

Chapter 3: India's trade policies

There is a detailed description and analysis of India's trade policies in the World Bank trade policy *Overview* report. This section summarizes and updates some of the principal findings of that report, and expands on some aspects that relevant for India's trade with Bangladesh.

Non-tariff barriers to imports. During the 1980s and before India had a comprehensive import licensing system under which imports of many products were effectively banned and most others were subject to stringent import licensing. The principal exceptions were inputs needed by exporters and a number of "essential" products such as foodgrains, that could only be imported by government import monopolies. The restrictions on imports of raw materials and manufactured intermediates were removed during India's 1991/92 reforms, but imports of nearly all industrial consumer goods and agricultural products continued to be restricted, either by import licensing which operated as a *de facto* import ban in most cases, or-especially in the agricultural sector- by "canalisation" through parastatals such as FCI. Among other things these import restrictions hobbled SAPTA, especially in the first two negotiating rounds in 1995 and 1997, when the other South Asian countries complained that it was meaningless for India to grant tariff preferences when the same products were subject to import licensing. In response to these complaints, in 1998 India exempted the SAARC countries from its general system of import licensing. At about the same time (following pressure at the WTO) it started removing these controls viz a viz the rest of the world, and the final 715 tariff lines were freed on April 1, 2001.

Against a background of almost 40 years of *de facto* autarchy, the abolition of this comprehensive import licensing system created considerable apprehension as to how well local producers of industrial consumer goods and of agricultural products would be able to compete with imports. Partly because of this apprehension, after the Uruguay Round, India made sure that it implemented all the WTO-compatible procedures that allow non-tariff restrictions to be applied to imports. These include in particular, government-mandated import monopolies or State Trading Enterprises (STEs), tariff rate quotas (TRQs) applied to a number of agricultural commodities, technical standards and regulations implemented by the Bureau of Indian Standards (BIS), sanitary and phyto-sanitary (SPS) rules mainly applied to agricultural and food products, other health and safety regulations, and anti-dumping. In May 2001 a "War Room" was established in the Ministry of Commerce, and a list of 300 "sensitive" consumer products was published, imports of which were subsequently regularly monitored so as to be able to take prompt action to pre-empt or minimize disruption caused by imports to local producers,

During the past few years, discussions of trade and other policies in India have begun to recognize that the earlier concerns about the ability of local producers to compete without protection from the import licensing system and/or from high tariffs were vastly exaggerated, and there is new confidence in the competitiveness of Indian producers, as evidenced by rapidly growing exports and foreign exchange reserves, and faster overall economic growth. Along with these new perceptions, there are signs of some consequent relaxation of the vigilance with which the various non-tariff protective measures are being pursued¹⁰. These changed attitudes have also underpinned the dramatic reductions in industrial tariffs which started in 2002/03 and are described below.

