EPCG SCHEME AND ITS EVOLUTION

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In this article an attempt is made to understand one of the most popular scheme – Export Promotion Capital Goods Scheme and its evolution in India despite the opposition by some of the WTO members. Though the scheme has been misused many a times by the license holders but due to its immense importance to the growth of India's exports it has been carried on for importing at reduced custom duties . It is interesting to see how it survives at a time when the import tariffs are also reducing. Will the scheme survive over the period or meet a gradual death is something to wait and watch for?

India ranked 27th in the world merchandise exports in 2008 and in commercial services exports it ranked 9th but the country which today is doing so well in the international trade was known as one of the closed and isolated economy during the period 1947 to late 1980's. Up until the 1980s, India was not interested in exporting its goods and services abroad and not ready to open its economy to foreign investments. This period was marked significantly with swadeshi ideology , elaborate licences, regulations and the accompanying and proliferating bureaucracy but in the late 80s, the government, led by Prime Minister Sh. Rajiv Gandhi, removed price controls and reduced corporate taxes. These measures increased the rate of growth but also led to high fiscal deficits and a worsening current account. The situation aggravated with the collapse of the Soviet Union, which was India's one of the major trading partner, and the first Gulf War, which caused a hike in oil prices, and a major balance-of-payments crisis for India.

Later the country under the then Prime Minister Mr. Narsimha Rao had to accept bailout loan of $1.8 billion from IMF with certain conditionalities which in return demanded reforms. In response, Prime Minister along with his finance minister Dr. Manmohan Singh initiated the economic liberalization of 1991.

As part of reforms, India removed restrictions on foreign trade and reduced custom duties and tariffs on imports. In 1992 Foreign Trade Regulation Act was formulated and it replaced the Imports and Exports (control) Act 1947. This act was meant to facilitate the imports and augment the exports. For increasing the exports from India various schemes were also introduced from time to time.

One of such earliest schemes - EPCG (Export Promotion Capital Goods) scheme was introduced in April 1990 by Sh. P. Chidambaram, Minister of Commerce under the Import Export Policy 1990-93. This scheme led to the growth of exports as the custom duties were really very high during that period. It helped the exporters in technological upgradation as well as reducing the initial cost of capital goods.

In this article, we make an attempt to understand the basics of EPCG scheme and its relevance.

What is an EPCG SCHEME ?

EPCG scheme is Export Promotion Capital Goods Scheme which is meant to boost our country's export by allowing import of capital goods for pre production, production and post production (including CKD/SKD thereof as well as computer software systems) at a reduced custom duty.

Introduction of the scheme - Introduced during 1990, the Scheme allowed import of capital goods at a concessional rate of 25 per cent customs duty with an export obligation of three times the CIF value of imports to be completed within four years from the *date of import*. Under Exim Policy 1992-97, the concessional rate of duty was reduced to 15 per cent and the export obligation raised to four times, to be discharged within five years. In respect of licences issued after 1 April 1993, the obligation period was reckoned from the date of *issue of the licence* which was a change from the earlier practise of recognising it from *the date of import.*

Purpose/benefits of the scheme :

This scheme has primarily helped exporters to become more competitive as it reduces the initial capital investment and also helps them to avail the latest technology not available locally . It has also helped in boosting exports in the initial years of introduction when the customs duty on capital goods were very high.

Eligibility for the scheme : EPCG scheme covers manufacturer exporters with or without supporting manufacturer(s)/ vendor(s), merchant exporters tied to supporting manufacturer(s) and service providers. EPCG Scheme also covers a service provider who is designated / certified as a Common Service Provider (CSP) by the DGFT, Department of Commerce or State Industrial Infrastructural Corporation in a Town of Export Excellence subject to provisions of Foreign Trade Policy/Handbook of Procedures with the following conditions:-

(i) EPCG licence to be given to the CSP should have a clear endorsement giving the details of the users and the quantum of Export Obligation (EO) which each user would fulfill;

(ii) Such exports will not count towards fulfillment of other specific export obligations ; and

(iii) Each one of the users of the CSP apart from the CSP should furnish 100% bank Guarantee (BG) equivalent to their portion of duty forgone apportioned in terms of quantum of EO to be discharged by them and the B.G. will be enforced in the event of the obligation not being fulfilled.

