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Awareness and Utilization of Free Trade Agreements amongst the Textile and Clothing Export Firms of India

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Abstract

Today, India is witnessing the signing and negotiating of several trade agreements. It is also fast tracking these deals with several nations. In this context of India's policy of regionalism and its revamped foreign strategy, it is pertinent to understand the stand of the business community towards these. The study is an attempt to draw a relationship between the awareness and utilization of trade agreements and firm level characteristics. The final sample size in the present research consisted of 310 exporting firms from major textile and clothing hubs of India. The results from the survey point that the awareness level of free trade agreements for the exporting firms is highly dependent on the size of the firm and exports as a percentage of firms' revenue. The larger firms in the study were more likely to be aware of trade agreements. The utilization rate for trade agreement was also significant for the size of the firm, and diversified markets. Association although weak was observed for the strength of employees and the years of establishment of the exporting firm in utilization of the FTAs. Thus, our conclusion is that smaller companies were less likely to make use of trade agreements. Few policy suggestions to make the awareness and utilization levels of FTAs higher for the small sized exporting firms are given. This will aid in making FTAs a level playing field and bring it into the arena of international trade.

Keywords: Free Trade Agreements, Utilization, Awareness, Firm Size, Regression, Chi square, Exporter, Textile and Clothing, SME

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Introduction

According to WTO's latest report, free trade agreements are the most popular form of economic grouping in the world today. (WTO, 2019). These are a part of the changing landscape of the trading system in the world. (Crawford and Fiorentino, 2005). A free trade agreement is the second form of economic grouping where two or more nations decide to abolish tariffs among themselves, but they maintain their individual tariffs with other nations. Due to their ease in the formulation, trade agreements are being negotiated and signed all around the globe. There are contentions whether these trade agreements enhance trade or are impediments to trade. Few of the research works take these agreements to be welfare enhancing. (Summers, 1991). Sally (2006) found the FTAs becoming too burdensome along with lack of trade creation for exporters.

On the flip side, some studies emphasize on negotiations at the multilateral level. (Bergsten, 1991; Krugman, 1991). Bhagwati (1991) terms them as the "Termites in the trading system" and Panagariya (2006) calls them as "Inherently discriminatory". The proliferation of these could be due to the "domino effect." (Baldwin, 1993) where not being a part of the agreement proves to be disadvantageous for the non-members, resulting in an inclusion rush. Menon (1991) attributes this to the "spaghetti bowl" effect. The global trade system consists of overlapping FTAs. For some joining these trade agreements means an increase in market access along with a desire to strengthen ties in the economic and political arena. (Urata, 2002). Similar views are shared by laird (1999) who attributes the proliferation to political and social reasons. According to Wonacott (1996), these proliferating agreements create welfare for the hub but a loss for the spokes in the

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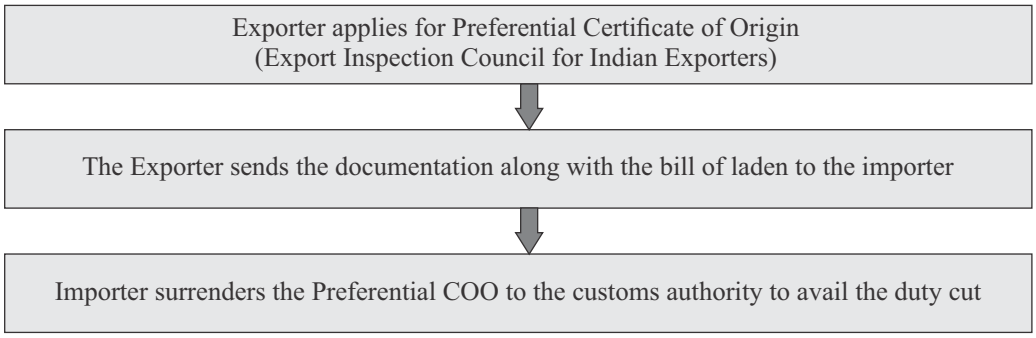
system. Lee and Park (2006) contend that the hub and spoke strategy is worst for members of overlapping RTAs and the world economy. The welfare and output are unevenly distributed in favor of hubs. Hubs are countries which have multiple FTA partners which are the spokes.

