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A licence to deceive

Exporters should be helped by lowering administered prices of basic inputs and cost of credit, says Uttam Gupta

IN a recent directive issued by the Directorate-General of Foreign Trade (DGFT), various enforcement agencies have been asked to stop all investigations into possible misuse of the value based advanced licence (VABAL). VABALs were issued under the duty exemption entitlement certification (DEEC) scheme introduced in April 1992 primarily as an incentive to exporters for promoting exports. It envisaged import of duty free raw materials against fulfilment of export obligations, the sole objective being to enhance the cost competitiveness of manufactured products that have an inherently high import content.

The scheme was clearly misused by exporters and various enforcement agencies registered scores of cases involving fraudulent exports, exaggeration of export proceeds to claim duty free benefits and evasion of income tax on remittance receipts. If the investigations had been allowed to be pursued, enforcement authorities maintain, they would have recovered customs and excise duty of over Rs 4,000 crore. Besides, collection by way of income tax on export profits would have been of a similar magnitude.

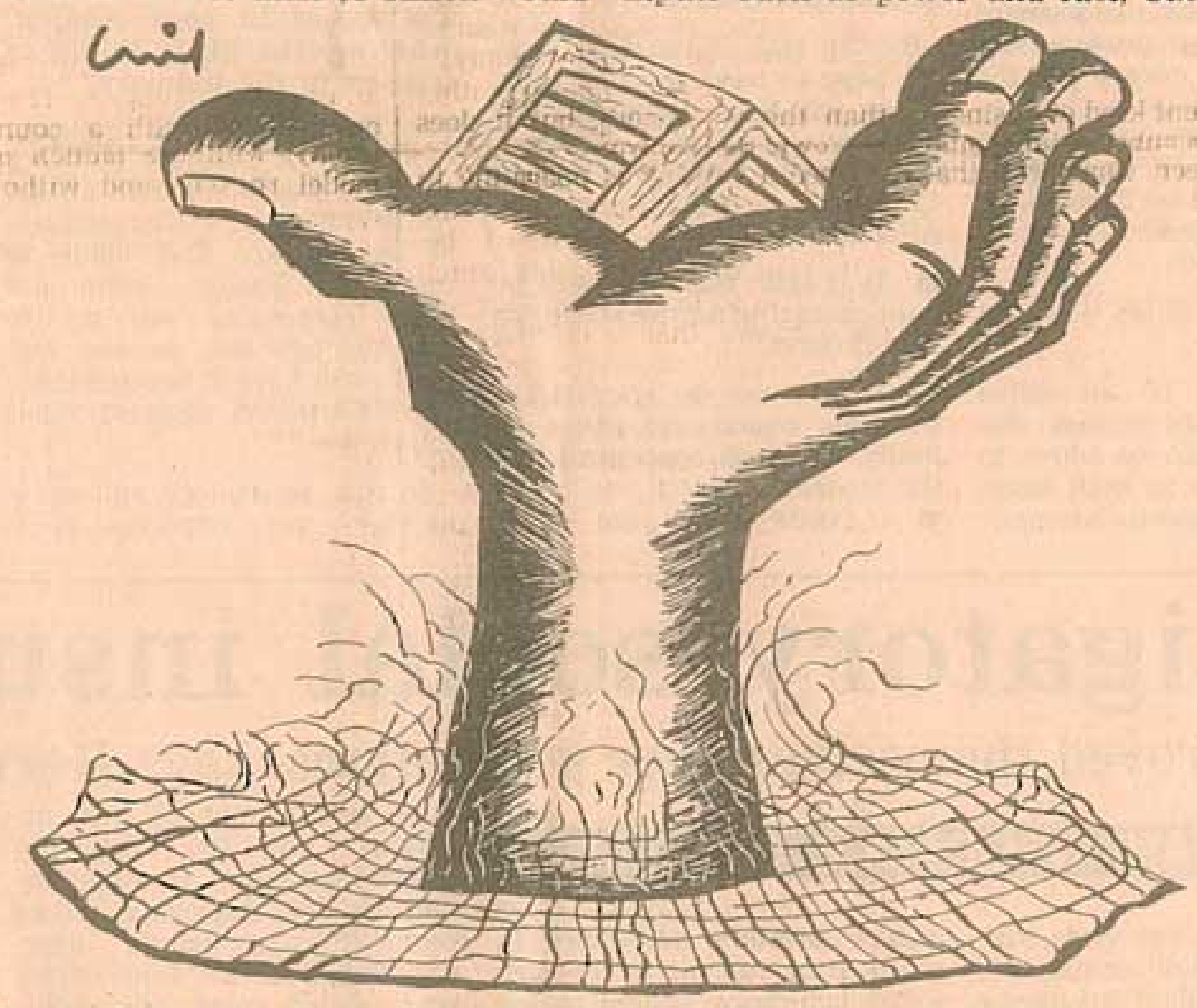
The finance ministry has reasons to get upset as this revenue would have enabled it to present a more promising picture. Going on the basis of provision made in the the budget for 1994-95, i.e. Rs 6,000 crore, adjustment for Rs 8,000 crore would lead to an unprecedented situation of Rs 2,000 crore surplus.

