EXPORT PROMOTION THROUGH BONUS IMPORTS: AN APPRAISAL OF INDIA'S EXPERIMENT

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The purpose of writing this paper is first to describe and then to appraise an experiment in the field of export promotion which was recently tried in India. It will be of interest to many, particularly in underdeveloped countries faced with chronic balance of payments deficits under the pressure of their development programmes, to know how this experiment in export promotion worked and what results, if any, it achieved in India.

I

As a special measure to promote exports of manufactured products, the Government of India introduced a scheme in 1962 whereby import licences were issued against exports of specified products. This was one of the latest of a number of export promotion measures[1] adopted by the Indian Government in recent years until the devaluation of the Indian Rupee on June 5, 1966 when all *other* export promotion measures, including this scheme, were suspended. It is very interesting to note that for quite some time until recently, export promotion did not receive much attention in India. Between 1952 and 1961, India's exports increased at the rate of 1.25% a year. Even more important was the general feeling among the country's planners and academic economists that the prospects of increasing exports were none too bright and also that import-substitution on a large scale was the more appropriate policy to adopt, little appreciating that import-substitution would put even greater strains on the country's balance of payments in the initial stages.

For each export product covered by this particular scheme of export promotion, a specified percentage of the F.O.B. value of the export item was allowed as what was called 'import entitlement.' What is novel in the Indian scheme is not the fact that import entitlement was related to export performance but, as we shall observe, the manner in which the two were linked. Pakistan too has had an import entitlement scheme, called Bonus Voucher Scheme, in existence since 1960.

For the purposes of the Indian scheme, all exports can be said to have been divided into two groups: one which did not suffer from any price-disadvantage in the international market and a second which suffered from price-disadvantage in the international market. The exports eligible for import entitlement under the scheme belonged to the latter group and they

1 See Manmohan Singh, *India's Export Trends*, Oxford, Clarendon Press, 1964, pp. 337–340 for a full description of current export policy in India.

comprised less than 20% in value of the total yearly exports from India. These included cotton and rayon textiles, woollen and silk fabrics, vegetable oils, engineering goods, chemicals and allied products, sport goods, handicrafts, and carpets. The balance of exports comprising over 80% in value of the total yearly exports belonged to the first group and consisted largely of traditional items which "did not require any major assistance for promoting their exports because in most cases their internal prices were more or less at par with the international prices of these products."[2]

The import licence acquired under this scheme in India could be used for the import of raw materials required in the manufacture of export products and also for the import of machinery and parts. Further, the entitlement might be availed of by the exporter himself or transferred or sold to another manufacturer who (a) manufactures products covered by the scheme and (b) exports (or sells for export) a part of his products.

The total value of import licences issued under the Indian scheme rose from $70 million a year during 1962 and 1963 to between $100 and $110 million in 1964 and 1965. The scheme was suspended in mid-1966 when the Rupee was devalued by 36.5%.

The objective in offering import entitlements was, to put it in the words of the 1964–65 Report of the Indian Ministry of Commerce, "to keep the [export] industries modernized and to assist them with imported essential raw materials, components, etc., which are not indigenously available." In this manner, the Report argued, the manufacturers/exporters of the export items eligible for import entitlement under the scheme were provided with "a dependable source of availability of these raw materials and components as compared to the manufacturers and producers who are too much attracted by the sheltered internal markets and internal higher prices and, therefore, do not desire to export."

Much more importantly, however, the import entitlement offered under this particular scheme was supposed to make exporting an attractive business.[3] The scheme could be said to offer incentive in two ways: (a) in the almost automatic entitlement to import the inputs which were not locally available, and (b) in the entitlement to import *over and above* the actual import-content of the export product. No doubt, even a manufacturer producing for the local market would be entitled to an import licence of the value of imported inputs, i. e., which covered the cost of his inputs not locally available, but it might not be granted as expeditiously as the licence to exporters against

