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ABSTRACT OF THE THESIS

Preferential Trade and Rules of Origin:
A Study of India’s Preferential Trading Arrangements

This thesis is placed in the context of the growing number of preferential trading arrangements (PTAs) in the world trade system. PTAs are contractual trade agreements among two or more nations whereby the nations exchange tariff concessions on select products. Proliferation of such PTAs has generated a debate on the effects of such agreements and has also brought to the fore the role played by Rules of Origin (RoO) in such arrangements. RoO are the criteria used to define where a traded product is made. They are an essential part of trade rules. In the specific context of a PTA, RoO determine whether a traded product originated in the PTA exporting member or not. If yes, then the product can get tariff concession prescribed under the agreement. If not, then normal most-favoured-nation (MFN) tariffs are applicable to the product.

This study focuses specifically on the PTAs entered into by India, as no comprehensive work on all of India’s PTAs is present in the literature, to the best of my knowledge. The study tries to analyse three issues. First, the impact of tariff preferences on India’s trade with PTA partners is examined. Second, the design and enforcement issues of RoO under the PTAs are evaluated. Third, firm-specific issues with respect to use of PTAs are explored. Special focus has been given in the analysis to the India-Sri Lanka FTA (ISFTA) as it has been in operation for over a decade now and thus its effects could be examined more meaningfully as compared to later agreements, which are in effect only for a few years.

As of December 2011, India had fifteen PTAs in operation with twenty five countries in Asia and Latin America. From preliminary data analysis of India’s trade with these countries it was found that after the PTAs came into force there was an increase in overall trade values, both in exports and imports. However, the increases in value of India’s exports to the PTA partners could be mostly explained by increases in the value of exports of non-preferential items i.e. items not part of the tariff liberalisation schedules under the PTAs. On the other hand,
the increases in India’s import values from the PTA partners, after the PTAs came into effect, could be mostly explained by the increases in import values of preferential items. Thus impact of tariff preferences were analysed only with respect to imports from the PTA partners. Also, since a reasonably sufficient time period is required to find impact of tariff preferences under a PTA, only the PTAs with Sri Lanka and Thailand were chosen, as they have been in operation for more than five years. Other Indian PTAs have either come into effect recently, or they are non-reciprocal, or very few items have got tariff concessions under them, and therefore are not included in the analysis of effect of tariff preferences.

In the trade literature the gravity model is used mostly for analysing effects of PTAs. Such gravity models use a PTA dummy variable to find effect of tariff preferences on overall trade. In this thesis an alternate methodology was proposed. A panel data analysis was carried out to ascertain if the increase in the values of top import products over the years could be attributed to the preferences they got under the agreements. This is a more precise methodology as trade values of preferential items are regressed on the tariff preferences each item gets under a PTA. In the econometric exercise it was found that the variables, import values of preferential items and tariff preferences, were non-stationary and integrated of order one. Cointegration tests showed the variables to be cointegrated. Thus, a dynamic panel data methodology, dynamic generalised least squares (DGLS), as suggested in the literature, was employed. The analysis revealed that tariff preferences have had a positive and statistically significant impact on imports of preferential items, from both Sri Lanka and Thailand.

For analysing the design of RoO under India’s various PTAs, a RoO restrictiveness index available in the literature was used. There are two ways to think about restrictiveness of RoO design – how much a rule permits, and how much it affects producers and trade. How much producers and trade get affected by a particular rule, is difficult to measure as it differs by products, markets and industries. Therefore, for analysing restrictiveness of RoO the first definition of restrictiveness is employed in restrictiveness indices developed in the literature. This study, used an appropriate RoO restrictiveness index and found the designs of RoO in most of India’s PTAs to be medium to high restrictive when compared
with RoO regimes from PTAs across the globe. It was found that such restrictiveness was due to the absence of supplementary rules in the design of RoO of the PTAs. As newer PTAs have incorporated such supplementary rules to relax the stringency of main methods of origin determination, RoO restrictiveness index values under such recent PTAs are less. It was, however, noted that India’s recent PTAs have incorporated complicated RoO design compared to the initial agreements. There are also differing RoO under the different PTAs giving rise to possibilities of complexities in trade operations.

