

India's Free Trade Agreements and Micro, Small and Medium Enterprises

A Case Study of the Leather Industry

I. Introduction

In recent years, India's international trade policy has been increasingly moving away from WTO's multilateral framework towards **Free Trade Agreements (FTAs)**. While the WTO's multilateral trade framework obliges its member countries to reduce border duties and adhere to higher labour and environmental standards, FTAs aim at total elimination of all tariffs and contain many items that are not part of the rules of the WTO (See Box 1). Since FTAs have such wide coverage they can create a significant impact on domestic production system. As a result, FTAs may severely impact the growth prospects of certain key sectors of the economy including the **Micro, Small and Medium Enterprises (MSME)** sector.

India's MSME sector in general and certain industries in particular play an important role in its economic and social arena. Given the fact that 26 million MSMEs in India employ about 60 million people, contribute about 8% to its GDP, 45% to its industrial output and 40% to its exports, it is important that any major trade policy in India should keep in mind the trade prospects of MSMEs. Especially in the context of international trade, the interface between FTAs and some industries in the MSME sector could be of significant consequence as provisions contained in the FTAs could have far reaching impact on their growth prospects. The leather and leather products industry is one of these industries. This case study intends to highlight what are the various relevant provisions in FTAs pertinent to leather industry, what do these provisions and chapters mean and how they may impact the growth prospects of the leather and leather products industry.

Box 1: What are FTAs?

FTAs are trade agreements between two countries (or blocs) which aim to give each other access to markets by lowering or removing border protection measures such as border taxes on exports and imports, and other barriers (such as standards, processes). FTAs can cover trade in goods (such as agricultural or industrial products) or trade in services (such as banking, construction, trading etc). FTAs can also cover other areas such as intellectual property rights (IPRs), investment, government procurement and competition policy.

II. Why is the Leather Industry Important?

Table 1: Estimated Employment in Different Segments of Leather Industry (Figures in lakhs)

Sector	Total Employment	Women's Employment	% Share
Flaying, curing and carcass recovery	8	0.35	4
Tanning & finishing	1.25	0.25	20
Full shoe	1.75	0.55	31
Shoe uppers	0.75	0.63	84
Chappals (Indian style open footwear) & sandals	4.5	1.5	33
Leather goods & garments	1.5	1.23	82

Source: Council for Leather Exports

The leather and leather products industry is one of India's oldest manufacturing industries. The industry employs about 2.5 million people with a large number of them belonging to poor and marginalized sections of society. The highest number of people is employed in the most basic activity of this sector which is flaying, curing and carcass recovery followed by Chappal and sandals making. The leather industry also provides employment to a large number of women. More than 80% workers employed in the leather goods and garments and shoes uppers segments are women (see Table 1). Women are also employed in small jobs done on scrap leather.

Moreover, nearly 70% of the leather sector is comprised of small-scale firms, although there also

exists a significant number of medium and large-sized firms in all segments of the industry. The Indian leather industry is spread in about six key segments: (i) tanning and finishing; (ii) leather footwear; (iii) footwear components; (iv); leather garments; (V) leather goods; and (Vi) saddlery and harness. The footwear and saddlery and harness segments have the highest shares of the household, tiny and cottage sector. In the tanneries segment, the presence of the medium and large-scale sector is the strongest with a share of 55% (see Table 2). The presence of small- scale units is the highest at 95% in garments, followed by leather goods, saddlery and harness.

The major production centres of leather and leather products are located mainly in the eight states of India namely Tamil Nadu (Chennai, Ambur, Ranipet, Vaniyambadi, Trichy and Dindigul), West Bengal (Kolkata), Uttar Pradesh (Kanpur and Agra), Punjab (Jalandhar), Delhi, Andhra Pradesh (Hyderabad), Karnataka (Bangalore) and Maharashtra (Mumbai). Tamil Nadu, by the number of production centres located, is the biggest leather exporter of the country.

Table 2: Sector/Product-wise Major Production Unit Types (in %)

Sector/Product	Household, Tiny and Cottage Industry	Small-scale Sector	Medium & Large-scale Sector
Tanneries-leather	10	35	55
Leather footwear	60	25	15
Non- leather	15	70	15
Garments and outerwear		95	5
Leather goods	10	85	5
Saddlery & harness	40	60	--

Source: www.siadipp.nic.in/publicat/footwear.htm

III. Policy Framework in the Leather Industry

The policy framework of the Indian leather industry seeks to achieve its objectives mainly through two key policy routes: (1) small-scale sector development; and (2) export promotion. While the former aims at maximisation of employment in the labour-intensive industry, the latter emphasises enhancing value addition across the supply chain to maximise export earnings.

In order to protect and promote the small-scale sector that largely dominates the leather industry, many leather products were provided reservation for exclusive production in small scale industries (SSIs) since 1967. However, in the wake of economic reforms initiated in the early nineties, the importance of small sector itself underwent a drastic change, especially for export-oriented sectors such as leather. Consequently, a gradual process of de-reservation began. Eleven (11) items were de-reserved in June 2001, including semi finished hides and skins, leather shoes, washers and lace. No industrial licence is required any longer to manufacture most of the items in the leather industry. Only some items (like chappals, sandals and garments, gloves and fittings for leather goods) are reserved for exclusive manufacture by small-scale units, which can be produced by non small-scale units after obtaining an industrial licence subject to an export obligation of 50%. Various enabling policy incentives related to raw material, marketing and finance available until now to the industry on account of being largely in SSI, have also been gradually withdrawn. Large enterprises are now allowed to produce products that were earlier reserved for the small-scale sector particularly in export-oriented sectors.

