

Sensitivity of Tariff Cut for Textiles & Clothing Sector under NAMA Negotiation: Options for India



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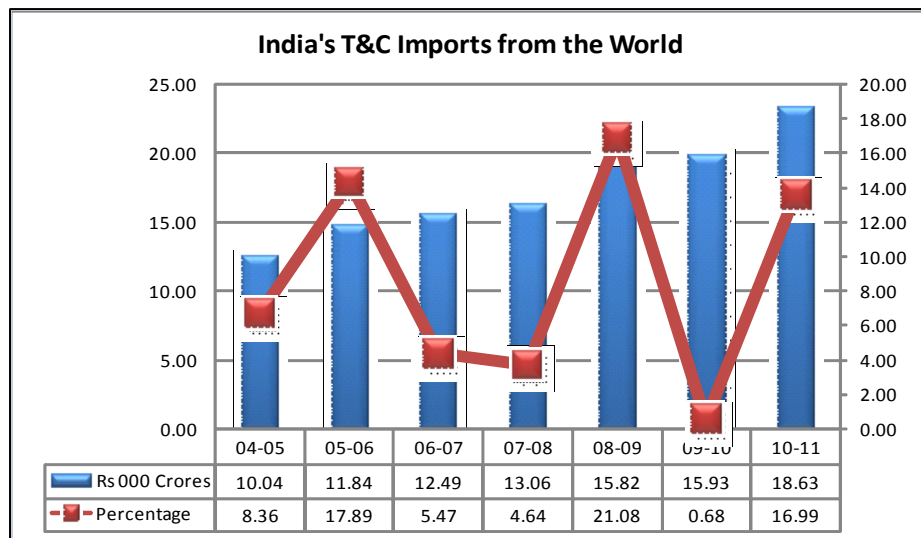
Abstract

The member countries of WTO are negotiating on the modalities of tariff cuts for Textile & Clothing sector under the Non-Agricultural Market Access Negotiations (NAMA) as envisaged in the Doha Development Agenda. Even the SWISS formula has already been accepted by the members for the tariff cuts. But differences have been persisting on the co-efficients to be applied for the developed and developing countries. This paper tried to analyse the impact of different co-efficients proposed by the member countries on the T & C sector of India by applying extensive data simulation exercise. The paper has also analysed the impact of other major proposals like Paragraph 8 of flexibilities, treatment of unbound tariffs and trade effects of tariff cut on India. We also examine the impact of the tariff cut on the on applied duties and government revenue under NAMA negotiations, for each of the six-digit level lines of the Harmonized System classification (HS-6 level).

Introduction:

The trade on Textiles and Clothing's (T&C) has significantly benefited the producing countries in the post ATC regime due to phasing out of quota. India being a major producer and exporter of T&C has also been benefited. The export trend of the sector during the last five years has indicated an increasing trend during the entire period except 2009. The reasons for such an exception needs to be explored but presumed to have happened on account of the 2008 global financial crisis. The export of textile and clothing has grown from Rs.90.23 thousand crores in 2004-05 to Rs.127.75 thousand crores in 2010-11. Most importantly, the growth of export has also brought about shift in product basket from textile to clothing, tilting towards the value added and diversified products.

At the same time, the period also experienced surge in import of textile and clothing to country. The import has surged to Rs. 18.63 thousand crores during 2010-11 from Rs.10.04 thousand crores in 2004-05. Barring 2009-10, import has been experiencing a growth rate of more than 10 percent over the years. The growth of import has been highest in 2010-11 and registered a percent change of more than 15 percent as compared to the previous year. While plethora of factors may be responsible for the surge in imports, the most visible reason could be the progressive reduction of tariffs in T & C products by Indian government over past few years coupled with the product diversification for export purposes which requires raw material import. The reduced tariff has enhanced the price competitiveness of the imported products and there has been a surge of imports to the country. Among the countries, China has emerged as a leading source of India's textile imports in the last ten years. The volume of imports from China has increased to Rs 6774 crores 2009-10 as against Rs 8360 crores 2010-11.



