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Revival and Expansion of Export Subsidies during 1966-70

Although the June 1966 devaluation was accompanied, as we have seen, by the elimination of the budgetary tax credits and the import entitlement schemes, the ensuing period was characterized by a steady growth of export subsidization, again largely of a selective and variable nature and embodying, in practice, many of the features of the schemes prior to devaluation.

We shall first trace the major developments, organizing our analysis by type of subsidization rather than by strict chronology. Next, these diverse subsidies will be quantified with a view to determining the degree of subsidization they provided at different points in time, so that both their importance and their effects on export performance can be assessed.

METHODS OF SUBSIDIZATION

Cash Subsidies.

The major change in methods of export subsidization in the post-devaluation period was the large-scale introduction of cash subsidies on an *explicit* basis. These were introduced in August 1966 for most engineering goods and chemicals and were successively extended to a number of items. By the end of 1967, they embraced the bulk of engineering goods, chemicals, processed foods, paper products, sports goods, woolen carpets, steel scrap, prime iron and steel, and cotton textiles, yarn and "made-up" goods amounting to over 15 percent of total exports in 1964-65 and 1965-66.

1. The subsidies were *selective*. They ranged from 10 to 25 percent *ad valorem*.¹ In contrast to the main thrust of the pre-devaluation subsidies, therefore, the selectivity was clearly narrower, confined to a very limited number of rates. As *between* the different groups, the range was again narrower than before, from 2 to 25 percent. However, the inter-group differences in rates were not altogether negligible. Cotton piece goods had subsidies ranging from 2 to 8.5 percent; made-up cotton goods generally carried 4.25 percent; steel scrap had 5 percent; biscuits had 3 percent; confectionery was 17 percent; and 25 percent applied to many engineering goods.

2. Furthermore, there is unmistakable evidence that the export subsidies were adjustable upward, not merely by explicit changes in the rates in periodic announcements, but also by special dispensation if the export order in question was "sizable." Frankena has shown, on the basis of interviews with leading exporters of engineering goods, that the government was willing to consider an *ad hoc* increase in cash subsidy when this was considered necessary to secure (i.e., to induce an exporter to quote a low enough price on) an export order worth \$0.67 million or more, and there are several cases where additional cash subsidies of 2.5 to 5 percent of the f.o.b. value were given.

Import Replenishments.

Although the import entitlement schemes were abolished with devaluation, they were soon replaced in August 1966 by import replenishment schemes. Under the latter, exporters were again assigned import licenses of a value which was a pre-specified percentage of the f.o.b. export value. While the two schemes were virtually alike in their modes of operation, except for a few differences to be noted shortly, the major difference was supposed to be that the replenishment licenses merely replaced the supposed import content of the export whereas the entitlement licenses were alleged to have been generally at *twice* this import-content value (and hence embodying an element of "open" subsidy).

Of course, in a situation where imports carry a scarcity premium, a replenishment license will also amount to a subsidy on exports. And we must therefore take it into account in estimating total export subsidization in the Indian economy.² The "equivalent" *ad valorem* subsidy may further be approximated by multiplying the replenishment rate by the premium at which the replenishment license can be sold.³

It is significant that, despite the intention to differentiate the replenishment scheme from the earlier entitlement schemes, many features of the latter were quickly to emerge in the former:

1. The *transferability* of the licenses was subjected to control, as before. We have already noted the irrational nature of the restrictions on transfer-

ability of licenses as among the numerous entitlement schemes. Identical restrictions were to be carried over into the replenishment schemes, thereby lowering the subsidy-worth of the scheme and also making its operation cumbersome without any justifying rationale.

2. Furthermore, just as the rule that the entitlements should be twice the import-content was rarely observed in practice, and in fact was violated in favor of larger allotments, the available evidence points to identical tendencies of the replenishments to go well beyond the value of the (direct) import-content. Thus, Frankena has found that in many cases, including machine tools, stationary diesel engines, electric fans, sewing machines and certain chemicals, the face value of licenses was considerably greater than the average current import-content of the exported product.