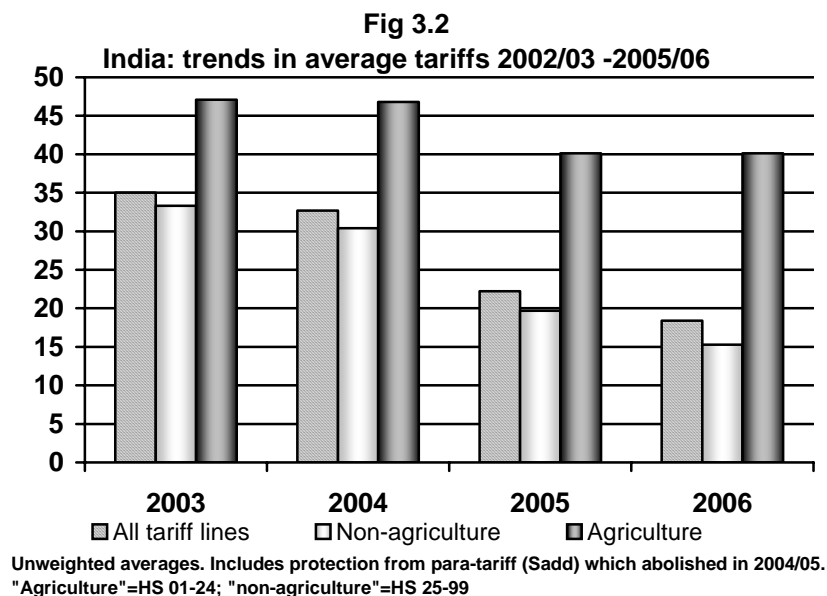
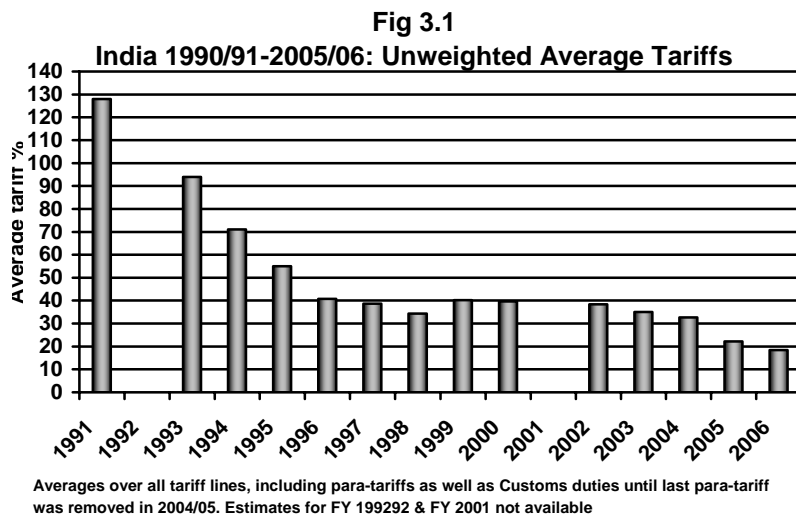
¹⁰ For example, the "sensitive list" of products has been removed from the Ministry of Commerce (DGFT) website, reportedly because (for most products on the list) despite tariff reductions, there have been few imports to monitor. In addition, some important products (notably a number of steel products) have been omitted from the list of products requiring compulsory BIS certification, and anti-dumping activity appears to have slowed.

Customs clearance at land border Customs posts India has 83 Customs posts on its land borders with Bangladesh. All except three are formally authorized to clear all kinds of exports and imports¹¹. This contrasts with Bangladesh's land border Customs posts, only four of which have unrestricted clearance powers for imports from India (see section 4 below). Whether all of the Indian Customs posts actually have the capacity for unlimited clearance is another matter, since legal exports of many Indian products are obliged to go by the few land border crossings-especially Petrapole-Benapole-at which the Bangladesh customs posts are authorised to clear them.

Tariffs. As well as removing QRs from intermediates and capital goods, the 1991/92 reforms reduced tariffs and pre-announced a tariff reduction program. Under this program tariffs came down steadily from prohibitive levels at the beginning (average almost 130% in 1990/91) to much lower levels (average about 35%) in 1997/98 (Fig 3.1). Then, in large measure to compensate for the removal of the consumer good QRs, during the following four years this downward move was reversed and tariffs went up. In 2000, this upward trend was supplemented by the introduction of prohibitively high specific tariffs to protect textile fabric and garment producers.

However, only a year after the final removal of import licensing, a new tariff reduction process started in 2002/03. This new program focussed on industrial tariffs. There were three major omissions:

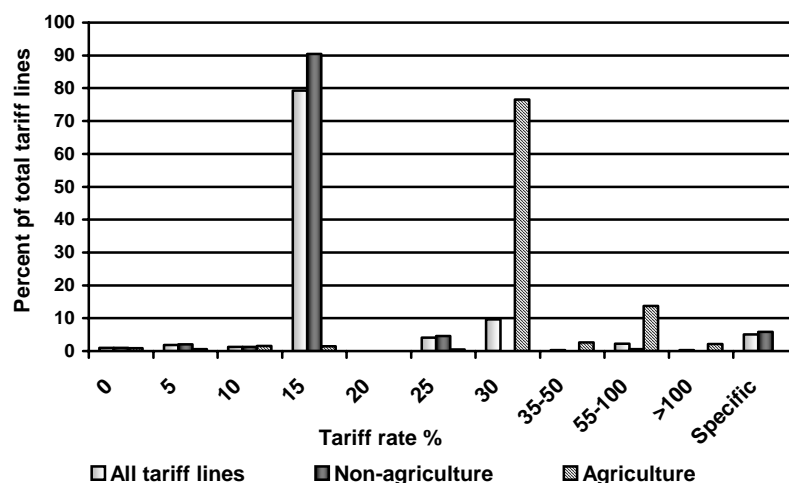
- Agriculture, livestock, fisheries and processed foods (HS 01-24)
- Textile fabrics and clothing products, about half of which continue to be protected by specific tariffs
- A few important manufacturing sectors, notably the auto and fertilizer industries