WHAT CAN BE IMPORTED AS CAPITAL GOODS?

Capital goods shall apart from machinery include spares (including refurbished/reconditioned spares), tools, jigs, fixtures, dies and moulds, spare refractories and catalyst for existing plant and machinery (imported earlier under EPCG or other wise). Second hand capital goods, without any restriction on age, may also be imported under EPCG scheme. The word 'Otherwise' mentioned above does not include capital goods procured domestically.

Conditions for import of Capital Goods Import of capital goods shall be subject to Actual User condition till export obligation is completed.

TYPES OF EPCG SCHEME

There are two options available under this scheme for import:

1. At Zero Duty
2. At Three Percent concessional duty

At Zero Customs duty, EPCG scheme allows import of capital goods for pre production, production and post production (including CKD/SKD thereof as well as computer software systems) subject to an export obligation equivalent to 6 times of duty saved on capital goods imported under EPCG scheme, to be fulfilled in 6 years reckoned from authorization issue-date. The zero duty EPCG scheme will be in operation till 31.3.2012. The scheme will be available for exporters of :

1. engineering & electronic products,
2. basic chemicals & pharmaceuticals,
3. apparels & textiles,
4. plastics,
5. handicrafts,
6. chemicals & allied products

7. leather & leather products;
8. paper & paperboard and articles thereof,
9. ceramic products,refractories,
10. glass & glassware,
11. rubber & articles thereof, plywood and allied products,
12. marine products,
13. sports goods and toys

Zero Duty EPCG scheme shall not be available for import of goods mentioned in the following chapters of ITC (HS) Classification:

Chapters 1,2,4 to 24, 25 to 27, 31, 43, 44(except plywood and allied products), 45 , 47, 68, 71, 81 (metals in primary and intermediate forms only), 89, 93, 97, 98 ITC(HS) 4011 to 4013, ITC(HS) 7401 to 7406, 7501 to 7504, 7601 to 7603, 7801, 7802, 7901 to 7903, 8001, 8002 and 8401.

However, zero duty EPCG Scheme will be available for handicraft exports under Chapters 5, 68, 97.

Imports under zero duty scheme shall also not be available for units who are currently availing any benefits under Technology Upgradation Fund Scheme (TUFS) administered by Ministry of Textiles, Government of India. Zero duty EPCG scheme shall also not be available to applicants, who avail in that year, the benefit of Status Holder Incentive Scheme.

Concessional 3% duty EPCG scheme allows import of capital goods for pre-production, production and post production (including CKD/SKD thereof as well as computer software systems) at 3% Customs duty, subject to an export obligation equivalent to 8 times of duty saved on capital goods imported under EPCG scheme, to be fulfilled in 8 years reckoned from Authorization issue-date.

More concessions to agro based units , and units in cottage or tiny sector have been given where import of capital goods at 3 % Customs duty shall be allowed subject to fulfilment of export obligation equivalent to 6 times of duty saved on capital goods imported, in 12 years from issue date of the Authorization .

Concessions have been given for SSI units also as they are allowed import of capital goods at 3 % Customs duty, subject to fulfilment of export obligation equivalent to 6 times of duty saved on capital goods, in 8 years from issue date of the Authorization, but on condition that the landed CIF value of such imported capital goods under the scheme does not exceed Rs. 50 lakhs and total investment in plant and machinery after such imports does not exceed SSI limit.

However, in respect of EPCG Authorization with a duty saved amount of Rs. 100 crores or more, export obligation shall be fulfilled in 12 years

An EPCG Authorization can also be issued for import of capital goods under Scheme for Project Imports notified by the Central Board of Excise and Customs under S. No. 441 of Customs Exemption Notification No. 21/2002 dated 01.03.2002. Export obligation for such EPCG Authorizations would be eight times (6 times for zero duty EPCG scheme) of duty saved. Duty saved would be difference between the effective duty under aforesaid Customs Notification and concessional duty under the EPCG Scheme.

