Chapter -3

REVIEW OF LITERATURE (PART I)

INDIA – THE FOREIGN TRADE POLICY 2015-2020 AND FREE TRADE AGREEMENTS (FTA)

One of the objective of the research is to study the government export incentive schemes and various free trade agreements signed by government of India to ASEAN countries. Researcher has already explained economics of India, Thailand, Indonesia and Vietnam in previous chapter. It is important to study the Foreign Trade Policy of India and Free Trade Agreement between India and ASEAN countries along with the implication of FTA on India and select countries.

The best document to study export policies are “INDIA -The Foreign Trade Policy 2015-2020, published by Ministry of Commerce and Industry Department of Commerce. (Notification dated 1st April 2015) and ASEAN-India Trade in Goods (TIG) Agreement which was signed in Bangkok on 13 August 2009 by government of India. The researcher has taken review of both these documents and explained below.

The new five-year Foreign Trade Policy, 2015-20 provides a framework for increasing exports of goods and service as well as generation of employment and increasing value addition in the country, in keeping with the “Make in India” vision of our Hon’ble Prime Minister. The focus of the government is to support both the manufacturing and service sector, with a special emphasis on improving the ease of doing business.

This foreign trade policy (FTP) is also accompanied by a detailed FTP, which explain the vision, goals and objective supporting foreign trade policy and lays down a road map for India’s global trade engagement in the coming years. One of the important organization in channelizing government policies are Directorate General of Foreign Trade. The details of DGFT are given as below.
3.1. DGFT (Directorate General of Foreign Trade)

Directorate General of Foreign Trade is a government organization in India and responsible for the formulation of Exim guidelines and principles for Indian importers and exporters of the country and its objective is promoting Indian exports.

3.1.1 Functions of DGFT:

- DGFT’s main function is to implement Foreign Trade Policy of India by introducing various schemes and guidelines.
- DGFT perform its functions in coordination with state governments and all the other departments of Ministry of Commerce and Industry, Government of India.
- To Grant Exporter Importer Code Number for various Exporter and Importers. (IEC-IMPORT EXPORT CODE)
- DGFT permits or regulate Transit of Goods from India.
- To promote trade with countries and grant the permission of free export in Export Policy Schedule 2.
- DGFT also play an important role in controlling DEPB (Duty Entitlement Pass Book) Rates.
- To set standard output-input norms.

3.2 Simplification and Merger of Rewards Schemes

Earlier policies are having different 5 incentive schemes for different segments for e.g. for Agriculture sector incentive scheme is Agriculture Infrastructure Incentive Scrip. All these schemes are merged into 1 scheme called Merchandise Export from India Scheme (MEIS). Below in detailed researcher has explained MEIS & earlier schemes merged in MEIS.

3.2.1 Merchandise Exports from India Scheme (MEIS)

Earlier there were 5 different schemes viz.

- Scheme No 1 -Focus Product Scheme
• Scheme No 2- Market Linked Focus Product Scheme
• Scheme No 3- Focus Market Scheme
• Scheme No 4- Agriculture Infrastructure Incentive Scrip
• Scheme No 5- Vishesh Krishi and Gram Udyog Yojana

For rewarding merchandise exports with different kinds of duty scrips with varying conditions attached to their use. Presently every one of these plans have been converted into a one scheme called Merchandise Export from India Scheme (MEIS) and there would be no conditionality attached to the scrips issued under the scheme. These rewards are calculated basically on FOB value of the products.

3.2.2 Service Exports from India Scheme (SEIS)

Served from India Scheme (SFIS) has been replaced with Service Exports from India Scheme (SEIS). SEIS shall apply to ‘Service Providers located in India’ instead of ‘Indian Service Providers’. Thus SEIS provides for rewards to all Service providers of notified services, who are providing services from India, regardless of the constitution or profile of the service provider.