On the export policy front, in order to promote the development of the domestic leather industry, as well as to keep in line with overall international trends in leather industry exports, the period since 1973--74 has been marked by increasing emphasis on the exports of value-added products. In 1972, a government committee, known as the Seetharamiah Committee, recommended among other things, a ban on exports of raw hides and skins, quota restrictions on export of semi-finished leather, a simultaneous increase in finished leather production capacity, and incentives for increasing finished leather exports. In addition to the quota restrictions, semi-finished leather was subject to an export duty of 25%. A large number of incentives were given to exports, following the recommendations of the Committee. Cash Compensatory Support for exports was extended to leather exports in 1973, and Duty Drawback was also provided. Generous airfreight subsidies were provided to overcome disadvantages in long-distance transportation. The second major policy thrust came in the form of the Kaul Committee report in 1979 to look into the problems of capital goods needed in the production of leather. Accordingly, the import duty on tanning, finishing, footwear and leather goods machinery was reduced to a uniform rate of 25%. The third committee, known as the Pande Committee, appointed in the mid-eighties, recommended measures to augment raw material availability, strengthen the modernisation process and promote footwear as the most important item of export. The committee in its report published in 1985 recommended that imports of finished leather be permitted to compensate for the shortage of raw material, and imports of raw hides

and skins, wet blue leather and crust leather should also be on Open General Licence (OGL). In order to promote footwear exports in keeping with world trends, it recommended the production of footwear on large scale as well as the development of manpower in footwear engineering, design, pattern making, etc.

The Fourth Committee and perhaps the last committee set up exclusively for the leather industry, in its report published in 1992, argued that while employment generation is a major objective for a traditional industry like leather, this can be achieved best if export growth is accelerated and India's share is improved. Accordingly, the committee made five major recommendations for promoting exports:

- (i) Abolition of reservation for specific products for production in the small-scale sector;
- (ii) Licencing requirements for the industry should be removed;
- (iii) Foreign collaborations should be cleared quickly and routinely and that Indian firms should be permitted to enter into joint ventures in order to gain access to raw material abroad;
- (iv) Setting up a variety of educational institutions and training centres to train manpower for the industry;
- (v) A technological package to modernise the industry were identified.

This Committee ushered the Indian leather industry into an era of economic reforms characterised by delicensing, dereservation and import liberalisation. Some of the current policy schemes for the leather industry include duty free import facility for leather product manufacturers including footwear, duty drawback facility and service tax exemption on transport of certain goods, etc.

IV. What are the Key Chapters and Provisions in the FTAs?

Under FTAs, the key trade issues can be classified into two categories: **Goods Trade Issues and Non-Goods Trade Issues**. Under **Goods Trade issues**, the important agreements pertain to agreements on mainly six issues: (I) Import duties; (II) Export measures; (III) Non-tariff measures; (IV) Rules of Origin; (V) Anti-concentration clause; and (VI) Sectorals (Zero for Zero reduction). Under the **Non-Goods Trade** issues, there are four key issues: (I) Intellectual Property Rights policy; (II) Investment policy; (III) Public Procurement policy; and (IV) Competition policy. Trade facilitation and dispute settlement are also included under FTAs.

Note: For more details on FTA Provisions and Key Features, see Part I and Part II of this series.

V. Trade Pattern in the Leather Industry: World and FTA Partners

The leather industry in India is significantly trade and export oriented. Under the Harmonised System (HS) of classification of products (goods) for trade purposes, leather products come under four different chapters: nos. 41

Table 3: HS Codes of Leather Products, Chapters 41, 42, 43 and 64 (with examples at 4 digit level)

HS Code/ Chapter 41: Raw Hides and Skins (Other Than Furskins) and Leather	HS Code 42: Articles of Leather, Saddlery and Harness; Travel Goods, Handbags and Similar Cont. Articles of Animal Gut (Othr Thn Silk-Worm) Gut.	HS Code 43: Furskins and Artificial Fur, Manufactures Thereof.	HS Code 64: Footwear, Gaiters and the Like; Parts of Such Articles.
HS 4101: Raw Hides & Skins Of Bovine/Equine Animals (Fresh/Slaughtered-Dried-Limed-Pickled-Preserved But Not Tanned parchment-Dressed/Further Processed)W/N Dehaired/Split	HS 4201: Saddlery And Harness For Any Animal (Including Tractsleads, Knee Pads, Muzzles, Saddle Cloths, Saddle Bags-Dog Coats & The Like) Of Any Materials	HS 4301: Raw Furskins (Incl. Heads, Tails, Paws and Other pieces Cuttings, Suitable for Furriers Use) Except Raw Hides & Skins of Headings No.4101.4102/4103	HS 6401: Waterproof Footwear with Outer Soles & Uppers of Rubber/Plastics Uppers Neither Fixed To Soles Not Assembled by Stitching-Riveting Etc.
HS 4104: Tanned/Crust Hide & Skin Of Bovine(Including Buffalo) Or Equine Animal Without Hair W.O.N Split But Not Further Prepared	HS 4202: Trunks, Suit Cases, and Other Cases Holster & Travelling Bag, Hand Bag And Other Similar Containers Bags Wallets Boxes Purses,	HS 4303: Articles of Apparel-Clothing Accessories and Other Articles Of Furskin.	HS 6403: Footwear with Outer Soles Of Rubber, Plastics, Leather/Composition Leather & Uppers of Leather
HS 4107: Leather Further Prepared After Tanning/ Crust Including Parchment-Dressed Leather Of Bovine Without Hair W.O.N. Split	HS 4203: Articles Of Apparel and Clothing Accessories of Leather or of Composition Leather		HS 6404: Footwear with Outer Soles of Rubber-Plastics Etc & Uppers of Textile Materials.

