ECONOMIC LAWS PRACTICE

ADVOCATES & SOLICITORS

An Analysis of
Annual Supplement 2006 to
The Foreign Trade Policy 2004-09

The Indian Commerce Minister launched the Annual Supplement 2006 of the FTP on April 07, 2006. The FTP, as articulated by the Indian Commerce Minister, is driven by the twin objectives of doubling India's percentage share of global merchandize trade within the next five years and to act as an effective instrument of employment intensive economic growth.

This Annual Supplement is being released when India has actually started realizing its true trade potential and moreover being recognized as a serious global player in trade both in empirical as political terms.

With trade-to-GDP ratio of around 29-30% and given that Indian exports expected to reach US$ 120 billion during this fiscal, the Commerce Minister had to announce an Annual Supplement having a potential to:

1. Deepen the integration of sectors that had already created a mark on the global trade scenario;
2. Further the integration of employment intensive sectors into the global scenario so that they would have an opportunity to extract a premium from this integration;
3. Provide an impetus to indigenous sourcing; and
4. Create an environment fomenting reduction in the cost of value addition for the domestic manufacturing sector facing razor-sharp competition on Indian soil as well as globally

At the same time, the Annual Supplement had to address the intensifying concerns about export incentives within the FTP, being:

1. WTO-incompatible; and
2. Burdensome on the fiscal exchequer.

This note in the following sections tries to analyze whether these objectives have been achieved in this Annual Supplement 2006 of the FTP.

SECTION ONE: DEEPENING THE INTEGRATION OF SECTORS WITH A GLOBAL IMPRINT

The growing trade in services over the past half-a-decade has played a strategic role in integrating the Indian economy and Indian people with the global economic milieu. Accounting for around 54% of the GDP and steadily moving towards acquiring a 5% space in global services trade by 2010, the services sector had to be provided with the necessary policy stimulus from the Commerce Ministry backed by the Ministry of Finance.

The Gems & Jewellery sector contributes more than US$ 18 billion to the foreign exchange reserves. Historically, this sector has been an ambassador of our craftsmanship, enterprise and modernity. Serious challenges are emerging to Indian players in this sector due to a range of direct and indirect measures that have been adopted by Governments of Israel, Belgium, Thailand, and UAE.

With the objective of transforming India as a gems and jewellery hub, the Finance Minister took the first step in the right direct by announcing that he will be setting up a committee to understand the direct tax concerns of this sector.

The Commerce Minister, utilizing the space provided by the FTP, has introduced measures for facilitating export of value added products catering to the changing needs of the market, facilitating efficient product movement across borders and allowing import of essential inputs to the Gems & Jewellery sector.

Name of the Scheme	Salient Features added in this Annual Supplement
Scheme for the Gems & Jewellery Sector	Import of precious metal scrap / used jewellery will now be allowed to enable efficient utilization of large melting, refining and jewellery manufacturing facilities set up in the country. Re-import of rejected precious metal jewellery will now be permitted subject to restriction of certain duty exemption benefits. Permission to export jewellery on consignment basis has been awarded to overcome the problem of re-importing unsold items. Export of cut and polished stones for treatment to enhance the quality and value shall now be permitted, subject to receipt of these goods within 120 days. Reduction in the value addition norms for articles of gold / platinum / silver jewellery from 7% to 4.5% will enhance value addition at lower costs. The replacement of a bank guarantee by a legal undertaking for eligible exporters is expected to reduce transactions costs.

Served from India Scheme	The ‘Served from India Scheme’ was launched when the FTP (2004-09) was launched. The new scheme seeks to create a powerful and unique `Served from India' brand that is instantly recognised and respected the world over. The Commerce Ministry has consistently added new features to this Scheme in order to make it exporter friendly and less-resource-cumbersome. Services against which service providers can now avail benefit under this Scheme are now listed in Appendix-10 of the Handbook of Procedures (Vol.1). The scheme has been extended to the healthcare and educational service providers as well as engineering process outsourcing (EPO) and knowledge process outsourcing units (KPOU). Services exports in Indian Rupees, which are otherwise considered by the Reserve Bank of India as having been paid for in free foreign exchange, will now qualify for benefits under the ‘Served from India Scheme’. E.g. The Hotels can now allow their foreign guests to pay them in Indian rupees rather than exhorting their guests to pay in foreign currency only. With the help of language in paragraph 3.6.4.3.1 service providers can now account for foreign exchange earned through international credit cards and other RBI-permitted instruments, for the purposes of computation of entitlement under the Scheme. Benefits of the Scheme earned by one service provider of a Group Company can now be utilized by other service providers of the same Group Company. This is now applicable to managed hotels too. According to the Annual Supplement, this “measure aims at supporting the Group service companies not earning foreign exchange in getting access to the international quality products at competitive price”. This new initiative allows transfer of both the scrip and the imported input to the Group Service Company, whereas the earlier provision allowed for transfer of imported material only. The benefits that can be enjoyed by Stand-alone restaurants under this Scheme have been reduced by 10% of their FOB value of exports. Vehicles which are freely importable otherwise cannot be imported availing the benefit under this Scheme Duty free credit scrip earned under the scheme is also permitted for payment of duty in case of import of capital goods under lease financing. The benefit under the scheme is not available to Deemed Exports and exports made by SEZ and EOU units
BPOs/ITES sector	Procedural changes have been effected in order to enable players in this sector to avail of refund of Central Sales Tax. In the absence of such a benefit, the units in this sector preferred sourcing their hardware equipments from abroad. With the introduction of such a measure, the growth in demand for inputs required in this booming sector (e.g. IT equipment, computer hardware, cables etc.) will go a long way in positively impacting India-based hardware manufacturing companies.

