Why not zero-rate exports?

India's merchandise exports grew at 12% per annum for the period April to December in this fiscal year. This is a decent pace considering that until the middle of 2016, exports had been contracting for more than 18 months in a row. But the sobering fact is that even with 12% growth this year, the total annual exports achieved as of April 2018 will be lower than the corresponding number in April 2014. In four years, despite our relentless focus on manufacturing, on the ease of doing business, competitiveness and foreign direct investment, the total increment in exports is less than zero.

One can offer many explanations such as global shrinkage of trade (but India's loss of share was disproportionate); or the impact of falling commodity prices (crude fell by 60%, and one-fifth of India's exports are petrol and diesel); increased protectionism in the era of Donald Trump; more recent disruptions caused by demonetisation and the goods and services tax, or GST (upsetting small, medium and informal enterprises in the value chain). Other reasons are the domestic handicap of higher infrastructure and logistic costs and the burden of taxation. These latter factors are captured in India's competitiveness, which has improved its its global ranking. One other factor is India's virtual absence in global value chains (GVCs). The iPhone travels through multiple stages across countries and assembly lines before being sold as "made in China". Each step in that value chain is an "export" earning for the respective country, however small it may be. What is true of phones and electronics is also true of textiles and machinery. As India negotiates further trade liberalization with 15 other countries in a mega deal called the Regional Comprehensive Economic Partnership (RCEP), it will demonstrate greater willingness to embrace GVCs.

Note that the GVC concept is contradictory to our earlier stance of insisting that free trade agreement should entail substantial value addition in the partner country, and not just a minuscule GVC increment. International trade is much more between internal departments of the same company located in different countries, than between nation states. Unfortunately, trade statistics still continue to measure inter-nation trade, without discounting how much of that is simply intra-firm trade.

crackIAS.com

These reasons might partly explain the lacklustre export performance. It becomes even more worrisome when we compare it to East Asian peers like Thailand, Malaysia or South Korea. These countries do not export petrol and diesel, nor are their exports dominated by minerals and ore or primary products. Even with the uncertainty caused by neighbouring North Korea's nuclear stance, the southern neighbour clocked high export growth. This is also the year when the global economy is experiencing synchronized growth and boom, with the International Monetary Fund revising many forecasts upwards. India's exports have traditionally responded strongly to improvements in global economy outlook, but so far the indications are not strong enough.

Surprisingly, most of the Fortune 500 companies have a presence in India, and many have manufacturing facilities. They are not here simply doing tariff jumping, to be able to cater to the domestic market. Many firms, most notably in automotive and chemicals, use India as a manufacturing hub to export in the region and globally. If they have found India attractive to invest, why are manufacturing exports not more robust? India also has a limited window to capture the space being vacated by China in labour-intensive manufacturing. These too are not relocating to India as fast as they move to, say, Vietnam, Bangladesh or even Sri Lanka. But India has the scale.

One particular factor which can be addressed immediately is the burden of inter-state or integrated GST (IGST). One of the cardinal principles of trade is that you do not export taxes. The GST reform in India moved all indirect taxes to a consumption type, destination-based tax system, with input credit based on invoices. For within-states consumption, there is central GST (CGST) and

state GST (SGST). For inter-state sale where consumption is outside the state which is supplying (or producing) the good or service, the applicable tax is CGST and IGST. For exports, since consumption is outside the country, it will and should not be taxed as per the cardinal principle. It should be zero-rated, i.e. a GST rate of zero, and all input tax credits are paid to the exporter. Imports have to pay GST since consumption occurs in India. Unfortunately, in its current design, exporters pay IGST and then apply for a refund. Since refunds can be delayed by as much as six months, that cost of capital which is locked up, is a non-reimbursed cost. With wafer-thin margins of profit, this cost of delay can wipe out the exporter. The GST council gave some relief, by substituting a bank guarantee or letter of credit in lieu of actual payment of IGST by exporters. This is a poor substitute, and bank charges will continue to apply. There is also a discussion of a digital wallet, or tradable IGST credits. All this is band aid. We must do away with IGST and zero-rate all exports. In a well-argued policy paper, Vijay Kelkar and V. Bhaskar argue for a cleaner IGST mechanism to not just give exporters a level playing field, but also make inter-state commerce simpler.

For India to realize its full export potential, and to increase its share of manufacturing in the economy, to create industrial jobs on a large scale, much needs to be done. This includes fiscal incentives for exports, appropriate exchange rate management, improved logistics and infrastructure, and so on. But zero-rating of IGST on exports of goods and services is an urgent priority.

Ajit Ranade is chief economist at Aditya Birla Group.

Comments are welcome at views@livemint.com

END

Downloaded from **crackIAS.com**

© **Zuccess App** by crackIAS.com

crackIAS.com