One pertinent question arising out of the import trend of textiles is that does the surge in imports is going to adversely affect the domestic textile industry in the long run? Further, the NAMA negotiations under the framework of WTO is considering a drastic reduction in tariff rates across the

harmonized tariff lines once the co-efficient of the Swiss formulae and the flexibilities to developing and the less developed countries are agreed upon. On that context, the impact of the tariff reduction under the Swiss formulae with varied coefficients on the sector needs to be assessed for its impact on the sector.

NAMA Negotiation

A key element of the Doha Development Agenda (DDA) negotiations under the WTO is the liberalization of trade in industrial products called Non-Agricultural Market Access (NAMA). The mandate on the NAMA negotiations has explained in Paragraph 16 of the Doha Ministerial Declaration which has stipulated on the modalities to be agreed, to reduce or as appropriately eliminate tariffs, including the reduction or elimination of tariff peaks, high tariffs, and tariff escalation, as well as Non-Tariff Barriers (NTBs), in particular on products on export interest to developing countries. Even though industrial tariffs have been significantly reduced after successive rounds of multilateral trade negotiations, some developed countries still follow the policy of high tariffs on products for protecting their domestic market, which is highly trade distorting. The situation in developing countries is also not better as the simple average bound tariff rates on industrial goods varies from zero to 37.7 per cent for India (WTO, 2002). Before examining the tariff profile of India and the alternative methods of tariff liberalization, it is necessary to discuss the binding principles for unbounded tariff lines and mark up issues as it is very much important for applying the formula approach on the tariff lines.

Proposals on binding and mark up

In the Uruguay Round, many developing countries increased the range of their bindings significantly. In manufactured goods, it was estimated that the binding coverage rose from some 21 percent of tariff lines to 73 percent (WTO, 2007). This became an important issue in the NAMA negotiations, where industrial countries have been pressing for tariff commitments from developing countries that would reduce applied rates. Second, it has sometimes been argued that while developed countries have access

to instruments such as safeguards, and countervailing and anti-dumping measures which can be used to modify tariffs where no gap exists between bound and applied rates, these are not so readily available for developing countries. The main reason attributed is that the provisions and procedures associated with the use of these contingency measures is very complex and administratively demanding for developing countries. It is an empirical question whether developing countries have made widespread use of the so-called binding overhang¹ as a surrogate instrument of contingency trade policy. Two counter-arguments against this line of reasoning to justify binding overhangs are that there is no multilateral accountability involved and that, at least in some cases, developing countries are using standard contingency trade policy and also insisting on maintaining the gap between bound and applied rates. The third related issue referred to above concerns the relationship between MFN and the principle of reciprocity. This probably reflected a terms-of-trade concern in the early days, when negotiations were between a few large countries capable of affecting world prices through their own trade policy actions. A large country that liberalized unilaterally might risk raising the world price of an import by increasing domestic demand following the removal of trade barriers. Such effects could be neutralized if countries moved together in liberalizing their trade regimes, hence the attraction of reciprocity. Reciprocity, no doubt, also had domestic political economy attractions since it would make trade liberalization resisted by importers seemed appealing to export interests who anticipated matching liberalization in foreign markets. Small countries with limited trade shares encounter difficulty striking reciprocal bargains in the GATT/WTO style of negotiations. Large countries worry about other large country free-riders if they agree to a "reciprocal" bargain with a small country which then has to be extended to all trading partners on a MFN basis. This is one line of argument put forward to explain limited engagement by developing countries in GATT/WTO negotiations, and the fact that tariff peaks and escalation have tended to be more prevalent on products of interest to developing countries. The opposing line of argument is that developing countries face higher tariffs in their major markets precisely because they have not engaged in multilateral negotiations more actively and lowered their tariffs accordingly. However, some concrete suggestions have been proposed by many member countries like

Suggestions

- 1 Marking up of unbound tariffs and applying the bound tariff formula
 - a) Canada, Hong Kong, China, New Zealand have suggested a flat 5 percent marking up
 - b) Mexico has suggested as non linear mark up system whereby lower unbound tariffs will have a high mark up than high unbound tariffs
- 2 Binding these tariff at average rates with or without ceiling
 - a) ABI proposal offers an average reduction on unbound tariffs which are to be bound at average levels
 - b) Malaysia proposes binding these tariffs at an average level of 25 percent with a ceiling of 40 percent

