POLICY PAPER 4

GATT AND AGRICULTURAL EXPORTS - HOPES AND REALITIES

C.C.Maji
A. Bhattacharya

NATIONAL
CENTRE FOR
AGRICULTURAL ECONOMICS AND
POLICY RESEARCH (NCAP)

FOREWORD

The signing of General Agreement on Tariff and Trade (GATT) by India has set in mixed reactions. Both optimism and pessimism have gained currency in the debates on GATT. The authors of this paper have attempted to bring in some realism into the on-going discussion. This paper is a variant version of an earlier paper presented by the authors at the symposium on the Impact of Uruguay Round on Agro-Exports organised by the Indian Institute of Foreign Trade (IIFT) in collaboration with APEDA. The authors have analysed the probable impact of the Market Access Commitment of GATT on the Indian agricultural export. The paper also provides suggestions to increase agricultural exports by (a) increasing productivity and quality through higher investment in agricultural research, (b) strengthening infrastructural facilities especially transport, storage and marketing and (c) ensuring remunerative price to the producers through public intervention in the market.

May 1995
New Delhi

C.C.Maji
Director

1

INTRODUCTION

The General Agreement on Tariff and Trade (GATT) signed by India has generated a lot of controversies, debates and discussions. While the protagonists view the GATT provisions as a silverlining for Indian farm exports, the antagonists have discovered grand designs of subjugation of national interests in them. Unfortunately, both the groups have built their arguments around ambiguities that flow from myopia, distortions and misinterpretations of the ground realities in Indian agriculture. GATT or no GATT, Indian agriculture cannot escape from the stark reality of fierce competition emerging in the global scenario. Since GATT has now become a *fait accompli* as far as India is concerned and the World Trade Organisation (WTO) has come into existence to replace it, there is no point in continuing the *ex-ante* debate on whether the provisions of GATT are beneficial or harmful to Indian agriculture. The objective of the present paper is to discuss the implicit assumptions underlying the hopes and conjectures about agricultural export and the ground realities and peculiarities of Indian agriculture. The focus of the paper is on the Market Access Commitment of GATT and emerging export potential of agricultural commodities.

<u>GATT Provisions</u>

The three major provisions of **Market Access** in GATT, relevant to agricultural trade are :

(1) Reduction in tariff and replacement of non-tariff barriers.

(2) Progressive reduction in government subsidies that encourage over-production and generate surplus which, in turn, is disposed through export subsidies or destroyed.

For developing countries, a limit of ten percent of the Aggregate Measure of Support (AMS) has been stipulated separately for product and nonproduct specific AMS. Trade distorting subsidies for farmers will be cut by 20 percent over a period of six years for developed countries and 13.3 percent for developing countries over a period of ten years.

(3) Progressive opening up of markets:

Countries with closed markets will have to import at least three percent of their domestic consumption of farm products to be stepped up to five percent over a period of six years. Developing countries are also required to import agricultural commodities to the extent of two percent of domestic consumption in the first year of GATT, to be stepped up to 3.33 percent at the end of six years. This clause is relaxable for economies facing balance of payment crisis. This apart, there are agreements on sanitary and phyto-sanitary measures designed to introduce harmonised health and safety codes.

So far as provision (1) and (2) are concerned, there is some kind of unanimity that, in general, the present level of subsidy in Indian Agriculture is lower than the stipulated cut-off level of ten percent, although in the case of specific commodities the product specific AMS could be more. Similarly, due to India's balance of payment (BOP) problems, it does not have any **Market Access** commitment at present. But given the improved position of BOP and the full convertibility of Rupee the exclusion clause may not hold now or at least in the near future, if the present trend continues.

2

ASSUMPTIONS

Before proceeding further it would be worthwhile to understand the following basic assumptions behind the gloated optimism about GATT provisions related to Market Access *vis-a-vis* the export of farm products.

Assumption 1 : Increased Market Access provided in GATT both in the developed and developing countries per se will automatically expand export market for Indian farm products.

Assumption 2 : India, being one of the large producers of certain farm products, will *automatically* have the lion's share in the global export in those commodities.

Assumption 3 : Diversified agro-climatic conditions and varied production base give India a distinct edge over other developing countries in capturing the major share in the world export market for non-conventional, horticultural products such as vegetables, fruits and flowers.

Assumption 4 : Reduction in the level of subsidies for agricultural production in the developed countries in accordance with the provision of GATT will increase the cost of production and hence price of farm products in those countries and will *automatically* render Indian farm products relatively cheaper in the international market as India is not subject to such a commitment.