¹¹ Customs notification No 63/94-Cus.(N.T)

For most industrial goods, there was an especially large tariff reduction in 2004/05 resulting from a cut in the generally applied maximum Customs duty accompanied by the abolition of the Sadd¹², the one remaining para-tariff¹³. This was followed by a further cut in the maximum industrial tariff to 15% in 2005/06, and to 12.5% in 2006/07. Without counting the specific textile and clothing tariffs, during the four years average industrial tariffs fell by more than half to 15.3%. Moreover, the compression of tariffs as the ceiling came down greatly reduced their variance: before allowing for the specific

Fig 3.3
India 2005/06
Distribution of tariff lines



tariffs, **90 percent of industrial tariffs are now¹⁴ at 15%** (Fig 3.3), **far lower and far more uniform than they have ever been in the past 50 years.** Even after allowing for the specific textile and clothing tariffs and assuming that these all involve *ad valorem* equivalent rates in excess of 15%, almost 85% of industrial tariffs are at the uniform 15% rate. Moreover, the decline in the maximum tariff has made large numbers of *ad hoc* reductions for particular users or uses irrelevant, and has been accompanied by major simplifications of the tariff schedule in which many of these have been eliminated¹⁵. For many Indian manufacturing industries, with their domestic sales protected by a 15% tariff against imports, and buying from domestic suppliers also protected by 15% tariffs or importing inputs over a 15% tariff, effective protection to their processing margins in the domestic market is also around 15%, far lower than the effective protection rates that were generally available from the tariff structure only three or four years ago, and only slightly above the processing margins available from exporting. Consequently, relative to selling in the domestic market, exporting is now much more attractive for Indian firms than it was even in the recent past. From the perspective of SAARC countries including Bangladesh, these changes mean that Indian domestic markets for most manufactured goods are highly competitive, with prices that are close to world prices, and are likely to be difficult to penetrate even with complete exemption from Indian tariffs under bilateral or multilateral free trade arrangements such as those planned under SAFTA.

<i>Tariff</i>	<i>% share of 10,558 non-agricultural tariff lines (HS 25-99)</i>
<15%	4.3
15%	84.6
>15%	5.3
Specific & >15%	5.8

¹² Special additional duty: prior to its abolition, 4% of the assessable value of an import plus Customs duty plus additional duty

¹³ A very small “education cess” equal to 2% of (Customs duties plus additional duties) was introduced in July 2004. With a Customs duty of 15% and the normal 16% additional duty, this is equivalent to 0.67% of the cif price. It is ignored in the rest of this paper

¹⁴ In fiscal year 2006/07, 90 percent of industrial tariffs are at 12.5%.

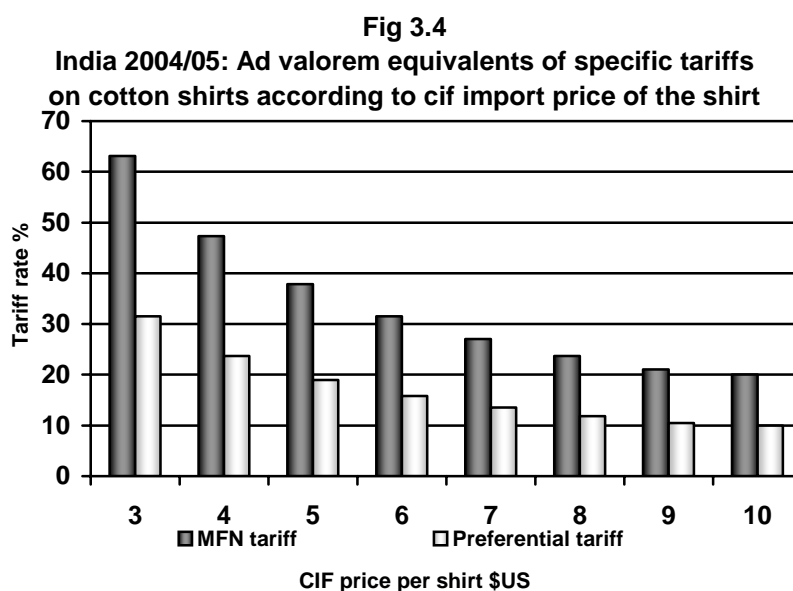
¹⁵ In particular, many items have been removed from the annual “Jumbo” exemption notification. As discussed in the trade policy *Overview* report (Vol II, p.41), these *ad hoc* exemptions and partial exemptions have long been a source of complexity and opacity in Indian trade policies.

