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Customs Duties in India: Progressive Rationalisation and Rethinking

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ABSTRACT

Customs duties are imposed to raise revenue for the government. Apart from the revenue function, import duties provide a protective barrier for domestic industries. Radical reforms have been introduced in the import tariff since 1991. These reforms were necessary because the customs tariff had become, over the years, very complicated in terms of multiple rates, innumerable exemptions, excessive controls, and elaborate procedures. These infirmities of the customs tariff often led to delays, harassment, corruption, and litigation. Moreover, rationalisation and simplification of the customs duties was needed to move towards a market economy, freedom of trade, and opening up the Indian economy to the outside world. The country has moved towards moderate rates of taxation with a view to improve compliance and reduce litigation.

***Keywords**: Customs duties, Reforms, Rationalisation, Export duties.*

1.0 Introduction

Just as domestic production flows provide the base for excise taxation so also international trade flows are the basis for customs duties. Customs duties are probably the most ancient form of taxation. They are as old as international trade itself. Customs duties are payable on goods exported from or imported into a country. Import duties are usually levied with *ad valorem* rates and their base is determined by the domestic value of the imported goods calculated at the official exchange rate. Similarly, export duties are imposed on export values expressed in domestic currency. Customs duties are imposed to raise revenue for the government. Apart from the revenue function, import duties provide a protective barrier for domestic industries. Other measures to protect indigenous industries from foreign competition include import licensing, import quotas, and outright import ban.

1.1 Legal framework

The Constitution of India grants exclusive powers to the Central Government to

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impose duties of customs. By virtue of entry 83 of List I in the Seventh Schedule of the Constitution of India, the Central Government is empowered to impose 'duties of customs including export duties'.

During the British rule, various customs and tariff enactments were passed from time to time, the following two being the main: 1. The Sea Customs Act, 1878, and 2. The Tariff Act, 1934. After Independence, the Sea Customs Act and other allied enactments were repealed by a consolidating and amending legislation entitled the Customs Act, 1962. Similarly, the Act of 1934 was repealed by the Customs Tariff Act, 1975.

1.2 Types of customs duties

In accordance with the provisions of the Constitution, various types of customs duties are imposed by the Government under different Acts of Parliament. Following are the important customs duties levied on goods imported into or exported from India.

***Basic Customs Duty*: ** Under Section 12 of the Customs Act, 1962 (the main enactment), all goods imported into India are chargeable to a duty. The rates of this duty, popularly known as basic customs duty, are indicated in the First Schedule of the Customs Tariff Act, 1975. The duty may be a percentage of the value of the goods or at a specific rate. The Central Government has the power to reduce or exempt any goods from these duties.

***Additional (Countervailing) Duty of Customs*:** Under Section 3(1) of the Customs Tariff Act, 1975, an additional duty on goods imported into the country is leviable. The rate of this duty, popularly known as countervailing duty, is equal to the excise duty on like articles if produced or manufactured in India. If the rate of this duty is on *ad valorem* basis, the value for this purpose will be the total of the value of the imported article and the customs duty on it (both basic and auxiliary). The underlying philosophy of a countervailing duty is to ensure that the protection provided by the import duty to domestic industry is not reduced. Till the early 1960s, countervailing duty was levied on a select basis on products which were considered to erode the margin of protection to the domestic industry on account of the excise duty. In course of time when the number of excisable goods increased, the selective use of countervailing duty was found to be inadequate and complicated. Therefore, the Indian Tariff Act, 1934, was amended in 1963 to insert a new Section 2A to provide for the levy of countervailing duty in all cases where excise duty was leviable on a similar indigenous commodity.

***Export Duty*:** Under Section 12 of the Customs Act, 1962, goods exported from India are chargeable to an export duty. The items on which export duty is chargeable and the rate at which the duty is levied are given in the Second Schedule of the Customs

Tariff Act, 1975. Under Section 8 of this Act, the Government enjoys emergency powers to increase the existing rate or to levy fresh export duty depending on the circumstances.

