FREQUENTLY ASKED QUESTIONS ON FREE TRADE AGREEMENTS

Free Trade Agreement (FTA) is an arrangement between two or more countries or trading blocs that agree facilitate trade and to reduce or eliminate certain barriers to trade in goods, services, and investments. Ordinarily, whenever a product is traded across international borders, the importing and exporting countries apply certain charges, which are in the nature of tariffs or duties on the products being exchanged. Such an imposition of tariff/duty invariably increases the cost of procuring the products. FTAs seek to reduce or eliminate such tariffs and thereby make available easy access to the domestic markets of partner countries. FTAs are entered into primarily, in relation to goods and services; however, extensive agreements may even provide relaxations in investor regulations and facilitate transfer of Intellectual Property.

1. Why are FTAs important?

In an increasingly globalized world, FTAs play an important role in implementing, increasing, and facilitating international trade. By entering into FTAs, countries obtain easier market access into other partnering countries. This also leads to increased foreign trade, which results in robust foreign investment opportunities for all partner countries.

2. Why are FTAs relevant for trade in India?

For any individual or enterprise that is desirous of developing trade relations with India, FTAs play a relevant role as these agreements have always been looked at as an important tool to enhance trade and investments in the country. India has signed a significant number of such trade agreements with various countries. However, reports suggest that, while FTA utilization in developed countries is as high as 70-80%, utilization of FTAs in India, by exporters as well as importers, is significantly low as compared to the extent of opportunity available. The low utilization highlights the alarming failure to utilize the benefits available to the industry. India must ensure that availing benefits available under these agreements and improving trade relations with other countries soon becomes the norm.

3. What are the advantages of FTAs?

FTAs are negotiated between countries for a number of reasons, such as:

(i) Eliminating tariffs and other non-tariff barriers to provide FTA partners easier market access;

(ii) Promoting foreign investment by partner countries by relaxing investor restrictions and regulations. It also promotes foreign investment from non-partner countries that may be interested in making use of the stimulated market conditions of either country;

(iii) Reaffirming the providing of National Treatment and of the Most Favored Nation (MFN) Principles to both parties in accordance with Articles III and I of GATT 1994, respectively;

(iv) Providing for IP regulation and protection that may have otherwise been open to infringement because of the existing trade relations;

(v) Allowing adopting measures against anti-competitive activities in order to facilitate trade and investment flows between the parties; and

(vi) Providing for simplified and clear dispute resolution methods.

4. Which are the significant FTAs entered into by India?

India has signed more than eighteen trade agreements, including with ASEAN countries, Japan, Korea, Singapore, SAARC countries and SAPTA countries. Organizations engaged in global trade and cross-border supply of eligible goods, should explore this opportunity to reduce costs, be competitive in the global market and become profitable.

5. What are Rules of Origin (RoO)? What are the general criteria applied for arriving at the RoO?

Rules of Origin (RoO) are the criterion required to determine the country of origin of a product for the purposes of international trade. Different criteria are applied by each participating Government, and the most widely used conditions are:

(i) Substantial transformation of input products;

(ii) Change in tariff classification;

(iii) Specific manufacturing or processing involved;

(iv) Extent of manufacturing or processing carried out in the exporting country.

To qualify for an exemption/ preferential tariff under an FTA, a Certificate of Origin (CoO) is required to be obtained by the exporter, for the subject product. The CoO is issued on satisfying the RoO conditions, as are provided in the respective FTAs. These certificates are essential for exporters to prove from where their goods come from and therefore stake their claim to the benefits that the goods may be eligible for in the country of import. This CoO is required to be submitted at the landing port of the importing country by the importer, to avail FTA benefits.

7. How can exporters maximize FTA benefits?

Organizations should set up a mechanism (of origin management), based on their supply chain, manufacturing process, products exported and the applicable FTAs, which can successfully evaluate the FTA benefits/ conditions. The mechanism should be transparent, auditable, provides sufficient self-checks and fulfills Government audit requirements, if any.

A typical origin management process involves:

(i) Identifying the raw material, components, inputs, etc. used for manufacturing of an export product;

(ii) Computing value addition or local value content;

(iii) Determining whether the significant transformation requirements, as prescribed by RoO, are satisfied;

(iv) Tracking the supply chain and costing/pricing information of inputs and raw material sourced/ used;

(v) Creating an automated system, which is integrated with the organizations ERP and supports extraction of necessary data/ information for a CoO.

A well thought through and mature system, allows organizations to standardize the entire process, measure the benefits, raise red flags for any non-compliances, as well as supports during audit proceedings by the tax authorities.

8. How can importers maximize FTA benefits?

Organizations should invest and make efforts to:

(i) Evaluate and identify the products qualifying for FTA benefits;

(ii) Impart appropriate trainings on the processes involved to claim benefits;

(iii) Increase coordination with the exporter of goods to understand satisfaction of RoO and not rely solely on the CoO received;

(iv) Maintain appropriate data, information and documents to support any queries that may be received from the tax authorities.

Imparting appropriate and timely trainings on FTA benefits can result in substantial cost savings for importers, resulting in better profitability and competitiveness.

9. Why must parties claiming benefits under FTAs be audit-ready?

Preferential benefits and duty concessions are extended by the importing country and hence also exercises control by examining the accuracy and correctness of origin claims. In India, the responsibility lies with Customs authorities to investigate for any fraudulent or wrongful claim of preferential duty.

To address this issue specifically, Union Budget 2020-21 has introduced a new chapter in the Customs Act, 1962 to lay down the powers and process for examining preferential duty claims. This newly introduced chapter empowers the customs authorities to restrict or deny any benefits if the response to their preliminary enquiry is not satisfactory.

Considering this, importers in India should not solely rely on the CoO which may be provided by the supplier of goods, but instead, maintain sufficient information/ checks to avoid any conflicts with the customs authorities. Similar to exporters, the importers should also install appropriate processes to be able to demonstrate the following in case of enquiry, audit or investigation by customs:

(i) Goods brought into India satisfy the conditions of RoO;

(ii) Duty benefit has been correctly claimed and that the same can be supported through relevant documents/ information;

(iii) "Reasonable care" was exercised while claiming the preferential duty benefits; and

(iv) The classification and valuation of products is correct and can be co-related with the import invoice and CoO.

10. Where can one find tariff concessions available in India's FTAs?

The Department of Commerce website contains all relevant information on India's FTAs including but not limited to the tariff concessions and removal of other non-tariff barriers to trade.