In contrast to industrial tariffs, tariffs on “agricultural” products (defined in the broad sense to include fisheries, livestock and livestock products, agricultural products and processed foods) were left out of the new tariff reduction program: they came down just a bit in 2004/05 but in 2005/06 on average they were about 40%, almost three times the level of non-agricultural tariffs (Fig 3.2). They are also much more dispersed than industrial tariffs (Fig 3.3): just over three quarters are at 30%, but there are many very high tariffs, with 13.7% of the total tariff lines subject to tariffs of between 50% and 100%, and 2.1% of tariff lines with tariffs well over 100%. As in Bangladesh (see discussion in the next section) there are high tariffs protecting domestic production of processed foods, and also therefore this section of the manufacturing sector.

<i>HS chapter</i>	<i>Processed food products included in the HS chapters</i>	<i>Average tariff %</i>
04	Dairy products, eggs, honey etc	34.1
15	Animal & vegetable fats and oils etc	75.5
16	Preparations of meat, fish, crustaceans etc	34.1
17	Sugar and sugar confectionery	35.4
18	Cocoa and cocoa preparations	30.0
19	Preparations of cereals, starch or milk; pastry cook products	31.2
20	Preparations of vegetables, fruits, nuts, etc	30.2
21	Miscellaneous edible preparations	30.0
	Average of 8 processed food chapters	37.6

In addition government import monopolies have continued for all the foodgrains except maize and barley, and tariff rate quotas are used to regulate imports of powdered milk, maize, crude sunflower and safflower oils, and refined rape, mustard, colza and mustard oils. Hence, in these sectors there are extensive barriers against import competition, even though (as discussed in the trade policy *Overview* report¹⁶) domestic prices of many agricultural commodities-including for example the principal food grains and sugar-in most years are not very different from world prices.

Specific duties protecting the textile and garment industries Just before the withdrawal of import licensing from textiles and garments in April 2001, the government imposed specific duties on a large number of textile fabrics and garments, in order to protect domestic producers against low price import competition. The specific duties are applied to approximately 41% of the fabric and clothing tariff lines in the textile and clothing HS chapters (chapters 50-63)¹⁷. At present these tariffs are the greater of the standard 15% rate, or the specific amount (usually Rupees per metre of per kg, or per garment). The ad valorem equivalent of these duties varies with the cif price: for example (see