3. The restrictions on transferability were accompanied by restrictions on *what could be imported*, in common with the entitlement schemes. Again, as with the latter, these restrictions were occasionally evaded by the authorities. Further, the early entitlement scheme restrictions on eligible imports had already been weakened over time—especially in that exporters were allowed to import items other than those identified as the direct import-content of the exported products, provided they were direct inputs into what the exporter produced *altogether* (e.g., he may have a multi-product operation) or into items produced by the entire export promotion *group* (e.g., plastics) within which the entitlements had eventually come to be transferable. The same pattern of (restricted) eligibility was to be carried over into the replenishment schemes; and no further “liberalization” was permitted in principle.

4. Aside from the fact that “banned” items were occasionally made available under the replenishment licenses, these licenses carried a premium in the market (despite the import liberalization during the post-devaluation period) in part due to the fact that they were not source-tied as against the AU licenses which frequently made imports possible only against (higher-cost) source-tied aid.⁴

The only respect in which the replenishment scheme appears to have been different from the entitlement scheme is in the relative stability of the rates (which, as before, were set as a percentage of f.o.b. export value). In addition, exports to the Soviet bloc were to become eligible for replenishment with free-foreign-exchange licenses.

Supply of Indigenous Materials at International Prices.

Although the idea of supplying domestic materials at international prices for export purposes had been conceived and implemented in respect to the supply of iron, steel and tinplate to the engineering industry, prior to the devaluation, it was adopted at a significant level in May 1967 for the supply

of iron and steel with eligibility for all manufacturers using primary iron and steel.

These schemes eventually were to extend to winding wires, PVC resin and aluminum as well. However, as Frankena has noted, the latter schemes were not operated with the same efficacy as the steel scheme. Thus, the PVC resin scheme during 1969 and 1970, under which some raw materials for plastics and cable insulation were supplied at international prices, required an *offsetting* transfer by the exporter of part of his replenishment licenses to the supplier of these materials—thus reducing the subsidy on that front. Further, in some cases, as with aluminum supplies to user-exporters at international prices, this meant an effective subsidy to the users but, on the other hand, the sale of aluminum at these concessional prices was counted as an offset against export obligations of the aluminum producers. Furthermore, some of the concessions were not of durable value, since they were based on informal agreements with the government rather than legislation. For example, in 1967 the manufacturers of winding wires agreed to give a price concession to exporter-manufacturers of electrical equipment such as fans, motors and transformers; in 1969 several manufacturers of winding wires were withholding such a price concession to user-exporters.

The steel scheme did work more effectively, however, as it was based on the principle of direct subsidization of the steel price.⁵ And the subsidy element in the scheme was indeed positive (as quantified in the next section) since the domestic steel prices exceeded the foreign prices—until the rise in international steel prices above the Indian control prices in late 1969.

Unfortunately, however, the scheme had drawbacks similar to those of the other subsidy schemes we have just reviewed. The subsidy was restricted (without any economic rationale that we can find) to steel of certain kinds, and again to steel produced by certain major producers; and there were administrative delays.

Other Subsidies.

In addition to the three forms of subsidization reviewed above, the post-1966 period was characterized by three other measures which amounted to direct subsidization of the export sector: (1) drawbacks and rebates on import and excise duties paid on direct inputs; (2) subsidization through the State Trading Corporation of a growing range of exports; and (3) subsidization of freight rates.

Furthermore, numerous *indirect* subsidies operated at different levels, in a variety of guises. Thus preferences were increasingly granted to exporting firms in respect of (1) AU and CG licenses on volume and source-tying, (2) facilities to invest abroad, (3) licenses to expand capacity domestically and (4) supply of rationed inputs.

Moreover, the government occasionally resorted to policies aimed at "taxing" the firms which did *not* export, by (1) requiring penalty-carrying export obligations prior to licensing, for example, and (2) actually penalizing firms (by denial of AU licenses, etc.) in certain industries when they did not export pre-specified shares of their estimated production.⁸

We review all these policies, in turn.

DRAWBACKS AND REBATES

The refund of excise and import duties on direct inputs into exports predated the devaluation, as we already know from Chapter 3. These policies were continued into the post-devaluation period.