Export under the DEEC scheme increased from a meagre 15 per cent in 1991-92 to 35 per cent in 1992-93 and further to a high of 52 per cent in 1993-94. In value terms, considering the total exports of about Rs 68,000 crore, exports under this scheme during the year would thus be well above Rs 30,000 crore. And, given the widespread reported misuse of VABAL, it can be safely inferred that a substantial portion, in any case not less than 50 per cent of the total exports under the scheme, were only on paper (either through over-invoicing of exports or no physical exports and transaction shown only on books). Needless to mention that such exporters would have arranged remittance of foreign exchange through the *hawala* route.

It is for enforcement authorities to indicate the precise magnitude of such exports. This is imperative to enable a correct assessment of the actual export performance.

With such an adjustment, the estimate for the value of actual exports during 1993-94 will have to be substantially revised downwards. Besides, considering that no adjustment on account of imports would be necessary as that much imports related to the misused VABAL has already taken place, the position with regard to the trade deficit and overall BoP situation will no longer look as comfortable.

The former estimated by the government at less than $1 billion would be much more. In so far as the contribution to foreign exchange goes, in terms of sheer arithmetic, there is accretion to reserves. But, the fact remains that these represent our own rupees circulating in the parallel economy which would not only get back into the system but even get further multiplied due to the raw materials/components imported at zero customs duty sold in the domestic market at a hefty premium. Increasing our foreign exchange reserves in this manner is totally unacceptable given its highly inflationary consequences.



When the government decided to allow import of raw materials without payment of customs duty purportedly with the intent of encouraging exports, it was not without cost to the economy. Apart from the resultant loss of revenue, duty free import of the raw materials and components has serious implications for domestic industries.

Considering that the prevailing duty levels are significant, being as high as 50 per cent in some cases, VABAL abusers can sell the imported raw materials in the domestic market at a price even lower than the cost of domestically produced material and still make substantial profit. In contrast, the domestic manufacturers not only suffer from the handicap of having to pay high prices for basic inputs such as power and fuel, but also suffer from the disadvantage of having to pay high excise duty. The possibility of indigenous industry seeking any countervailing duty on the likely imports to offset the excise duty disadvantage is also not available due to the special dispensation available to importers under the DEEC scheme.

Whereas the negative consequences of the DEEC scheme have been felt in abundant measure both by the exchequer and the domestic industry, the positive effects — enabling competitiveness of export-oriented industries, export earnings, spurt in industrial activity — are largely on paper.

The RBI may perhaps, have some reason to feel relieved as, unlike normal exports, wherein the conversion of dollar remittances results in net pumping of rupees into the economy and a resultant problems of managing inflation, in these cases, to the extent there is rupee inflow, equivalent rupees have also moved out of the system for financing purchase of dollars in the *hawala* market.

The greatest possible damage is in terms of generating an impression that the country has done well on the export front. A still bigger damage will be the lack of any stimulus to develop the production base.

Although, the government is intending to liberalise and institute market-based incentives, in the context of export promotion, it is still not willing to relinquish its intervention. That would probably explain why, after having dispensed with the cash compensatory support and duty drawback, the incentives through import route had to be brought in. The fact that in some quarters introduction of the duty free import scheme is interpreted as a compensation for the loss suffered on account of withdrawal or erstwhile supports, further underscore the point.

Introduction of partial convertibility followed by full convertibility by itself would have given enough of an incentive to exporters. But, perhaps, in a bid to show extraordinary results, the government brought in schemes like VABAL which are not only inconsistent with the spirit of liberalisation, but also, subject to misuse.

Having made a substantial advance in liberalising external trade and introducing a market-determined exchange rate, it would have been perfectly in order for the government to withdraw completely from the scene. That would have made possible an objective evaluation of the new market-based system. But, more important, exporters would be under pressure to work the hard way.

It is never too late. As a first step, it is necessary that the VABAL be abolished forthwith. We should be prepared to forego the psychological satisfaction of showing impressive export performance and accept the hard core reality. Second, investigations into the misuse need to be pursued and appropriate action initiated. Third, efforts should be made to help the exporter by lowering administered prices of basic inputs, cost of credit and improving infrastructural services.