***Cesses on Exports*:** Certain cesses are leviable on specified articles of export under various enactments of the Government of India. These cesses are collected as duties of customs and handed over to the agencies in-charge of the administration of the commodity concerned. Presently, cesses are imposed on exports of coffee, coir, lac, mica, tobacco (unmanufactured), oil cakes and meal, marine products, cashew kernels, black pepper, cardamom, iron ore, animal feed and turmeric.

2.0 Revenue Significance

The relative contribution of customs revenue in the total tax yield of the Central Government has shown fluctuations due to changes in the foreign exchange situation, domestic production levels, and trends in international trade. For example, in the late 1950s, several restrictions and bans were imposed on imports in view of the difficult foreign exchange position, resulting in fall in revenue from import duties.

During pre-Independence days and even during early post-Independence period, customs duties formed the mainstay of Central tax revenues. However, the relative share of customs duties started declining from early 1950s in view of protective trade policy and dwindling foreign exchange reserves. The share of customs revenue in Centre's total tax collections dropped from 38.9 percent in 1950-51 to as low as 16.3 percent in 1970-71. Since then, customs revenue has maintained an upward swing, accounting for 25.8 percent in 1980-81, and 35.8 percent in 1990-91 (Table 1.1). This upward trend was attributable to the changed emphasis from physical to fiscal controls to regulate imports. As the Long Term Fiscal Policy, 1985, maintained, "The basic thrust of customs tariff reforms will be to place increasing reliance on tariffs to regulate imports and progressively reduce the role of quantitative restrictions in this regard. The move in this direction should increase revenues, encourage less import-intensive forms of production, moderate the unjustifiably high protection granted by quantitative restrictions to certain industries and reduce the delays and uncertainties associated with the administration of import licensing." (*Government of India, 1985, p.40*)

Of late, there has been a decline in the relative importance of customs as a source of revenue. In 2000-01, the share of customs revenue in the total Central tax collections stood at 25.2 percent which further declined to 17.1 percent in 2010-11. It was estimated at 14.8 percent in the budget for 2014-15 (Table 1). This reversal of trend is due to opening up of the economy and the policy of progressively reducing import duties.

Presently, customs revenue is mainly composed of import duties levied on a wide range of commodities. In the budget estimates for 2014-15, import duties accounted for Rs. 1,98,551 crore (98.4 percent) of total customs revenue of Rs. 2,01,819 crore (Table 2). Apart from revenue function, import duties act as policy instrument to provide protection to domestic industry, conserve and ration scarce foreign exchange, and frame general international trade policy.

Table 1: Trends in the Relative Significance of Customs Duties in Gross Tax Revenues* of the Central Government: Selected Years

(Rs. crore)

Central taxes	1950-51	1960-61	1970-71	1980-81	1990-91	2000-01	2010-11	2014-15
A+B Gross tax revenues	404 (100.0)	888 (100.0)	3,206 (100.0)	13,179 (100.0)	57,576 (100.0)	1,88,603 (100.0)	7,93,072 (100.0)	13,64,524 (100.0)
A. Direct taxes	174 (43.1)	290 (32.6)	870 (27.1)	3,004 (22.8)	11,025 (19.1)	68,306 (36.2)	4,45,962 (56.2)	7,36,221 (54.0)
B. Indirect taxes of which	229 (56.7)	599 (67.5)	2,337 (72.9)	10,175 (77.2)	46,552 (80.9)	1,20,297 (63.8)	3,47,110 (43.8)	6,28,303 (46.0)
Customs duties	157 (38.9)	170 (19.1)	524 (16.3)	3,409 (25.8)	20,644 (35.8)	47,542 (25.2)	1,35,813 (17.1)	2,01,819 (14.8)

* Before transferring States' share in Central taxes; 2014-15 Budget estimates.

Figures in parentheses are corresponding percentages of gross tax revenues.

Sources: Government of India, Ministry of Finance, *Explanatory Memorandum on the Budget of the Central Government* (various years); *Receipts Budget* (various years); and *Budget at a Glance*, 2014-15.