To create modern infrastructure in retail sector, concessional duty benefits under EPCG scheme shall be extended for import of capital goods required by retailers having minimum area of 1000 sq. meters. Such retailer shall fulfill export obligation i.e. 8 times of duty saved, in 8 years.

Validity period for import of capital goods and provision for extension in export obligation period will be as separately provided in the Handbook of Procedures. All other provisions pertaining to concessional 3 % duty EPCG scheme under this Chapter, to the extent they are not inconsistent with the above provisions of zero duty EPCG scheme, shall be applicable to the zero duty EPCG scheme also.

In case CVD is paid in cash on imports under EPCG, incidence of CVD would not be taken for computation of net duty saved, provided the same is not CENVATed.

Under EPCG Import of motor cars, sports utility vehicles/all purpose vehicles shall be allowed only to hotels, travel agents, tour operators or tour transport operators and companies owning/operating golf resorts, subject to the condition that:

(i) total *foreign exchange earnings* from hotel, travel & tourism and golf tourism sectors in current and preceding three licensing years is Rs. 1 .5 crores or more.
(ii) 'duty saved' amount on all EPCG Authorizations issued in a licensing year for import of motor cars, sports utility vehicles/ all purpose vehicles shall not exceed 50% of average foreign exchange earnings from hotel, travel & tourism and golf tourism sectors in preceding three licensing years.
(iii) vehicles imported shall be so registered that the vehicle is used for tourist purpose only.

Import of Restricted items of imports mentioned under ITC(HS) shall only be allowed under EPCG Scheme after approval from EFC (Exim Facilitation Committee) at Headquarters.

Export obligation

Export Obligation shall be fulfilled by export of goods manufactured/services rendered by the applicant. Shipments under Advance Authorization, DFRC, DFIA, DEPB or Drawback scheme, or incentive schemes would also count for fulfilment of EPCG export obligation.

Because of its advantages, this scheme has been misused many a times.

Many EPCG license holders are not able to fulfil the Export Obligation under the scheme. During the period 1994-95 to 2003-04, as many as 33,169 EPCG licences valued at Rs 61,075 crore (cost, insurance and freight) and Rs 2,95,125 crore (free on board) were issued. Out of this, 31,181 licences valued at Rs 2,83,053 crore finally came up for EO fulfilment and 1,988 licenses valued at Rs 12,050 crore were surrendered / cancelled But in the remaining valid licences, the export obligations were fulfilled only in respect of 16,672 licences (53.5 per cent) for a value of Rs 71,970 crore (25.4 per cent).

MISUSE OF THE EPCG SCHEME

During the year 2008-09 the EPCG scheme was misused involving the duty amount of Rs 67.20 crores

1. During 2008-09 Kolkata Zonal Unit of DRI had initiated investigations into misuse of EPCG Scheme by nine importers of mining industry. These units had not installed the capital goods imported by them under the EPCG Scheme at the addresses declared in the respective condition sheets. Some of them even suppressed the name and address of the supporting manufacturer at the time of obtaining the Licence issued by the DGFT. Further, these capital goods were being used by third parties on hire basis in violation of the conditions of the EPCG Licence and the provisions of the Notification No. 97/2004-Cus dated 17.09.2004. The above importers did not have any factory / mines at the specified addresses in their own names. In these cases, a total of 45 machines valued at Rs. 47.17 Crore (approx.) having total duty involvement of Rs. 10.60 Crore were seized from the licensees.

2. On the basis of specific information DRI Kolkata Zonal Unit searched the office and factory premises of M/s. Rashmi Cement Ltd. on 04.06.2010, who imported “prime mild steel hot rolled coils” at concessional rate of duty under E.P.C.G. scheme through Kolkata port and sold in the local market without utilisation in their factory for manufacture of capital goods as declared. Preliminary investigation revealed that they had imported 4841 MT of mild steel hot rolled coils under E.P.C.G. scheme in March, 2010 and out of which 3749 MT was sold into local market and thus evading a huge amount of Customs Duty of Rs 1.81 crores.