India has not been behind in signing of trade agreements. Since the globalization era in 1991, India has entered into several FTAs. India's first FTAs were forged with its neighboring countries of Nepal and Bhutan. These were limited in scope. Subsequently, many comprehensive agreements with countries in South Asia and South East Asia were signed. Currently, trade treaties are being negotiated with several countries such as Australia, United Kingdom and the UAE. Despite FTAs, India's appetite for the multilateral agreement will not be lost, thus unilateral trade liberalization is advisable with uniformity in rules across FTAs. The initial advantage in terms of increase in market share will be sustained only if there is a continuous increase in production. (Seshadri, 2009). Thus, India has actively followed the parallel track of bilateral regionalism. Mehta and Narayanan (2006) have tried to study various trade agreements and tried to place them in line with the global trends citing isolation as a major reason and WTO discriminatory treatment. The non-exclusion of services and investment also puts India at a major disadvantage. According to Anand (2009), India can succeed if services are included. It stands to lose due to its high trade barriers in comparison to other nations where barriers are low already. Non-discrimination is thus preferable to preferential treatment.

These trade agreements are the new order and a reality in the world of trade today. It is now clear that India's export led growth will be fueled by these agreements. The trade agreements to be successful will require mutual concessions and benefits for the parties involved. Thus, these need to be meticulously planned and negotiated keeping in mind the long-term goals and should be fair and balanced. Whether these agreements are being utilized by the end-users and facilitating the business is a pertinent question. The current study has been made in the backdrop of India's signing of multiple trade agreements. Today India is finalizing its trade pacts with countries across the globe, few being Australia, UK, and the UAE. Trade agreements are inflection points for more strategic partnership between countries. We make an attempt in the current research work to analyze whether the traders in India are utilizing these considering India's new policy of regionalism.

Use of Trade Agreements

The developing countries do not have separate data of trade that goes through the preferential route. The final beneficiary of the trade agreement is the importer who gets concessions on the imported goods. This is done when the exporter exports the goods through the preferential route. (Figure 1). The exporter files to apply for a preferential Certificate of Origin (COO) with the concerned authority. In India, this is the Export Inspection Council (EIC). Once the exporter receives the COO, he sends the documents to the importer who submits these to the concerned custom authority and takes advantage of the tariff cuts by paying a lesser duty on the exporter's good. Thus, the importer gets benefits in the form of lesser duties. The indirect benefits could accrue to the exporter in the form of his good becoming more competitive, increased sales, and gaining new buyers.



Source: Compiled by Authors

Figure 1: Process for Utilization of Trade Agreement

Review of Literature

Various studies have been done relating to the use of the agreements in the developed countries where preferential data is available. These make use of ratios to understand the utilization rates. These find high utilization rates particularly in the case of the EU and the US. (Keck and Lenldle, 2012; Candau et al., 2004).

The other set of studies are confined to few pockets of the world which includes mostly the south and south east Asia. These countries do not have trade data through the preferential route. In a study on FTA utilization by Philippine firms, Wignaraja et al. (2010) found low awareness and utilization rates where 20% of the firms were using and 40% planned to use it. Kawai and Wignaraja (2009) covered firms in five countries. 21% of firms utilized the FTA and usage was highest for firms in Japan. Wignaraja et al. (2009) found low utilization rates in Thailand firms with only 24.7% of firms using the FTA whereas 45.7% planned to use them. Julien et al. (1994) studied Small and Medium Enterprise (SME) firms in Quebec region in context of the US-Canada FTA, only 26.5% of the respondents considered themselves as sufficiently informed and 29% planned to take some action. Hirastuka et al. (2009) in a study on Japanese firms pointed to low levels of utilization and more utilization by larger firms. Contradictory to the earlier studies a study done on the utilization rate of Thai agricultural exports by Taratorn et al. (2008) found high utilization rates which in case of ASEAN-China FTA was as high as 91.65% and Thailand-Australia FTA(TAFTA) it was 82%. Deshal et al. (2011) found high utilization rates in case of trade agreements which Sri Lanka has with Pakistan and India which were 77% and 70% respectively. In another study on Sri Lankan exporters' Wijaysiri (2007) sees utilization rates as high as 89% in case of US GSP and 40% in EU GSP.