¹ binding overhang, i.e. the gap between bound and applied MFN tariffs

Extent of New Tariff Bindings

An increase in the coverage of bindings depends on valuable outcome of tariff negotiations, the gap between the new bindings and the applied tariffs (i.e. the lesser the difference, the more valuable the binding). Extended binding coverage was one of the main contributions by developing countries in the industrial goods during the Uruguay Round. A Secretariat assessment of the results from this Round, for a sample of 21 developing countries, concluded that their average binding coverage had increased from 21 percent to 73 percent, covering 61 percent of their imports. It was also estimated that developed countries had increased binding coverage from 78 percent to 99 percent, covering 99 percent of their imports. Practically all Members that have acceded to the WTO since 1995 have done so with "full bindings."

Share of Tariff Lines bound (%)	No. of Members	Developed countries	Developing countries	LDCs
100%	54"	2"	43	9
+95 < 100%	28	7	17	4
+35 < 95%	14	0	12	2
+15 < 35%	12	0	5	7
< 15%	17	0	7	10
Total	125"	9"	84	32

Source: Own calculation based on WTO -2008 World Tariff Profiles

However, even if 82 members have bounded at least 95 percent of their non-agricultural tariff lines, there are 44 Members who have bounded tariff lines less than that. It also includes 29 members with less than 35 percent of their lines bound. Furthermore, a significant amount of imports fall in unbound tariff lines in both developed and developing countries i.e approximately 13.8 percent of Japan's imports and some 38.8 percent of India's imports fell under tariff lines with no binding coverage during 2001.

NAMA Negotiations

Category according to the draft NAMA modalities	No.	Binding coverage (%)		Simple average of bound tariffs		
		Current	Resulting from Doha	Current	Resulting from Doha	Reduction in the average (%)
1. Developed countries	9	98.9	100	6.5	2.4	63.9
2. Developing countries	84	81.5	95.6-96.6	28.7	18.2-18.5	35.4-36.6
exempted from tariff reduction	13	100	100	12.2	12.6	N. A.
With low binding coverage	12	10.8	77.1	24.8	30	-21.2
SVE	23	96.7	99.6	41	25.8	37.1
Applying the formula	36	88.6	97.7-100	28	11.4-12	56.4-59.3
	32	51.6	>51.6	43	43	N. A.

Source: Based on draft modalities described in TN/MA/W/103/Rev.3 and July 2008 discussions as reported by the chairman in JOB (08)/96

Hence binding commitment across the tariff lines is an important facet of the NAMA negotiation and needs to be addressed for successful completion of Doha Development Round.

Indian Textile and Clothing Sector

The Indian textile and clothing industry continues to have an important place in the national economy as regards employment, value addition or income generation, and export earnings.

Table3: Contribution of the T&C sector in select South Asian countries						
Country	Employment in T&C Sector (Million)	T&C exports as share of total exports (%)	Share of imports in T & C two major markets of world (%)			
			EU 2005	EU 2004	US 2005	US 2004
Bangladesh	2	84.5	5	5.6	2.6	2.3
India	35	16.77	7.5	6.8	5.4	4.6
Nepal	5000	26.7	0.1	0.1	0.1	0.2
Pakistan	2.3	66.65	3	3.6	3.1	2.9
Sri Lanka	273,600	51.87	1.1	1.3	1.8	1.8

Source: ILO(2005b); Adhikari & Yamamoto (2006); and SAWTEE/ Action Aid Nepal(2006)

The T&C sector is of paramount importance to countries as can be seen from Table-3. In India, for example, this sector provides direct employment to almost 35 million people who include a substantial number of people from the socially excluded classes and/or tribes and women. It contributes approximately 14 percent to India's industrial production, 4 percent to its GDP, and 13 percent to the country's export earnings. The textile sector is the second largest provider of employment after agriculture. Similarly, in the case of Bangladesh, 2 million workers are employed in the textile sector, and 80 percent of them are women. The sector accounts for close to 85 percent of Bangladesh's total export earnings. The sector's contribution to employment in Bangladesh, India and Pakistan remains more or less the same even in the post-quota era, with minor variations within multiple sub-sectors. However, the situation is quite different in the case of other countries in the region. In Sri Lanka, the sector accounts for approximately 6 percent of GDP, 6 percent of the labour force, and nearly 40 percent of industrial production in terms of value.

