

# INDIAN INDUSTRIAL TARIFFS: TOWARDS WTO DEVELOPMENT ROUND NEGOTIATIONS\*

by

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## **SUMMARY**

- At the time of the Uruguay Round negotiations in World Trade almost all of India's tariff lines were not subject to tariff commitments. India had then committed to bind its tariff lines for 62 per cent of its industrial products. This will reduce the trade-weighted average tariff from the 71.4 per cent to 32.4 per cent.
- In 2001-02, India's average tariff rate was 30.8 per cent (i.e. of industrial products, defined by HS 25-97), and no line was subject to any QRs. This also included all unbound lines, whose level of average tariff was around 34 per cent during 2001-02.
- In this report, an attempt has been made to analyse India's current bindings in terms of domestic sensitivity to import and to identify tariff lines (or commodities). Effort has also been made to suggest the possible level of binding rates in the present multi-lateral negotiations. An analysis has been carried out for 9,467 tariff lines (of the industrial sector) which are defined by the 8-digit level of Harmonised System (HS-1996). In a somewhat general framework, the analysis has been carried out by using the following criteria:
  - (i) Level and growth of India's imports and exports during the last five years;
  - (ii) Change in imports with changes in import policy and/or tariff rate;
  - (iii) Input from industrial apex bodies, chambers, experts, etc.;
  - (iv) Price elasticity: change in imports with respect to change in tariff/prices;
  - (v) Safeguard and anti-dumping duties;
  - (vi) Small scale industry items; and
  - (vii) Input from different stakeholders.
- The analysis conducted in this study can be classified into two broad steps: *Step 1* involves an identification of items/commodities which are sensitive with respect to imports, and

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their possible degree of sensitivity, e.g. insensitive, moderate sensitive, sensitive or highly sensitive. These items have been divided into different categories as per India's import policies during the last few years, and the Non-BoP list of the WTO.

- Based on the degree of sensitivity, the level of binding rates of different industrial items/commodities for next round trade negotiations have been suggested as a part of the analysis in *Step 2*.

- In this study, we have identified 9,467 items/commodities under following five groups:

**Group 1 (*Bound Items-Significant Cut*):** Tariff lines where **bound rates** are very high and India could bring them **down**.

**Group 2 (*Bound Items-Inadequate Rate*):** Tariff lines where existing bound rates are considered **inadequate**

**Group 3 (*Bound Items-Sufficient Rate*):** Tariff lines where the existing levels are considered just **sufficient**

**Group 4 (*Unbound → High Binding Rate*):** Tariff lines which owing to domestic sensitivity could not be bound or need to be **bound at high levels or specific duties** need to be indicated

**Group 5 (*Unbound Items → Significant Cut*):** Tariff lines of low trade interest, which may be bound at low levels so as to provide us leeway **to bound** other more sensitive lines at comparatively higher levels, etc.

Based on an identification of the commodities in different categories (*Step 1*) with different degrees of sensitiveness or insensitiveness and various other criteria, these commodities were divided into the above-mentioned five groups.

- Having identified the different commodities (**Groups 1-5**), we simulate the appropriate level of binding rates for the present WTO negotiations. The proposed binding rates for the commodities in Group 2 (***Bound Items-Inadequate Rate***), Group 3 (***Bound Items-Sufficient Rate***) and Group 4 (***Unbound → High Binding Rate***) are mostly suggested on the basis of: highly sensitive imports, strategic industry, safeguard/anti-dumping duties, recommendations of apex industrial bodies/government departments, etc. The binding rates for items of Group 1 (***Bound Items-Significant Cut***) and Group 5 (***Unbound Items → Significant Cut***) have been suggested using a linear reduction formula.