Menon (2013) concludes the utilization rates to be in the range of 10%-25% and are rarely found to be over 25 in East Asia. Similarly, by Laos and ASEAN nations. In a study by Hayakawa et al. (2013) on the use of AFTA by Japanese affiliate firms found that larger firms utilized FTAs more, and those whose origin of procurements were more diversified, and affiliates which exported to countries with higher tariffs. FTA use also varied for sectors and locations. Tambunan and Chandra (2014) on the utilization rate of FTAs by Micro, Small and Medium Enterprises (MSME) found that majority of the ASEAN FTAs are being poorly utilized by MSMEs and they are the least active economic actors in the region. Utilization of preferences is low especially for the smaller exporter. (Ciuriak and Bienen, 2014). Dieter (2012) concludes low utilization rates in Asia partly due to the complicated rules of origin. In a study of firms in Malaysia, Arudchelvan and Wignaraja, (2015) found that utilization of FTA by firms was dependent on firm size along with several other factors such as knowledge, foreign licensing, technological upgradation, and increased exposure to foreign trade. Zhang (2010) observed low utilization rates was observed for firms in People Republic of China which was 35.6% in 2009. Wignaraja et al. (2010) did a survey on 100 firms in Thailand and found most of the non-usage of FTAs was reported by SME firms with low access to production networks. Posigo (2013), it was found that utilization of bilateral FTAs is low in Malaysia and Thailand but shows sectoral variability. Wigjoseptina et al. (2013) in a survey-based analysis in Indonesia according to the number of COO issued, reported that the utilization of FTAs was more for medium and large sized firms than the smaller firms.

Jha (2011) made use of data on preferential Certificate of origin filled (COO) filled by the exporters concluded that the utility rate of trade agreements is very less in India, it was highest for India-Sri Lanka Free Trade Agreement. (ISFTA), and stood at 11%. Thus, RTAs have not benefitted Indian exporters and the utilization rates are low. These are between 5% to 25% (Saraswat et al., 2018). Study reports by (Delloitte, 2018; MVIRDC, 2018) suggest poor utilization rates by Indian exporters. A qualitative study done by Shyam and Geetha on the impact of the ASEAN-India Free Trade Agreement (AIFTA) on various stakeholders in the fishery sector and derived positive results from the consumers, marketers, and the exporters.

Most of the studies have cited low utilization rates but none of these has associated this with firm-level characteristics in India's context. Firm-level surveys play an invaluable part to assess the business activity of developing countries like India through FTAs. Thus, a better understanding of the impact of FTAs is sought

through these. The current study intends to fill this gap by studying the utilization and awareness levels of exporting firms in the Textile and Clothing Industry (T & C) in India based on various firm level characteristics. The research gap in the area has led to the following research questions