Note: For full list of leather products at 4-8 digits, go to [http://www.dgciskol.nic.in/itchs2007/itc\(hs\).htm](http://www.dgciskol.nic.in/itchs2007/itc(hs).htm)

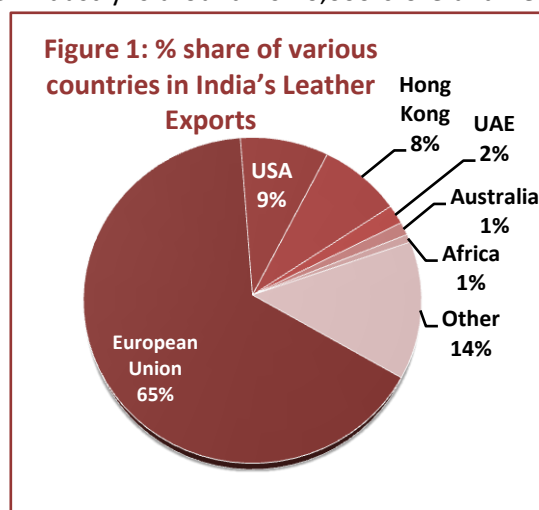
or raw leather; 42 or leather articles; 43 or furskin-related products; and 64 or footwear and similar products. These two-digit classifications are described in Table 3 (header row). Products can be categorised under each chapter even at more disaggregated levels, by 4 (called heading), 6 (sub-heading) or 8 digits. So for an MSME entrepreneur who is interested in trade issues either for exporting or for imports, the most important task will be to find out the HS code of the product he/she produces. Table 3 also provides some examples of product categories at 4 digits.

Note: How to assess your HS code? Check the list given at [http://www.dgciiskol.nic.in/itchs2007/itc\(hs\).htm](http://www.dgciiskol.nic.in/itchs2007/itc(hs).htm)

India in World Trade

In line with the intended objective of export promotion policy in the leather Industry initiates way back in 1972, the share of the value-added finished products in the total exports from the leather sector has gone up considerably from 20% in 1970s to 80% today. The leather and leather products industry has been an export oriented industry and is among the top ten export earning industries of the country. The Indian leather sector accounts for around 3% of the global leather-related trade. The size of the Indian leather industry is around Rs 40,000 crore and near about 45% of its production is exported.

The export of leather and leather products in the financial year 2010--11 was over Rs 17,000 crores (USD 3844.86 mn), recording a growth rate of about 8% over the previous year. In the last five years, exports have consistently gone up except in the year 2009-10. The major markets for Indian leather products are Germany, UK, Italy, USA, Hong Kong, France, Spain, the Netherlands, Belgium, UAE and Australia (see Fig.1). These 11 countries together accounts for nearly 78.09% of India's total leather products export (www.leatherindia.org). Europe alone is the export destination for more than 65% of India's leather exports (See Fig. 1). While export to Germany, USA, UK, Italy, France, Hong Kong, Spain, the Netherlands, Russia, New Zealand, Canada, South Africa, UAE and Japan have shown positive growth, export to Australia, Greece, Switzerland, Portugal and Ireland have shown a decline during 2010--11.



India's share in world imports is less than 1%. Current applied MFN duties¹ stand at simple average rates of 7.57% for Chapter 41 (raw leather), at 10% for Chapter 42 (leather articles), at 2.5% for Chapter 43 (furskin and products) and at 10% for Chapter 64 (footwear products). Individual products have different tariff rates.

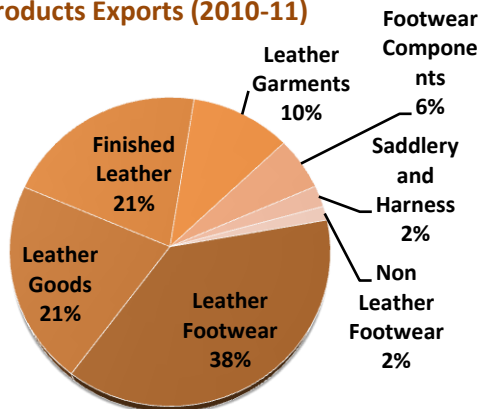
The product-wise export and import pattern shows that an estimated 15% of the total purchase of leading global brands in footwear, garments, leather goods and accessories in Europe, and 10% of global supply is outsourced from India. The footwear sector is the leading segment of the Indian leather industry. Export of footwear (of different categories taken together) alone holds a major share of 45.05% in India's total leather products exports followed by exports of leather goods (21.19%) and finished leather (21.09%) in the year 2010-11 (See Fig. 2).

At a more disaggregated level, in trade of raw hides and skins, India exports more than it imports or has a trade surplus. Exports of raw hides and skins, small in volume compared to other segments, have witnessed a decline of about 8% in 2009-10 compared to 2008--09. The leading export destinations for India's raw hides and skins (other than fur skins) under Chapter 41 are Hong Kong and Italy followed by China and Vietnam. The two leading countries from where India imported its raw hides and skins are Italy and Saudi Arabia. Within Chapter 41, leather further prepared after tanning/crust and patent & patent laminated leather contribute about 52% and 33% of exports under this category (HS 41). India imposes export taxes on raw leather unto the stage of wet blues to encourage the domestic leather industry.

Under Chapter 42 (covering leather articles) again, India has a trade surplus. Trunks and suitcases, etc and articles of apparel and clothing seem to be the only exports, and imports of trunks and suitcases

¹ MFN applied duties are current applied duties that are the same for all WTO members. Preferential rates can be given to countries through bilateral agreements including FTAs or the General System of Preferences (GSP) which gives preferential treatment to developing countries.

Figure 2: India's Leather & Leather Products Exports (2010-11)



form 85% of all imports under this chapter. However, as compared to 2008--09, in the year 2009--10 the exports share under this category have gone down by 6% and imports share have gone up by 4%. The leading export destinations and import sources for Indian leather articles are listed in Fig. 3.

International trade under category 43 is not very significant. Under Chapter 43, articles of furskin apparel and clothing form the bulk of exports while raw furskin forms the bulk of imports.