Although at present the share of export duties in customs revenue is very low (1.6 percent in the 2014-15 budget), it was not always so. In the early 1950s, export duties formed a significant proportion of customs revenue, though this situation could not be maintained for long. The yield from export duties reached a peak figure when it formed 29.9 percent of total customs revenue in 1950-51. By 1960-61, export duty revenue had been reduced to 8.2 percent of total customs revenue.

Another upsurge in the relative share of export duties is observed in 1970-71 when they formed 12.0 percent of customs revenue. Since then, the revenue importance of export duties has decreased (Table 2). Like excise levies, the revenue from import duties is also concentrated in a select few commodities including petroleum oils and crude, electrical machinery, organic chemicals, project imports, plastics etc. These are the items which form the bulk of India's imports and hence customs revenue.

Table 2: Trends in the Relative Shares of Import and Export Duties in Total Customs Duties: Selected Years

(Rs. crore)

Year	Customs duties	Import duties	Export duties	As percent	
				Col.3 of Col. 2	Col. 4 of Col. 2
1	2	3	4	5	6
1950-51	157	110	47	70.1	29.9
1955-56	166	128	38	77.1	22.9
1960-61	170	156	14	91.8	8.2
1965-66	539	537	2	99.6	0.4
1970-71	524	461	63	88.0	12.0
1975-76	1,419	1,336	83	94.1	5.9
1980-81	3,409	3,292	117	96.6	3.4
1985-86	9,526	9,443	83	99.1	0.9
1990-91	20,644	20,532	36	99.5	0.5
1995-96	35,757	35,647	110	99.7	0.3
2000-01	47,542	47,400	142	99.7	0.3
2005-06	81,800	81,015	795	99.1	0.9
2010-11	1,35,813	1,32,541	3,272	97.6	2.4
2011-12	1,49,328	1,42,849	6,479	95.7	4.3
2012-13	1,65,346	1,62,496	2,850	98.3	1.7
2013-14	1,75,056	1,72,239	2,817	98.4	1.6
2014-15	2,01,819	1,98,551	3,268	98.4	1.6

2013-14 Revised estimates; 2014-15 Budget estimates.

Sources: Government of India, Ministry of Finance, *Explanatory Memorandum on the Budget of the Central Government* (various years); *Receipts Budget* (various years).

3.0 Import Tariff Policy

Early Post-Independence Period: Soon after Independence, the Government decided to follow a restrictive import policy, particularly in view of the rapid depletion of sterling balances. In his very first budget (1947-48) of independent India, the Finance Minister outlined the salient features of this restrictive policy in the following words:

"Broadly speaking, that policy consists of dividing imports into three categories: free, restricted, and prohibited. Imports of food, capital goods, the raw material of industry and certain essential consumer goods are free and no exchange restrictions

are placed upon their imports. Consumer goods which are not absolutely essential are licensed on a quota basis, while others which in the context of the economy of this country must be regarded as totally unessential and luxury imports have been altogether prohibited."[1]

During the early post-Independence period, customs policy remained in turmoil owing to a series of domestic and international happenings. India's commitments under the General Agreement on Tariffs and Trade (GATT) were given effect to in 1948, the rupee was devalued in September 1949, and the Korean War broke out in 1950. Being a signatory to GATT, India could not raise, above a certain level, import duties on a wide variety of goods, but enjoyed reciprocal concessions from its trade partners. Imports of articles which enjoyed concessions under GATT constituted 19 percent of the value of total imports while the value of exports which received concessions was 79.6 percent of our total exports in 1952-53. The concessions obtained included items like mica, cashewnut, and various jute goods. The concessions granted pertained mainly to consumer goods and machinery. Since the actual rates of import duty on machinery, which formed the bulk of imports, were already low than the rates fixed by the Agreement, the effective concessions were chiefly on consumer goods. Although the Fiscal Commission, 1949-50, supported India's adherence to GATT in view of the need for international co-operation, the country later on felt the need to withdraw from GATT 'bindings' when the domestic production base was strengthened and diversified. Following re-negotiations in 1971 and 1973, a host of items 'bound' under GATT were freed to provide protection to domestic industries.