The rate of reward under SEIS would be based on net foreign exchange earned. The reward issued as duty credit scrip, would no longer be with actual user condition and will no longer be restricted to usage for specified types of goods but be freely transferable and usable for all types of goods and service tax debits on procurement of services / goods. Debits would be eligible for CENVAT credit or drawback.

3.2.3 Incentives (MEIS and SEIS) to be available for Special Economic Zones (SEZs)

Duty credit scrip to be freely transferable and usable for payment of custom duty, excise duty and service tax. All schemes issued under SEIS + MEIS and the merchandise imported against these schemes are completely transferable.

Schemes can be used for the following:

• To make payment of customs duty for import of input/raw material including capital goods.
- To make payment of excise duty on domestic procurement of Raw Material/inputs or goods, including capital goods as per notification released by DoR.
- Various payment of service tax on procurement of services as per notification released by DoR.
- To make payment of basic customs duty paid in cash or through debit under Duty Credit Scrip can be taken back as Duty Drawback as per DoR Rules, if imported inputs are used for export.

3.2.4 Status Holders

Business pioneers who have successfully added exports are proposed to be seen as Status Holders and given exceptional treatment with a particular finished objective to reduce their trade costs and time. Earlier it is known as 1) Export House, 2) Star Export House, 3) Trading House, 4) Star Trading House, 5) Premier Trading House, all this has been now changed to One, Two, Three, Four, Five Star Export House. The criteria for toll execution for affirmation of status holder have been changed from Rupees to US dollar benefit.

Table 3-1 :- Criteria for obtaining export house status.

<table>
<thead>
<tr>
<th>Status category</th>
<th>Export Performance FOB/ FOR (as converted) Value (in US$ million) during current and previous two</th>
</tr>
</thead>
<tbody>
<tr>
<td>One Star Export House</td>
<td>3</td>
</tr>
<tr>
<td>Two Star Export House</td>
<td>25</td>
</tr>
<tr>
<td>Three Star Export House</td>
<td>100</td>
</tr>
<tr>
<td>Four Star Export House</td>
<td>500</td>
</tr>
<tr>
<td>Five Star Export House</td>
<td>2000</td>
</tr>
</tbody>
</table>

**Analysis:** - Star export house status is normally given based on export performance. As shown in above table as FOB sales increases exporter get more stars & can avail more export benefits.

Manufacturers those are having Status Holders status can be self-certify their own manufactured goods as origin from India to qualify for special treatment under different Preferential Trading Agreements [PTAs], Free Trade Agreements [FTAs],
Comprehensive Economic Cooperation Agreements [CECAs] and Comprehensive Economic Partnerships Agreements [CEPAs] which are in operation. They are allowed to self-certify the goods as manufactured ref to their Industrial Entrepreneur Memorandum (IEM) / Industrial License (IL)/ Letter of Intent (LOI).

3.3 Boost to “MAKE IN INDIA”

To boost make in India concept, various initiatives taken by Government as briefed below:

A. Reduced Export Obligation (EO) for domestic procurement under EPCG scheme:

Earlier export obligation for was 90%, in case capital goods are procured from indigenous manufacturers, now reduced to 75%, in order to promote domestic capital goods manufacturing industry. Higher level of rewards under MEIS for export items with high domestic content and value addition.

In following pages researcher has discussed various initiative taken by government to boost the Make in India concept and export.

   A) Other New initiatives (EOUs, EHTPs and STPs)
   B) Niryat Bandhu
   C) Duty Exemption

B. Other new Initiatives

New initiatives for EOUs, EHTPs and STPs

EOUs, EHTPs, STPs have been allowed to share infrastructural facilities among themselves. Transfer of goods and services allowed between such units. They can negotiate and purchase centrally & then distribute to various plants. This will reduce cost of transportation, other logistic costs and result in maintaining effective supply chain.

EOUs have been permitted office to setup Warehouses close to the port, this will help to expedite the delivery.
STP units, EHTP units, software EOUs are allowed to use duty free equipment for training & develop skills of their employees.