The category 64 that includes footwear is perhaps the most significant in terms of export earnings. The exports exhibit a positive trend and imports have shown a negative trend in 2009-10 compared to 2008-09. The leading export destination countries and import sources of footwear and other products are given in Fig. 3. Under Chapter 64, footwear with outer soles

of rubber/plastic with outer soles and uppers of leather forms 81% of footwear segment exports, while waterproof footwear and footwear with outer soles of rubber/plastic and uppers of textile material constitute 43% and 33% of footwear imports.

The importance of FTAs in India's leather trade can be realised from Fig. 3. Since FTAs open up trade as border duties go to zero, Indian exports can get more market access in partner countries but imports can also get more inroads into India. If we look at the top 10 countries to and from which India exports and imports its leather products, the domination of FTA partners is clear. In Fig. 3, we look at the two major segments of India's leather trade, chapters 42 (leather articles) and 64 (footwear). Eight out of ten export destinations for both groups of products are India's future FTA partners. Among countries from which we import, three are future FTA partners and three are current partners in leather articles. Two and four are future and current FTA partners in footwear. On the import front, China is the country with the largest share in India's imports and Indian producers' main competitor. But an FTA with China is not on the cards yet; therefore Indian leather producers are protected from Chinese competition to a certain extent. In the next section, we shall see whether and where the current FTAs give trade advantage to Indian leather producers.

Note: Do you sell to or buy from any of these countries?

Figure 3: Top 10 Export Destinations and Import Sources of Leather Products and FTA Partners

(% shares in categories/HS Chapters in brackets)

Commodity: 42 ARTICLES OF LEATHER, SADDLERY AND HARNESS; TRAVEL GOODS, HANDBAGS AND SIMILAR CONT. ARTICLES OF ANIMAL GUT (OTHER THAN SILK-WRM) GUT		Commodity: 64 FOOTWEAR, GAITERS AND THE LIKE; PARTS OF SUCH ARTICLES.	
Top 10 Countries to Which We EXPORT	Top 10 Countries from Which We IMPORT	Top 10 Countries to Which We EXPORT	Top 10 Countries from Which We IMPORT
Germany (17.76)	China P Rep (68.21)	UK (19.66)	China P Rep (53.10)
USA (13.63)	France (6.95)	Germany (14.88)	Italy (9.49)
UK (13.21)	Italy (5.33)	Italy (13.93)	Hong Kong (4.96)
Italy (8.33)	Hong Kong (3.54)	France (9.59)	Nepal (4.75)
Spain (7.89)	USA (2.66)	USA (8.20)	Vietnam Soc Rep (4.26)
France (7.69)	Germany (2.29)	Spain (6.36)	Thailand (3.87)
Netherlands (4.49)	Unspecified (1.39)	Netherlands (4.32)	USA (3.30)
United Arab Em. (3.12)	Vietnam Soc Rep (1.38)	Belgium (2.67)	Malaysia (2.41)
Australia (2.86)	Korean Republic (1.25)	United Arab Em. (2.62)	Taiwan (2.23)
Denmark (2.80)	Singapore (0.90)	Portugal (1.50)	Germany (1.77)
Source: Based on data from MoC website.			
FTAs Signed		FTAs Close to being Signed	

VII. FTAs and Key Issues for the Leather Industry

a) Tariff Rates and Market Access

Table 4: India's Tariff Reduction Commitments in ASEAN

Tariff Reduction Commitments	Products (HS Code/name)
Immediately to 0 (Normal Track 1)	41 (Raw Leather, most products with some exceptions); 4301-4302.30.00 (Fur items)
0 by 31 Dec 2013 (Normal Track 1)	4104.11.00-4115 (Tanned hide to composition leather); 4303.10 Furskin articles of apparel and clothing accessories; 4304 Artificial Fur and Articles
0 by 2016 (Normal Track 2)	4206.00 Articles of gut (other than silk-worm gut), of goldbeater's skin, of 4206 bladders or of tendons; 64031200 Ski-boots, cross-country ski footwear and snowboard boots; 6403.91.90 other footwear covering the ankle non leather
5% by 2016 (Sensitive Track)	4201.00.00 Saddlery and harness etc to 4205.00.90 Other; 64 (Footwear) almost All lines
Excluded from cuts (Exclusion List or EL)	6402.19 Other (rubber& other Non-ski boots & ski footwear)

Source: Compiled by Authors

FTAs aim to reduce actual import tariffs (or duties) to zero in more than 85% of products (for more information see Part I and II of this series). India has offered up to 90% of products for zero duty in the currently signed FTAs. The rest of the products (called tariff lines) can be kept in the exemption/exclusion/negative list where duties can stay at current applied levels. Trade negotiators may designate different tracks such as normal track, sensitive track and reduce duties based on the sensitivity of the product, and at different rates. This will mean tariffs will be made zero over different time periods. For example, see Table 4 where the schedule for India's tariff reduction in leather products under different tracks in the India-ASEAN FTA is given. For example, India will immediately cut duties to 0 in raw leather, fur

items (Normal Track 1). Saddlery, leather products and most lines of footwear are in the sensitive track where duties will be cut to 5% by 2016.