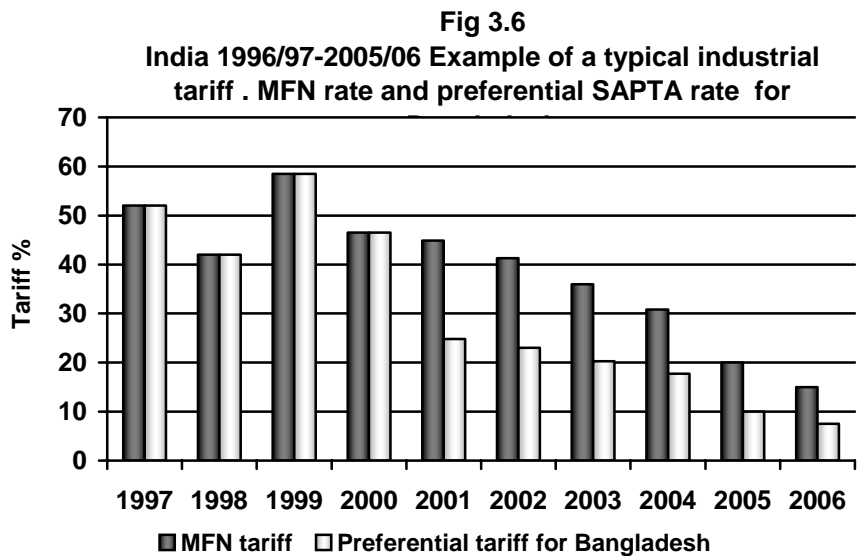
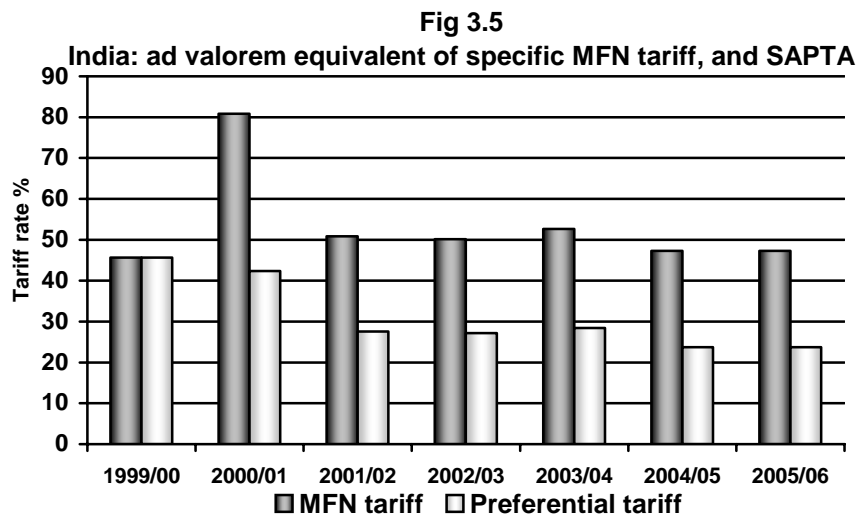
¹⁶ See especially Vol III, pp 10-12.

¹⁷ For more on the India’s specific tariffs, see the chapter on textiles and garments in the trade policy *Overview* report (Vol III, Ch 3, pp 63-64 and Appendix tables)

Fig 3.4) for a man's cotton shirt, at prevailing world prices of \$3 to \$4 per shirt, it is equivalent to an *ad valorem* MFN tariff of between 63% and 47%: only for luxury brands selling at well over \$10 cif per shirt would the 15% ad valorem become the operative tariff. This system was designed to make it impossible or very difficult for other developing countries with strong textile and garment industries to compete in India. It also has the effect of excluding the products to which the specific duties are applied, from subsequent reductions in *ad valorem* tariffs. For example (Fig 3.5) between 2000/2001 and 2005/2006 the *ad valorem* equivalent of the specific duty on a \$4 man's shirt has remained at or just slightly below 50% since 2001/02, even though the regular *ad valorem* tariff on the shirt went down from about 45% to 15% during the same period.

Ready made garments are Bangladesh's principal export, and these specific tariffs in India are of special concern to it in the context of regional trade arrangements including SAPTA and SAFTA. The SAPTA preferences are applied to specific as well as ad valorem duties, but-as is the case with the MFN duties-the ad valorem equivalents for standard low price imports are much higher than the preferential ad valorem rates, and their use has also excluded the products to which they are applied from India's general tariff reduction programs (as illustrated in Fig 3.5). To continue the example of mens' cotton shirts, without the specific duty the preferential tariff for Bangladesh would be 7.5%, but in 2004/05 the preferential specific tariff was equivalent to an ad valorem tariff of 31.6% on a \$3 shirt, and to a tariff of 23.7% on a \$4 shirt (Fig 3.4). As discussed in the case study of the RMG industry, given the low margins between fabric costs and garment export prices, tariffs at this level make it very difficult for Bangladesh RMG exporters to compete in India

India's SAPTA preferences for Bangladesh, Nepal, Bhutan and Maldives are "less developed" (LDCs) members of SAPTA, and the more developed members (India, Pakistan and Sri Lanka) can extend tariff preferences to them without being obliged to extend the same preferences to the other more developed members. At present India has given preferences to Bangladesh on approximately 2925 tariff lines, about 58% of the total number of its approximately



5000 6-digit HS lines¹⁸. Two thirds of these preferences were agreed in the third SAPTA negotiating round and came into force during India's 2000/01 fiscal year. A majority of the preferences are special "LDC-only" preferences: most of these are 50%, some are 60%, and a few 15%, 75% or 100%. The others are preferences also given to the "developed" SAPTA members i.e. to Sri Lanka and Pakistan, and most of these are less generous-10% or 15%: only a few are as high as 50%.