- **Group 2 (*Bound Items-Inadequate Rate*)** has 30 items where the present level of the bound rate is considered inadequate because of impositions such as: safeguard duty, anti-dumping duty, highly sensitive imports, small-scale industry or items of strategic industry, etc. Most of these items belong to sectors such as chemicals & fertilizers (9 items), rubber & plastic products (7 items), other base metals, and electric & non-electric machinery. The level of the binding rate (*ad valorem* or specific) has been suggested on the basis of additional anti-dumping/safeguard duties, recommendations of industry/government departments, etc. In some cases, the suggested rate is in the form of specific/mixed duties.
- We have identified 627 items where the present level of the binding rate is considered adequate (**Group 3** or ***Bound Items-Significant Rate***). Out of 627 items, 566 belong to textile and information technology sectors whose bindings have been recently concluded. They also include 262 items whose bound rate is 0 per cent. The remaining 61 items belong to diversified sectors like electric machinery, fertilizers, rubber, etc.
- **Group 4 (*Unbound → High Binding Rate*)** consists of a list of unbound items, which could not be bound in the WTO negotiations or needed to be bound at higher levels. We have identified 167 items in this group. A large number of these items belong to commodity groups like fertilizer, automobile, small scale and toy industries. The binding rates, in this group, are suggested on the basis of the recommendations of apex industrial bodies, commodities which are highly sensitive to imports, strategic industries, government departments, etc.
- **Group 1 (*Bound Items-Significant Cut*)** identifies 6061 commodities where presently the level of the bound rate is high and India can bring this down conveniently. Taking a glance at the distribution of these commodities within different commodity groups (HS chapters), it can be noticed that all the said commodities fall under **Group 1**, for example, those belonging to HS chapter 35 (albuminoidal substances), chapter 37 (photographic or cinematographic goods), chapter 41 (raw hides and skins, leather), chapter 45 (cork and articles of cork), chapter 47 (pulp of wood or of other fibrous), chapter 68 (articles of stone, plaster, cement, asbestos, mica or similar materials) and chapter 86 (railway or tramway locomotives).
- Similarly, **Group 5 (*Unbound Items → Significant Cut*)** also contains 2582 unbound items, which can be bound at a lower rate. All the commodities of sectors defined by the following fall in **Group 5** namely: HS chapter 3 (fish and crustaceans...), chapter 15

(animals or vegetable fats...), chapter 33 (essential oils and resinoids; perfumery...), chapter 42 (articles of leather, saddlery...), chapter 46 (manufactures of straw...), chapter 65 (headgear and parts thereof), chapter 67 (prepared feathers and down...), chapter 74 (copper and articles thereof), chapter 76 (aluminum and articles thereof), chapter 78 (lead and articles thereof), chapter 79 (zinc and articles thereof), chapter 92 (musical instruments and parts and accessories of such articles), chapter 93 (arms and ammunition...), chapter 97 (works of art, collectors' pieces and antiques), chapter 98 (project imports, laboratory chemicals...), and chapter 99 (misc. goods).

➤ The binding rates of items belonging to **Group 1 (*Bound Items-Significant Cut*)** and **Group 5 (*Unbound Items* → *Significant Cut*)** have been simulated using the Linear Reduction Formula, under alternate scenarios:

- (i) *Base Scenario*: Reduction in binding rates<sup>1</sup> by 51.7 per cent (or decline in the average MFN Tariff Rate from the present level of 31.06 per cent to 15 per cent).
- (ii) *Base Scenario with increase in Tariff Escalation*: Reduction in binding rates<sup>1</sup> of the raw material by 43.6 per cent, 51.7 per cent for the semi-manufactured and 59.7 for the finished goods.
- (iii) *Liberal Scenario*: Reduction in binding rates<sup>1</sup> by 67.8 per cent (decline in average MFN tariff rate to the level of 10 per cent).
- (iv) *Conservative Scenario*: Reduction in binding rates<sup>1</sup> by 35.6 per cent (decline in average MFN tariff rate to the level of 20 per cent).

These alternative scenarios have been suggested keeping in view: (i) India's unilateral tariff policy, and (ii) stage of processing of items. A selection of the most appropriate scenario depends upon India's unilateral medium and long-term tariff policy.