3. During 2005 -06 several cases of misuse of the EPCG Scheme were detected during the year. The most significant of these related to the import of Luxury cars.

Investigations revealed that a large number of cars had been imported under the Scheme by non existent entities, that such cars were transferred to third parties and never used for the purpose for which they had been imported and that income from unconnected activities had been used to discharge export obligations. In the course of investigations 97 cars were seized.

4. An EPCG licence was issued (July 1997) to M/s. Seva Medicals Limited, Mumbai for import of capital goods worth Rs.1.73 crore at concessional rate of duty against export of disposable needle for syringes worth Rs.6.92 crore but glass syringes instead of disposable needles were exported. As such the duty forgone amounting to Rs.74.87 lakh plus interest of Rs.66.42 lakh (upto March 2003) was recoverable from the licencee.

5. M/s Enercon India Ltd in April 2004 imported through Kandla Commissionerate two consignments of "Cover Sheet for tent" rope structure and other accessories, classifying these as capital goods for the manufacture of wind operated electricity generator. The goods were cleared at the concessional rate of duty was incorrect. This resulted in short levy of duty of Rs 1.34 crores which was pointed during audit in August 2004, the department confirmed in February 2006 issuance of two demands totalling Rs 1.34 crores with applicable interest.

6. M/s Sun Fibre optics, an erstwhile EOU unit, on conversion was issued (February 2001) an EPCG licence by the RLA, Bangalore to import capital goods worth Rs. 1.05 crore with an EO of Rs. 5.23 crore to be fulfilled within a period of eight years. The licencee imported (February/April 2000) capital goods worth Rs. 1.04 crore under the EOU scheme and saved duty amounting to Rs. 52.62 lakh on coming over to the EPCG scheme. Audit scrutiny revealed that the licencee did not furnish all the prescribed block wise reports for fulfillment of export obligation, even after two months of the expiry of the validity (April 2009) of the licence. Accordingly, the licencee was liable to pay the customs duty forgone amounting to Rs. 52.62 lakh and interest of Rs. 65.12 lakh (upto May 2009).

7. M/s Rubber wood (India) Pvt. Ltd. Kottayam, Kerala was issued (August 2000) an EPCG licence by the RLA, Cochin with a c.i.f. value of Rs. 1.17 crore against an export obligation of Rs. 5.83 crore to be fulfilled within a period of eight years. The EO was later revised to Rs. 6.05 crore against the actual import of goods worth Rs. 1.21 crore. Audit scrutiny revealed that the licencee failed to fulfill the prescribed block wise export obligation for the 3rd & 4th block years. The licencee exported goods worth Rs. 1.83 crore against the prescribed EO of Rs. 6.05 crore till the expiry of the validity (August 2008) of the licence. Accordingly, it was liable to pay the proportionate customs duty forgone amounting to Rs. 16.92 lakh alongwith interest. On the matter being pointed out (September 2008), the RLA stated (March 2009) that a show cause notice had been issued (October 2008) for nonfulfillment of EO. The department further added (March 2009) that the unit being under a World Bank aided project, was fully exempt from the payment of customs duties on import of capital goods and the licencee had already approached the policy relaxation committee (Committee), New Delhi for waiving the EO, a decision on which was pending (April 2009). According to the auditors the reply of the department is not tenable because for availing of exemption under the world bank aided project, the project has to be approved by the Government of India (GOI) and the importer has to produce at the time of clearance of such goods a duty exemption certificate from an officer not below the rank of deputy secretary to the GOI, regarding usage of these goods for execution of the project. These conditions have not been fulfilled in the instant case.

8. Misuse of the Scheme by parties in the manufacturing sector was also detected. Machines imported under the Scheme were diverted to other units of the Licence-holder instead of being installed where export products were being manufactured/ processed. A case of importation of capital goods not permitted to be imported under the scheme was also detected. Intelligence indicates that processing catalogues are imported under the EPCG scheme by mis-declaring their use for maintenance/ installation of capital goods. Exporters of Soyabean extractions are taking undue advantage of the scheme by claiming the use of unconnected Machinery in the production of export goods. Reports also indicate that the export

obligation under the EPCG is discharged by way of third party exports which have no nexus with the machinery imported under the scheme.

