by Reserve Bank, a certified copy of such guarantee should be submitted to the concerned Regional Office of RBI within 15 days from the date of issue of such guarantee to or on behalf of the RBI. If and when such guarantee is invoked, the Indian company should approach the concerned Regional Office or Reserve Bank through their authorized dealer for effecting remittance, towards the invoked guarantee. After effecting the remittance, the particulars thereof should be reported to Resevre Bank as in the case of remittances made for equity and for loan. (Sources: Exports, What, Where, How-paras Ram

Self Assessment Questions

1. What is a joint venture? Explain its main characteristics.
2. What are the basic objectives of the joint ventures?
3. Explain remittance towards equity, loans and invoked guarantee.
4. What is acquisition of shares and issue of holdings license?
5. Examine the conditions for getting automatic approvals of joint ventures.
6. Define- Direct Investment, Host Country, Indian Party, Joint Venture and Wholly Owned Subsidiary.
7. Examine the factors influencing the selection of a country for establishment of joint ventures.

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Lesson 5.4 - Project and Consultancy Exports

Learning Objectives

After reading this lesson you will be able to understand:

- Meaning of Project and consultancy Exports
- Profile of the project export
- Special features of construction export and its problems
- Major assistance by the Govt. for construction exports
- Meaning of Consultancy exports
- Incentives to consultancy exports
- Future of consultancy exports

Introduction

There are many indicators of economic development and one of them is the composition of exports. By exports one generally feels of export of goods and services. A less developed country exports mostly agricultural and allied goods and thus its exports items bring less foreign exchange. That is the reason why these less developed countries always complain about unfavourable terms of trade. After the country has achieved a level of development, its composition of foreign trade also undergoes changes- from agricultural goods to industrial goods, and lastly knowledge based goods. These goods are mostly in the form of services and come under expertise like engineering projects and consultancy projects. Thus exports of these goods not only bring more foreign capital but also add to the prestige of the country.

Meaning of Project Export

Project exports include Turnkey projects such as rendering of services like design, civil construction, erection and commissioning of plant or supervision thereof, along with the supply of equipment. It also includes, engineering services contracts, involving the supply of services alone, such as design, erection, commissioning or supervision of erection and commissioning.

Consultancy services contract generally include the preparation of feasibility studies, project reports, preparation of designs and advice to the project authority on specifications for plant and equipment, preparation of tender documents, evaluation of tenders and purchase of plant and equipment. This also includes civil construction contracts, with or without preparation of designs or drawings for the civil work to be undertaken.

Profile of the Project Export

The profile of Project exports in India has not been encouraging. Still during last three decades, India has been able to register its presence it the world arena of this type of exports. Thus we can say that in the last three decades, India has achieved a moderate success so far as project export and capital goods and civil engineering jobs are concerned. On an average these categories account for about 40 percent of India's total engineering exports.

Even in the glooming weather the success achieved by the Indian companies in the field of construction contracts can be considered as spectacular. The Middle East Countries emerged as the very important markets for infrastructural projects because of their huge revenue gained through oil. Since 1981 Indian companies have secured contracts in the field of Township, Airports, High Rise Buildings, Water and Sewerage Treatment Plants, Flyovers and, New railway lines from the countries like Iraq and Libya.

The year 1981 is considered to be the peak year provided contracts worth ₹ 1,594 crores to Indian construction companies. Since 1981, however a decline has set in construction project exports. But Indian companies have found new avenues in Afghanistan and Kuwait and are waiting for the better from Iraq in the near future.

The contracts secured in the recent years have been quite diverse in nature, indicating the growing versatility and technological capabilities of Indian project exporters. The West Asian region still continues to be the major markets in South East Asia and Sub-Saharan Africa account for the remaining half.

Construction Project Export and its Problems

The present construction scenario on the international level is quite complex and intense competition is found among big giants due to the reduced size of the global construction market which was estimated to be around $225 billion during 1985-90 annually as per the study of the World Bank.

Problems

1. Competition among construction companies is the major problem before the Indian companies because they have to compete with the giants in this field operating for a ling time and having better expertise.

2. Financial constraints have posed big limitation on the underdeveloped countries to implement execution even those projects which are absolutely necessary for developing the infrastructure facilities.

3. Another factor which does not favour Indian companies in the international scenario is that the Indian consultancy firms have not developed much. Consultants who are forerunners of the project have a dominant role to play for the award of contracts as well as for laying down specifications for the material to be used in the projects, et c. It is usually observed that these consultants lay down specifications and terms and conditions which are mostly to the advantage of contractors, though having adequate experience, do mot either get pre qualified are unable to offer competitive bids due to these reasons.

Major Assistance for Project Export

One of the most prominent reasons behind less participation of the Indian project exporters has been the cost associated with such participation. It is roughly estimated that it costs around ₹ two lakhs for a tender of about ₹ 10 crores. In order to solve this problem, the government announced a new system of assistance in September 1986 to subsidies the costs of participation in global tenders.

