NITYA
tax associates

THE GREAT INDIAN TRADE WALL: A CASE OF MEASURED PROTECTIONISM - *ANALYSIS OF INTERNATIONAL TRADE MEASURES IN BUDGET 2020*

INTERNATIONAL TRADE MEASURES IN BUDGET 2020

The Union Budget, 2020-21 may not be remembered as an epochal budget, such as the budget of 1991, but it will certainly be remembered for effecting a tectonic shift in the nation's policy towards international trade. The changes in customs sphere such as increase in customs duty on finished goods as well as certain raw materials, stringent measures to ensure FTA compliances, introduction of tariff quota as safeguard measure and enabling provisions for imposition of non-tariff import restrictions, all indicate a protectionist trend - a U-turn from LPG – liberalisation, privatisation and globalisation advocated since 1991. This shift was first noticed in the Budget speech of 2018-19, which announced a "calibrated departure from the underlying economic policy of reducing customs duty".

The Government aims to augment domestic value addition and safeguard the domestic industry by disincentivising import of goods, imposing minimum quality standards to prevent influx of low-quality goods and prevent fraudulent availment of FTA benefits.

In this article, the authors attempt to critically analyse India's protectionist stand and test the same on the anvil of fundamentals of economics.

BACK GROUND TO INDIA'S EXIM SCENARIO

Post-independence, the nation's fledgling economy required crutches of protectionism for survival. However, relentless protectionism till the 90's stunted the nation's economic growth until the country open its gates for global trade in 1991.

The introduction of LPG, heralded promotion of private enterprises and reduction in tariff barriers. The Government started executing bilateral and multi-lateral preferential / free trade agreements ('FTAs') to promote international trade. These measures gave a new thrust to the Indian economy. On the domestic front, lack of proper infrastructure prevented India from becoming a manufacturing giant, despite being in possession of great capability. Most of the multi-national companies in India merely undertake assembly operations. The surge in import of cheaper and poor quality electrical and electronic goods, plastics, chemicals, mechanical appliance etc., has hurt Indian manufacturers. Resultantly, over a period of time, India's trade deficit (i.e. import minus export) has been steadily increasing especially with specific countries like China alone accounts for 56 percent of total deficit, followed by Hong Kong (14.5 percent), South Korea (13.3 percent) and Japan (11.6 percent).

This situation has often been made worse by a haphazard change in customs duties over the years. It is in this context that the current budgetary measures deserve analysis.

ANALYSIS OF MEASURES

Indigenisation v. globalisation

The most significant hike in import duty on finished products and parts has been made for electrical appliances, mobile phones, commercial vehicles and electric vehicles. The underlying intent seems to disincentivise import of such finished goods and simultaneously increase their indigenisation. Theoretically, this sounds good, but it is important to consider few facts. Companies undertaking manufacture of technological products in India, import raw materials owing to dearth of quality domestic variants. Importantly, Indian exports incorporate imported goods to the extent of 50 percent of their value majority of these imported goods (nearly 50 percent) are used for making export products. When the domestic manufacturers produce for the international market, the goods need to be competitive on quality as well as cost front. The Chief Economic Advisor in its Economic Survey also advised for reduction of customs duty on import of raw materials. Accordingly, hike in customs duty on imported parts will not bode well for companies engaged in manufacture of technological products.

The present move also seems to contradict the Government's 'Assemble in India' campaign. This remodeling of the 'Make in India' campaign was aimed to increase India's exports by targeting the lowest level of value addition – assembly. This is how China integrated its domestic manufacturing industries with assembling units for catering to global 'network product' companies. In the midst of US-China trade war, it was prudent for India to focus on assembly and cater to global manufacturers looking at alternatives to China. However, with customs duty hike on certain imported raw materials, it seems as if the Government is not fully committed to its 'Assemble in India' campaign.