After the outbreak of the Korean War, important changes were introduced in the tariff structure under the Finance Act, 1951. The general surcharge of one-fifth on import duties (levied in 1942) was increased to one-fourth. The rate of surcharge on liquors which was fixed at 100 percent in 1948 was raised to 155 percent.

In pursuance of its general policy of gradually replacing quantitative restrictions by higher import duties, the Government raised import duties on a number of items including articles made of paper, cutlery etc., in the 1955-56 budget. Simultaneously, import quotas were liberalised. The already high level of import duties, particularly on luxury articles, did not leave much scope for raising additional revenue from this source, a fact lamented by the Finance Minister in his 1957-58 budget (final) speech.

Customs Reorganisation Committee (Chairman: F.C. Badhwar), 1957-58: In January 1957, the Government of India appointed the Customs Reorganisation Committee under the chairmanship of F.C. Badhwar. The Committee was asked "to conduct a comprehensive enquiry into customs procedures and organisation and to make recommendations for their improvement." The Committee found that a major cause of

disputes and delays in the clearance of imported goods was the faulty and inadequate classification system for determining customs tariff. It observed, "The complexity of the Customs Tariff will be evident from the fact that the whole range of goods constituting the country's foreign trade are grouped under 576 tariff items only as compared with 4850 classification heads in the 'Statistical Indian Trade Classification' which has recently been adopted for purposes of recording the country's trade statistics. Whilst the range and variety of imported goods have been continuously expanding in the post-war period, there has been little or no corresponding revision or elaboration of the customs tariff schedule." (*Government of India, 1957-58, p.12*)

The Committee was also critical of too many rates of duty. It commented, "we should similarly point out the existence in the Indian Customs Tariff of too wide a range of *ad valorem* rates of duty which must inevitably add to the difficulties in the day to day application of the tariff, particularly when tariff descriptions carrying different rates could apply to the same article. Almost all multiples of 5 up to 100 are to be found in these rates." (*Government of India, 1957-58, p.13*).

The Committee recommended, *inter alia*, (a) thorough revision of the Customs Tariff by aligning it closely with the Import Trade Control Licensing Schedule, and (b) removal of anomalies in rates of duty for similar categories of goods.

The worsening foreign exchange crisis reached its climax when in 1965 foreign exchange reserves touched the critically low level of less than Rs. 100 crore. Moreover, the Customs Reorganisation Committee, 1957-58, had criticised the multiplicity of tariff rates. Consequently, a drastic rationalisation of the import duty structure was undertaken in 1965, resulting in the introduction of a set of three rates of import duty: 40 percent on basic raw materials, 60 percent on semi-processed and intermediate goods, and 100 percent on finished consumer goods. The Committee on Rationalisation and Simplification of Tax Structure, 1968, also favoured few rates of import tariff. It opined, "Except for a few 'luxury' items like watches, jewellery, alcoholic beverages and perfumes, there is need only for three or four rates of duty." (*Government of India, 1968, p. 14*). In spite of the rationalisation exercise of 1965, duty changes were made frequently depending upon the emerging situation. The three rates of import duty were scaled down following devaluation of the rupee in June 1966 to prevent the cost of imports going up to the full extent of the devaluation. However, in view of the difficult balance of payments position, the rates of import duty were gradually restored in due course to pre-devaluation levels. Rationalisation of import tariff was again attempted in 1971 when the following four rates of import duty were introduced: 30 percent, 40 percent, 60 percent, and 100 percent.

