POLICY AND REGULATIONS

As India tries targeted intervention to improve exports, there are creases that need to be ironed out

Synopsis

The government has launched various schemes, from Make in India to FMS to PLI, to boost trade competitiveness. While the moves towards atmanirbharta are proving to be a boon for many sectors, high indirect taxes and inverted duty structures are major killjoys.

By Nilanjan Banik

In economics, there is a concept of intra-industry trade, which is trading in similar items. For example, China exports Lenovo computers to Japan and in return imports Sony computers. When countries trade in similar technology-intensive items, trade becomes mutually beneficial. And trading partners get access to each other’s market, leading to availability of a bigger variety of

products to their consumers. To top it all, they don't have to incur a huge trade deficit making trade sustainable. The problem arises when trade involves low- and high-technology intensive products.

Take for instance India's trade with one of its largest trading partners - China. India's trade deficit with its neighbour is on the rise. We primarily export low-technology intensive items such as iron ores, slags and ash, diamonds, mineral oils, cotton, shrimps and prawns, and fruit and vegetables. India's imports from China comprise high-technology intensive items such as integrated circuits, automobile parts, parts for telephone sets, and automatic data-processing machines. China has a 5.35% share in India's total imports, while India accounts for a puny 0.87% of the total imports by China. In fact, evidence suggests the exporting firms are more tech-advanced with a higher factor productivity, allowing them to compete in the world market.

At present, Indian firms do not have the capabilities to manufacture high-technology intensive items. To fire fight this increase in trade deficit, returning to protectionism seems to be a natural and an easier option. However, not so long ago — sometime during 2005 — India experimented with further opening up border trade. The country in fact signed six different Regional Trading Agreements (RTAs) between 2006 and 2010.

1. South Asian Free Trade Area in 2006
2. India Bhutan Trade Agreement in 2006
3. India Chile Preferential Trade Agreement (PTA) in 2007
4. India MERCOSUR PTA in 2009
5. India-ASEAN FTA in 2010
6. India South Korea Comprehensive Economic Partnership Agreement in 2010

This, however, led to overall increase in trade deficit for India. Current account deficit as a percentage of GDP also rose from 0.67% in 2007 to 5.0% in 2012. This prompted the policymakers to adopt an inward-looking policy by increasing tariffs, particularly on electronics, mechanical and electrical items. During the last decade, simple average tariffs for India rose 25% from 8.9% in 2010-11 to 11.1% in 2020-21. The proportion of tariff lines exceeding the 15% mark rose from 11.9% in 2010-11 to 25.4% in 2020-21.

The *atmanirbhar* drive

The idea of taking protectionist measures do not bode well if you are building long-term capability for manufacturing high-technology intensive items. To reduce dependence on foreign imports, the government of India launched programmes such as the National Manufacturing Policy in 2011.Subsequently, schemes like Make in India (2014) and the Atmanirbhar Bharat Abhiyan (2020) were also launched.

Additionally, several instruments were introduced. Schemes such as Focus Market Scheme (FMS) and Production Linked Incentive (PLI) were launched. Under FMS, the government is providing incentives on exports that can be used later to settle against future import duties on raw material to be used for exports.

PLIs were given in the form of tax rebates, import and export duty concessions, and easier land-acquisition terms such as a cut in the land-registration tax. The idea is to enable foreign and domestic firms to invest in greenfield and brownfield projects.

China's entry into the WTO in 2001 led many foreign multinationals invest in that country. Technology-advanced foreign companies entered into a joint venture with their Chinese counterparts, eventually making the latter more productive.

India is following a similar playbook and hoping that the government schemes will lead to increase in competitiveness of its firms in the pharmaceutical, medical equipment, electronics, telecom, automotive components, advance chemical batteries, and textile sectors. In fact, to facilitate technology transfer from developed countries, foreign direct investment (FDI) in the pharma and medical-equipment sectors has been allowed up to 100% through the automatic route.

The move has already been proved beneficial to some sectors. For example, in the case of high-value-added pharmaceutical exports such as formulation and vaccines, India is doing well. The share of domestic value-added content in foreign final demand went up by 6.2%, from 32.6% in 2005 to 38.8% in 2016. Collaborations between Indian generic pharma companies with the global MNCs — Piramal Healthcare with Abbott Laboratories, Ranbaxy Laboratories with Daiichi Sankyo, Dr. Reddy's Laboratories with GlaxoSmithKline, Shantha

Biotechnics with Sanofi-Aventis, and Biocon with Bristol-Myers Squibb – have helped Indian firms move up the value chain.

The PLI scheme has seen foreign smartphone manufacturers such as Foxconn, Wistron, Nokia, Coral Telecom, to name a few, showing interest in investing in India. This is likely to enhance competitiveness and productivity growth for the Indian manufacturing firms operating in the electronic circuits and smartphone domains.

Gaps that need a fix

While these schemes are a welcome move, there is a need to look at some of the domestic distortions that are hurting export competitiveness. Consider the case of textile and aluminium industries. India's textile and apparel industry, a USD150billionsector employing close to 100 million people. The same is the case with the manufacturers of finished aluminium products, especially makers of automotive components and engineering goods. Both these sectors are labour intensive and an increase in exports will have a multiplier effect on job creation.

However, exports from these sectors stagnated between 2010 and 2019. For this, domestic policies are to be blamed. In India, apparel items below USD14 (INR1,000) attract a Goods and Services Tax (GST) of 5%. For apparel items exceeding USD14, the GST rate is 12%. Even such a lower indirect tax can be detrimental for export competitiveness. For any manufacturer in the textile industry, they also need to invest in value-added services such as marketing, warehouse rentals, logistics, courier, and other product-fulfilment costs. However, these additional activities attract a GST rate of 18%. All these taxes add up to 5% price differential between the Indian and its competitor firms from Bangladesh and Vietnam in the international market.

The same goes for manufacturers of aluminium automotive components.These are finished products made with raw aluminium. There are three primary producers of raw aluminium in the country, two in the private sector (Hindalco and Vedanta), and the third one is in the public sector (Nalco).These three big players control over 90% of the raw aluminium market in India.

The government has protected the raw-aluminium industry by imposing a custom duty of 8.35% (basic plus ad valorem duty) which makes Indian

manufacturers producing final aluminium products such as automotive components less competitive in the world market.

Additionally, the GST rate on aluminium automotive products is 18%, which is among the highest in the GST slab. This makes the business unsustainable even in the domestic market. In the world market, Indian companies lose out to their Chinese counterparts, where the government gives 16% subsidy to manufacturers of final aluminium automotive products.

Inverted duty structures were in fact responsible for the failure to develop technology-intensive electronic and auto-component sectors. Although FDI came in, most part of it went towards importing final electronic components, thereby increasing trade deficit. The idea of integrating Indian firms to the Asian value-chain network never happened because of inverted duty structure that favoured imports of finished products, but not their components.

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