STATE TRADING CORPORATION

Effective export subsidization had also occurred in regard to products such as rice, sugar, art silk fabrics and jute goods. The State Trading Corporation (STC) sold these exports at losses which were financed by profits that arose from imports canalized through the STC. This policy was also carried into the post-devaluation period.

SUBSIDIZATION OF FREIGHT, MARKETING AND CREDIT

The pre-devaluation subsidies had extended to freight concessions to exporters in the hinterland, grants to promote participation in exhibitions abroad, and credit concessions. These policies were to continue into the post-devaluation period. Thus, in the engineering goods sector, transportation to a port more than 200 miles distant normally entitled the exporter to rail freight concessions up to 50 percent.

The marketing promotional subsidies extended not merely to participation in foreign exhibitions and overseas expenses, but also to visits of foreign delegations to India. There were also income tax concessions for all export marketing expenditures. In addition, the government continued to expand credit facilities to exporters. Thus, during 1967, the Reserve Bank of India began to charge a concessional rate of 4.5 percent to commercial banks for refinancing facilities relating to the pre-shipment and post-shipment advances made by banks to exporters. During 1969, export credits up to 10 years at 6 percent by exporters were subsidized provided certain conditions were fulfilled relating to low import-content and repayment in hard currency. Even these conditions were occasionally waived.

PREFERENTIAL SUPPLY OF RATIONED INPUTS

Since scarcity cannot always be meaningfully translated into dearness, it is useful to mention here government allotments of rationed materials to exporters on a preferential basis. In addition to the scheme for supplying

indigenous steel at concessional, international prices, the supply of scarce and rationed iron and steel to exporters was accorded high priority in principle. This was also the case with aluminum, cycle tires and materials for tires and plastics. However, no quantitatively spelled-out policy in this regard can be discerned in the policy announcements during the post-devaluation period.

PREFERENTIAL LICENSING TO EXPAND CAPACITY AND TO UTILIZE EXISTING CAPACITY

Preferential allocation of AU and CG licenses to firms that export was also to become an explicit and an important part of government export-promotion policy in the post-devaluation period. Thus, in 1968, engineering firms exporting more than 10 percent of their production were made eligible for such treatment by an announcement from the Ministry of Foreign Trade, and later in 1968 the Ministry announced that licenses of the value of \$2.7 million had already been issued to 46 export-oriented industrial firms.⁷ Moreover, in 1969, the government allowed firms exporting more than 10 percent of their output to import (under their AU allocations) from preferred sources. During 1970–71 firms which exported 25 percent of output in 1969 were given all AU licenses for import against free foreign exchange (source-untied), firms which exported 10 to 25 percent were given two-thirds of their AU licenses to import with untied funds and firms which exported less than 10 percent were given only half their AU licenses to import with untied funds.

PREFERENTIAL TREATMENT FOR FOREIGN COLLABORATION

Among the important preferential treatments promised to exporting firms was the possibility of a more lenient attitude toward them when foreign collaboration was sought. The leniency was sought in the direction, not merely of expediting decisions, but also in the sense of permitting collaboration in “non-priority” industries and even in industries such as “trade” where collaboration was traditionally banned. In fact, in several such cases the government actually went so far as to make a formal export obligation a pre-condition for approving a foreign collaboration or investment, as with IBM and Coca-Cola prior to devaluation.

PREFERENTIAL TREATMENT REGARDING FOREIGN INVESTMENT BY EXPORTERS

The government also gave preference to exporters for investing abroad. This privilege was of value to firms (1) whose domestic investment outlets were being restricted—the case with the Large Industrial Houses under the revised industrial licensing policy aimed at stricter, effective control of their expansion; (2) who found foreign investments more profitable than domestic investments; and (3) who were seeking effective ways to export capital illegally, a process somewhat facilitated if the firm had foreign equity investments.

This preference took basically the form of permitting firms to purchase equity in a foreign enterprise when this resulted in the sale of machinery exports by the firm to this foreign enterprise. It was thus of value mainly to exporters of machinery and hence more restricted in scope than the other policies we have been reviewing. However, on occasion it could extend to firms not themselves exporting machinery (e.g., Oberoi Hotels) or to more complex deals.