100% EOU units have been allowed facility of supply of spares/components up to 2% of the value of the manufactured articles to a buyer in domestic market for the purpose of after sale services.

Such several facilities are given to boost Make in India.

**B. Niryat Bandhu**

Hand Holding Scheme for new Export/import business establishments.

DGFT is executing the Niryat Bandhu Scheme for helping new and potential exporter on the complexities of foreign trade through guiding, counseling, training to them. Focus is given to Small & Medium Scale industries to boost exports from them.

**C. Duty Exemption:**

Imports against Advance Authorization is free from all type of taxes, or any specific safeguard duty. Even imports of Capital goods under EPCG scheme is also exempted from all such anti-dumping, safe guard duty.

(Source-Foreign Trade Policy 2015-20)

**3.4. Free Trade Agreements (FTA’s):**

Other important document to understand trade relation between India and ASEAN countries is ASEAN-India Trade in Goods (TIG) Agreement which was signed in Bangkok on 13 August 2009.

Following are the details reviewed by researcher on Free trade agreement. Following advantages from trade are predicted by economic theory:

- Economic growth.

- Fall in prices after tariff reductions due to increased economies of scale as well as greater competition between firms.

- An increase in the variety of products available to consumers.
• Self-selection of firms with only the efficient firms surviving after trade Liberalization.

• Employment and wage effects associated with greater trade.

• Attracting Foreign Investments.

After understanding concept and advantage of Free trade Agreements, researcher has studied the FTA between India ASEAN countries and impact of FTA on selected countries.

3.4.1 ASEAN-India Free Trade Agreement (AIFTA)

ASEAN means the Association of Southeast Asian Nations which includes Brunei Darussalam, the Kingdom of Cambodia, the Republic of Indonesia, the Lao PDR, Malaysia, the Union of Myanmar, the Republic of the Philippines, Singapore, the Kingdom of Thailand and the Vietnam India started putting lot of emphasis on increasing trade relations with ASEAN countries in recent years. India has also signed FTA collectively with ASEAN Member States and individually as an ASEAN Member State. At long last, ASEAN and India signed the ASEAN-India Trade in Goods (TIG) Agreement in Bangkok on 13 August 2009 after so many negotiations of 6 years. Because of that in the most recent couple of years India's fare to ASEAN has expanded generously.

This FTA proposes to gradually slash tariffs for over 4,000 product lines over a staggered period, by 2016. However, certain specified products on both sides will be shielded to some degree. ASEAN-India bilateral trade has been growing steadily from 1993 and stood at US$ 43.9 billion as of 2009-10 with ASEAN”s export to India at US$25.79 billion and imports from India at US$ 18.1 billion as of the same year. As for foreign direct investment (FDI), the inflow from India to ASEAN member States was US$ 476.8 million in 2008, accounting for 0.8 per cent of total FDI in the region. Total Indian FDI into ASEAN from 2000 to 2008 was US$ 1.3 billion.

Indonesia's share of imports was the highest at 34% of India's total imports from ASEAN, followed by Malaysia (22%), Singapore (20%), and Thailand (13%). Though there has been a large increase in-trade flows, there is still potential for enhancing trade cooperation between India and ASEAN.
Table 3.2 India’s merchandise trade with ASEAN (All fig in Bn $)