Tariff profile of India

The trend of the tariffs imposed by India during last few years indicates that the simple average MFN applied duty of India in 2008 was 13 percent and 10.1 percent in non-agriculture sector. For non-agriculture products ,3.4 percent of tariff lines were duty free whereas 14.4 percent of tariff lines varies between 0 and 5 percent, 74 percent between 5 to 10 percent and 0.1 percent above 100 percent. The average MFN applied duty in case of textiles was 14.1 percent and clothing was 19.9 percent. Also the

maximum duty in case of textile was 122 and 97 in case of clothing as shown in annexure.

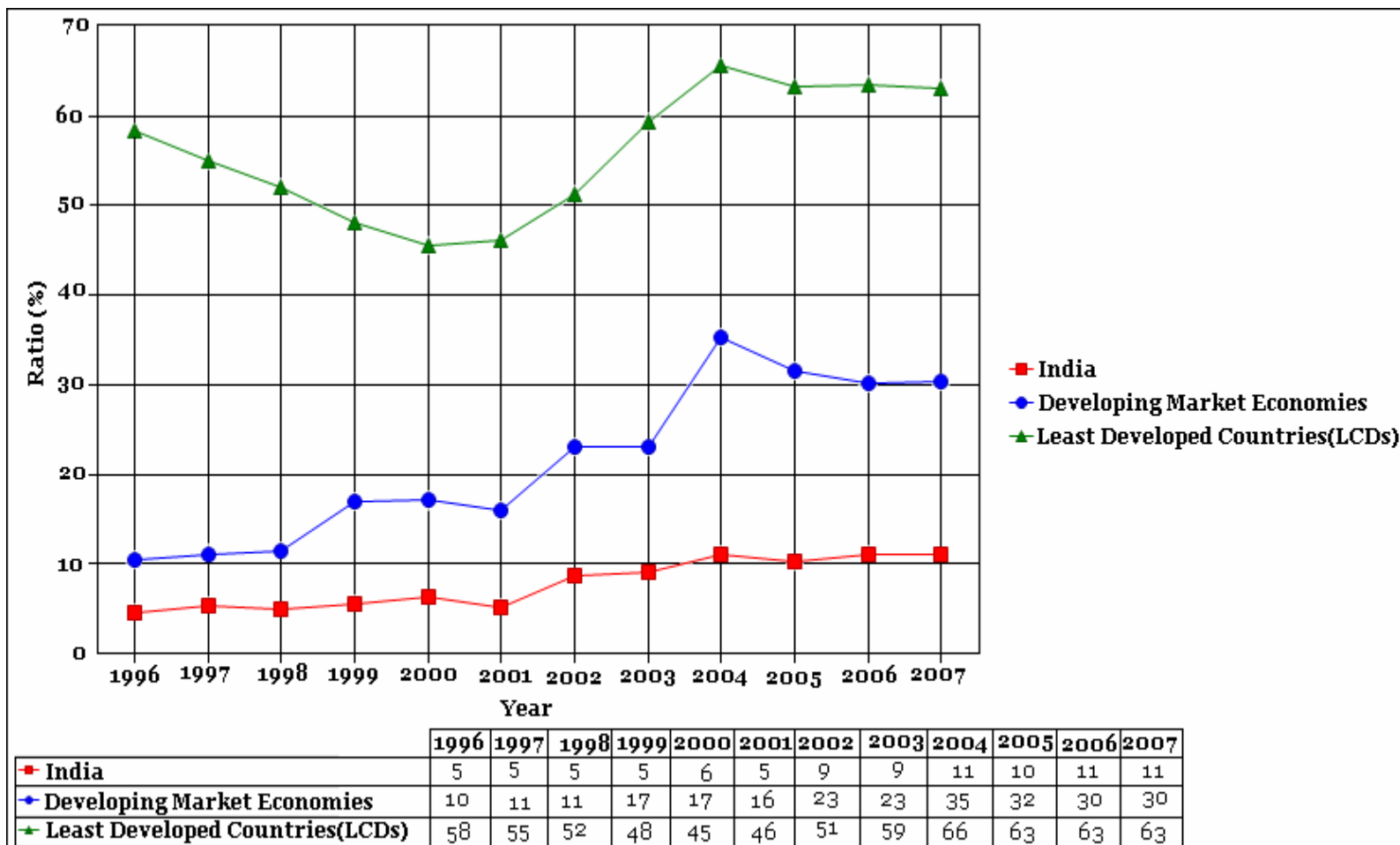
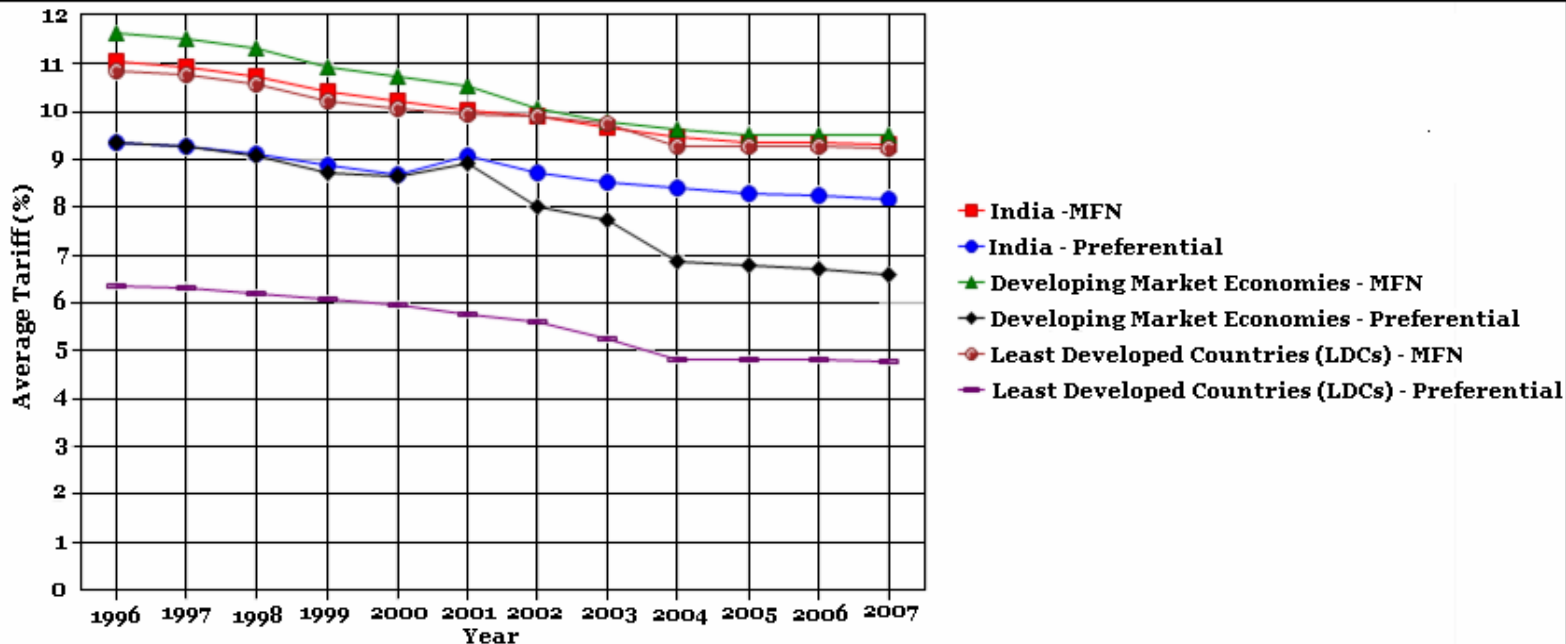