SECTION TWO: NEW SCHEMES WITH A FOCUS ON EMPLOYMENT GENERATION, LINKING VILLAGES TO GLOBAL TRADE AND IDENTIFYING NEW MARKETS

During the last financial year, the DGFT had commissioned the Research and Information System for Non Aligned Nations (RIS) to conduct a study to analyze the impact of export led growth on employment and to identify products whose exports would generate employment both at the skilled and unskilled level in semi-urban and rural areas.

The recommendations of this study find a resonance in the 'Focus Product' Scheme introduced in this Annual Supplement.

Name of the Scheme	Salient Features added in this Annual Supplement
Focus Product Scheme	This Scheme allows duty credit facility@ 2.5% of the FOB value of exports to 50% of the export turnover of notified products such as value added fish and leather products, stationary items, fireworks, sports goods, handloom products bearing handloom mark and handicraft items. The benefit, which will accrue to exports made with effect from April 01, 2006, has been granted to offset the high freight cost and other disabilities in relation to select international markets. It is important to note that the benefit is available to entire exports. The scrip and the items imported against it would be freely transferable. The Duty Credit thus obtained may be used for import of inputs or goods including capital goods, provided the same is freely importable under ITC(HS). The exporter can avail benefit under this scheme if he is not availing benefit under Focus Market Scheme or Vishesh Krishi and Gram Udyog Yojana. The benefit under the scheme is not available to Deemed exports and units operating under SEZ scheme and 100% EOU scheme or products manufactured by them and exported through DTA units.
Vishesh Krishi and Gram Udyog Yojana (VKGUY)	The inclusion of village and cottage industries under the Vishesh Krishi Upaj Yojana (VKUY) has now transformed the name of this scheme into Vishesh Krishi and Gram Udyog Yojana. This scheme is an alternate option to the Focus Market Scheme or the Focus Product Scheme. Any one option can be exercised in respect of the same product (s). On similar lines to the VKUY, the exports of village and cottage industry products will be awarded duty free scrip @ 5% of the FOB value of exports under the VKGUY. In order to promote indigenous sourcing, a built-in incentive has been introduced under the VKGUY for exporters utilizing domestic raw materials for export production. Such exports would now get additional benefits under VKGUY @ 1.5% of FOB value of exports compared to those who use imported agricultural products who shall get benefits at a reduced rate of 3.5%.

Identification of new markets in order to diversify risks associated with trade creation has actually been an idea that our present Finance Minister had toyed during his similar tenure within the Coalition Government that was in power during 1996-98. The

Commerce Minister within this Annual Supplement has successfully integrated this idea by putting in place a 'Focus Market' Scheme.

Name of the Scheme	Salient Features added in this Annual Supplement
Focus Market Scheme	This Scheme allows duty credit facility@ 2.5% of the FOB value of exports of all products to countries that will be subsequently notified. It is widely expected that countries from the Latin American and African region that are willing to establish closer ties with India through the route of FTAs will be a part of this list. The benefit, which will accrue to exports made with effect from April 01, 2006, has been granted to offset the high freight cost and other disabilities in relation to select international markets. It is important to note that the benefit is available to entire exports. The scrip and the items imported against it would be freely transferable. The Duty Credit thus obtained may be used for import of inputs or goods including capital goods, provided the same is freely importable under ITC(HS). The exporter can avail benefit under this scheme if he is not availing benefit under the Focus Product Scheme or Vishesh Krishi and Gram Udyog Yojana. The benefit under the scheme is also not available to deemed exports and Export turnover of units operating in SEZ/EOU/EHTP/STPI/BTP or supplies made to such units or products manufactured by them and exported through DTA units.

SECTION THREE: INTRODUCTION OF NEW SCHEMES WITH AN AIM TO PHASE OUT EXISTING SCHEMES

Consumption of imported inputs in small quantities does not become a sound commercial proposition in spite of being able to avail benefit under the Advance Licence Scheme (ALS). This inability therefore compels the exporter to source high cost inputs from local markets which finally makes his product globally uncompetitive.

To address this issue, the salient features of ALS and Duty Free Replenishment (DFRC) Scheme have been clubbed to evolve the Duty Free Import Authorization Scheme.