Table 5: India's and Japan's Tariff Commitments in the India-Japan CEPA

Duty Commitment	Base Duty (2007)	India's Committed Products	Japan's Committed Products
Immediately to 0	0	Raw Hides and skins (HS 4101-4103), Raw Furskin (HS 4301)	Raw hides and skins (4101-4103), Tanned or crust hides of sheep, lamb and other animals (4105 and 4106 both in wet stage) except those listed below, Tanned or crust hides and skins of bovine (including buffalo) or equine animals (4104-11, 19, 41, 49)(chrome dyed), Raw Furskin (4301), Artificial fur and articles (4304)
0 duty in 10 years (11 installments)	10	All other Categories of Leather (HS 4104-4115 including Tanned/Crust Hide & Skin; leather further prepared etc); Articles of Leather, Saddlery and Harness; Travel Goods, Handbags And Similar Cont., Articles Of Animal Gut (HS 42), Tanned furskin and all other fur products (HS 4302-4304); Footwear segments (64031200, 640320, 640351, 640359, 640391, 640399, 64042, 640451, 640610)	Whole hides and skins (4101-20, 50, 90 Other), Tanned or crust hides and skins of bovine (including buffalo) or equine animals (4104-11, 19, 41, 49)(not chrome dyed), Tanned or crust hides of sheep, lamb and other animals (4105 and 4106 both crust or in dry state, dyed or coloured), Leather further prepared (4107, 4112), Composition leather (4115). Saddlery and Harness (4201), Trunks and Suitcases (4202), Leather articles all lines except those listed below (4203), Footwear with outer soles of leather, uppers with leather etc (6403.20)
Exclusion/ Negative List (no duty ct)	0-16	All items under Footwear, gaiters etc (HS 64) except those listed above	Chamois Leather (4114), Belts and bandoliers-other (4203.30), Tanned or dressed furskins (43.02), Articles of apparel, clothing accessories and other articles of furskin (43.03), Footwear most lines except those listed above

Source: The India-Japan CEPA Document, Ministry of Commerce

Under its current FTAs, India has offered to reduce duties in the leather sector over a period of 0--10 years. India is also looking towards getting additional access in leather products in partner markets as they remove tariffs. Table 5 gives some examples of tariff commitments from India and Japan. In its FTA with Japan, both countries are protecting almost all segments of footwear (HS 64) and cutting duties by 10 years (the longest period in the IJCEPA

except a few items) in leather articles (HS 42). Japan has put all lines of footwear in the exclusion list except footwear with outer soles of leather, uppers with leather, etc (HS 6403.20) so Indian manufacturers will get no additional access at all. Trade in raw leather seems largely open on both sides though Japan has excluded chamois leather from duty cuts and kept non-chrome dyed tanned or crust hides on a schedule of 10 years. Japan has also excluded tanned or dressed furskins and furskin apparels from duty cuts.

India is also negotiating an FTA with the EU which is an important destination for Indian leather products. India will be looking to get the current MFN applied duties on leather and footwear products of 4.2% (maximum duty is 17%) removed totally. India already benefits from the GSP tariff which is given to developing countries in EU markets. This gives an applicable tariff rate which is zero for 'non-sensitive' products and is lower by 3.5 percentage points from the MFN applied tariff on 'sensitive' products. However, the FTA will give India preference at par with the least developed countries such as Bangladesh which get duty free-quota free access through the 'Everything but Arms' (EBA) initiative. Current duty free imports to EU stand only at 17% of total imports of these products. However, details of tariff commitments are not available as ongoing negotiations are conducted in secrecy and other non-tariff barriers (see below) may block Indian exports to the EU.

Note: Check what the tariff for your product is in various FTA partners' countries from FTA documents. (http://commerce.nic.in/trade/international_ta.asp?id=2&trade=i)

Preference Erosion: However, though India will get additional market access in the short run, the question is whether India will retain that share over the long run. As countries sign more and more FTAs, the preference each gets will erode or reduce over time. Therefore, if India signs an agreement with the EU, Indian producers can export at zero duty. However the EU is also negotiating an FTA with China. If that gets signed, Chinese products will also get entry to the EU at zero duty. The question will be whether India can retain gains even when other more competitive countries get similar preference.

b) Export Taxes

One of the key strength of the Indian leather industry is the availability of raw leather domestically owing to our huge livestock population. Today, the leather and leather products industry has moved tremendously upward in the value chain. From exporter of raw lather in 1970s, the Indian leather industry has transformed into exporter of value-added leather products and has become one of top export earning industries of the country. This has been achieved on the account of imposing export taxes on raw leather and removing import duties on finished leather. Currently India levies export taxes between 10% and 25% on tanned and non-tanned hides, skins and leathers including vegetable-dyed leather used by the saddlery industry. This discourages exports of raw leather out of country and ensures that it is available and accessible to Indian manufacturers. There is empirical evidence to show that export tax is an effective policy instrument in promoting value addition and development of leather industry. According to some estimates, value addition to finished leather compared to raw hides and skins is around 243% and for leather shoes around 850% (Traidcraft Case study, 2010, See Section X). Kenya revived its leather industry by imposing 40% export duty on raw hides and skins. This resulted in considerable increase in the number of tanneries, increase in employment opportunities and increase in incomes of leatherworkers in Kenya's leather industry.

However, some countries, especially developed countries, notably the EU, want export taxes to be completely removed in partner countries under FTAs. If this happens under FTAs, the millions of small artisans and small leather manufacturers as well as tanners and producers of finished leather could face severe shortage of raw material and they will no longer be trade competitive. As the Indian leather industry has already begun to face shortage of raw material, removal of export taxes could severely jeopardise its growth prospects.

Note: Check whether your competitiveness will be affected if raw material costs are increased.

c) Non Tariff Measures (NTMs)

Non Tariff Measures (NTMs) are all measures other than normal tariffs, namely; trade related procedures, regulations, standards, licencing systems and even trade defence measures such as anti-dumping duties, etc. which have the effect of restricting trade between nations. Those NTMS that generally cannot be justified under WTO law are termed as non-tariff barriers (NTBs). *For more on NTMs and NTBs see Part I of this series.*

On leather, standards are the most common NTMs, and are imposed generally on saddlery and harness products (HS 4201); trunks and suitcases, etc (HS 4202); articles of apparel and clothing (HS 4203); and footwear (HS 64). Apart from size, shape or capacity, standards most often relate to Residual Substances Limits (RSLs) of different

chemicals. The chemicals, type of machines to be used in production may be specified by countries. Even the process of certification of quality may be a barrier. All countries do not have uniform assessment standards and sometimes countries (e.g., Europe) want quality certificates on imported products to be issued only by European laboratories based on European standards. In addition, labour and environment related standards such as pollution emission and labour conditions are specified by countries such as in the EU.