Assumption 5 : This essentially asserts that (a) price differential is the sole determinant of demand for agricultural product in the global market and that (b) the commodities produced in India for export and those demanded in the developed countries are homogeneous in all respects to cater to the needs of the international market.

This, in turn, pre-supposes that production, packaging and processing technologies comparable to those of the developed countries are available in India so that product differential, if any, can be removed.

Assumption 6 : There will be enough marketable surplus in respect of agricultural commodities for export. In other words, this assumption ensures that the domestic demand which is growing with population and income would be satisfactorily met with increased production. Besides, it presumes that a substantial part of the profit earned by international trade in agriculture will reach the farmers to provide them with the necessary incentive to increase agricultural production of the desirable quality and create a marketable surplus for export.

3

GROUND REALITIES

Let us now survey the ground realities and the inherent peculiarities of Indian Agriculture in the light of the above assumptions.

It is well known that 80 percent of farmers are either marginal or small. It would, therefore, be worthwhile to (a) examine the above assumptions underlying the optimism regarding the so-called benefits to the country in terms of increased opportunity for agricultural exports that are likely to accrue from the provisions of **Market Access** in the GATT and (b)explore the measures needed to make Indian agriculture internally more efficient and globally competitive with a view to bringing the assumptions closer to reality.

India ranks second in the world (next to China) in production of vegetables and is the second largest producer of fruits (next only to Brazil). But it contributes only about 0.5 percent of the global trade in these commodities. Why? This low share in export is due to the fact that domestic consumption requirement is also very high. Furthermore, with increase in income and population the domestic demand for fruits and vegetables is expected to grow faster than their production. An unjustifiably large buffer stock of rice and wheat for which India is second and fourth largest producer respectively does not at all indicate a real export surplus. It merely confirms the lack of purchasing power of a sizeable proportion of our population and a low acceptability of these commodities in the developed countries for one reason or the other. Hence, a large volume of production does not necessarily imply a large share in the global market.

The optimism about the potential export of Indian fruits, vegetables, flowers and other non-conventional farm products is, however, based on guesstimate about their production in the absence of accurate production and consumption data on these "forecast crops" and as such, might differ substantially when it comes to the field level realities. The production and domestic requirement of vegetables in India for the year 1996-97 have been guesstimated at 51.0 million tones and 81.6 million tones while those of fruits at 27.9 million tones and 53.0 million tones respectively for the same year at the present level of population (Prakash, 1994). Even if we rely on these guesstimate there exists a huge gap between the production and the domestic consumption requirements. This clearly reveals the absence of any real surplus. On the contrary, these figures indicate existence of a large deficit suggesting the need for import of these commodities if the domestic requirements are to be met. Export promotion activities in respect of these commodities without a *quantum jump* in production may lead to increased export at the cost of deprivation and malnourishment of the domestic consumers.

Besides, even if it is assumed that the size of the global market expands in absolute terms due to *Market Access* clauses of GATT, it would be open to other competing countries in the same way as it is for India. It would be naive to think that India alone would enjoy a virtual monopoly position while the rest of the members would be unable to complete. In fact, India's present strength and future capability in relation to those of its competitors, rather than mere *access* would determine its actual share in the export market.

It is often argued that India has a vast potential for global trade in floriculture although the reality does not corroborate with this optimism. The world trade in flowers, especially cut-flowers, and potted plants is dominated by the Netherlands supplying about two-thirds and a half of the global requirements respectively(Prakash, *op.cit.)*. India's position in the global floricultural trade is too insignificant to merit an elaborate discussion.

Furthermore, infrastructure forms a crucial element even though it does not figure prominently in any serious discussion on the international trade in vegetables, fruits, flowers, fisheries, livestock and such other highly perishable commodities. Acute shortage of cold storage, transportation (all-weather roads), electricity, credit, and other facilities not only at the level of processing and packaging but also at the place where production takes place (farm) is an axiomatic truth in Indian agricultural scenario.

If diversified product base due to the existence of a large number of agro-climatic regions were to offer India any advantage in farm export over its competitors, there is no new cause for jubilation at present as the same has been existing over centuries and India has so far failed to exploit these advantages for consolidating its position in the global market.

Furthermore, export from India consists of mainly traditional items like Tea, Jute, Coffee, Rubber, Spices, etc. Available studies indicate that it is neither the access nor the larger size of the market but certain structural bottlenecks, price-competition, product specifications and brand names including quality and other factors which really stand in the way of increasing the export of India's conventional farm produces. **Market Access** provisions of GATT *per se*, therefore, have very little to do with increasing exports of traditional farm product.