PENALTIES FOR NON-EXPORTING FIRMS

As we have noted, government policy embraced contractual export obligations prior to permission to construct or expand capacity, with or without foreign collaboration, and in "priority" and "non-priority" industries. In addition, the government also resorted to an explicit policy of pressing producers in several of the (59) priority industries (to which import liberalization since June 1966 had been extended) to export at least 5 percent of total production or to face *de facto* penalties in the form of reduced AU allocations, restrictive source-tying of import licenses and refusal to expand output. This policy pre-dated the devaluation on an informal *ad hoc* basis; but it was formalized in 1968 and 1969.⁸

Clearly, therefore, the post-devaluation period was to witness an active resumption and expansion of export subsidization programs.⁹ We now proceed to quantify their magnitude.

QUANTIFICATION OF SUBSIDIZATION

The analysis in the preceding section has already indicated the complex nature of export subsidization even subsequent to the devaluation of June 1966. Unfortunately, this complexity is so considerable, especially in view of the number of rates of cash subsidy and replenishment licenses and the vastly greater number of premia on import replenishment licenses, that we must warn the reader that the (partial) quantification of the export incentives which we now attempt must be regarded as indicative only of broad orders of magnitude and as enabling us to assess *broadly* the trends in export performance since the devaluation.¹⁰ One should properly regard the great difficulty of developing reliable measures of effective subsidy rates in an economic regime of the type India possesses, and the consequent inability of the government to undertake any systematic analysis of export policy and results, as an important and particularly unfortunate consequence of such regimes.

Cash Assistance.

Broad orders of magnitude concerning subsidies in the form of cash assistance may be provided for engineering goods, chemicals and other groups.

Frankena's detailed study of the engineering industry in India gives (among other things) the major cash subsidy rates for 1969–70 for 80 percent of the engineering exports in 1969. By weighting the subsidy rates by the relative share in exports, we estimate the average cash subsidy rate for engineering goods (plus iron and steel) as 12.4 percent during 1969–70 and as 17.6 percent for engineering goods (excluding iron and steel).¹¹

We have also put together the cash subsidy rates for the entire post-devaluation period by the detailed classification by-product that is actually used to operate the scheme and which distinguishes among nearly 300 product-types. Unfortunately, while we did have these subsidy rates, we could not obtain a comparable classification for exports and therefore the export-share-weighted average cash subsidy rates which we wished to calculate (by even a rough-and-ready regrouping of exports by the subsidy-classification) could not be computed despite our attempts at securing the necessary information.

Domestic Materials at International Prices.

The principal scheme for providing exporters with inputs at international prices related to the supply of steel to the engineering industry. Quantifying this incentive as an *ad valorem* equivalent subsidy on exports of engineering goods required that we obtain the international London Metal Exchange (LME) prices for different types of steel, the corresponding domestic Joint Plant Committee (JPC) prices, multiply the difference (when LME < JPC prices) by the corresponding a_{ij} coefficients for the relevant steel inputs into engineering goods and then divide by the unit f.o.b. value of engineering goods exports.

The average (unweighted) subsidy implied by the difference between international and domestic prices of various categories of steel appears to have varied from zero during January–March 1970 to a high of 25 percent during October 1968–March 1969.¹² The cost of steel input as a proportion of total cost of production of engineering goods is estimated to be about 15 percent.¹³ Thus, at its maximum value of 25 percent, the subsidy on steel input to the engineering sector amounted to about 4 percent of the domestic cost of production. If we assume that the f.o.b. price of exports of engineering goods was around 50 percent of the domestic cost—and this may not be too far out, as Frankena's estimated range is 50–75 percent—the steel input subsidy would then be of the order of 8 percent of f.o.b. prices.

This number compares reasonably well with Frankena's estimate of 14 percent subsidy for steel pipes, tubes, and fittings and 8 percent for transmission line towers and other fabricated steel structures for mid-1969.¹⁴ Moreover, recent studies of selected exporting firms in 1968–69 indicate that, for railway wagon exports, the steel subsidy was more like 19 percent.¹⁵

Such schemes for providing materials at international prices apparently tended to increase during this period, and were of some importance for chemicals and plastics. Thus, in the plastics industry, raw materials such as low and high density polyethylene, PVC and polysterene were made available at international prices which were as much as 75 percent below the domestic price in some instances.¹⁶

Duty Drawbacks and Tax Rebates.