Research Questions

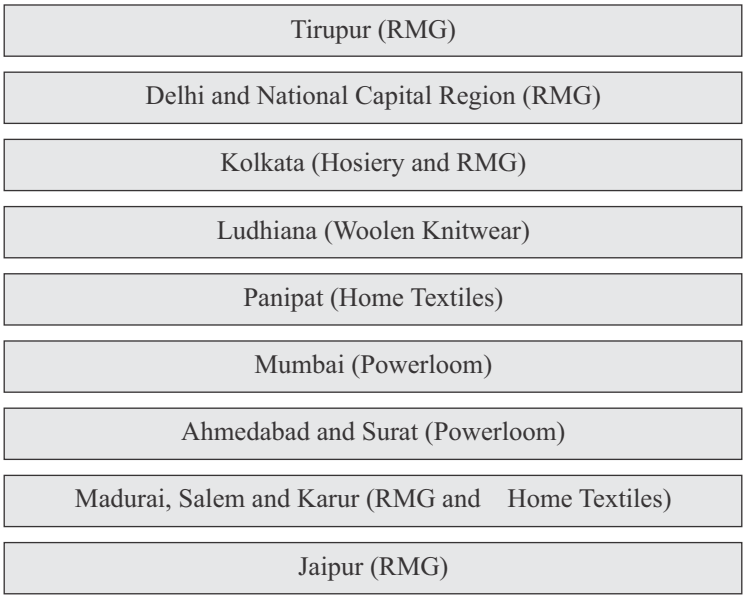
RQ 1: What is the awareness and utilization level of India's trade agreements amongst the T&C export firms of India?

RQ 2: What are the firm-level characteristics impacting the awareness and usage of trade agreements amongst the T& C exporters?

Data Collection and Sampling

The study followed a quantitative primary data assessment using a survey-based approach. The final sample consisted of 310 Textile and clothing exporters from major textile and clothing hubs in India. (Table 1). The companies were surveyed using a random sampling method by utilizing a two-stage cluster sampling process. This is an unbiased method of sample selection. Secondly, since the entire exporters' directory was available it was considered an appropriate method. Firstly, cluster sampling selected cities as clusters. Thereafter, export companies were chosen from the cities identified in the cluster. Clusters are geographical concentrations of affiliated companies in a particular industry or field. The list of clusters was identified from earlier reports. (AEPC, 2009, IBEF, 2019). The list of exporting companies was procured through the directories of the Apparel Export Promotion Council (AEPC) and Federation of Indian Export Organization (FIEO). The questionnaire was framed on a five-point Likert scale where exporters were assessed on their awareness levels. The aware exporter was further questioned on their utilization rates. The utilization rates were measured on firm level characteristics which was gathered from literature of previous studies in other Asian countries. (Wignaraja, 2009, 2010).

Figure 2: Exporter cities from Textile and Clothing Clusters in India



Source: Researcher's compilation from Exporters' directory

Research Method

We frame two binary regressions models on the awareness and usage level of free trade agreement which is influenced by several firm. A notable difference between binary logistic regression and linear regression is the nature of the dependent variable. Binomial logistic regression (often referred to simply as logistic regression), predicts the probability that an observation falls into one of two categories of a dichotomous dependent variable, based on one or more independent variables that can be either continuous or categorical/

ordinal. We predict the odds ratio in the presence of an explanatory variable. The model solves the gaps encountered in the Ordinary Least Square Regression (OLS) which are namely the problem of heteroskedasticity, the error terms not normally distributed, and getting values of probability greater than 1 and less than 0. The binary regression model for utilization was supplemented by Chi-Square analysis and Cramers V. These are robust non-parametric tests to understand the relationship between dependent and independent variables.

The Mathematical Model:

a) inary Logistic Regression Equation:

$$\ln\left[\frac{p}{1-p}\right] = a + BX$$

Where ln is the natural logarithm where $\log_{exp}$ where e= 2.71828

p is the probability that Y for cases=1 whereas 1-p is when Y for cases=0

Thus, $p/(1-p)$s the odds and $\ln\left[\frac{p}{1-p}\right] is\ the \log odds$

Thus, the natural log of the odds Z is given in the form of Binary Logistic Regression as

$$Z = \left(\frac{p}{1-p}\right) = B_0 + B_1X_1 + B_2X_2 + \ldots\ldots\ldots\ldots\ldots\ldots B_nX_n \ldots\ldots\ldots e$$

where B_1 is the average change in Z per one unit change in X_1.

Pearson Chi Square: is used to determine whether the utility of trade agreements is independent of the various firm level characteristics. The null hypothesis states that the two variables are independent of each other.

$$\chi_c^2 = \Sigma\ (O_i - E_i)^2 / E_i^2$$

Where O stands for the observed frequency And E stands for Expected frequency

Cramer's V: This gives us the strength of association of two variables. This is given as

$$\Phi = \sqrt{\chi^2 \ / N(k-1)}$$

Where N is the sample size and K is the lesser number of categories of either variable.