Indirect Taxation Enquiry Committee (Chairman: L.K. Jha), 1978: The Indirect

Taxation Enquiry Committee, 1978, examined at length the structure of import duties and recommended its rationalisation on the following lines, "(a) a levy adequate to give the degree of protection deemed necessary for particular products, (b) a revenue element, which would generally be the countervailing duty, being equal to the excise duty leviable on the same or similar domestic product, and (c) a regulator element which will be used on such factors as reinforcing import restrictions, preventing excess profits on account of scarcity of products in domestic market, and generally to regulate imports from the angle of conserving foreign exchange." (*Government of India, 1978, p. 139*)

Long-Term Fiscal Policy, 1985: The need for import tariff rationalisation was underlined in the Long Term Fiscal Policy (LTFP), 1985, also. The official document noted that the prevailing tariff rates were high and the tariff system was very complicated. Therefore, it stressed the need to reduce the rates and simplify the system. For carrying out these reforms, the LTFP distinguished between the following broad categories of imports:

1. Capital goods.
2. Raw materials.
3. Other intermediate goods including components.
4. Essential consumer goods like foodgrains, edible oils, and life saving drugs.
5. Non-essential consumer goods.

Understandably, essential goods were preferred to either remain exempt or bear low rates of import duties while non-essential items were singled out to either remain banned or subjected to high import tariff. Regarding the first three categories of goods the LTFP observed, "Ideally, in the long-run, there is a strong case for subjecting all capital goods, raw materials, components and other intermediate products to the same rate of nominal tariff. This system, if it could be implemented, would have several important advantages. First, the substitution of the present multiplicity of nominal tariff rates by a single rate would constitute an enormous simplification for both trade and industry as well as for the customs administration. Second, this would vastly reduce incentives for misclassification of imports to evade taxes. Third, a single nominal rate of import duty would assure a uniform rate of effective protection (that is, protection of value added) at different stages of production of intermediate and capital goods. This would encourage the economy to specialise in those activities in which it has competitive strength." (*Government of India, 1985, p.41*)

However, the LTFP cautioned that a major deviation from the present pattern of import tariff is not immediately feasible. Domestic industries have grown under different levels of protection and are in different stages of maturity. The rationalisation of import tariff has to be phased over a long period providing some differentials in import tariff

short of a uniform system of duties.

Consequent upon the rationalisation of import tariff on capital goods by the Finance Act, 1987, the rate of import duty on general machinery was reduced to 85 percent *ad valorem*. Import duty on components for machinery was fixed at 15 percent below the applicable rate on complete machines. This differential, in line with the recommendations of the LTFP, was intended to encourage the domestic production of capital machines instead of their total imports. Imports of capital goods for certain preferred sectors were allowed at relatively low rates of duty. For example, duty on equipment for fertiliser plants was 15 percent *ad valorem* and on machines, equipment, and tools for gem and jewellery 25 percent *ad valorem*. Electronics industry emerged as a preferred sector for fiscal incentives. The Finance Act, 1988, fixed a uniform concessional import duty of 60 percent *ad valorem* in respect of 280 items of machinery for the electronics sector. By the same Act, the duty on moulds, tools, and dies required by the electronics industry was reduced from 60 percent to 30 percent *ad valorem* with the underlying purpose of indigenisation and development of electronics and computers.

In short, guidelines suggested by the LTFP for reform of import tariff were never implemented comprehensively. In a half-hearted manner, some rationalisation of rates was effected in the case of components of capital goods, drug intermediates, and electronic goods.

In mid-l991 when the new Government assumed office at the Centre, it began the process of reducing import duties. The Finance Act (No. 2), 1991, reduced the *ad valorem* rate of basic plus auxiliary duties of customs to a maximum of 150 percent where it was more than that. Thus, tariff peaks above 150 percent were eliminated with the exceptions of duty on imported alcoholic beverages and passenger baggage. The then prevailing rates of import duty on capital goods for general projects and machinery were reduced from 85 percent to 80 percent. The rate of duty on their components was also reduced by 5 percentage points from the existing level of 65 percent.