➤ Some select important observations about the results of the alternate scenarios for the 6061 items in **Group 1 (*Bound Items-Significant Cut*)** are summarised below:

- (i) In the case of *Base Scenario*, the simulated values of binding rates range from 7.2 – 19.3 per cent with the peak tariff being around 20 per cent.
- (ii) All the commodities for a significant number of sectors (10 out of 76, defined by different HS chapters) can be reduced.
- (iii) In case of the *Base Scenario with increase in Tariff Escalation*, the simulated average values of binding rates of finished products are lower than that of semi-

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<sup>1</sup> In case an item belongs to Group 5, (unbound item) its reduction in tariff rate is suggested from the base level of 50 per cent.

manufactures; the binding rates of semi-manufacture products are lower than that of raw material. In view of this factor this is not a viable scenario.

(iv) In the *Liberal Scenario*, the simulated level of the peak tariff comes to 12.9 per cent, while the peak tariff rate in the *Conservative Scenario* is 25.8 per cent.

- **Group 5 (Unbound Items → Significant Cut)** - In the case of the *Base Scenario*, the suggested level of the binding rate appears uniformly at 24.1 per cent; 32.2 per cent for the *Conservative Scenario* and 16.1 per cent for the *Liberal Scenario*.
- The identified commodities of **Group 1 (Bound Items-Significant Cut)** and **Group 5 (Unbound Items → Significant Cut)** together show that the tariff rate of most of the commodities of the 33 commodity groups/sectors (defined by different chapters of HS classification) can be significantly reduced.
- In short, our investigation suggests:
  - India's current binding, for most lines/commodities, does not reveal a domestic sensitivity of competitiveness from imports.
  - The applied rates for a large number of lines are lower than their corresponding binding rates, but the differences between the applied and corresponding binding rates are not significant. The mean and average rate of a large number of unbound items is not significantly different from those of bound rates.
  - There exists a large scope for a wide spread binding of Indian industrial lines/items. There are very very few lines/commodities, which are highly import sensitive. India can still keep such industrial lines in the unbound category or undertake to bind these at a high level, in the present negotiations. In fact, the present study suggests that only one item, i.e. urea, should remain unbound. In other words, our study suggests that the number of industrial lines, subject to binding rates, can be increased from the 70 per cent figure at the Uruguay Round to around 99 per cent in the forthcoming round.
  - India can offer tariff cuts on a large number of tariff lines. Our analysis of 9467 tariff lines show that India can offer significant tariff cuts on 8643 lines (including 2582 unbound lines). Out of the remaining 167 unbound tariff lines, India can think of binding 166 lines at relatively higher tariff rates. There are 365 lines (excluding 262 lines which have a zero bound rate) where the present level of the bound rate is considered adequate. In this context, it should be remembered that the present study has also identified 30 tariff lines where the existing level of India's bound

rate is inadequate. The proposed binding rates for such commodities have been suggested after working out the *ad valorem* equivalence of safeguard/anti-dumping duties, etc.

- India can easily bring down the average (simple) tariff from a binding rate of 34.1 per cent<sup>2</sup> to 20.8 per cent, or even 15 per cent on the basis of the *Liberal Scenario*.
  - Similarly its peak tariffs can be brought down to 20 per cent for most of the tariff lines of the industrial sector.
  - The average MFN tariff rates, during 2001-02 of raw-material, of semi-manufactured and of finished goods were 23.6 per cent, 32.4 per cent, and 31.4 per cent, respectively. It is very difficult to believe that India's MFN average tariff rate of finished goods is lower than that of semi-manufactured goods. This is in contrast to the tariff structure of a large number of other countries. Hence, tariff escalation will not be an important issue for reducing India's binding rates.
  - Till 2000-01, the Indian custom tariff rates (MFN as well as binding) for most of the industrial commodities used to be defined in the form of the *ad valorem* rates. From 2001-02, the rates for a large number of Indian textile items have been defined in the form of specific duties. Our analysis shows that the *ad valorem* tariff equivalence of some select items is very high. Keeping this factor in mind, it is very difficult to advocate that future negotiations should be based on *ad valorem* tariffs.
- The present study also tries to hint at the modalities of negotiations.
  - Thus India should follow a mixed approach in the forthcoming negotiation process. It can offer deep tariff cuts on a large number of lines (8643 out of 9467) using approaches like the linear formula, etc. For other items, India should follow the 'request and offer' method, because it: (i) cannot reduce the present level of bound rates, or (ii) propose that the binding rates should be relatively on the higher side.
  - Our results show that there are significant number of commodity groups whose tariff rates can be declined for all commodities. In case the sector-by-sector approach is adopted, India should emphasise the commodity groups defined by HS chapters such as: chapter 16 (preparations of meat...), chapter 25 (salt, sulphur, earth...), chapter 26 (ores, slag and ash), chapter 30 (pharmaceutical products), chapter 36 (explosives...),