2 See "1965–66 Report of Ministry of Commerce," Government of India, New Delhi, p. 32.

3 It helped them, to quote from the same Report, "to partly compensate for the loss in exports and partly to be competitive with the non-exporting manufacturers in the country." We doubt that the exporters actually incurred losses on all items covered by the scheme. What the Report probably meant was that this scheme made exporting a more remunerative business than before, and therefore more attractive than selling in the local market.

entitlement under this scheme.[4] It is the second part of the entitlement, however, which contained a clear element of bonus of subsidy, the extent of subsidy, of course, depending on the premium the licence for the import of the particular machinery or raw material commands. Assuming that the premium was high, the bonus element of import entitlement could be said to have introduced substantial differentiation in favour of production for export as against production for internal sale.[5]

II

The general principle for determining the import entitlement under the Indian scheme was to allow by way of import "*twice the import-content*" of an export product "subject to a maximum of 75 per cent of the F. O. B. value of exports."[6] In actual practice, however, for certain items import entitlement was, at one stage, fixed at even 100%. Among the group, Engineering Goods, as many as 29 items were listed for 100% import-entitlement. The import entitlement for engineering goods ranged from 20% for items like wooden furniture, gramophone records, and bicycle components to 100% for non-ferrous semis, alloys and fully-processed manufactures, and stainless steel products.[7]

It follows from the general principle laid down for determining the import entitlement that, while half the value of import licence acquired under the Indian scheme might be said to compensate the manufacturer/exporter for the foreign exchange that he used up in manufacturing the product and exporting it,[8] the other half could be taken to represent the bonus intended to offer a subsidy to exporters.

As was stated earlier, Pakistan too has had a scheme of import entitlement and the scheme is still extant. Under Pakistan's scheme also, an exporter is entitled to what is called a bonus import voucher of the value of 75% of the F.O.B. value of export but one earns this entitlement in Pakistan regardless, ostensibly at least, of the nature or import-content of the export product. Further, the exporter in Pakistan can either sell or transfer the voucher or

4 Under a régime of strict import licensing as obtains in India, obtaining an import licence is no doubt bound to take time and, therefore, any measure that reduced this time-lag can have a strong promotional impact.

5 The premium that an import licence for some products has commanded in India in recent months was as high as 400%.

6 See "1965–66 Report of Ministry of Commerce," Government of India, New Delhi, p. 31.

7 Later in the year 1965, the rate-schedule was revised so that no export item got more than 75% in import entitlement.

8 We deliberately put it in this way because under the scheme, one was not obliged to export one's produce *on* utilization of import entitlement. Having once effected the export of the product eligible for import entitlement, one became entitled to an import licence regardless of whether one partook in the subsequent export-cum-entitlement round or rounds. Advance licensing for the import of raw materials was permitted under special circumstances to enable an exporter to fulfil his export contracts.

use it for importing almost anything including luxury items. In this respect, import entitlement under Pakistan's scheme can be said to hold a greater attraction than did import entitlement under the Indian scheme.[9]

Table 1. BONUS ENTITLEMENT UNDER THE INDIAN IMPORT ENTITLEMENT SCHEME

Export Product	FOB Value	CIF Value of Import-Content	Net Export Earnings (2)−(3)	Import Entitlement		Net Foreign Exchange Earning (4)−(6)	Bonus Entitlement as Percentage of Net Export Earnings (6)÷(4)
				Against Import-Content	Towards Bonus		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
A	100	10	90	10	10	80	11
B	100	15	85	15	15	70	18
C	100	20	80	20	20	60	25
D	100	25	75	25	25	50	33
E	100	30	70	30	30	40	43
F	100	37.5	62.5	37.5	37.5	25	60
G	100	50	50	50	50	0	100
H	100	60	40	60	40	0	100
I	100	70	30	70	30	0	100
J	100	80	20	80	20	0	100
K	100	90	10	90	10	0	100
L	100	100	0	100	0	0	100

Note: Import entitlement is calculated at 'twice the import-content,' and is distributed equally between columns 5 and 6 until we reach product H. For products H to L, import entitlement equals 100, of which the bonus part is the balance left after deducting the cover against import content.

