

Exchange Rate and Utilization of Free Trade Agreement: Perspective of Rules of Origin[§]

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Abstract: This paper investigates how exchange rates affect the utilization of a free trade agreement (FTA) scheme considering the importance of rules of origin (RoOs). Exchange rates affect exporters' compliance with RoOs through changing so-called value-added ratio, which is defined as one minus a ratio of non-originating input price to export product price. We present theoretical demonstration on this potential linkage, and provide empirical examination with rich tariff-line-level data on the utilization of FTA schemes in Korea's imports from ASEAN countries. Our theoretical framework proposes that a depreciation of exporters' currency against importers' currency enhances FTA utilization through improving value-added ratio, and those effects are stronger for products with higher demand elasticity. We also show strong empirical supports to those theoretical predictions.

Keywords: Free trade agreement; Exchange rates; Exchange rate pass-through; Rules of origin

JEL Classification: F1; F3

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