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<sup>2</sup> Average binding rate of all industrial items as on 1-1-2001. It also includes commodities/lines which are unbound. The applied rate (of 2001-02) of these items was taken for calculation of average rate.

chapter 44 (wood and articles of wood, wood charcoal), chapter 49 (printed books, newspapers, ...), chapter 69 (ceramic products), chapter 72 (iron and steel), and chapter 75 (nickel and articles thereof). It can include 23 more commodity groups because the tariff rate for most of these commodities can be significantly reduced. These commodity groups can be defined as HS chapter 35 (albuminoidal substances), chapter 37 (photographic or cinematographic goods), chapter 41 (raw hides and skins, leather), chapter 45 (cork and articles of cork), chapter 47 (pulp of wood or of other fibrous), chapter 68 (articles of stone, plaster, cement, asbestos, mica or similar materials), chapter 86 (railway or tramway locomotives), chapter 3 (fish and crustaceans...), chapter 15 (animals or vegetable fats...), chapter 33 (essential oils and resinoids; perfumery...), chapter 42 (articles of leather, saddlery...), chapter 46 (manufactures of straw...), chapter 65 (headgear and parts thereof), chapter 67 (prepared feathers and down...), chapter 74 (copper and articles thereof), chapter 76 (aluminum and articles thereof), chapter 78 (lead and articles thereof), chapter 79 (zinc and articles thereof), chapter 92 (musical instruments and parts and accessories of such articles), chapter 93 (arms and ammunition...), chapter 97 (works of art, collectors' pieces and antiques), chapter 98 (project imports, laboratory chemicals...), and chapter 99 (misc. goods).

- India should start the process of negotiations from the bound rates (or given rates for unbound items), and not from the applied rates. This may help India in binding its rates on the higher side. On the other hand, it may not lead to a deeper reduction in the binding rates by other developing countries because their applied rates are significantly lower than corresponding binding rates. In case the objective of our negotiations is to also to capture developing countries' market (and not just to protect of our industry), negotiations should start from the applied rates and they must:
- Lay an emphasis on tariff escalation, i.e. a higher reduction in the tariff rates of finished goods as compared to a reduction in the tariff rates of raw materials or semi-processed goods. There can be no disadvantage in such an emphasis because India's present structure of import duties does not contain a significant difference in the tariff rates of raw material, semi-manufactures and finished goods.
  - Negotiations should not concentrate on a reduction in the average tariffs but should be concerned also with a reduction in the peak tariff. Our results of alternate scenarios show that India's peak bound rates may not be very high in comparison to the average tariff, except for a very few items/commodities. The values of mean

and peak tariff for the of suggested rates (Liberal Scenario) are 15.0 per cent and 25.6 per cent, respectively. The term peak tariff must be defined in comparison to average tariff.

- Our analysis shows that it is possible to achieve the objectives of: (i) tariff peaks, (ii) tariff escalation, and (iii) Special and Differential treatment (S&D) treatment, if the proper formula is used in the negotiation process.
- The results of the present study do not advocate that specific rates of import duties be replaced by *ad valorem* rates. In case the tariff negotiations of textile items are held separately, India can safely recommend that future negotiations of industrial sector excluding textile sector should be based on an *ad valorem* tariff. In that case, if some country applies specific duties they must submit an *ad valorem* equivalence of specific duties.
- India and other developing countries should demand S&D treatment for (i) level of base rates for unbound items, (ii) higher cut-off points for identification of peak tariffs, and (iii) higher reduction in the tariff rates of finished goods as compared to tariff cuts of unfinished or semi-processed products.