In Table 1, export products have been classified under twelve categories[10] and net foreign exchange earnings have been calculated separately for each of the categories. The categories are arranged in the ascending order of total import entitlement. Also, a distinction has been drawn between 'Net Export Earning' and 'Net Foreign Exchange Earning' in the following manner:

(1) Net Export Earning=[F.O.B. value of Export]−[C.I.F. value of Import-content]

(2) Net Foreign Exchange Earning=[F.O.B. value of Export] −[Total Import Entitlement]

Since by definition:

(a) Total Import Entitlement=[Entitlement against Import-content] +[Entitlement towards Bonus]

9 Whether the 'liberal' import entitlement in Pakistan commanded a higher premium than the 'restrictive' import entitlement did in India would, of course, depend on the over-all situation in each country with respect to the availability or non-availability of foreign exchange.

10 This follows broadly the classification of Engineering Goods made under the Indian scheme.

and (b) Entitlement against Import-content=C.I.F. value of Import-content

Therefore, by substitution:

(3) Net Foreign Exchange Earning=[Net Export Earning] −[Entitlement towards Bonus]

The distinction drawn above is, as will be observed, very helpful. It brings out the incidence of bonus imports, as represented by import entitlement towards bonus, on foreign exchange earnings. While for product A, foreign exchange earnings decline from $90 to $80, for product G they decline from $50 to zero (see column 7 of Table 1). Further, this distinction enables us to see clearly the relationship under the Indian scheme between entitlement towards bonus and net export earnings. For product A, whose net export earning is $90, bonus entitlement is $10, whereas for product G, whose net export earning is $50, bonus entitlement is as high as $50 (see column 6 of Table 1). Thus, the lower the net export earnings of an export product, the greater is the bonus entitlement it earns under the existing scheme. That is, a higher bonus was offered to an export product yielding a smaller net export earning.

Table 2. BONUS ENTITLEMENT UNDER PAKISTAN'S BONUS VOUCHER SCHEME

Export Product	FOB Value	CIF Value of Import-Content	Net Export Earnings (2)−(3)	Import Entitlement		Net Foreign Exchange Earnings (4)−(6)	Bonus Entitlement as percentage of Net Export Earnings (6)÷(4)
				Against Import-Content	Towards Bonus		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
A	100	10	90	10	65	25	72.2
B	100	15	85	15	60	25	70.6
C	100	20	80	20	55	25	68.7
D	100	25	75	25	50	25	66.7
E	100	30	70	30	45	25	64.3
F	100	37.5	62.5	37.5	37.5	25	60
G	100	50	50	50	25	25	50
H	100	60	40	60	15	25	37.5
I	100	70	30	70	5	25	16.7
J	100	80	20	80	—	20	0
K	100	90	10	90	—	10	0
L	100	100	0	100	—	0	0

Note: Since under Pakistan's Bonus Voucher Scheme, import entitlement is set at 75% of FOB value of exports, the figure in Column 6 for each product is worked out as follows:

Import entitlement towards bonus for product A=(75−10)=65

and so on till we reach product J. Since the CIF value of the import-content of product J is 80%, it is assumed that the total import entitlement for product J would not be below 80%, if at all it must be manufactured and exported. The same would be true of products K and L. Thus on products J to L, the exporter does not get any bonus entitlement.

On the other hand, under Pakistan's Bonus Voucher Scheme, although there is no explicitly stated connexion between import entitlement and import-content, the bonus element of import entitlement can clearly be seen to increase with the increase in net export earnings. As can be seen from Table 2, for product A bonus entitlement under the Pakistan scheme works out to $65, whereas for product G it works out to $25 (see column 6).