Tax Reforms Committee (Chairman: Raja Chelliah), 1991: Reform of the customs tariff was high on the agenda of the Tax Reforms Committee constituted by the Government in August 1991. Its terms of reference enjoined it to examine and make recommendations, *inter alia*, on "simplification and rationalisation of customs tariffs with a view to reducing the multiplicity and dispersion of rates and to eliminate exemptions which have become unnecessary; (and) reducing the level of tariff rates, keeping in view the need for mobilising resources to facilitate fiscal adjustment and the objective of promoting international competitiveness." (*Government of India, 1991, p.1*)

In its Interim Report submitted to the Government in December 1991, the Committee suggested the following as elements of the programme of import tariff

reform, "(a) reduction of the general level of tariff, (b) reduction of the spread or dispersion of tariff rates, (c) simplification of the tariff system, (d) rationalisation of tariff rates, along with the abolition of numerous exemptions and concessions, and (e) abolition of the practice of making changes in effective rates through notifications." (Government of India, 1991, p. 97) Stressing the need for time-bound action, the Committee observed, "By 1995-96, the average tariff rate should be brought down to about 50 percent and the peak rate to about 80 percent. In the years 1996-97 to 1998-99, tariff rates should be reduced further to bring down the average rate to around 25 percent and the maximum rate to 50 percent by 1998-99." (*Government of India, 1991, p.143-144*)

4.0 Post-liberalisation Reduction and Rationalisation of Import Tariff

Following the recommendations of the Tax Reforms Committee, 1991, the Finance Act, 1992, lowered the peak level of import duties to 110 percent with the exception of passenger baggage and alcoholic beverages. With a view to reduce the cost of new investment, the duty on project imports was lowered from 80 percent to 55 percent and in the case of electronic industry to 50 percent. A deeper reduction to 30 percent was granted for capital goods for projects of coal mining and crude petroleum refining. For power projects, a uniform duty of 30 percent was fixed.

The underlying philosophy of reduction in tariffs was to promote competitiveness in the Indian industry. There was a feeling in Government circles that high tariff rates had the effect of creating a high cost industrial structure.

The Finance Act, 1993, made a significant simplification in the import tariff by merging auxiliary duty with basic duty, and also by reducing the maximum rate of import duty from 110 percent to 85 percent. The peak rate of import duty was further reduced from 85 percent to 65 percent by the Finance Act, 1994.

Continuing the process of reducing the high level of protection to domestic industry is continuing so as to foster competition and promote efficiency. The peak rate of import duty was reduced from 65 percent to 50 percent in 1995, and further down to 40 percent in the 1997-98 budget.

A special customs duty of 2 percent was imposed in the 1996-97 budget and a further special customs duty of 3 percent was imposed on certain items in 1997-98. In other words, special customs duty of 5 percent was in force for a period valid till 31.3.1999. However, the Finance Minister announced in his 1999-2000 budget speech the discontinuance of the 5 percent special customs duty with effect from 28.2.1999.

In another significant move, the Finance Minister reduced the then existing 7

major ad valorem rates of customs duty to the following 5 basic rates.

- 5 percent (the existing one)
- 15 percent (by substituting the existing 10 percent rate)
- 25 percent (by merging the 20 percent and 25 percent rates)
- 35 percent (by merging the 30 percent and 35 percent rates)
- 40 percent (the existing one)

However, in another move the Finance Minister imposed a uniform surcharge of 10 percent on all commodities excluding the following categories: (a) crude oil and petroleum products, (b) items attracting 40 percent rate of basic duty, (c) certain GATT-bound items and (d) gold and silver.

In other words, the imposition of surcharge raised the basic rate by 10 percent. For example, basic rate of 5 percent became 5.5 percent and 15 percent became 16.5 percent.

Still further, the Finance Minister reduced the peak rate of basic customs duty from 40 percent to 35 percent in his 2000-2001 budget, thereby reducing the total number of customs duty rates from 5 to 4, i.e. 35 percent, 25 percent, 15 percent and 5 percent. The surcharge of 10 percent imposed in the 1999-2000 budget became applicable to new peak rate of 35 percent. However, in the 2001-2002 budget, the surcharge of 10 percent was discontinued, making the peak level of customs duty decline from 38.5 percent to 35 percent. As regards further reduction in the peak rate of duty, the Finance Minister observed, "I have already promised that our customs tariff would be brought down to East Asian levels. I will like to move progressively within three years to reduce the number of rates to the minimum with a peak rate of 20 percent."[2]

The Government reduced the peak customs duty from 30 percent to 25 percent in the 2003-04 budget.