In leather and leather products, mandatory (legal national standards) and voluntary (specified by industry/sector) standards of products are laid down by many countries in the world, the EU and the US are the most notable. Fig. 4 lists some standard specifications of the EU, USA and China. There are also global standards on products such as safety shoes. Many of these may be difficult for Indian producers, especially smaller producers, to meet.

Figure 4: Standards in Selected Countries and World

Europe	<ul style="list-style-type: none"> •Mandatory: 17 RSLs •Mandatory: Germany has 3 more and a few other countries have 1-2 more mandatory RSL •Voluntary: Eco Label for Footwear (10 standards + waste treatment + packaging information + Parametres on Durability)
USA	<ul style="list-style-type: none"> •Mandatory RSLs (5) •No Voluntary standard
China	<ul style="list-style-type: none"> •Mandatory RSLs (2) •Voluntary: 12 conditions for footwear
Global	<ul style="list-style-type: none"> •Mandatory: Standards for Safety Shoes •Voluntary: ICT Eco-Tox Label, International Council of Tanners (5), Öko-Tex Standard 100, International Association for Research and Testing in the Field of Textile Ecology(5)

Source: <http://www.fisme.org.in/document/Leather.pdf>

For example, the waste treatment standards laid down by the EU stipulates how waste water from leather tanning sites should be treated and lays down chromium residue levels, reduction of COD content and specific test methods. These are very difficult for Indian small tanners to meet, as most plants of leather industry do not have adequate infrastructure including common effluent plants. Our field visits in Kanpur, Uttar Pradesh confirm this. Small producers find it difficult even to meet domestic standards and government support is negligible, so meeting international standards are even more difficult for them.

NTBs in India's FTAs

The WTO has standards and technical agreements (SPS and TBT Agreements²) which cover quality and technical standards and processes. Most FTAs have a chapter on NTBs, but most agree to abide by WTO's SPS and TBT Agreements. The India-ASEAN

and India-Malaysia Agreements follow this principle. But some FTAs, often by developed countries, target to lay down higher and stricter standards in their FTAs which may be difficult for developing countries to meet. Standards by themselves are hardly ever lowered under FTAs.

FTAs can also lay down additional mechanisms to simply NTBs. For example, in the India-Japan FTA, a Sub-Committee on Technical Regulations, Standards and Conformity Assessment Procedures, and SPS Measures has been set up to discuss having Mutual Recognition Agreements (MRAs). This involves mutual recognition of each others' standards and certifying processes and agencies. However, no Indian FTA until now has got an MRA in leather products. For India, which is negotiating an FTA with Europe, India's major market for leather products, it is important to get MRAs for small producers to benefit significantly.

Note: Check whether you can meet current standards and process requirements on exports to FTA partners and whether these are eased in the signed FTAs.

d) Rules of Origin (ROO)

FTAs require that for a product to get the zero or preferential duty in the partner country, the product must be produced largely locally or within any of the FTA partner countries. This means those products which use a lot of imported inputs (from other countries) cannot get the special concessional duty. The ROO for each country is specified in each FTA most commonly by two principles: i) the local content in total value added of a product must be above a certain percentage (specified by the country); and/or ii) the final product (according to its tariff classification) must be shown to be quite different from the imported inputs (this method is called CTH/CTSH). In

² The Sanitary and Phyto Sanitary (SPS) Agreement in the WTO lays down standards on health grounds and the Technical Barriers to Trade (TBT) Agreement lays down technical standards and procedures.

addition, countries can also ask for product specific rules (PSRs). Exporters also need to show a certificate of origin that proves that the product satisfies the ROO the process for obtaining which is often complicated. Apart from the satisfying the ROO, getting certificate of origin may be more cumbersome and costly for MSMEs.

ROO in India's FTAs with ASEAN, Malaysia, Japan and South Korea (See Table 6) include some local value content cut off levels and requires a change in at least tariff sub heading, i.e., the product is differently classified from the product imported as input though they may be in the same chapter (e.g., HS 42 Leather, Saddlery and Harness, etc) or heading (HS 4201 Saddlery and Harness).

The ASEAN and Malaysia FTAs do not contain any PSRs though the India-Japan FTA does have PSRs for leather products. These specify that there must be a change to heading under these chapters "from any other chapter". So for example, changes within the chapter "Leather, Saddlery and Harness etc" will not be accepted as having generated a new enough product and will not satisfy the ROO. But if the input belongs to any other chapter including raw leather (HS 41) it can satisfy the ROO. The India-South Korea FTA also has PSRs and has a higher cut off for value added but slightly easier CTH/CTSH rules. On the defensive front, India needs to use strict ROO in ASEAN/ Malaysia FTAs for blocking off products largely made in countries such as China. But the ROO is not very strict as it stands.

The EU usually has high cut offs in addition to PSRs, so it will be interesting to see what is included under the EU-India FTA, if signed. Obviously, it will be easier for Indian producers to meet ROO standards in ASEAN or Malaysia than in Japan and Korea. In spite of the duty reductions (see section on tariffs above) strict ROO may prevent expansion of Indian exports to the latter countries.

Note: Check whether you can meet the ROO for relevant FTAs and whether there are any product-specific rules of origin on your product.