Relevance of Scheme & WTO Compliance :

Although not considered export subsidy when notified, this scheme has been questioned during the review of India's legislation in the Special Meeting of the Committee on Subsidies and Countervailing Measures held at Geneva in July 1996. The payment of duty at a reduced rate or zero rate constitutes a financial contribution by the government. Revenue in the form of custom duty due is forgone and it confers a benefit on the recipient by lowering the duties payable or fully exempting him from paying the import duties on capital goods used for export production. Under this scheme the duty is exempted on the capital goods which are not consumed in the production process hence the scheme is held countervailable in all the investigations for eg in the case "The Subsidizing of certain flat hot-rolled carbon and alloy steel sheet and strip originating in or exported from India".The main contention from USA as well as EU being that there is no provision in the EPCG scheme that imported capital goods should be used only for export production. The objection from both the EU and the US few years back is basically on the premise that the EPCG scheme constitutes a 'Trade-Related Investment Measure' (TRIM) and is violative of the provisions of TRIMs Agreement and hence it should be phased out or scrapped.

Export subsidies are generally prohibited under WTO, but prohibition not applicable to ANNEX VII developing countries which includes India, provided "Export Competitiveness" in a product not reached; (Export Competitiveness by a country means that Export of the product reached a share of at least 3.25% in world trade of that product for two consecutive calendar years) . Therefore , under the Agreement on Subsidies and Countervailing Measures (ASCM), India may not have to phase out EPCG scheme so long as India is a developing country and achieves export competitiveness in a particular product as detailed in Agreement of Safeguards and Countervailing Measures.

Popularity of the scheme and Economic Aspect

The relevance of the scheme seems to be decreasing with reduction in tariffs. But still it will remain popular as long as the import tariffs are more than the reduced rates available under this scheme.

As per Economic Survey 2009-2010 substantial revenue is forgone on account of the different export promotion schemes. In 2009-10, revenue forgone could continue to be significant at more than Rs 50,000 crore due to enlargement of the scope of schemes in the Foreign Trade Policy 2009-14 and improvement in the export promotion rates in the DEPB, coupled with the bottoming out of the export fall. It therefore, recommended weeding out unnecessary customs duty exemptions and streamlining export promotion schemes to reduce duty forgone which could include reduction of tariffs on all capital goods to a uniform 3% while simultaneously withdrawing the EPCG Scheme.

Duty Forgone on Export Promotion Schemes

The Budget 2009-10, observed that the amount of revenue forgone continues to increase year after year. As a percentage of aggregate tax collection, revenue forgone remains high and shows an increasing trend. The effect is severe specially in the financial year 2008-09 which is bearing the strain of the reduction in excise duties in the stimulus package. In 2007-08, only 51.1 per cent of the notional customs duties was collected and collection percentage has worsened to 44.6 per cent in 2008-09. Thus ,while imports have gone up by 35.8 per cent in 2008-09, collections have barely risen, largely due to exemptions, which has resulted in 55 per cent of notional duties being forgone. Within customs duty, revenue forgone on account of export promotion of Rs 49,053 crore in 2008-09 is an important head of revenue loss. Duty forgone under the various export promotion schemes during the year 2006-07 was Rs. 66,368 crore which was 77 per cent of the total customs receipts. The total duty forgone under various schemes for the year 2007-08 and 2008-09 were as follows:

Sr. No	Name of the scheme	2007-08(Rs crore)	2008-09(Rs crore)
1	Advance Licence Scheme	17,654	12,389
2	EOU/EHTP/STP	18,978	13,401
3	SEZ	1,804	2,324
4	***EPCG***	***10,521***	***7,833***
5	DEPB Scheme	5,341	7,092
6	DFRC	607	111
7	Duty Free Import Authorisation Scheme	1,359	1,268
8	Duty Free Entitlement Credit Certificate	740	418
9	Target Plus Scheme	923	1,220
10	VKGUY	538	2,059
11	Focus Market Scheme	41	408
12	Served from India Scheme (SFIS)	642	531
	Total	**59,149**	**49,053**

Source: Receipts Budget 2009-10 of Union of India.