Fig: Proportion of total Developed Market Economies imports (by value) from Developing and Least Developed Countries, as compared with India, admitted free of duty for Clothing + Textiles Products

The above two figures show the average tariff by India has been reduced from 11 percent in 1996 to 9 percent in 2007 whereas in case of developing market it decreased from 12 in 1996 to 10 in 2007. As such the rate of decline in tariff rate by India is much higher as compared to the other developing countries. It appears the country is more committed to the tariff liberalization as compared to the similarly placed member countries of the WTO.

Negotiations on tariff cut: While debating on the modalities of the tariff cuts in the sixth ministerial conference at Hong Kong, the member countries have accepted the non linear Swiss formula with varied co-efficients for developed and developing countries to reduce tariff. The Swiss formula sharply reduces high tariffs and makes a deeper cut for small coefficients than larger ones; India has all along demanded that industrialized countries must accept a coefficient of 5 and developing countries at 30. However the following ranges of coefficients and flexibilities have been suggested by the members.



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
India - MFN	11	11	11	10	10	10	10	10	9	9	9	9
India - Preferential	9	9	9	9	9	9	9	9	8	8	8	8
Developing Market Economies - MFN	12	12	11	11	11	11	10	10	10	9	9	10
Developing Market Economies - Preferential	9	9	9	9	9	9	8	8	7	7	7	7
Least Developed Countries (LDCs) - MFN	11	11	11	10	10	10	10	10	9	9	9	9
Least Developed Countries (LDCs) - Preferential	6	6	6	6	6	6	6	5	5	5	5	5

Fig: Average tariffs imposed by Developed Market Economies on Clothing + Textiles Products from Developing and Least Developed Countries, as compared with India

- i) The developing countries which are prepared to cut tariffs by using a coefficient between 19 and 21 will be eligible for flexibilities up to 12-14 per cent of tariff lines that will be subjected to half formula cut "and that these tariff lines do not exceed 12-19 per cent of the total value of industrial imports".
- ii) The second option open to the developing countries using a coefficient between 19 and 21 is the flexibility to exempt 6-7 percent tariff lines from the formula cut provided their total trade value does not exceed 6-9 per cent of total industrial imports.
- iii) There will be the flexibility to exempt 5 per cent of industrial tariff lines from any tariff cut provided their total value of imports does not exceed 5 per cent.
- iv) The countries prepared to use a coefficient between 23 and 26 in the formula would have no flexibility,
- v) Ambassador Stephenson further expanded the range of flexibilities for South Africa by suggesting 1-6 additional percentage points along with 10 per cent tariff lines that will be subjected to half the formula cut if it uses a coefficient between 21 and 23.

If developing countries choose a coefficient between 21 and 23, they will be entitled to either cut (10) of tariff lines at half the formula cut with total value of imports not

exceeding (10) of the total value of industrial imports. The second option for developing countries was to use a coefficient between 21 and 23. The current NAMA-11 states that a difference of at least 25 points is needed between the coefficients for developed and the coefficient for developing countries.

Simulation Exercise: A simulation exercise is conducted to find out the implications of tariff cuts. The Uruguay Round bound rates, unbound tariff lines, and major imports have been taken to simulate the tariff reduction under the non-linear Swiss formula with different coefficients. The sample includes all low- and middle-income WTO member countries including developed countries, for which data for the bound tariff, applied tariff, and imports for 2001 or later years are available at the requisite level of detail. For the purpose of this study, data from the WITS database at the HS-6 digit level (688 tariff lines) have used. The bound & unbound data are separated. We take HS 2002 data on non agriculture goods from WTO website. For unbound we take different markup suggested by different member groups. Moreover, the simulations do not consider existing tariff exemptions that would limit the impact of tariff cuts. Accordingly, they are testing the maximum loss in fiscal revenue based on statutory rates. If data is missing for either for bound rates or for applied rates or for import values or for either two or for all that data is deleted. For unbound rates mark up of 5, 10, 25, and 30 as proposed by various countries (Canada, Europe, WTO and Argentina) is used. If Items are subject to specific or mixed tariff, then average ad-valorem duty has been considered.