The major help provided by the government in this regard is listed below:

1. MDA assistance for reimbursement of cost of preparation and submission of bids fr such projects will be given at the following rates:

   a. 50% of the cost subject to the following standard cost ceilings related to the Turnkey, Construction project, Operation and Maintenance Services Contracts. Bids which have the value up to ₹ 5 crores—₹ 1 lakh, Bids of value above ₹ 5 crores—₹ 2 lakhs, Bids of the value of ₹ 25 crores and up to ₹ 100 crores—₹ 4 lakhs, and Bids of the value above ₹ 100 crores—₹ 6 lakhs.

   b. The Government will reimburse the finance cost of bid bond in the following way:

MDA assistance will be given for 50 per cent of the financing cost of bid bonds. For the purpose of MDA grant, the maximum period of life for a bid bond would be assumed to be one year and any financing cost beyond the period of one year would be born by the company and no reimbursement for this would be made from MDA funds.

The subsidy towards financing cost will not be reimbursed in the event of bid being successful. A certificate from ECGC, Commercial Bank, EXIM Bank regarding net financing cost incurred by the Company will have to be furnished.

2. Besides Supplier's Credit and Buyer's Credit, the EXIM Bank has also been extending lines of credit to various developing countries with a view to encourage projects exports.
3. The Government has extended income tax exemption on earnings from exports of projects under Section 80 HHB of the Income Tax Act.
4. Import of used machinery and equipments by the project exporters has been allowed on concessional customs duty basis at 15% advalorem.
5. EXIM bank has also been extending lines of credit to various developing countries with a view to encouraging India's Project Export.
6. EXIM bank has recently introduced a strategic market entry support scheme to reimburse the cost of tendering in respect of successful bids submitted to multilaterally funded overseas projects.

Consultancy Exports

India is a very late entrant in the field of Consultancy Export market. This market was dominated by the developed countries where Subsidiary Sector was well developed to cater to the needs of the third world countries. But with the development of the economy, the number of engineering graduates has increased tremendously. And this is the reason that India boasts of having the third largest engineering manpower in the world.

Therefore, now, India is in a position to enter this highly sophisticated and expanding segment of world trade. India has over 200 consultancy and design organizations. India which earned merely ₹ 1 crore in the year 1974-75 became proud of herself when in the year 1993-94 she earned ₹ 1,369 crores.

The major areas in which Indian consultancy has achieved considerable success are technical management of cement plants, agricultural research services, setting up of molasses-based distilleries, sugar projects, petrochemical industries, design programming, computer software, cooling tower system, fuel firing systems, architectural, structural, electrical and air conditioning engineering designs, transport and communications management, techno economic feasibility repo0rts, market surveys, etc.

The major destinations or to say countries where exports of consultancy services were made are France, Japan, Norway, the UK, the USA, Russia, Holland, Switzerland, Sweden. Kuwait, Muscat, UAE, Saudi Arabia, Iraq, Iran, Algeria, Oman, Ethiopia, Cameroon, Tanzania, Singapore, Hong Kong, Sri Lanka, Korea, Indonesia, Pakistan, Malaysia and Laos.

The Government of India has given following incentives or concessions to the Consultancy Organization:

1. Those consultancy exporters whose annual foreign exchange earnings by way of export of services are not less than ₹ 5 lakhs, are eligible of foreign exchanged facilities for business development, purchase of tender documents, payments of commission, bid bonds etc.
2. For the purpose of covering risks, the ECGC has designed policies to cover specific transactions of services exports.
3. The Government is providing marketing Development Assistance to consultancy organizations which are registered with FIEO for undertaking market studies, opening of foreign offices, publicity campaigns and feasibility studies.
4. Income deduction is given up to 50% of the net foreign exchange earnings in computing total income.
5. EXIM Bank has introduced a scheme, under which deferred payment facilities are available from the Bank in respect of consultancy jobs to be undertaken from India.
6. The Government also provides facilities for bid preparation as already explained in the project export section.
7. Cent per cent income tax exemption is given on export profit from computer software.

Apart from that the Govt. has set up a “Consultancy Trust Fund” of US$) 5 million with the World Bank to be utilized for engaging Indian consultants for World Bank – financed projects.

Prospects for the Future

Indian firms have by now gained enough experience through participation in domestic projects of a diverse variety which is catering to the needs of the developing countries. Scope exists to initiate our presence in new markets, and cover new sectors.

The recent trends observed in the pattern of bidding by Indian project exporters are encouraging particularly for project opportunities in neighbouring and other developing countries. Indian project exporters technical and managerial capabilities are of the highest order in the world market. Indian project exporters are hopeful of penetrating new markets overseas to secure increased share in project exports.

Self Assessment Questions

1. Explain the meaning of Project and Consultancy Exports.
2. Examine the profile of project export.
3. Explain construction project export and its problems.
4. Explain major assistance given by the Government for project export.
5. What is consultancy export? Explain.
6. Examine the various incentives given by the Government to the consultancy organization.

CASE STUDY

The Managing Director of Shabbir Tiles & Ceramic Ltd. Decided to tour six West African countries in May 1995 in an effort to search for new markets for its glazed ceramic tiles because of mounting competitive threat, product line expansion in sanitary ware and table ware being considered.

He wants to show what is involved in a banter deal since it plays an important role internationally. He wants to illustrate the importance of business-government relations. He wants to examine the pros and cons of product line expansion.

He wants to consider what relevant criteria to examine when seeking market development in foreign countries.

Questions

1. What is involved in a banter deal?
2. How should company approach the government to seek a reduction of import duties? Devise a planned approach.
3. What additional information should the Managing Director seek before making decision about the six West African markets?
4. What are the advantages and disadvantages of product line expansion?

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