EDUPHORE IAS
WEEKLY CURRENT AFFAIRS

Topic of the week: WORLD TRADE ORGANISATION – AGREEMENT ON AGRICULTURE

WORLD TRADE ORGANISATION – AGREEMENT ON AGRICULTURE

Understanding the Rationale Behind WTO

- Countries differ not only in regard to the comparative advantage in producing various goods and services but also in respect of the level playing field.
- The principle of comparative advantage is built on the basis of the inter-country differences in costs and returns between different commodities.

David Ricardo

- David Ricardo's The Principles of Political Economy and Taxation does not mention taxes or subsidies determining the relative costs of production or prices of commodities. In his examples, one finds only production factors like land, labour and capital constituting the cost of production [Ricardo 1817].

Distorting level playing field

- Now, if some rich countries because of their ability to subsidise agriculture can sell their produce at artificially lower prices and thus undercut the market for the genuinely efficient or low-cost producers, then the playing field is highly uneven as the principle of comparative advantage is not followed.
- If some countries are taxing or discriminating against agriculture by heavily protecting their industry and through overvalued exchange rates, as most developing countries, their their competitiveness is eroded vis-a-vis countries which do not tax agriculture

Infant Industry Argument

- The world is highly heterogeneous with regard to the levels of development. There are countries at an advanced stage of development for infra & technology. On other hand, there are several countries which have only recently emerged from long periods of colonial rule. Such countries may need protection for some time in certain specific areas before they can tap and realise their potential so as to be in a position to compete with the advanced countries as trading partners on an equal footing.
- Therefore, institutional arrangements such as the WTO are essential for ensuring level playing field so that considerations of comparative advantage can have a free and fair play.

AGREEMENT ON AGRICULTURE

- WTO's Agreement on Agriculture came into force on 1 January 1995.
- It covers all basic agricultural products, products derived from them, wines, spirits, tobacco products, fibres such as cotton, wool and silk and raw animal skins for leather production.
- Not included: Fish and fish products, forestry products, rubber, jute, sisal, abaca and coir

Pillars of AOA

It provides for rules in three areas of trade in agriculture, called the 'pillars' of agricultural trade reform.

- **Market Access (tariffs and tariff rate quotas)**
- **Domestic Support (production related subsidies)**
- **Export Competition (export subsidies, export credit and international food aid)**

- The commitments of member countries in each are contained in their individual schedules.
- The commitment were to be implemented over 6 years by developed and 10 years by developing starting from 1995.
- The least developed countries not required to make any reductions.

MARKET ACCESS

- **Market Access** includes **tariffication, tariff reduction and access opportunities**.

Tariffication means that all non-tariff barriers (NTB) such as quotas, voluntary restraint agreements etc. need to be abolished and converted into an equivalent tariff.

Liberalisation

- Ordinary tariffs including those from tarifficationare to be reduced by an average of 36% over 6 yrs, Developing countries reduce tariffs by 24% in 10 years.

Quantitative restrictions

- **Developing countries, as were maintaining Quantitative Restrictions due to balance of payment problems, were allowed to offer ceiling bindings instead of tariffication.**
- Quantitative Restrictions due to balance of payments reasonsis a GATT consistent measure.

Special Safeguard provision

- Special safeguard provision allows the **imposition of additional duties when there are either import surges above a particular level or particularly low import prices as compared to 1986-88 levels.**

Commitment by India

- As India was maintaining Quantitative Restrictions due to balance of payments reasons,it did not have to undertake any commitments in market access.
- The only commitment undertaken is bind its primary agricultural products at 100%,processed foods at 150% and edible oils at 300%.
- For some agricultural products like skimmed milk powder, maize, rice, wheat, millets etc. which had been bound at zero or at low bound rates, negotiations under Article XXVIII of GATT were successfully completed in December, 1999and the bound rates have been raised substantially.

Implementation of Market Access

There is large variation across countries in their the market access commitments. Reasons:

- Tariffs in agricultural sector have remained at relatively high levels in many WTO Members, even after the enforcement of the AoA discipline.
- Implementation of the tariff rate quotas has been a problem.
- Atleast three concerns regarding the tariff structures emerged after Uruguay round
  - (i) Existence of tariff peaks,
  - (ii) Tariff escalation
  - (iii) Use of non-ad valorem tariffs (inherent non-transparent nature)

Tariff peaks

- In case of bound tariffs, problem of peaks is bigger problem in case of the advanced developing countries. South Africa's tariff peak of 597% and India's 300%, Korea 887% , US 350%.
- In case of applied tariffs, the average of the peaks for the OECD countries was considerably higher.