Swiss formula

Swiss formula is a non-linear formula. In the Swiss formula, tariff cuts are proportionally higher for tariffs which are initially higher. For instance, a country which has an initial tariff of 30percent on a product will have to undertake proportionally higher cuts than a country which has an initial tariff of 20percent on the same product. It was first used in Tokyo round.

$$\text{Swiss formulae} : t_1 = (a * t_0) / (a + t_0)$$

Properties:

- i) Higher the tariff, higher the cut
- ii) Higher the coefficient, lower the cut
- iii) All tariff after formula cut < than coefficient is 'a',
- iv) Initial tariff = 'a', cut is 50%
- v) Initial tariff > 'a', cut is more than 50%
- vi) Initial tariff < 'a', cut is less than 50%

Identifying Suitable Coefficient for India

Description	HS Lines	Percentage of total
Total Number of HS Lines	668	(100% of Total Sample Size)
Total Bounded Lines	468	(68.02% of Total Sample Size)
Total Unbounded Lines	220	(31.98% of Total Sample Size)

Source: Authors own calculation based on WTO data

Particulars	Co-efficients												
	10	12	14	16	18	19	20	21	22	23	30	35	
No. of Tariff Lines Affected	415	415	220	194	76	76	1	1	1	1	0	0	
% age of Tariff Lines Affected	88.68	88.68	47.01	41.45	16.24	16.24	0.21	0.21	0.21	0.21	0.00	0.00	
No. of Tariff Lines Unaffected	53	53	248	274	392	392	467	467	467	467	468	468	
% age of Tariff Lines Unaffected	11.32	11.32	52.99	58.55	83.76	83.76	99.79	99.79	99.79	99.79	100.00	100.00	

Here we see that as we increase the coefficient from 10 to 35 the percentage of tariff line decreases from 88.68percent to 0percent and number of tariff line increases from 11.32percent to 100percent. Also we find that in case of coefficient C=19 number of tariff line affected is 76, whereas it is 1 in case of coefficient C=20 which is a drastic reduction for India, after that the number of tariff line affected is negligible. Hence India should choose for coefficient of C=20 among the range 19-23 suggested by WTO. The details of HS 6 digit textile and clothing sector items new tariff after taking tariff cut, percentage reduction and government revenue are given in annexure at the end.

Table 6: Effects of Varied Coefficients on Unbound Tariffs

Particulars	Markup 5			Markup 10			Markup 15			Markup 25			Markup 30		
	Co-efficients														
	19	20	23	19	20	23	19	20	23	19	20	23	19	20	23
Number of Tariff Line Affected	218	218	218	218	0	0	0	0	0	0	0	0	0	0	0
Number of Tariff Line Unaffected	2	2	2	2	220	220	220	220	220	220	220	220	220	220	220

Source: Authors own calculation based on WTO data.

The number of tariff line affected in case of mark up of 5, when C=19 is 218 since here new tariff were coming less than applied duty. Whereas number of line affected were only 2, similarly the number of tariff line affected when C=20 was 218 and unaffected was 2. As we increase our markup to 10 with coefficient C= 20, the number of tariff line affected becomes zero and all the tariff lines are unaffected in the given sample of data. From there onwards Mark up of 15, 25 and 30 fetch the same result.

Conclusion

This study suggest that coefficient of 20 in the Swiss formula while applying tariff cut is most favourable for India as the number of tariff line affected is only 1 as compared with 19, which is affecting 76 tariff lines. At the same time there are some sensitive products which are mainly kept unbounded at HS 6 digit levels. The government should look into sensitive products in textile and clothing sector and take necessary steps (like keeping them in flexible items in negotiation etc) to protect these sector so that they can grow at a reasonable rate and contribute in overall development of industry. India has also significant trade & welfare effect in case US and Europe accept tariff cut as suggested by WTO. At the same time, the revenue effect is negative in most of the products which need to be taken in to account.