In India, the SAPTA preferences are applied to Customs duties (both ad valorem and specific) but were not applied to the Sadd duty: consequently, before the Sadd was abolished in 2004/05, the preferential protective rates for Bangladesh resulting from a typical 50% SAPTA preference, were in fact more than 50% of the general MFN rate. The preferences are scattered through 53 of the 97 HS chapters, so there are no SAPTA preferences for products covered by 44 of the 97 chapters. In practice Bangladesh is the only relevant beneficiary of India's LDC-only SAPTA preferences, since Nepal and Bhutan have long had duty free access to the Indian market under their bilateral treaties, and the Maldives trade is negligibly small (at least from India's perspective). Therefore, in a sense, these preferences constitute a *de facto* bilateral asymmetric preferential trade arrangement between India and Bangladesh, asymmetric because many substantial preferences have been given by India, but for all practical purposes few and negligible preferences for Indian imports have been given by Bangladesh (see discussion in the next section).

In order to qualify for India's SAPTA preferences, products imported from Bangladesh would have to satisfy the SAPTA origin rule, which is that the cif value of non-SAPTA imported inputs included in the exported product should not exceed 70% of the fob price, or put another way, that national value added should be no less than 30% of the fob price. In this respect Bangladesh has an advantage over the "developed" SAPTA members (India, Pakistan and Sri Lanka) for which the minimum value-added ratio is 40%. Both were reduced (from 40% and 50% respectively) in November 2000, mainly in response to complaints from the SAPTA members other than India, that the rules were too stringent. However, there was already some built-in flexibility from a provision that excludes inputs obtained in other SAPTA members in calculating the imported input ratios i.e. by in effect treating such inputs as part of the value-added. As discussed in the case study of the ready made garment industry¹⁹, this provision is extremely important for firms in Bangladesh wishing to export woven garments to India, because value-added margins in cutting, sewing and assembling garments from imported fabrics are typically around 30% of fob prices, and may be less. If these firms use fabrics imported from China or other non-SAPTA countries, this limits their ability to compete in exporting to India, because if they cut their export prices they may breach the rule of origin conditions and find that these shipments are subject to the higher MFN tariffs in India, rather than the lower SAPTA preferential tariffs. To get around this constraint, they can use imported Indian fabrics, even though they might not have done so if they had a free choice unconstrained by this consideration²⁰.

Fig 3.6 illustrates how India's SAPTA preferences for Bangladesh have developed since 1996/97, using the example of a typical industrial product subject to India's general maximum Customs duty and the para-tariffs that were applied up to 2003/04, and assuming a 50% tariff preference for Bangladesh during 2000/01 and after. This example brings out a number of points that are relevant for interpreting the stagnation of Bangladesh exports to India during this period.

¹⁸ Rajesh Mehta (op cit) p.8. These shares of tariff lines with SAPTA preferences were estimated using HS 6-digit tariff lines. These have now been replaced in India with an 8-digit classification and the shares calculated on this basis may have changed somewhat.

¹⁹ Garry Pursell (2005, March). *Free Trade between India and Bangladesh? A Study of the Ready Made Garment Industry*.

²⁰ In principle it would seem that Bangladesh woven garment exporters could also satisfy the origin rule by importing fabrics from Pakistan. India and Pakistan are the only SAPTA members with substantial export-oriented textile industries.