<table>
<thead>
<tr>
<th>Year</th>
<th>Export to ASEAN</th>
<th>Import from ASEAN</th>
<th>Trade turnover</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-2001</td>
<td>2.91</td>
<td>4.15</td>
<td>7.06</td>
<td>-1.24</td>
</tr>
<tr>
<td>2001-2002</td>
<td>3.46</td>
<td>4.39</td>
<td>7.85</td>
<td>-0.93</td>
</tr>
<tr>
<td>2002-2003</td>
<td>4.62</td>
<td>5.15</td>
<td>9.77</td>
<td>-0.53</td>
</tr>
<tr>
<td>2003-2004</td>
<td>5.82</td>
<td>7.43</td>
<td>13.25</td>
<td>-1.61</td>
</tr>
<tr>
<td>2004-2005</td>
<td>8.43</td>
<td>9.11</td>
<td>17.58</td>
<td>-0.68</td>
</tr>
<tr>
<td>2005-2006</td>
<td>10.41</td>
<td>10.86</td>
<td>21.3</td>
<td>-0.45</td>
</tr>
<tr>
<td>2006-2007</td>
<td>12.61</td>
<td>18.11</td>
<td>30.72</td>
<td>-5.5</td>
</tr>
<tr>
<td>2007-2008</td>
<td>16.41</td>
<td>22.68</td>
<td>39.08</td>
<td>-6.27</td>
</tr>
<tr>
<td>2008-2009</td>
<td>19.14</td>
<td>26.2</td>
<td>45.34</td>
<td>-7.06</td>
</tr>
<tr>
<td>2009-2010</td>
<td>18.11</td>
<td>25.8</td>
<td>43.91</td>
<td>-7.69</td>
</tr>
<tr>
<td>2010-2011</td>
<td>25.63</td>
<td>30.61</td>
<td>56.24</td>
<td>-4.98</td>
</tr>
<tr>
<td>2011-2012</td>
<td>36.74</td>
<td>42.53</td>
<td>79.27</td>
<td>-5.79</td>
</tr>
</tbody>
</table>

(Source:-Indian Ministry of Commerce and Industry)

Analysis – It is observed that trade has substantially increased between India and ASEAN countries. After FTA in 2009, it has almost doubled from 45 Bn $ to 80 Bn $. However, the last column is showing balance of trade i.e. difference between total export & total import. It has been observed that Total imports from ASEAN countries is more than total exports made by India to ASEAN countries. Balance of trades increased in 2008 to 2010, however again reduced in 2010-2012. It is also important to notice that the Imports are more than the exports, however it is quite possible as India as a single country having trade with 11 different ASEAN countries and lot of natural minerals like coal, rubber, iron ore ar imported to India from ASEAN countries.

3.4.2 Impact of FTA on Indonesia

The economic crisis of 1997 -98 forced Indonesia to liberalize its domestic market based on the International Monetary Fund (IMF) led restructuring and reforms program. The automotive policy in Indonesia was modified and revised during the process of liberalization of domestic market.

A) Withdrawal of incentives for local content usage

Lower import tariffs for completely knocked down (CKD) and completely built unit (CBU) vehicle units Removal of restrictions on importing CBU vehicles
The liberalization policy changed the automotive industry and permitted local assemblers to import components from competitive suppliers. This enabled automotive components supplier to become efficient and competitive. The policy brought in competition from the imported vehicle segment creating a more competitive vehicle industry in Indonesia. Indonesia implemented the AFTA in 2002. Implementation of AFTA had a high impact on the automobile industry. Manufacturers have been able to bring down their costs through the ASEAN Industrial Cooperation Scheme (AICO) scheme, in which traded automotive components within ASEAN are subjected to a maximum tax of 5.0 percent. The AICO was a prelude to the formation of the AFTA. The trading countries however, need to have at least 30 percent local interest or equity. Participating companies must also fulfill 40 percent local content requirement. Tariff rates for components have been declined to 0-5 percent under the Common Effective Preferential Tariff (CEPT) agreement, an AFTA mechanism. Both these arrangements reduced the cost of production and have led to lower vehicle prices in Indonesia.