Analysis and Findings

The awareness rate of trade agreements amongst the 310 exporters was found to be 65% i.e., 218 exporters. The number of users and non-users of trade agreements was 131 and 87 respectively in the survey study.

a) In the first part of the study, we discuss the dependent variable which is aware or not aware of the trade agreements. The independent variables are the various firm-level characteristics. Similarly, in the utilization model, the dependent variable is utilization where the exporters' who are not aware have been excluded.

b) Independent Variable: Exports as percentage of Revenue (< 25% and > 25%), Employee number (2 categories of < 200 and > 200), Years of establishment (< 20 years and > 20 years), Annual Turnover (< 100 million, between 100-500 million and > 500 million). In the utilization model, the number of countries the exporter exports to and industry of operation (textile or clothing) has also been added (<5 countries and > 5 countries).Both the models were significant with a Nagelkerke value of 0.128%. and 0.157 for awareness and utilization respectively. This implies the independent variables in the model can successfully predict the variation in the dependent variable 12.8% and 15.7% times. The results showed significant results implying the model to be a significant improvement over the null model. The Hosmer and Lemeshow test provided a good fitment to both the models.

The regression results for awareness model were found to be significant for annual turnover and exports as a percentage of revenue

1) The exporters whose exports as percentage of revenue was greater than 25% were 1.9 times more likely to be aware of free trade agreements. Companies whose annual turnover stood between 100-500 million were 3.5 times more aware of free trade agreements than those whose annual turnover was less than 100 million. Larger companies with turnover greater than 500 million were 2.9 times

more aware of free trade agreements.

2) For utilization of trade agreement, the regression results were significant for annual turnover and the number of companies, the export company was exporting to. The probability of an export company utilizing the trade agreement decreased by 0.6 times (negative sign in the model) if the company's annual turnover was less than 100 million and decreased by 0.5 times if the company's annual turnover was between 100 million-500 million in comparison to companies with turnovers of over 500 million. The probability of an export company using the trade agreement decreased by 0.07 times if it was exporting to lesser than five countries.

Table 2: Regression Results for Awareness Model

	B	S.E.	Wald	df	Sig.	Exp(B)	95.0% C.I.for EXP(B)	
							Lower	Upper
Exports_revenue1(1)	0.69	0.3	6.36	1	0	1.994	1.166	3.41
Employee_number1(1)	0.17	0.5	0.11	1	0.7	1.183	0.442	3.164
Years1(1)	0.35	0.3	1.04	1	0.3	1.414	0.726	2.754
Annual turover			4.96	2	0			
Annual turover(1)	1.26	0.6	4.88	1	0	3.506	1.152	10.67
Annualturover(2)	1.08	0.6	3.93	1	0.1	2.947	1.012	8.58
Constant	-2.62	0.5	33.3	1	0	0.073		

Author's Compilation from data generated through SPSS

Table 3: Regression Result for Utilization Model

	B	S.E.	Wald	df	Sig.	Exp(B)
Exports_revenue1(1)	-0.23	0.32	0.522	1	0.47	0.793
Employee_number1(1)	-0.2	0.49	0.171	1	0.679	0.815
Years1 (1)	-0.27	0.36	0.565	1	0.452	0.766
Annualturnover			2.066	2	0.036	
Annualturnover(1)	-0.42	0.53	0.616	1	0.432	0.66
Annualturnover(2)	-0.69	0.49	1.952	1	0.162	0.503
Industry			2.815	2	0.245	
Industry(1)	-0.16	0.35	0.201	1	0.654	0.854
Industry(2)	-0.62	0.38	2.725	1	0.099	0.537
Count_countriesnew(1)	-2.61	1.05	6.241	1	0.012	0.073
Constant	3.867	1.11	12.2	1	0	47.81

Author's Compilation from data generated through SPSS

Results from Chi-Square and Cramers V

The association between the firm-level characteristics and usage of trade agreements was tested using Chi-square. As, in the chi square test, the association between the dependent variable which is the use of trade agreements is done separately for every independent variable. No significant association was found between utilization rate and exports as a percentage of revenue, and industry of operation.