After evaluating RoO design issues, enforcement issues were looked into. Enforcement problems in administering RoO were explored through two case studies. Both copper imports from Sri Lanka and edible oil imports from Sri Lanka and Nepal increased tremendously after the PTAs with the respective countries came into force. The case studies revealed that Indian companies went to Sri Lanka and Nepal to take advantage of tariff differentials offered by the PTAs. These companies violated RoO value addition (VA) norms through simple accounting manipulation. Under-invoicing of value of imported inputs or inclusion of profit margins made domestic content of the final product high in the exporting countries and, thereby, the final product satisfied required VA norms under RoO of the PTAs. The surge in imports of copper and edible oils from the PTA partners affected Indian domestic industry in these sectors and it took some years before such malpractices could be checked.

For finding firm-specific issues in use of PTAs first, primary data was collected from the Indian certifying agencies (Export Inspection Council and Federation of Indian Export Organisations) and next a primary survey of exporters was undertaken. Analysis of data on issue of certificates of origin (CoO) by the certifying agencies revealed that use of preferences by the Indian exporters under the various PTAs is minimal. Despite many PTAs in operation, the unilateral preferences under the Generalised System of Preferences (GSP) schemes of the developed nations are still the most sought after preferential schemes by the exporters. On an average, over the period 2004-05 to 2008-09, only about 3 per cent of CoO was issued for all of India’s PTAs taken together as compared to about 96 per cent under GSP. Remaining one per cent of CoO was issued under
the Generalised System of Trade Preferences (GSTP) of developing countries. It was found that among all the PTAs, the ISFTA was used most by the exporters. On an average, approximately 50 per cent of all CoO issued for PTAs was issued under the ISFTA. However, it was found that only 11 per cent of India’s total export consignments to Sri Lanka in 2008-09 were issued CoO. This indicates under-utilisation of the PTAs by the Indian exporters. After the ISFTA the next most sought after PTA is the Asia Pacific Trade Agreement (APTA) and the SAARC Preferential Trading Arrangement (SAPTA). It was found that the South Asian Free Trade Agreement (SAFTA), despite encompassing more tariff concessions than the SAPTA, was not used by the exporters as much as the SAPTA. In 2008-09 only one per cent of CoO was issued for SAFTA as compared to 26 per cent of CoO issued for SAPTA. The study points to the role of RoO in the low utilisation of SAFTA.

A primary survey of exporters, specifically exporting to Sri Lanka from Delhi, Calcutta and Chennai, was next undertaken to find firm-specific issues in the use of the ISFTA --the bilateral PTA that has been in force for the longest time and which has been used most by the Indian exporters. In the sample of 51 exporters, 24 firms used the ISFTA. The surprising fact that emerged from the survey was that there was lack of awareness (33 per cent) about the ISFTA among many of the exporters. This, and the fact that products do not get preferences (33 per cent), were the two main reasons cited by the export firms in the sample to not use the ISFTA. Most of the firms using the ISFTA (60 per cent) felt that the trade agreement had helped in increasing their exports to Sri Lanka. The survey identified some non-tariff barriers (NTBs) that Indian products face in the Sri Lankan market. The survey did not find RoO to be the culprit for the low utilisation of ISFTA. Cost of satisfying the rules was found to be minimal (less than one per cent of the value of the export shipments). Most firms, however, said that the certification process is cumbersome due to the inordinate delays that arise out of the physical verification requirements. When suggestions were elicited, most firms wanted more information on all the PTAs. Many firms also wanted changes in the physical verification requirement in getting the CoO.
The study then tried to discern firm-specific determinants in the use of ISFTA. First, it was found that those firms having high export to sales figure were also the ones to use the ISFTA more. Thus, a major exporter uses the ISFTA more than a firm whose exports constitute minor part of its sales. Second, it was found that new firms were using the ISFTA more than old firms; this was probably because the new firms are more technology savvy and thus are more aware about the agreement. Lastly, it was noticed that small firms were using the ISFTA more. This maybe because of the fact that for a small firm, which caters to only one or two markets, the Sri Lankan market accounts for a big share of its exports than a big firm, which exports to many countries and thus the small market of Sri Lanka may not be that important. Thus big firms may not bother to do the extra paperwork to get benefits of the agreement whereas for a small firm the preferential tariff margin under the ISFTA may help it to stay in business. However, these results were found to be statistically insignificant when the chi-square tests were used, perhaps because of the small sample.

In light of the findings some policy strategies, which may help in future PTA negotiations, are suggested in the conclusion. Limitations of the present study and future research areas are also charted out. The biggest limitation of the study is the inability to extend the primary survey to the Indian importers – data required for the purpose could not be availed from the Indian Customs. Also a bigger sample size in the survey of exporters would have made possible more quantitative research. As RoO and preferences affect different industries differently a case study approach focussing on a particular industry may have given better insights. Future research in this area can help overcome the limitations of this study.