Off-budget Package of Tax Concessions, January 2004: The Finance Minister Jaswant Singh announced on January 8, 2004 an off-budget package of tax concessions which mainly pertained to indirect taxes (excise and customs). The most notable of these was the reduction in the peak rate of import duty across the board (except for agricultural goods) from 25 percent to 20 percent. Simultaneously, he abolished the 4 percent special additional customs duty (SACD). Both these changes became effective from January 9, 2004. These measures considerably lowered the protection levels for the domestic industry. However, the two measures are expected to bring down input costs of the manufacturing sector, enabling it to make Indian products globally competitive.

It may be recalled that former Finance Minister Yashwant Sinha announced an 8 percent SACD in 1998-99 and rolled it back to 4 percent in the official amendments.

SACD was meant to offset the burden of local taxes borne by the domestic industry.

In the 2005-06 Union budget, the peak rate o\f import duty on non-agricultural products was reduced from 20 percent to 15 percent. It was further reduced to 12.5 percent and 10 percent in the 2006-07 and 2007-08 budgets respectively. The 10 percent rate continues for the financial year 2014-15. Table 3 records the progressive reductions in the peak rate of import duty. In this context, *Economic Survey*, 2009-10 observed, "India has been progressively lowering peak customs duty. Contrary to popular belief, the fall in peak duty has neither led to a fall in revenue collections, nor a wiping out of the domestic manufacturing sector. In fact, peak duty falls have been accompanied by rise in customs duty collections. The trend follows the Laffer Curve Effect which indicates that lowering of taxes produces higher economic activity and higher revenue realization." (*Government of India, 2009-10, p.172*)

Table 3: Progressive Reductions in Peak Rate of Import Duty

(percent)

Year	Rate of peak duty
1999-00	40
2000-01	38.5
2001-02	35
2002-03	30
2003-04	25
2004-05	20
2005-06	15
2006-07	12.5
2007-08 to 2014-15	10

Source: Government of India, *Budget Papers* (various years).

5.0 Recent Thinking on Customs Tariff

Customs Tariff Report (Chairman: Arvind Virmani), 2002: This Report was submitted to the Government by the Inter-ministerial Group in January 2002.

The Report made the following main recommendations to the Government.

- Introduction of a single customs duty (20 percent) on all products by 2004-05. Tariff rates below 20 percent on some products be brought to 20 percent while peak tariff rate be brought down to 20 percent. According to the Report, a single uniform import tariff implies that the effective protection for all producers is also equal to this single uniform tariff.

- Phasing out all exemptions, barring those on security considerations, by 2004-05.
- Removal of all anomalies in the levy of customs duty by reclassifying all goods and services into two broad categories, viz. producer goods and consumer goods instead of raw materials, components and parts, and final goods.

The Group made out a case for reducing import duties to a near-uniform basic rate of 10 percent by the end of 2005-06 and 5 percent by the end of 2011-12. The ASEAN free trade agreement proposes to bring down ASEAN rates to the 0-5 percent range by 2010 even for highly sensitive agricultural goods.

It is noteworthy that producers seek a low import tariff on raw materials and intermediate goods, and high tariff on finished goods.

Import Duty Structure Recommended by Task Force on Indirect Taxes (Chairman: Vijay Kelkar), 2002: The Task Force laid down a broad approach to customs tariff reforms in India. It envisages a zero duty for essential items, 10 percent duty for raw materials, inputs and intermediate goods and 20 percent for final goods by 2004-05. Following introduction of States' Value Added Tax (VAT), these duties are proposed to be further reduced to 5 percent for basic raw materials, 8 percent for intermediate goods, 10 percent for finished goods and 20 percent for consumer durables by 2006-07. However, in order to reap efficiency gains from further opening up of the economy, systemic changes in customs procedures and trade facilitation based on modern best practices, which rely on self compliance, may be necessary.