B) Import duties and luxury taxes

According to the new automotive policy formulated, there are no restrictions to Indonesia on importing new automobiles and their components. Indonesia was one of the first ASEAN countries to liberalize its automotive components market. No tax concessions are available for use of imported components based on the degree of local content achieved. Import tariffs have been reduced across the board for the completely knocked down (CKD) kits and other components. They have been using the ASEAN Industrial Cooperation (AICO) scheme, in which traded automotive components within ASEAN are subjected to a tax ceiling of 5 percent. The trading countries however, need to have at least 30 percent local interest. Liberalization has increased competition in the OEM and aftermarket. Assemblers are not forced to use local content and are free to obtain cheaper components elsewhere. Accession of imported components from Asia is increasing and the aftermarket segment is becoming more attractive. The domestic manufacturers are facing attrition and a more competitive and efficient components industry is emerging in Indonesia.
3.4.3 Impact of FTA on Thailand

The Automotive Policy of Thailand underlines the export expansion policy of the Thai automotive industry. Thailand has signed FTAs with Australia, New Zealand and China in 2005, with India in 2006 and with Japan in 2007. The Free Trade Area (FTA) agreement with Japan was perceived to be a threat for the automotive components industry in Thailand. Contrary to popular assessment that this agreement will reduce the demand for the locally manufactured components, it has enabled Thailand emerge as the manufacturing base for Japanese OEMs. Thailand has complied with the WTO and the AFTA regulations by liberalizing its automotive market completely.

Numerous car vehicles and parts MNCs have put resources into the household market in Thailand and have exchanged assets and innovation into the business. These variables profited the segment producing industry in Thailand as far as having admittance to the most recent assembling innovation. Inside the ASEAN district, Thailand remains the main exporter of auto segments to Japan, representing about portion of all fares from ASEAN, trailed by Indonesia and the Philippines, whose particular shares every record for right around a fourth of aggregate fares. India-Thailand FTA containing 82 things, including a couple of car parts, for example, lighting gear, suspension and transmission segments, these things have been proceeded onward a tax lessening in three squares starting March 1, 2004 and finished on March 1, 2006, running from 50 to 75 to 100% diminishment in taxes.

3.4.4 Impact of FTA on Vietnam

Vietnam can turn into a center point for auto parts supply in the ASEAN local by using its upper hands. Vietnam joined ASEAN in 1995 and has part in AFTA since 1996. In 1998, it turned into an individual from Asia-Pacific Economic Cooperation and picked up WTO participation in 2007. Vietnam right now gives 6 percent of the aggregate auto segments sends out from ASEAN to Japan. Worldwide Japanese segments suppliers that have built up minimal effort operations with the end goal of sending out back to Japan create most sent out segments. Charges relevant to the car and auto segments industry are intended to support sends out and ensure nearby creation. This strategy is upheld by critical corporate expense motivations accessible
to recently settled organizations, especially to organizations situated in speculation zones or working in supported areas. Most recent seven years of promotion to the WTO, import obligations relevant to totally assembled units (CBUs) and parts will be decreased. Import obligations on CBUs could be decreased up to 50 percent. Under the WTO, motivating forces in light of fare proportions might be evacuated. New motivating forces in view of other criteria would apply.

One of the positive impacts of Vietnam’s WTO membership on foreign direct investment is: -

Duty Reduction: Import duty are reduced for merchandise utilized as inputs for residential generation and also private and Government utilization. By and large, import duty rates on inputs for delivering sends out and different products, for example, apparatus and hardware have been decreased amid the WTO transaction process. In addition, exporters are discounted import obligations on inputs utilized for creating sends out. Vietnam is really occupied with a large number of exchange contracts.

3.5 FTA – India –Thailand Case Study

To Understand enhancement of Trade between two countries due to FTA, let’s take example of: - INDIA – THAILAND Bilateral Trade

India and Thailand have an excellent relationship in trade and business. Trade between India and Thailand is growing at an amazing rate. Diplomatic relations between India and Thailand were established in 1947, soon after India gained independence. India started a policy in 1993 which was named 'Look East Policy' and the same strategy was developed by Thailand too, which was named 'Look West Policy' in 1996. India's Look East Policy and Thailand's Look West Policy set the stage for a substantive consolidation of bilateral relations.