Significant value of Pearson Chi Square < 0.05 was obtained for company's annual turnover (Chi-square value= 0.015), strength of employees. (Chi-square value = 0.033), Years of establishment (Chi-square value= 0.048), No. of countries exported to (Chi-square

value=0.0). The measure of Cramer's V further gave the measure of association between the predictor and the outcome variable. A value which is < 0.2 shows weak relation, a value between 0.2-0.3 shows a moderate relationship whereas>0.3 signifies a strong relation. According to these, we find weak association for strength of employees (Cramer's V =0.144), years of establishment (Cramer's V=0.13), moderate association for annual turnover (Cramer's V=0.29) and the strongest association was noted for country wise diversification in exports and utilization rate. (Cramers V= 0.38) . Further companies with strength of less than 200 employees were 1.9 times less likely to use trade agreements), years of establishment (companies which had lesser than 20 years of establishment were 1.8 times less likely to be using trade agreements). (Table 4 to Table 6)

Table 4: Chi-Square Test

Chi-Square Values	Value	df	Asymp. Sig. (2-sided)
Exports as Percentage of Revenue	2.034a	1	0.154
Strength of Employees	4.540a	1	0.033
Years of Establishment	3.921a	1	0.048
Company's Annual turnover	8.44	2	0.015
Industry of Operation	5.099a	2	.078
Number of Countries Exported to	32.832a	10	.000

Author's Compilation from data generated through SPSS

Table 5: Cramer's V

Cramer's V	Value	Approx Sig
Strength of Employees	0.144	0.033
Years of Establishment	0.13	0.048
Company's Annual Turnover	.297	.015
Industry of Operation	.153	.078
No. of Countries Exported to	.388	.000

Author's Compilation from data generated through SPSS

Table 6: Odds Ratio

Risk Estimate			
Odds Ratio	Value	95% Confidence Interval	
		Lower	Upper
Odds Ratio Strength of employees (below 200 / greater than 200)	1.937	1.05	3.576
Odds Ratio for years of establishment (less than 20 years / greater than 20 years)	1.82	1.003	3.318

Conclusion and Policy Suggestions

The larger companies in the survey with an annual turnover of over 500 million and with exports as a higher percentage were more aware of trade agreements. Utilization rate was also higher for them and also whose number of export markets were higher i.e., greater than 5. Association between utilization rates was also found between strength of employees and the number of years of establishment of the company. The awareness and utilization rates amongst the T& C exporters were low. This rate of utilization to become all pervasive in the developing nations requires strong government measures with knowledge spread. This is specifically true in the case of India where the T& C sector is significantly composed of the SME. Following are few policy suggestions for the stakeholders to take advantage of these.

- Focus on the smaller export companies: The study results from the survey show that both the awareness and utilization rates are lower for small companies in comparison to the large-sized companies. Thus, the future policy-making on trade agreements should focus on the smaller export companies to make them more aware and eventually utilize trade agreements, which may also lead to the diversification of markets for them. It is pertinent to bring them into the arena of the preferential trade to take full advantage. This could also mean different rules of origin compliance by them to make it easier. Thus, full welfare will be realized if the benefits of the FTAs percolate to the smaller exporter. Such measures by the government could include more help through technological upgradation, financial support, and electronic data exchange. The smaller companies require stronger institutional support for active involvement in export through FTAs. A strong information dissemination with regular conducting of seminars is essential.

- Two-way communication: Trade agreements will have impact only if the business utilizes it. The policy-making should thus focus on widespread awareness programs. These awareness programs should provide dissemination of knowledge through various channels such as conducting seminars, trade fair meetings, visits in various export clusters by the government officials. This is possible through large widespread programs through governments' behest. Such programs in various ASEAN countries of Thailand have seen high success rates with an increase in usage of trade agreements.