On the assumption that export products with import-content exceeding 50% were also covered by the Indian scheme under review, but subject to an effective ceiling of 100% *total* import entitlement, the position with regard to bonus entitlement would be as is worked out for categories H to L in Table 1. Thus it is not that the export product with high import content, say 60%, was not entitled to any bonus but with the effective ceiling of *total* import entitlement at 100%, bonus entitlement would not exceed 40% of the F.O.B. value of export.[11]

It can be observed from Table 1 that under the Indian scheme, the *bonus entitlement increased as net export earnings declined* until we reach the export product 'G'. For products G to L, bonus entitlement as a proportion of net export earnings remained constant at 100% (see column 8 of Table 1) and *total* import entitlement worked out to 100% of F.O.B. value. The question naturally arises: What did the economy stand to gain from allowing 100% *total* import entitlement? Obviously, the gain in foreign exchange earning in such cases was nil. The only defence for giving 100% total import entitlement could be that it was a purely temporary measure intended to help manufacturers/exporters in these particular lines to establish their foothold abroad. But it would then follow that once this was achieved, the quantum of import entitlement would be reduced so that these exports started contributing to the country's net foreign exchange earnings.

No doubt, imports against bonus entitlements entailed an additional outlay of foreign exchange. Nevertheless, such bonus imports were sanctioned under the scheme because bonus imports, it was felt, would help in securing an increase in net foreign exchange earnings. Net foreign exchange earning is, as we have indicated above, obtained by deducting the value of bonus imports from net export earning which, in turn, is obtained by deducting the C.I.F. value of import-content from the F.O.B. value of an export product. With a view, therefore, to achieving the objective of such a scheme as the one under review, the import bonus should be related either (a) *positively* to net export earning, or (b) *negatively* to the import content of the export product. When the bonus is linked in this manner the natural tendency on the part of the exporters would be to go for exports with lower import content and the urge will be to increase (and maybe even overstate) the local content of the export product. This is how they could earn the maxi-

11 Thus for export products with import-content of over 50%, *total* import entitlement worked out to less than twice the import-content. In this particular case of 60% import-content, the bonus would be 40%. If, however, the effective ceiling on *total* import entitlement were 75%, the bonus in this case would be only 15%.

mum import bonus. If, however, by some strange quirk of logic the import bonus was linked positively to the import-content of an export product, the tendency on the part of the exporter would naturally be to go in for the export of products with higher import-content. Also, there would be an urge to increase (and if possible, even overstate[12]) the import-content. But this clearly vitiates the whole purpose which the import bonus is intended to serve.

Strangely, however, under the scheme of import entitlement, as it operated in India, the import bonus did increase with the increase in import-content, with the result that the import bonus as a proportion of net export earnings declined with the increase in net export earnings (see column 8, Table 1).

The same cannot be said of Pakistan's Bonus Voucher Scheme under which bonus entitlement as a proportion of net export earning increases with the increase in net export earning (see column 8 of Table 2), although the scheme does not explicitly seek to link bonus imports with either net export earning or import-content.

III

This brings us to the question of appraising the results achieved in India under the above scheme. In order to appraise the achievements of the scheme, we have attempted to relate (a) *the increase in net foreign exchange earnings* from the export products covered under the scheme to (b) *the total outlay on bonus imports* during a year. As we observed at the very outset, the bonus part of import entitlement should have made a material difference to the exporter and is, therefore, the relevant part to be taken into account in making the appraisal. Also, the bonus imports represent the additional cost in foreign exchange incurred under the scheme.[13] Further, the *total outlay*, and *not just the increase in outlay*, on bonus imports is taken into account because it is the entire outlay and not just the increase in outlay on bonus imports during any year which is directed to securing increased net foreign exchange earnings.

Let us now apply this criterion to the performance between 1962 and 1965.[14] On the assumption that half the value of total import entitlements

12 It must be conceded that if the import bonus did not vary from transaction to transaction, no gain would accrue from either overstatement of import content or understatement of local content. But exporters could still shift, with advantage, from a product earning a lower import bonus to that earning a higher import bonus per dollar worth of export, and the latter would in this case be the product with a higher import content.