Defending the home turf: Non-tariff barriers and Tariff Quotas

Apart from bringing tariff barriers, the Government is equally stressing on non-tariff barriers by imposing restrictions on import of goods causing injury to nation's economy. Off late, tariff barriers have become unpopular in international trade and India's FTA partners viz., South Korea, Japan and Thailand are increasingly imposing non-tariff restrictions to control import of goods they deem undesirable. The Ministry of Commerce and Industry has recently directed Bureau of Indian Standards to frame standards for over 4,500 tariff items. Also, the DGFT has cautioned importers against adopting "Others" HSN for classifying imported goods. Such measures will not only protect domestic market from excessive competition but will ensure availability of quality products in the Indian market.

The Government is also trying to protect domestic industry through imposition of tariff quota; a first for India . The term 'quota' in the context of International trade is a measure enabling a country to completely restrict import of a product once its import exceeds a prescribed limit. The term 'tariff quota' is a measure where-under higher tariff (customs duty) is imposed on import of a product on breaching such limit. While the former is prohibited barring few exceptions, the latter is a commonly used tool to safeguard economy from influx of undesirable goods. However, the rules made for implementing the same, needs to comply with the WTO's Agreement on Safeguards.

To address the rising concerns regarding abuse of FTA benefits through fraudulent Country of Origin certificates ('CoO'), the Government has inserted another set of checks and measures. The customs authorities have been given infinite powers to challenge CoOs and even suspend FTA benefits upon non-satisfaction. Undoubtedly, the free reign allowed to customs officers may not augur well for bona fide importers. Such unilateral act on India's part may not augur well with the partner nations particularly when two sovereign nations have consented to CoO as an evidence of Country of Origin of imported goods in their bilateral agreement. But the Government's stance seems quite non-negotiable in this regard particularly as India pulled itself out of Regional Comprehensive Economic Partnership ('RCEP') since its demand for imposition of stringent CoO compliances between member nations and introduction of safeguard measures were not accepted by the forum.

CONCLUSION

One may view the above measures as restrained protectionism to say that the Government is testing the protectionist hypothesis before taking a definitive stand. The other view is that these are fundamental measures which every developing nation needs to adopt, and India is late to the game. Although some protectionism is necessary in the current economic scenario, these measures must not be completely divorced from ground realities. The Economic Survey points out several crippling setbacks faced by an Indian manufacturer, viz. high logistics cost, overwhelming compliances, lack of proper manufacturing infrastructure etc. A manufacturer is required to comply with over 50 legislations and overcome humongous logistical barriers. One may boast of India's progress on World Bank's rankings of 'Ease of Doing Business' but we still lag way behind on certain basic parameters. Till we enhance our internal capabilities, any trade barrier will only lead to economic inefficiency and impact the choice and purchasing power of Indian consumers'.

The authors firmly believe that 'Make in India' must not be a mere reproduction of the 'Swadeshi movement' but must recalibrate to suit the needs of current economy. Post-modern economics favours inter-dependence rather than independence by promoting international trade and eliminating barriers to free trade. Therefore, India cannot oscillate between being aspirational on export front and being extremely cautious on import front. International trade functions on reciprocity, and Indian exports may face the backlash of global distrust.

To sum up, the aspirations and objectives of the Government are fairly clear viz. boost Indian exports, protect domestic market and promote indigenous goods. However, the road map seems unclear, at best, it is a work in progress. All said and done, what the Indian market requires at this stage is certainty in the economic policy for international trade. Instead of fluctuating tariffs on different products in each Budget, the Government must set a definitive trend so that businesses can better plan and align their operations.

[1] NITI Aayog – A Note on Free Trade Agreements and their Costs
[2] The Economic Survey of 2019-20 noted that India's Import Elasticity of Exports stood at 1.1 i.e. for a 1 percent increase in imports there is a 1.1 percent increase in exports
[3] Amendment to Section 11 of the Customs Act, 1962
[4] Amendment to Section 8B of the Customs Tariff Act, 1975
[5] Economic Survey, 2019-20, Volume I, Chapter 6

Puneet Bansal
Managing Partner
NITYA Tax Associates

Sneha Ghosh
Associate
NITYA Tax Associates