

Inverted Duty Structures and the Paradox of Negative Effective Protection in India, 2000–2014

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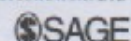
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Abstract

In recent years, sections of Indian industry have complained that they are being harmed by an inverted duty structure (IDS). That is, tariffs on their imported inputs are higher than that on their outputs. In this article, we argue that the concept of effective rate of protection (ERP), despite its limitations in the context of general equilibrium theory, provides an appropriate tool for analysing this issue. We outline the theory underlying the calculation of ERP and its relationship with IDS. We then offer new estimates of ERP for the period 2000–2014 using a data source that, unlike those used by earlier authors, enables us to construct a time series on ERP for each sector, using different tariff rates applied by India on imports from different countries. We find many instances of IDS but none of them results in negative ERP. Cases of negative ERP are found in a few sectors and years for which the counterfactual value added under free trade is negative. We discuss some possible explanations for this phenomenon. Finally, we show statistically and econometrically that, in line with theoretical expectations, ERPs are positively related to the degree of tariff escalation.

JEL: F13, F14, O24

Keywords

Effective rate of protection, inverted duty structure, preferential trade agreements, tariff escalation, tariff inversion, trade policy

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