The import duty and indirect tax drawbacks and rebates had a vastly differential incidence among different products. Thus the different indirect tax rebates that were estimated for 1969 by Frankena in the engineering industry ranged from 2 percent of f.o.b. value to 49 percent. A more comprehensive sample survey during 1969-70, which noted the importance of such drawbacks and rebates for exporters of lamps and tubes, cables and wires, radio and auto accessories, tires and tubes and small tools, found this incentive to range from 2 to 60 percent during this period.¹⁷

We have found it impossible to arrive at a meaningful average figure for the export-subsidy equivalent of these benefits by different groups. We may note, however, that the export-share-weighted average rate for the engineering goods studied by Frankena for 1969 turns out to have been between 17.5 and 18 percent.¹⁸ Thus, despite the continuing administrative difficulties attendant on getting this benefit, it would appear that it did provide a fairly sizable export incentive during the post-devaluation period.

State Trading Corporation Losses.

In terms of its announced policies, the STC was prepared during the post-devaluation period to absorb losses on exports of rice, sugar, copra extractions, coffee, fruit and vegetables, processed foods, art silk fabrics, jute goods, cement, plywood, figures and wired glass, sports goods and human hair. During 1969-70 to 1971-72, the major losses were absorbed in art silk fabrics and in jute goods. The export-share-weighted average subsidy on all STC exports assisted in this way, calculated as the ratio of losses to export value, was 14 percent in 1969-70 and 20 percent in 1970-71.¹⁹ The subsidy rates, so calculated, on the two major items, art silk fabrics and jute goods, turn out to have been 23.5 percent and 10.5 percent, respectively, as an average for 1969-70 and 1970-71.

Overall Assessment.

Unfortunately it is nearly impossible to indicate even the orders of magnitude of the benefits implied by the other export incentives which we listed in

the preceding section. Unpublished sample surveys and interviews during 1968 to 1970 strongly suggest that some of these other incentives may well have implied, for specific firms, incentives in the order of 10 to 20 percent on an *ad valorem* basis, particularly in the engineering industry.²⁰

Thus, for example, the grant of "preferred-source" AU import licenses to exporting firms was important in machine tools, diesel engines, small tools, abrasives, tires and tubes, batteries and accessories and transformers, among other products, in 1969-70. The preference for expansion of capacities was claimed to be of importance by the interviewed firms in batteries, tires and tubes and electric lamps, where there was fuller capacity utilization. The occasional ability to procure banned and restricted items under AU imports against export performance also improved profitability in some instances.

The vast complexity of the total "package" of export assistance thus precludes any citing of a reliable number as *the* "effective" equivalent *ad valorem* export subsidy rate during the different years since the devaluation. It is clear, however, that in engineering goods in particular and to a large ex-

TABLE 7-1
Approximate Range of Average Subsidy of Selected Exports
since the 1966 Devaluation

Scheme	Range of Effective, Equivalent Export Subsidy (% of f.o.b.)
1. Cash subsidies	15-20
2. Import replenishment licenses	15-30
3. Domestic materials at international prices ^a	5-15
4. Drawbacks and rebates	10-20
5. Preferential licensing	10-20
6. Total range ^b (i)	50-90
(ii)	55-105

NOTE: These average rates apply mainly to the groups: engineering goods, chemicals and plastics, as mentioned in the text. They conceal considerable variation among individual products. Also note that there are products which are known to have had subsidies outside of the figures we have put down, so that we are indicating only what appear to us, on the basis of the foregoing analysis, to be the average orders of magnitude in subsidization on each account since 1966; and further, that in many of the categories the subsidization moved upwards toward the upper end of the range with the lapse of time.

a. Recall that these are important only for steel and some plastic inputs.

b. (i) excludes row (3) and (ii) includes it. STC losses are excluded from these totals but should be added for art silk fabrics: they amount to 10 to 20 percent of f.o.b. values.

tent in chemicals, plastics and other "new" industries (i.e., sports goods, paper products and processed foods, in the main), the export incentives since devaluation must have averaged around 50 to 90 percent on an effective, *ad valorem* basis (Table 7-1).