As regards potential price advantage flowing from GATT provisions, there is every reason to doubt how India alone would stand to benefit *vis-a-vis* other competitors in terms of cost advantages and competitive edge. Therefore, India is no special beneficiary of GATT. Eventhough there could be some truth in the assumption that prices of farm products in the developed nations would rise once subsidies are withdrawn, which would probably increase the competitiveness of Indian farm products by making them relatively cheaper, it would be an oversimplification to presume that, given the higher level of technological progress, the developed nations would not resort to cost reducing technological innovation to offset the negative impacts of withdrawal of farm subsidies on cost of production. At the present juncture, the developed nations have already taken a great leap forward in biotechnology, tissue-culture and the other related frontiers of scientific research which would give them further cost advantage in the production of commodities being contemplated for increased export by developing countries like India. Their virtual monopoly in these areas of technological innovations might block the prospects for India's competitive advantage and consequently the export of farm products in the global market unless substantial progress through increased investment in these areas of research is made to catch them up. Real and sustainable cost reduction is achieved only through increased productivity. Although India is a major producer of a number of farm products in absolute terms, it ranks among the bottom rung of the ladder in terms of productivity inspite of Green Revolution. The "high-yielding" technology of Indian agriculture has reached a stage where a further increase in productivity is hardly cost-effective. Moreover, price comparison is meaningful only when the products are homogeneous.In terms of quality, most of Indian farm products do not conform to the international standards on account of sanitary and phyto-sanitary restrictions, processing and packaging specifications, etc. This is evident from the rejection of Indian mangoes by Japanese importers due to various organic/inorganic residues on the mango-skin for which Indian exporters had to import special machines for further processing this commodity Besides, a farm product is rarely consumed in its raw and unprocessec form in the West due to tastes, habits, health standard considerations anc a host of other factors. Given the stringent health standards consumers ir the developed countries will unlikely buy Indian fresh or even processec vegetables and fruits due to high pesticide and insecticide residues. These products have to be freed from the chemical residues, processed anc packed in the way they are normally consumed in the developed countries. Although this would ultimately add to the value of the farm products i calls for increased investment in modern technologies resulting in ar increase in the cost of production. Similar is the case with animal products, particularly meat. There are only two modern abattoirs in the whole country as big as India. The unhygienic way in which animals are slaughtered and the meat is processed can even turn a hard-core Indiar non-vegetarian to a permanent vegetarian, not to speak of acceptability of the product in other countries, especially the developed ones. In addition, the quarantine requirements in meat exports, particularly with respect tc foot and mouth and rinderpest diseases can not be met at least in the near future, as these diseases have not been eradicated from the country.

Recently, it has been a common practice for some economists turned consultants to assess the competitive advantage and export potentials for apparently the "same" farm products simply on the basis of price-differentials ignoring the quality differences. In the case of rice, export from India mainly consisted of *basmati* variety which fetches a premium in the export market. *Basmati* rice was allowed for export as it was a high-value commodity and the country was deficient in other varieties of rice in relation to domestic requirement. Therefore, it would be wrong to equate *basmati* rice to any other *non-basmati* rice varieties.

However, there are instances where market surveys have been conducted on the basis of price advantages of Indian farm products in the same line as that of an industrial product. To illustrate, a recent NCAER study [Gulati, *et.el.*] asserts that "Results based on the analysis of export competitiveness carried out in this study reveal that rice is a highly competitive crop of India and wheat has also become competitive after correcting for overvalued exchange rate. In fact, average Normal Protection Coefficient(NPC) under *exportable hypothesis* for rice in last four years has been 0.46 using *shadow exchange rate*. This indicates that Indian rice prices are about 54 percent lower than world prices, thus, clearly showing the high export competitiveness of Indian rice. The comparable average NPC for wheat for last four years is 0.83 showing that Indian wheat prices are about 17 percent lower compared to world wheat prices. From the export point of view these two crops rank first and second among four cereal crops considered in this study."