The two countries have also decided to increase the trade between each other from $6.7 billion in 2010 to its double in 2014. Major items of Thai exports to India include: machinery and machinery appliances; organic chemicals; electrical machinery and parts; rubbers; plastics; auto parts/accessories; fabrics; refrigerator compressors. Major items of Thai imports from India include: precious and semi-
precious stones; machinery and machinery appliances; iron and steel; auto parts/accessories and medicinal and pharmaceutical products. India has also inked a Free Trade Agreement (FTA) with Thailand for setting up of a free trade area covering goods, services and investment. The Indo-Thai FTA covers as many as 84 items and several areas in the first phase including services, investment, economic cooperation and goods like food items, tourism, auto parts and electronic goods.

Table 3-3 India’s trade with Thailand

<table>
<thead>
<tr>
<th>INDIA trade with Thailand (US$ MILLOINS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
</tr>
<tr>
<td>Export</td>
</tr>
<tr>
<td>Growth (%)</td>
</tr>
<tr>
<td>Import</td>
</tr>
<tr>
<td>Growth (%)</td>
</tr>
<tr>
<td>Total Trade</td>
</tr>
<tr>
<td>Growth (%)</td>
</tr>
</tbody>
</table>

(Source: -Government of India, department of commerce)

Analysis - Trade between India and Thailand is also growing. It has reached to 83Mn$ from 46Mn$ from 2009 to 2012. However the balance of trade in negative i.e. more imports from Thailand than India. Thailand is gaining more advantage of FTA in comparison to India.

3.6 Potential Negative Effects of FTAs: -

So far we have seen various advantages and benefits due to various FTA’s between countries. However, FTA can have certain disadvantages or negative impacts, which is summarized below: -

- Trade Diversion: Trade diversion refers to the possibility of an FTA member country switching its import supplier from a more efficient (low cost) country to a less efficient member country resulting in an inefficient allocation of resources.

- Dumping: Dumping refers to the practice of a foreign country selling its product in the home market at a price that is lower than its “fair value”. While this can occur
even in the presence of trade barriers, the elimination of tariffs in the home country increases the probability of this occurrence and can cause considerable harm to domestic industries that can be driven out of business altogether.

• Unemployment: The reduction of tariff barriers leads to greater competition in the domestic market for the imported product leading to loss of market share and laying off of workers in that sector. In the short run, this kind of dislocation can cause considerable hardship to the affected workers.

• Excessive Dependence: Free trade can result in the shutting down of a number of industries that are unable to compete with cheaper imports. This may lead to excessive dependence on foreign supplies for a number of commodities – a situation that could have adverse effects if there were a disruption in any of the foreign supplies.

Finally, we find ample evidence to suggest that the FTA will open up opportunities for Indian businesses in Malaysia, Singapore, Indonesia, Thailand and Philippines. Important initiatives announced by the respective governments in these countries as well as projects with open tenders that will become accessible to Indian businesses to further their business interests in these countries. These opportunities will result in enhancing the growth of key businesses in these sectors with the benefits of income and employment generation in India that will add to the India growth momentum.

Summary
The new Foreign Trade Policy 2015-2020 is really a simplified policy, which will really help to boost export from India. 5 different incentive schemes which were in exist in past are now merged in one simplified scheme as MEIS for goods & SEIS for various services. This scheme will definitely help the exporters to take advantage of these incentive schemes and boost the exports. Star house status is also helping various exporters to take advantage of various facilities to make export easy. Even Tyre and Wheel manufacturers chosen for this study will also be benefited by MEIS scheme and can become cost competitive in export market.
Even the free trade agreements done by India with various South East Asian countries will help to improve the trade between India and selected countries. It is also observed that overall trade has increased between India and ASEAN countries after signing of FTA. Tyre and Wheel industry will also certainly have benefited by this free trade agreement and import duty is likely reduced in selected countries.

Researcher will also study the actual benefits of MEIS as well as Import duties for Tyre and Wheel industry. It will also compare such advantages availed by other countries while exporting Tyres and Wheels to selected South East Asian countries. Based on actual data and above study Gaps will be found out and suitable suggestions will be done to government bodies for improvements.