Table 6: Rules of Origin in Selected FTAs			
ASEAN/ Malaysia		Japan	South Korea
Changes in Tariff Heading	Tariff Sub heading (or changes at 6 digit levels)	Tariff Sub heading (or changes at 6 digit levels)	Tariff Sub heading (or changes at 6 digit levels)
Local/ FTA/ Regional Value Cutoff	>35%	>35%	>40% (for leather products under PSRs)
Product Specific Rule (CTH/ CTSH related) for Leather		There must be a change to heading (4 digit level) under Chapters 41, 42, 43, 64 "from any other chapter".	Chapters 41 and 42 and HS 6405: A change to heading from any other heading (changes at 4 digit levels) Chapter 64: 6401.10, 6402.12-6402.19, 6402.30-6403.19, 6403.30-6404.11 and 6406.20: A change to sub-heading from any other heading (changes at 4 digit levels)

Source: Relevant FTA Documents

e) Intellectual Property Rights (IPRs)

In FTAs, developed countries such as the EU, USA, Japan and Switzerland want to impose on India such IPR commitments that go beyond WTO's TRIPS commitments. **The stricter IPR regime** will create some major problems for large number of small enterprises in the leather industry. During field visit, most of the leather enterprises in Kanpur said that though they do feel the need to patent their designs, there is a lack of awareness, resources and capability regarding IPRs among the small leather entrepreneurs. We also saw that most shoe exporters do not have their own trademarks or brand names. They sell under a different brand name in destination countries. This may be a good strategy to ensure sales as Indian brands may not be known in destination countries and small producers do not have the resources to market their own brands. However, in the long run an enterprise must be able to establish its own brand in order to be able to reap advantages from IPRs.

Another IPR relevant to leather industry is Geographical Indications (GIs). Kanpur's saddlery industry has a high reputation for its unique product and is also registered as a GI product in the Indian GI registry office. However, the benefits from GI registration have not yet been realised. For this, the Indian government will have to register and seek protection for its Kanpur saddlery products as GI products in relevant countries. This requires large funds but small saddlery producers neither have the resources nor the awareness nor the capabilities for doing so. On the other hand, the EU countries may get many of their leather processes and products patented and obtain GI status

for their leather products in Indian market. As a result, Indian leather Industry could face variety of trade challenges.

Note: Have you applied for or registered any intellectual property instrument (e.g., Geographical Indications, Patents, Trademark, Collective Mark, etc)?

f) Public Procurement (PP)

Under FTAs government purchases at Central and state levels may have to be liberalised and producers in partner countries may have to be given equal rights to access this market. This means that special preferences given to MSMEs such as waiver of tender fees and guarantee money, offer to match the lowest bid, etc. (**See Part I of this series for more details**) may not be allowed as these will be seen as discrimination. The Indian leather industry does sell to the various segments of the government such as the army, railways, etc. Though no government gives access to defence purchases even under FTAs, India may have to give access to Railways, and other segments. Until now India has not given access to the PP market to any country, but the EU has made strong demands to include it in its FTA with India. Since almost all the leather sector consists of MSMEs, the preferential access for MSMEs is currently not very real unlike in other sectors. Even then, unless the government includes an exception for MSMEs in its FTAs while giving access to the PP market, Indian leather MSMEs may just lose out to bigger companies in partner countries. Though Indian leather products are cheaper compared to developed country products, bids can also be granted on quality grounds. So leather producers may consider the option of asking for exceptions on grounds of being an MSME if India gives opens up its PP market under any FTA in future.

g) Investment

Some FTAs include chapters on investment that can allow foreign investment up to 100% in every sector unless otherwise specified. The FTAs with Japan, South Korea, Malaysia and Singapore contain investment chapters. Even the ASEAN agreement is to include an investment chapter at a later stage. As a reciprocal, Indian producers will also be able to invest in partner countries.

Box 2: Investment Provisions in Leather Sector in India's FTAs with Japan and South Korea

- *In the India-Japan and India-South Korea FTAs, India has retained exceptions for the MSME sector* (<24% foreign equity) and current MSME FDI norms will continue. This means prior approval will be needed for Japanese and Korean investors to invest more than 24% in the MSME sector and they are subject to performance requirements.
- *In the India-South Korea FTA, India has also retained exceptions vis-à-vis the leather sub-sectors:* Tanning, curing, finishing, embossing, japanning of leather; manufacture of leather footwear; manufacture of leather apparel; manufacture of consumer goods of leather; scrapping, currying, tanning, bleaching and dyeing of fur and other pelts for leather trade; manufacture of leather and fur products. Under this India reserves the right to adopt or maintain any measure to impose performance requirements.
- *On the other hand, in the India-Japan FTA, Japan has imposed restrictions on Indian investments in the leather and leather products manufacturing sub sector.* For several products including leather tanning and finishing, mechanical leather products (except gloves and mittens), leather footwear, leather gloves and mittens, baggage, handbags and small leather cases, sporting and athletic goods, **national treatment is not given to Indian companies**. So Japanese companies can be treated more favourably than Indian ones. Under this reservation, "the prior notification requirement under the Foreign Exchange and Foreign Trade Law applies to foreign Investors" including Indian ones.

In India foreign investment in the leather sector is already fully open through the automatic route (where no special government permission is required). So India may not get additional FDI just because of FTAs. However, currently there are restrictions on investments and many performance requirements specifically in the MSME sector which may be removed under FTAs. Countries usually impose performance requirements on foreign investment such as; limits on ownership, board membership, and on exports; compulsory local content, compulsory transfer of technology etc. These requirements can be used to improve opportunities for MSMEs. Since the leather sector is largely MSME, these rules may prevent FDI in smaller units but will not restrict FDI in large enterprises. If these restrictions are lifted in the FTAs, the MSME sector may get more FDI but the chances of takeovers of small units by large foreign players will also increase significantly.

Note: Assess whether you benefit from FDI or be able to compete with fully owned foreign companies/multinationals?