Without going into the questions of the appropriateness of the method, market price quotations of rice / wheat as a homogeneous product irrespective of varieties, time frame, etc. used in the study, it is necessary to understand some structural and other limitations of such an approach. The Nominal Protection Coefficients (NPC) only show the ratio of the market (private) price to the economic (border) price of a commodity. The first and foremost limitation of NPC in revealing the competitive advantage or otherwise is that it pre-supposes the homogeneity of the commodity in question in the domestic and the international markets. The assumption of homogeneity of the products is far from valid. Needless to say that specificity and preference have cost attached to them. Besides, a value of NPC less than unity does not necessarily imply that we have a competitive advantage in that commodity since the NPC for the concerned commodity may be still lower in some other country than that obtained in India. Hence one should not be jubilant about NPC values being less than unity and hasten to conclude that we have competitive advantage based on these values. One can, however,conclude that the commodities for which NPC < 1 are "exportable". Furthermore, the prices in the world market fluctuate widely even within a short period of time and hence are not reliable. Because of a large absolute volume of transaction involved in India's decision to buy (sell) in the global market, there would be a large increase (decrease) in the world price proving all our calculations wrong and negating the so-called advantage of trade. Such an experience has been well documented in the past.

Available studies indicate that the share of the primary producer of perishable high-value farm products in the consumers rupee normally ranges from 15 to 30 percent --- a share which is too low to attract the farmers to generate real surplus of farm produce of the desired quality to benefit the exporters. Neither the farmers have adequate market incentives to produce more nor does the country have any definite and comprehensive programme for agricultural trade as well as for eliminating unnecessary intermediaries and passing the benefit to the farmers. Thus, the interest of the core unit of production, the farmer, is likely to be relegated to the background in the overall scheme of agricultural export. Obviously, he would not find much interest in producing the edible farm produce of right quality (with less pesticide and other chemical residues) acceptable to the consumers in the health conscious developed countries and playing an important role in the process of commercialisation of agriculture. One can legitimately ask : why should the farmer take the pain to produce a surplus when the lion's share of the profit goes to the traders and the intermediaries? Market Access is thus no boon in itself.

Some economists even suggest that the contract with the importing countries must be honoured irrespective of the level of our total production of the concerned commodity which might fall short of our domestic needs in any given year due to natural calamities. They argue that the shortfall in domestic production may be met by purchase from other countries with a view to keep the export commitments. The argument is not only ridiculous but preposterous inasmuch as it ignores the seasonality and hence fluctuations in agricultural production, and more importantly, it implies that the people of the importing countries be fed at the cost of starvation and malnutrition of our own people during such bad years and that too by incurring a huge loss in purchase and sell of the commodity concerned at the prices ruled in the international market. The major drawback of the euphoria about GATT provisions stems from our ignorance of the ground realities of Indian agriculture and the global export market.

The foregoing discussion clearly indicates that the assumptions underlying the optimism are not in consonance with the ground realities, as they exist to-day, and hence India's performance in the world trade cannot be improved unless the existing conditions are changed suitably by conscious policy decision in the strategic areas of trade and their expeditious implementation.

4

RE-ORIENTATION

There is no denying the fact that GATT has now become a stark political reality and an economic compulsion for India to face the stiff competition --- a competition not necessarily based on free and fair play of the rules of the game. India has, therefore, to take advantage of the emerging trade opportunities in the agricultural commodities including plantation and field crops, livestock, poultry and fisheries.

There is much apprehension that sporadic success stories of individual exporters of farm products in India with cheap labour might prove to be an exporters' paradise, given the existing wide price spread that act as a serious constraint in attracting the primary producers to generate surplus farm production of the desired quality. As a matter of fact, the farmers cannot make any qualitative distinction between exploitation by national traders and the much dreaded MNC's. The situation cannot be turned to India's advantage unless the major share in the gain from the trade in the form of higher prices and profit is passed on to the farmers, especially the most disadvantaged small and marginal ones, by eliminating the avoidable middlemen and thereby narrowing down the existing price spread, particularly in respect of the perishable, high-value and non-conventional commodities. What is needed is an effective safeguard against exploitations of the primary producers by trade, national or international.

Moreover, in order to capitalise on the increased market access and to edge out other competitors a continuous technology upgradation becomes imperative to lower the real cost of production of exportable agricultural commodities. This clearly calls for an increased investment, private as well as public, in agricultural research, both in the frontier areas of basic research and applied research for generation of technology consistent with higher productivity and ecological/environmental sustainability.