- Between 1996/97 and 1999/2000 there were relatively few products with preferences. Imports from Bangladesh without preferences would have had to compete in India with domestic producers after paying tariffs which ranged from just over 40% to almost 60% during these years. Products with preferences (not indicated in the diagram) would have still been subject to tariffs which varied between 20 and 30 percent during the period. For three of these years (1997/98, 1998/99, and 1999/2000) Bangladesh exporters of consumer goods were exempt from India's import licensing system and in this respect had a major advantage over exporters from non-SAARC countries, but it seems that the Indian tariffs (whether or not reduced by preferences) were too high for them to take advantage of this opportunity
- After 2000/01 there was a big increase in the number of products with tariff preferences for Bangladesh, and this is illustrated in Fig 3.6 by the introduction of a preferential tariff for Bangladesh in this year. Since 2000/01 both MFN tariffs and the corresponding lower preferential tariffs for Bangladesh have steadily declined. From the viewpoint of Indian traders, this would have made importing from both Bangladesh and the rest of the world more attractive, relative to buying from local suppliers, with a substantial margin of preference for imports from Bangladesh. However, up to 2003/04 only Indian imports from the rest of the world have been growing, not Indian imports from Bangladesh, and this pattern was continuing in the first three quarters of 2004/05, when the MFN tariff for this representative industrial product was 20%, and the preferential tariff for Bangladesh only 10%. As already noted, this suggests that the explanations for the stagnation of Bangladesh exports to India have to do with comparative advantage and supply side factors in Bangladesh, not lack of demand or protection in India.

Anti-dumping Anti-dumping (AD) is one of the WTO-legitimate measures that India introduced during the 1990s, as a way of providing extra protection as its tariffs came down and its import licensing system was dismantled. As of June 2004, 117 anti-dumping measures were in force affecting exporters in 29 different countries and 167 different products²¹. By the late 1990s and early 2000s, India had become the world's most active user of anti-dumping. However, there are recent indications that AD activity has been slowing: the number of new cases brought during 2003/04 was 14 compared to 30 in each of the previous two years²².

In the beginning the products affected by AD were almost all intermediate goods which had been freed from QRs during the 1991/92 reforms, but Indian firms also began to bring AD cases against imports of consumer goods after QRs were also removed from them between 1998 and 2001. There is an extensive discussion of India's anti-dumping policies and practice in the World Bank trade policy *Overview* report²³. Three major points made in that discussion are:

- Nearly all products that have been subjected to AD duties were being exported to India at generally prevailing international prices. In a number of cases the Indian firms which obtained AD protection were exporting the same products at the same prevailing international prices. Whether or not that is the case is irrelevant for an AD finding: the only considerations are whether there is a "dumping margin" and whether there is "injury" to domestic firms. A "dumping margin" is defined as the excess of the product's domestic price in the exporting country, or the export price to third countries, over the export price to India.

²¹ India, Ministry of Commerce and Industry, Directorate General of Anti-Dumping and Allied Duties, *Annual Report 2003-2004*.

²² This may have been influenced by EU objections (taken up at the WTO in December 2003) to Indian AD procedures, and more generally by increasing confidence in India as to the international competitiveness of Indian industries.

²³ Op cit Vol II, pp 74-79.

- The anti-dumping duties are applied to imports from individual exporting firms. They usually vary from firm to firm and are imposed on top of normal import duties. In many cases the AD duties are prohibitively high and effectively exclude the affected firms from the Indian market.
- The texts of the AD cases make it clear that the AD duties imposed in early cases are intended as a warning to exporters in other countries to charge “fair and reasonable” prices in exporting to India. This intimidation factor may be more important in restraining import competition than the direct effects of the AD duties that are actually imposed.

What is the relevance of India’s anti-dumping for India’s imports from Bangladesh? So far, there have only been three cases involving SAARC countries, two in Nepal, and one in Bangladesh. The Bangladesh case was finalized in December 2001, and involved Indian imports of lead acid vehicle batteries from Japan, Korea, China and Bangladesh²⁴. Anti-dumping duties were imposed on all imports from the four countries, and in the case of the Bangladesh firm these were prohibitive and blocked all subsequent exports to India. The Bangladesh firm did not provide what the Indian AD Authority considered to be adequate information on its domestic prices and costs, and so the “dumping margin” was estimated from the “best information available”, which as is usual in such cases, was data on the costs and prices of the complaining Indian firms. However, the Bangladesh firm was protected by very protective high tariffs in the Bangladesh domestic market. Using a supplementary duty, these were increased from an already high level in FY 98, as follows:

<i>FY 1998</i>	47.2%
FY 2001	69.3%
FY 2003	75.3%
FY 2004	85.5%
FY 2005	72.2%

According to a spot check in Bangladesh in late 2003, actual domestic battery prices were approximating world prices plus these tariffs. This suggests that had the Bangladesh firm provided its domestic price and cost data in the form requested by the Indian AD Authority, the “dumping margin” and the AD duty determined by the AD Authority may well have been even higher than the margin and duties determined on the basis of Indian domestic costs and prices.