13 Our assumption is that the other part of import entitlement (i. e., the cover against import-content) would have been given in any case. But we must concede that our assumption might not be entirely valid. It is generally accepted that several industries in India are currently working below capacity, mainly for want of imports of raw materials and intermediates in adequate quantities. In such circumstances, it could well be argued that even that part of the entitlement which covers the import content of an export product is given to raise the utilization of capacity but with a view *not* to increasing the availability of output locally but to increasing exports.

issued under this scheme represented bonus entitlement, the bonus imports in the year 1964 would be around $55 million. If, however, one allowed for the fact that for certain export products (like products H to K) bonus will work out to less than 50% of import entitlement, bonus imports for 1964 might be put at $50 million. As against this, while the *increase* in the *F.O.B. value* of export products covered by the scheme in 1964 over 1961 was $110 million,[15] the increase in net foreign exchange earnings attributable to the same export products was only $42 million.[16]

Thus it might be claimed that the Indian scheme of import entitlement was responsible for an increase in the country's net foreign exchange earnings to the extent of $42 million a year.[17]

India's *total* merchandise exports in 1964 exceeded those in 1961–62 by $310 million. The corresponding net increase in foreign exchange earning may be put at $208 million.[18] As against this, the maximum net foreign exchange earning under the above scheme is estimated at $42 million. Thus the net maximum gain to India in 1964 on account of this scheme can be put at 20% of the estimated increase in total net foreign exchange earning. Thus the contribution of the exports assisted under the scheme (comprising 20% of the total exports to the country) to the additional foreign exchange earning was about the same as that of the exports belonging to the category not eligible for assistance under the scheme.

In appraising the above result, one could, no doubt, take the stand that since the objective of the scheme was to rectify the price disadvantage from which the items assisted under India's import entitlement scheme suffered in

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14 To adjudge the success or failure of the scheme on the basis of 1965 performance would be unfair because special circumstances prevailed in 1965. We have, therefore, made our appraisal on the basis of 1964 figures.

15 This is the excess of the 1964 value of the exports covered under the scheme over the corresponding figure for 1961–62. In 1965, there was a decline of about $21 million in these exports and this was entirely accounted for by vegetable oils because production of oil seeds suffered precipitously because of bad weather.

16 This is worked out by deducting from $110 million, (i) $50 million, the amount of bonus entitlement estimated for 1964 and (ii) $18 million, the estimated import-content of the increased exports assuming that the import coefficient is the same as for the total exports (viz., 0.1635) covered under the scheme.

17 It may well be argued that not the entire increase can be attributed to bonus imports. In 1962–63, a rebate of one-tenth of income tax was allowed on income *attributable* to all exports and in 1963–64, exports of certain industries were offered an additional rebate of tax on 2% of their exports. (See my article, "Export Promotion through Tax Incentives," *The Economic Weekly* (1965), pp. 1659–64, for an appraisal of tax incentives offered to exporters in India.) Both these concessions should have contributed, to some extent at least, to this increase.

18 This is calculated by deducting from $310 million, (i) $50 million, the amount of bonus entitlement estimated for 1964, and (ii) $52 million, the estimated import content of all additional exports assuming that the import coefficient is the same as for the exports covered by the import entitlement scheme.

the international market, the scheme can be said to have fulfilled its purpose satisfactorily by having contributed to the country's net foreign exchange earnings at the same rate as that shown by the items of exports which did not suffer from such price disadvantage.

Nevertheless, it cannot be overlooked that India's import entitlement scheme could have yielded the same result at a lower cost, i. e., involving a smaller outlay of foreign exchange on bonus imports, than was actually incurred. To put it differently, the scheme should have yielded better results at the same cost if the incentive it offered in the form of import bonus were not so patently misdirected. The cost incurred under the Indian scheme to earn every dollar of additional foreign exchange would have been lower if the import bonus it offered were linked positively *not* to import content of the export product *but* to its net export earnings, as, for instance, is achieved by Pakistan through its Bonus Voucher Scheme. This, however, should not be taken to suggest that within the category eligible for assistance under the scheme distinction should not have been drawn on the basis of the price-disadvantage suffered by the items in the international market. What certainly is suggested is that between two items of export within this category, an item with higher net export earning for every dollar of the country's gross receipt from export (i. e., with lower import content) should earn a larger import bonus than the other item with lower net export earning (i. e., with higher import-content).

And who knows if the import entitlement scheme in India had been so designed as to secure the best results at minimum cost, the urgency of taking recourse to the extreme measure of devaluing the Rupee might have been averted altogether!