VIII: Conclusion

The leather industry in India is expecting to get **additional markets** through India's FTAs. The FTA with the European Union will be one that it will be eagerly watching. However, some of the current FTAs show that additional market access in leather articles through the **reduction of tariffs** will materialise in about 10 years time and many items in footwear may be in the negative list of countries (duties will not be cut) that have their own leather industry such as Japan. But in countries where India can get tariffs reduced or removed, it can get more access. However, it still has to meet the **standards and other NTBs** laid down by the developed countries. Meeting standards is a major problem for smaller producers, and the certification processes are also complicated. Unless the government provides the support to upgrade standards and improve technologies, and set up transport and marketing facilities from key production centres, much of the potential gain in partner countries will not materialise. The leather industry must also ensure that there are not other barriers such as in the **Rules of Origin** which are often used to block imports. In the South Korean FTA, for example, ROO are stricter in leather products than they are generally. In the long run, preference erosion from FTAs will also be a major concern as competitors such as China will also get into FTAs with key partners. Another issue facing Indian producers will be cost management while upgrading standards and technologies. But if **export taxes** on raw leather have to be removed for the EU, and later for other partners, it may affect their prospects for accessing cheap raw materials and can push costs up. Indian tanners and leather products manufacturers will all be affected. Indian leather industry will also be denied the opportunity to maximise the potential for value addition. Indian producers also need to upgrade **IPRs** and register Trademarks, GIs and design patents. They need much more resources and government support in this than they get at present. On **investment**, India has not got much additional scope in countries like Japan. India has itself restricted access to foreign investors in the leather sector either through an MSME exemption or a through a separate exemption for the leather industry, in some cases such as in the Japan and South Korea FTAs. This is to prevent takeover of the leather enterprises by foreign companies.

In terms of **import competition**, the leather industry is quite competitive in India though imports of key products such as leather articles and footwear come from China. Since India is not yet signing an FTA with China, current duties will protect Indian producers to a certain extent. India's strategy in terms of duty reduction varies from FTA to FTA depending on the competition. For example in the FTA with ASEAN, India has one item on the **exclusion list** but many items including saddlery on the **sensitive list** (with duties reduced only to 5% by 2016). But in its CEPA with Japan, India has kept many more items on the exclusion list but saddlery is going to see duty cuts to zero in 10 years. Producers must ensure that sensitive sectors are on the exemption list. India can also use **Rules of Origin** more proactively to block imports from third countries. If **public procurement** is opened up under FTAs such as with the EU, Indian producers may face more competition from foreign producers in key markets even if they are price-competitive. This is unlikely to happen in the near future, but leather producers should be prepared to ask for exemptions.

Finally, FTAs may give some gains to the leather industry in terms of lower or zero tariffs. But in the longer run, higher competitiveness, upgrading standards while retaining price competitiveness will enable Indian producers to get real access and beat global competition. The Indian industry should also look towards a growing domestic market and utilise the protection it still has to capture this to the fullest extent. Given fluctuating conditions in the global economy, this is a prudent option.

IX: How and Whom to Influence in the Government to Make Your Voices Heard?

- Get your MSME associations interested and build strong alliance of the MSMEs on the issue
- Based on the information and analyses, articulate your argument and do collective submission to the following:

Name of Office Bearer/ Organisation	Contact Information
Prime Minister, Prime Minister's Office, GOI	Fax: 011-23016857/9545, Tel: 011 2301 8939
Chairman, Standing Committee on Commerce, Rajya Sabha	rsc-comm@sansad.nic.in, Tel: 011 23034036
Minister, Ministry of Commerce and Industry (MOCI), GOI	cim@nic.in Fax: 011-23062947
Minister of State, Ministry of Commerce and Industry, GOI	Fax: 011-23062321
Secretary, Department of Commerce, MOCI	csoffice@nic.in, Fax: 011-23061796
Secretary, Department of Industrial Policy and Promotion, MOCI	rp-singh@nic.in, Fax: 011-23061598
Chairman, Council of Leather Exports	cle@cleindia.com, Tel : 044-28594367/63

X. How to Access More Information on FTAs and Assess the Impact on Your Enterprise?

The goods trade and non-goods trade issues contained in FTAs significantly impact the trade prospects, especially of the MSMEs. Not only those MSMEs which are engaged in exports and imports, but even those which trade only domestically need to be aware and alert of the policy changes in the international trade rules. Hence you will need to keep track of development on both the fronts, MSMEs as well as the FTAs front.

Access to Information about FTAs and MSMEs

Source and Types of Information on FTAs	Weblinks
FTA Documents, Min. of Commerce and Industry, GOI	http://commerce.nic.in/trade/international_ta.asp?id=2&trade=i
WTO Cell of Indian Institute of Foreign Trade	http://wtocentre.iift.ac.in
Information on Non-Tariff Measures (NTMs)	http://commerce.nic.in/trade/international_ntm.asp?id=4&trade=i
Information on IPRs	http://dipp.nic.in/intellectual_property_dipp.htm
For Data on India's trade	http://commerce.nic.in/tradestats/indiatrade.asp
For Data on Trade and Commerce	http://dgft.gov.in/
Where can you access more information about the leather sector?	
Developing the Leather Sector in Kenya through Export Taxes: The Benefits of Defying the EU	http://www2.weed-online.org/uploads/case_study_leather_sector_in_kenya.pdf
Kanpur leather Industry	http://msmefdp.net/ResourceBank/Diagnostic%20Study/Kanpur%20Diagnostic%20Study%20-%20Internal.pdf
Indian leather Industry: Perspectives and Export Potential	http://www.eximbankindia.com/leather.pdf
Handbook on Mandatory and Voluntary Standards on Leather and Footwear Products	http://wtocentre.iift.ac.in/UNCTAD/04.pdf
Occupational Health and Safety Issues in Leather Craft	http://www.aiacaonline.org/policy-switch-asia-reports.asp?links=sa5
Leather Industry in India	http://www.cec-india.org/index.php?option=com_content&view=article&id=490%3Aleather-industry-in-india&catid=68%3Aworking-paper&Itemid=27
For information on Leather Exports	www.leatherindia.org

How Can You Assess the Impact on Your Enterprise?

Having known the source of information on FTAs, now you can assess the situation and analyse the impact FTAs may have on your enterprise. Seek answers to these questions given in **Part I and II of this Series**.



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