As regards customs exemptions, the Task Force recommended removal of all exemptions except in case of (a) life-saving goods, (b) goods of security and strategic interest, (c) goods for relief and charitable purposes and (d) international obligations including contracts. The Task Force recommended the following pattern of import duty (Table 4).

To recapitulate, prior to tax reforms initiated in 1991, import tariff had a variety of rates for different items, and even for the same item depending on its end use. Such a cumbersome system led to legal disputes pertaining to import classifications and encouraged corruption in the administration of customs tariff.

Radical reforms have been introduced in the import tariff since 1991. These reforms were necessary because the customs tariff had become, over the years, very complicated in terms of multiple rates, innumerable exemptions, excessive controls, and elaborate procedures. These infirmities of the customs tariff often led to delays, harassment, corruption, and litigation. Moreover, rationalisation and simplification of the customs duties was needed to move towards a market economy, freedom of trade, and opening up the Indian economy to the outside world. The country has moved towards moderate rates of taxation with a view to improve compliance and reduce litigation.

Table 4: Import Duty Structure Recommended by the Task Force on Indirect Taxes

0 percent	For items like life-saving drugs and equipments, sovereign imports (defence and security related goods) and imports by RBI.
For other goods by 2004-05	10 percent for raw materials, inputs and intermediate goods. 20 percent for consumer durables.
By 2006-07	5 percent for basic raw materials like coal, ores and concentrates, xylenes etc. 8 percent for intermediate goods which will be used for future manufacture (capital goods, basic chemicals, metals etc.) 10 percent for finished goods other than consumer durables. 20 percent for consumer durables.

Source: Government of India, Ministry of Finance and Company Affairs, *Report of the Task Force on Indirect Taxes*, December 2002, p. 169.

6.0 Export Tariff Policy

Export duties can become an important source of revenue when a country enjoys monopoly or near-monopoly in certain products in the international market. In the early 1950s, India had foreign market dominance in commodities such as jute, tea, and textiles. Hence, export duties fetched sizeable revenues. As this dominance grew weaker over the years, the rates of export duty had to be reduced.

The devaluation of rupee, along with the sterling, against the dollar in September 1949, and the Korean boom considerably increased the demand for India's exports. The comparatively strong position in respect of certain commodities in the world market led to wide profit margins, encouraging the Government to impose or enhance export duty on a number of items including jute manufactures, cotton textiles, and black pepper. Apart from raising revenue, export duties also served to stabilise domestic prices. However, the need to promote India's exports led to a gradual scaling down of export duties. Following the devaluation of the rupee in 1966, export duties were re-imposed on a number of goods including jute manufactures, tea, raw cotton, groundnuts, hides and skins, and mineral ores. The objective was to mop up a part of the windfall gain accruing to the exporters as a result of devaluation. However, they had to be withdrawn in course of time to ensure competitiveness of our exports in the world market. Exports are encouraged, in certain cases through subsidies, to narrow the ever-widening deficit in the balance of payments.

Despite the fact that export duties have lost their importance from revenue angle (Table 1.2), they have not been completely dispensed with. Occasions do arise when there is considerable disparity between the domestic and international prices of certain goods enjoying a comparatively stronger position in the export market, and levying of export duties may be justified to mop up a part of the profits of the exporters. At present, export duties are levied on a few commodities such as coffee, mica, black pepper, hides and skins and leather. Export duty on an item is levied after considering such factors as domestic production and likely exportable surpluses, demand for the item in the foreign markets, changes in exchange rates, and the prices prevailing in the international market. It is noteworthy that the Government can impose/enhance export duties without prior approval of the Parliament because such duties do not fall on the Indian consumers.

Endnotes

1. Government of India, Ministry of Finance, *Speeches of Union Finance Ministers: 1947-48 to 1984-85,* p. 8.
2. Government of India, Ministry of Finance, *Budget Speech of the Finance Minister, 2001-2002, Part B*, p. 31.

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