NOTES

1. See S. N. Krishnan, *Export Incentives and the Exchange Rates* (New Delhi: USAID, 1967), for detailed statements of the subsidy rates in the two major groups, engineering and chemicals.

2. The notion that this is *not* a subsidy, however, seems to be prevalent in certain bureaucratic circles. It is partly an erroneous result of the notion, which has some economic rationale, that exports must be exempted from import duties on inputs.

3. There *are* qualifications to this method. However, as an approximation, it seems to be the best that can be managed empirically.

4. An additional advantage claimed by importers was that bureaucratic delays were less of a problem than they were with AU licenses. Further, multi-product firms could always use their replenishment licenses to import inputs for "non-priority" production within the firm, even when AU licenses for such purposes were restricted.

5. However, see qualifications below.

6. For some evidence, see Frankena, "Export," pp. 344-346.

7. *Ibid.*, p. 190.

8. Frankena states that "according to press reports, maintenance import licenses were cut 5 percent in 1969-70 for 250 firms in engineering and non-engineering industries and were to be reduced by 20 percent in 1970-71." *Ibid.*, p. 194.

9. We have not been able to secure any systematic and reliable evidence on whether the government sought to effectively subsidize exports by buying preferentially from exporting firms or whether public sector enterprises were *de facto* subsidized in order to promote foreign sale of their production. We should also mention that barter-deal trade which permitted exports at rather better prices than if they had been undertaken in freer markets and correspondingly involved similarly higher import prices in turn, could also be regarded as a form of export-subsidization.

10. In our statistical analysis of export performance in Chapter 9, therefore, we do not use these calculated subsidy rates as inputs into our regressions although it would have been useful to take the subsidy-inclusive export prices as an explanatory variable. Instead of using these rates, we have tried to estimate the impact of the liberalization package through dummy-variable analysis and to assess the results of this analysis in light of the necessarily very rough and broad orders of export subsidization developed in this section.

11. Note that where we did not have detailed breakdowns of exports by relevant subcategories we have used simple average cash subsidy rates and multiplied them by the overall export figure for a category, as with iron and steel. See Frankena, "Export," Table III-7.

12. The details on the domestic and international prices of some major types of steel during this period were acquired by us from the Ministry of Steel and the Engineering Export Promotion Council, Bombay.

13. This figure is obtained from the inter-industry flow table for the year 1964-65 prepared by M. R. Saluja of the Indian Statistical Institute, by dividing the cost of steel

input (at 1960-61 producer's prices) by the value of output (at 1960-61 producer's prices) of electrical equipment, non-electrical equipment, transport equipment and metal products. It is clear that the composition of production will not necessarily correspond to the composition of exports; however, to add this extra sophistication to our exercise would involve tremendous work and still a lot of guesswork.

14. Frankena, "Export," Table III-7. His overall estimate is 3 percent, p. 344.

15. This information is based on unpublished studies conducted by the Administrative Staff College of India, Hyderabad.

16. Thus, in 1968, the international price of low-density polyethylene was Rs. 1,900 per metric ton whereas the domestic price was Rs. 7,480; for polysterene, these prices were Rs. 1,800 and Rs. 6,460, respectively; and for PVC, they were Rs. 1,675 and Rs. 3,944, respectively. The full list of materials available in 1971 at international prices included low-density and high-density polyethylene, PVC resin, polysterene, phenol and urea formaldehyde molding powder and PVC.

17. Administrative Staff College at Hyderabad Sample Survey: results communicated to us in official interviews.

18. In this case, it makes little difference whether one includes or excludes iron and steel.

19. These calculations leave out the items which did not attract losses in the relevant year.

20. Frankena, "Export," p. 191. The author calculates a figure of 25 percent on one license. This underlines the fact that the figures in Table 7-1 represent, as we clearly emphasize, only broad and necessarily rough orders of magnitude.