It is also said that creation of such a scheme was necessary as the ALS was being challenged in a number of jurisdictions and therefore it was pertinent to help exporters with a Scheme that had a potential of providing benefits of ALS with a certain level of WTO-compatibility.

Due to the introduction of such a scheme, DFRC Scheme is being phased out and shall be available only for exports effected up to April 30, 2006.

Name of the Scheme	Salient Features added in this Annual Supplement
Duty Free Import Authorization Scheme	This Scheme, which will come into force from May 01, 2006, offers the facility to import the required inputs including fuel, energy, catalysts before the exports. The Scheme allows for duty free imports of specified inputs for export production as per the Standard Input Output Norms. The Authorization under this Scheme will be issued on satisfaction of 20%-value addition condition (with the exception of items under gems & jewellery and specific items for which value addition norms are prescribed) with actual user condition till the export obligation is fulfilled. However, in respect of SION Norms, which are subject to "actual user" condition or for import of fuel under the general norms or where SION norms allow import of some specific products, the authorisation shall be issued with actual user condition for these inputs and no transferability shall be allowed for these inputs even after fulfilment of export obligation. Transfer of such items shall be allowed only against import licence for that item. Imports made under this authorization will be exempt from payment of basic custom duty, additional customs duty, education cess, anti dumping duty and safeguard duty, if any. No CENVAT credit facility shall be available for inputs either imported or procured indigenously against the authorisation. Drawback shall be restricted to duty paid materials. Such Authorisation can be issued either to a manufacturer exporter or merchant exporter tied to supporting manufacturer(s) for import of inputs required in the manufacture of goods. The Authorisation can also be issued in the name of the Sub-contractor of the main contractor, provided the name of the sub-contractor(s) appears in the main contract. It allows transferability of scrip once the export obligation is complete.
Target Plus Scheme	This scheme has been withdrawn. Under the erstwhile scheme, the exporters of goods were eligible to claim duty entitlement benefit at a specified percentage of incremental exports.

SECTION FOUR: POLICY PERTAINING TO IMPORTS OF GENETICALLY MODIFIED MATERIAL

Taking cue from the adjudication associated with the dispute between EU and the US, wherein US has successfully challenged the measures adopted by the EU to stop the imports of GM products, the Commerce Ministry has been taken immediate steps to start issuing clear guidelines for import of genetically modified material.

While making such imports, products which have been subjected to genetic modification will carry a declaration stating that the product is genetically modified. In the absence of such a declaration, in spite of the product being genetically modified will only make the importer liable for penal action under Foreign Trade (Development & Regulation) Act, 1992.

SECTION FIVE: OTHER MEASURES

Second Hand Goods

The concept of ‘remanufactured’ goods has been introduced under the FTP. The remanufactured goods have been classified under the category of Second hand goods and the import of such goods is restricted against the license issued in this behalf.

However, the term remanufacture has not been defined. Therefore, to determine what constitutes “remanufacture”, reference can be made to the judicial precedence under other allied and tax laws.

The import of second hand goods particularly personal computers / laptops, photocopier machines, air conditioners, diesel-generating sets, have been restricted against the license.

EPCG Scheme

The duty saved amount in case of hotels, travel agents, tour operators or tour transport operators and companies owning / operating golf resorts under the EPCG scheme is restricted to 50% of the average foreign exchange earnings in the preceeding three licensing years.

The benefit under the EPCG scheme is now not available for import of capital goods for creating storage and distribution facilities for products manufactured or services rendered for exports by EPCG licence holder.

For existing licence holders, as an export facilitation measure, the export obligation period has been extended by a further period of 2 years on payment of 50% of the duties payable in proportion to the unfulfilled Export obligation.

Measures will also be announced to provide flexibility in maintenance of average export performance under EPCG scheme.

Facilitation to Export Houses

Two Star Export Houses and above would be permitted to establish Export Warehouses subject to guidelines issued by the Department of Revenue. The Export Warehouses can source the goods from various manufacturers in India without payment of duty for the purpose of exports.

Benefits of Un-rebated Service Tax and Fringe Benefit Tax under various Schemes

Details are being worked out for neutralization of the burden of Service tax and FBT on exports by factoring the cost of these taxes under various duty exemption and duty remission schemes.

Amendment to Export Oriented Unit Scheme

With a view to encourage EOUs and facilitate smooth and efficient operations thereof, the following amendments have been brought about in the EOU scheme:

- Procurement and export of promotional materials like brochures, posters, etc. up to 1.5% of FOB value of previous years export.
- Procurement and export of spares, components up to 1.5% of FOB value of exports provided that such exports are to the same consignee / buyer of the export goods and within the warranty period for such goods.
- The facility of supply of goods to DTA units against payment in foreign exchange from their EEFC account for the purpose of fulfilment of NFE has been withdrawn.
- Fixation of time limits for finalising the disposal of matters relating to EOU's
- Disposal of left over material by the Textile sector on the basis of previous year imports

Interest payment on Refunds

It has been decided that interest for delayed payment of refunds would be made by the Government to ensure accountability and cut delays.

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