The key lesson from this case is that products which sell in Bangladesh at high prices made possible by high tariffs and/or other protective instruments, and are exported at much lower international prices-even if the latter are the prevailing normal prices in international trade-are vulnerable to anti-dumping actions of this kind. This is true generally for exports to all countries which have operative anti-dumping systems, even if the Bangladesh share in the importing country’s market is very small, if Bangladesh is one of a number of countries that have a larger combined market share. In this regard it is relevant to note that there is no provision in SAPTA that prevents members from taking AD action against each other, and none has so far been envisaged for SAFTA.

As regards Bangladesh’s trade with India, the large number of Indian AD cases against exporters in China and other countries, and (except for the acid battery case) the absence of AD actions against Bangladesh exporters, is an advantage for Bangladesh exporters by sheltering them to some extent from the competition of these other exporters. However, most probably this situation principally reflects the absence of Bangladesh exports. Were they to expand, even if their shares in the Indian markets of individual products were small, the exporting firms face the risk that they will be caught up in Indian AD

²⁴ Details of the case are on the Indian anti-dumping authority website at http://commerce.nic.in/adfin_leadbat.htm

actions mainly concerned about imports from other countries, as happened in the acid battery case. The best strategy for reducing the likelihood that AD cases will be brought, and for minimising the damage if they are, is to follow low protection policies in the domestic market. By following its present protection policies with the almost automatic use of para-tariffs to provide very high protection levels (see section 4 below) Bangladesh is doing the opposite and increasing its vulnerability to AD actions in India and elsewhere, if these protected industries begin to export.

Export policies India operates an extremely comprehensive set of export policies which have been an outcome of many years of efforts to make remove or offset barriers and disincentives for exports that were an inevitable by-product of its import substitution policies.²⁵ Two aspects of these policies that are relevant for India's trading relationship with Bangladesh in the context of a bilateral FTA or SAFTA are the following:

- Rebates for exporters under duty neutralization schemes such as duty drawback and DEPB²⁶ have been substantially reduced during the past five years as tariff levels have declined. For example, DEPB rates for exported garments which were 16% during 2002/03 had been reduced to a range of between 3.2% and 8.5% in December 2004. As pointed out in the RMG case study, these reduced DEPB rates mean that Indian domestic prices of exportable garments (as well as of other exportables) are likely to be not far above fob export prices, and may be below cif prices, increasing the difficulty for Bangladesh RMG exporters to compete in the Indian market, even under an FTA. This reduces or even removes the standard 'uneven playing field' problem of an FTA on the Indian side i.e. the problem that FTAs will normally allow exporters to exempt or rebate import duties on inputs in the normal way, but that the exported products then compete without paying tariffs with producers in the partner country, which pay normal tariffs on their imported inputs.
- In recent years India has demonstrated that it is willing to subsidize its exports of rice when there have been large domestic surpluses. In some years India's exports were large relative to the narrow international market and probably reduced world prices, with resulting economic welfare benefits to Bangladesh as an importer. Bangladesh would need to think carefully about the economic costs and benefits of this if rice were to be included in an FTA with India. India has also been willing to subsidize wheat and sugar exports when there have been domestic surpluses, but in these cases the volumes have not been sufficient to have much impact on world prices, so this is less of a complication in thinking about these two sectors in the context of a bilateral FTA or SAFTA.

²⁵ An up-to-date outline of these policies is in the World Bank trade policy *Overview* report (vol II, Chapter 4)

²⁶ Duty Exemption Pass Book. This system is described in the *Overview* report and in recent changes in DEPB rates for garments are given in the RMG industry case study (Table 6, p.15).