- Benefits of trade agreements: The export companies should be apprised of the trade agreements in place and those which are being negotiated by the government. The appraisal of benefits should let the exporters know how their products may become more competitive leading to an increase in their export's sale. The benefit could also accrue in the form of the firm getting new buyers. If the exporter is utilizing imported material, these may include a reduction in costs.

- Smoothing of the process: This can be done by making the use of trade agreements easier for the business. This may involve several factors such as reducing costs of trade agreements (hiring of labor and other resources) and by doing away with unnecessary paper work. Shortening of time in receiving the preferential certificate, more transparency at customs, standardized procedures, easier rules of origin, easier tariff classification, and giving preference to electronic data exchange will also help. Custom procedures should be smooth with all firms getting equality of treatment. The government can also investigate adopting e-customs for faster clearance of goods. A good example to follow would be the self-certification system works in developed nation of US. Thus, by making the whole process simple and one-stop will attract the smaller firms more to the use of FTAs.

- Active involvement of the private sector: The awareness programs relating to the use of FTAs should involve the private sector. This may include involvement of the private trade associations which are present in all the textile and clothing clusters such as Tirupur Export Association in Tirupur district of India. Thus, closer public-private cooperation for an increase in awareness and utilization of FTAs is need of the hour.

- Removal of domestic distortions: Free trade agreements go hand in hand when other problems in the sector are eliminated. This could mean labor policies, active involvement of sector in other government policies, taxation, upgradation of technological know-how. The technological upgradation will help these smaller companies to meet the international standards. They require more support from the government which is sector-specific in nature. This will aid in making the products competitive in the world market. This will also help them in product and market diversification.

- Involvement of exporters at ground level: While framing new trade agreements the exporters should be consulted at ground level such that the benefits can be maximized. This can also include increasing the scope and coverage of the agreement. Countries such as Thailand and Vietnam have a consultation with exporters on FTA provisions before signing of the official document.
- Reduction of Costs and costs waivers: Reduction of

costs related to the rules of origin requirements may sometimes involve heavy compliance costs by the exporters' which is particularly high in the case of developing countries. (Jongwanich and Kohpaiboon, 2017; Hayakawa et al., 2013). Good practices in ROO administration will help in reducing transaction costs for SMEs. (Kawai and Wignaraja, 2009). The smaller firms find it difficult to meet the cumbersome costs. The government could also investigate waving the costs altogether for the smaller exporter. Thus, these measures will push the relatively newer and smaller companies to enter the arena of international trade by utilizing free trade agreements.

We finally conclude that more active utilization by the smaller exporter is the only way to increase the overall utilization of the FTAs and make them percolate more in the arena of international trade. Thus, as in other parts of Asia, it is recommended to make the free trade agreement approach as highly SME centric. Concrete and centric efforts by the government will be required. These will provide improved and extended services to make the smaller companies aware of these and providing them a sufficient level of support for usage of these. Thus, adequate evidence is obtained to make streamlining of FTAs in India's trade by adequate awareness and subsequent utilization of these amongst the smaller companies. Trade will only improve if usability of FTAs increases besides the reduction in tariff.

Limitations and Scope for Future Research

The current research has focused only on the T& C exporters. Thus, only one sector was covered in this research work. The work focused on trade agreements in general and not the separate agreements which India has signed. The exporters were questioned only on their awareness and utilization of trade agreements. The study did not include the importers of the trade agreements. Future studies could also focus on sectoral disaggregation of exporters. Studies focusing on different trade pacts which India has and how they differ in utilization rates will also be enriching in the field. Exporter's perceptions through a conceptual framework which includes cost, benefits, impediments, and enablers will also bring enrichment in the area. The preferential data in terms of preferential COO filed will also aid the researchers in the field. An in-depth qualitative study involving various stakeholders from top policy makers, larger export houses, custom officials and importers will give relevant insights to further enhance the use of trade agreements.

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