Besides, investment in rural infrastructure should be increased with a greater and direct access of millions of small farmers to the institutions/organisations including the domestic markets so that Indian farm exports could enjoy a sustainable competitive advantage in the international market. Since the scope for on-farm capital formation and investment in agriculture by farmers themselves is limited by the preponderance of small and marginal farmers the Government and the private traders/exporters should take the onus of increased investment in research and extension, transport, storage including cold storage, power and other infrastructural facilities. Private investment in research and infrastructure has become all the more important in view of a sharp decline in agricultural investment in India (both public and private) in the eighties with no indication to increase in real terms in the near future. Besides, considering the increased flow of foreign exchange in the recent times, public investment in rural infrastructure can be stepped up in these areas by spending a part of this earning. This will strengthen the infra-structural base of India's agriculture and reduce the inflationary pressure at the same time. Unless such investment takes place agriculture in general, and the non-conventional sub-sectors in particular, would most likely stagnate resulting in generation of little or no surplus at the farm level with no reduction in the real cost of production.

At present an estimated 30 percent-40 percent of the fruits and vegetables in the country are damaged and spoiled before they reach the market. In order to reap the benefit of GATT and to eliminate such huge wastage processing industry should be strengthened with the installation of modern plants and equipment. Besides, perishable, non-conventional commodities including vegetables, fruits, flowers, dairy products, etc. should be covered under the Minimum Support Price (MSP) and procured directly from the producers for further processing and packaging with a view to minimising the wastage and reducing the price spread. Unless suitable organisations are devised at the *grassroot* levels to effectively link the primary producers of exportable farm products to international markets for distribution of the benefits of GATT, there would be widespread disparity with inevitable socio-economic consequences. Corporate or Contract Farming with adequate legal safeguards should be promoted and linked with the small and marginal producers so that the benefits of trade and export directly reach these vulnerable sections of our society. At the same time development of lease market should be encouraged and legally protected so that the small size of operational holding does not restrict agricultural growth.

There is a potential danger of distortion in the cropping pattern and consequently on food security if export of high-value, non-conventional crops is over-emphasised. The argument that India should produce non-food crops and buy foodgrains from other nations if that is advantageous is a strange logic and should not be reflected in any of our policies. Given our past experience, food security should be the nation's *first safety rule* in any game, national or international.

There is also a potential danger associated with the increasing export of farm products through the Multi-National Corporations (MNC's) as this would distort the existing market structure, enmesh farmers in economic dependence in the absence of alternative market access and expose them to increased risks in the international markets. This also raises the issue as to whether the dependence on the market maneuverability of MNC's allowing them to exploit the farmers is a socially justifiable option in the overall development strategy. As has been the experience in the export of Darjeeling tea, MNC's, often shadow the brand advantages of the country to further its own profit motive. Besides, the monopolistic influence of the MNC's would dampen the very spirit of competition which the GATT is supposed to promote. Adequate safeguards should be provided against the exploitation of the farmers by the MNC's.

While there is an immense potential for many unconventional, high-value farm products to become competitive in the global market, (like horticultural products including vegetables, fruits, medicinal plants, etc.) **Market Access** clauses of GATT *per se* do not ensure an *automatic* increase in the export of these products unless real domestic issues concerning Indian agriculture are squarely addressed to in a meaningful way. Besides, lack of competition in the domestic market for agricultural products does not fit well in the overall scheme of the GATT which aims at increasing competition among the member countries.

In general, the quality of all agro-products, raw or processed, meant for export has to be improved to meet the stringent international standards and vegetables and fruits, in particular, have to be totally free from pesticidal residues or below the critical levels in order to be accepted in the developed countries. For this purpose, appropriate quality control measures and modern processing and infra-structural facilities which are not currently available in the country should be developed or even imported without much loss of time. In order to become a significant player in the world market it is necessary to ensure a sizeable marketable surplus of the exportable farm products through a faster growth in productivity than that of population and of domestic demand. The productivity growth should also be higher than the inflation rate to result in a reduction in real cost of production. Both the objectives of quality and quantity improvement should find priority in the agenda for future agricultural research and development in this country.

If the signing of GATT by India is any indication, then definitely it does not fit well into the overall degenerated work-culture and Research and Development(R & D) environment we are living in. The reward and punishment system in the R & D work-culture, unrelated to efficiency parameters and individual efforts to achieve higher goals, have to be reoriented, if not radically changed, if India's vast reservoir of available talents is to be put to the best use in the national interest.

REFERENCES

Gulati, A, Anil Sharma and Kailash C. Sharma. 1994. Export Competitiveness of Selected Agricultural Commodities, National Council of Applied Economics Research, New Delhi.

Prakash, J. 1994. Production of Fruits, Vegetables, Cut-flowers and Ornamentals - Global Scenario - Export Opportunities for India, Agriculture and Industry - Survey 1994 - Vadamalai Media, Coimbatore.