While some exemptions are needed particularly at this juncture to promote exports, there is scope for reducing the duty forgone by rationalization and convergence of these schemes. One such example is related to the EPCG scheme. At present, basic duty for capital goods in the general case is 7.5 per cent. In 2007-08, more than 20 per cent of machinery imports were on EPCG account. This has come down to 12.9 per cent in 2008-09 due to significant reduction in the differential between normal and EPCG duty. As a result, revenue forgone was Rs 10, 521 crore in 2007-08 and Rs

7,833 crore in 2008-09. The EPCG duties at present are Nil for export-oriented, labour-intensive sectors and 3 per cent for others. With import duties of general capital goods being reduced consistently, the differential with total EPCG has come down from 35.4 per cent to 21.5 per cent during the last five years

Duty forgone and imports under EPCG

YEAR	CAPITAL GOODS DUTIES (BASIC-EXCISE-4% SAD)	TOTAL DUTY	EPCG DUTY	DUTY FORGONE	REVENUE FORGONE (ESTIMATED IN RS CR)	ESTIMATED EPCG IMPORTS ON THE BASIS OF REVENUE FORGONE (RS CR)	MACHINERY AND PARTS IMPORTS IN CH. 84, 85 OF CUSTOMS (TARIFF) RS CR	SHARE OF EPCG IN MACHINERY IMPORT (%)
2005-06	15- 16-4	40.369	5	35.369	5,332	15,075	1,14,286	13.2
2006-07	12.5-16-4	37.250	5	32.250	9,152	28,378	1,50,152	18.9
2007-08	7.5- 16-4	31.011	5	26.011	10,521	40,448	1,82,603	22.2
2008-09	7.5- 14-4	28.639	3	25.639	7,833	30,551	2,36,216	12.9
2009-10	7.5 -8-4	21.523	0*/3	21.5*/18.5	NA	NA	NA	NA

*__Concession for export-oriented, labour-intensive sectors. Covers engineering and electronic products, basic chemicals and pharmaceuticals, apparels and textiles, plastics, handicrafts, chemicals and allied products, leather and leather products.__

Conclusion :

Due to the decline in global trade, our exports have also suffered a decline in the last 10 months due to a contraction in demand in the traditional markets of our exports. The protectionist measures being adopted by some of the developed countries have also aggravated the problem.

Taking into account the decline in exports, the facility of Re-fixation of Annual Average Export Obligation under EPCG scheme for a particular financial year in which there is decline in exports from the country, has been extended for the 5 year Policy period 2009-14. To increase the life of existing plant and machinery, export obligation on import of spares, moulds etc. under EPCG Scheme has been reduced to 50% of the normal specific export obligation.

But the ultimate question remains - Will the scheme of EPCG remain attractive to the exporters in the coming years? The reason being with the present customs duty structure of 7.5% on capital goods vis-a-vis EPCG duty at 3%, the resultant duty saving is only 4.5%. These factors of minimal duty saving and higher export obligation as compared to actual duty saving makes this scheme highly ineffective and major exporters are not using this scheme. Moreover the instances of misuses and revenue forgone makes this scheme quite expensive for the departments. As long as India is in Annex VII countries of WTO this scheme is non countervailable hence this scheme should be continued but on zero duty according to various trade organisations to attract major exporters to make use of it. Improvements should be made in the simplification of the scheme.

As the whole DGFT and Customs is EDI operated, the EPCG licenses should be redeemed on the basis of bank realisation certificates only which has all the details of invoice, shipping bills, awb/bill of lading , date of receipt etc. There should be strict vigilance and co-ordination between DGFT and Customs. When the EPCG licensee is granted a license for import of particular capital goods as per the definition in the foreign trade policy and Harmonised system of Nomenclature Code, then it must be ensured by the customs at the time of clearance that only that item is cleared at the port of import. There should be strict co-ordination and control over the items mentioned in the license and actual import.