Tariff escalation

- Tariff escalation is the **levels of tariff protection that countries provide to products as they go up the processing chain.**
- This problem exists across WTO members, irrespective of their stage of development.
- For the North American countries tariff escalation was observed in animal and animal products, for the South Asian countries, grains and grain products.
- Among the product groups that were most affected because of tariff escalations, meat and meat products and grains and grain products were among the more prominent.

Non-ad valorem tariffs

- These were used to conceal the high tariffs maintained by countries using them. Most of the countries having very large reliance on non-ad valorem tariffs are from the developed world. Eg Switzerland.
- Reasons for the use: Non-ad valorem tax can provide increased protection against large drops in import prices and the lack of transparency associated with these rates.
- Their use has been pointed by several developing countries as one of the key problems in securing additional market access in the major markets.

DOMESTIC SUPPORT

- The WTO agreement envisages **two kinds of support for agriculture -Domestic support and export subsidies.**
- Domestic support is further classified into five categories:
    A) Aggregate measure of support (AMS), which includes product specific and non-product specific support/ Amber Box
    B) Green-box support
    C) Blue -box support
    D) Deminimus support
    E) Special and Differential (S and D) treatment box.

- Of these, the **WTO agreement requires a reduction only in AMS and export subsidies**, whereas support under all other heads is exempted.
- The non-exempt support can be further grouped into two types, one representing the commitment of a country to the WTO and the second showing actual levels of AMS and export subsidy provided by member countries.

<u>Aggregate Measure of Support</u>

It includes

- Sum total of **Subsidies on inputs such as fertiliser, water, credit and power**
- **Market price support** measured by calculating the difference between domestic administered market price and external reference price (world price) multiplied by the quantity of production eligible to get applied administered price.

Reduction

- For domestic support policies, the total support given in 1986-88, measured by the **total AMS, should be reduced by 20% in developed countries (13.3% in developing countries).**

<u>De minimums support</u>

- If the value of **domestic support provided (both under the product specific and non-product specific categories)is less than 5% of the value of production for developed countries and less than 10% for developing countries**, then these are also excluded from any reduction commitments.

<u>Green Box</u>

- Policies which have <u>no or at most minimal trade distorting effects</u> on production are excluded from any reduction commitments.
- Green box includes items such as **decoupled income support**, **research expenditures**, **pest-control measures**, **training and extension expenses**, inspection, **marketing service** and **promotion expenses**, and **infrastructure expenses**. Some of the direct payments are also listed in this category.
- There is ambiguity in head and expense classification, which makes the green-box support (GBS) highly contentious.

<u>Special and Differential Treatment</u>

- S&Dprovisions are also available for developing country members.
- These include **purchases for and sales from food security stocks at administered prices provided that the subsidy to producers is included in calculation of AMS**.
- Developing countries are permitted **untargeted subsidised food distribution to meet requirements of the urban and rural poor.**
- Also excluded for developing countries are **investment subsidies that are generally available to agriculture and agricultural input subsidies generally available to low income and resource poor farmers in these countries.**

Commitment by India

- **India does not provide any product specific support other than market price support.**
- India was not required to reduce its spending on farm subsidies since its current levels of spending were far below the limits set by the AoA.
- **Food security issue:**Food security is an important welfare tool in India. Government's MSP policy is considered to be subsidy by WTO and counted towards country's overall ceiling on trade-distorting support (fixed at 10% of value of produce for developing countries). India as part of G-33 group of developing countries has demanded that public procurement subsidies in the form of MSP should not be treated as trade distorting and be allowed without limits.
    - WTO on the demand of developing countries provided for Peace Clause. According to it, the domestic support measures and export subsidies of a WTO member will be allowed even if the subsidy breached the WTO specified limits.
    - **India invoked the peace clause for exceeding the ceiling of 10% under the Amber box on the support it offered its paddy farmers in 2018-19**.
    - India again invoked the peace clause WTO, for exceeding the 10% ceiling on support it offered its rice farmers in 2019-20. India informed the WTO that it exceeded its subsidy ceiling as the value of its rice production in the year 2019-20 stood at $46.07 billion. It stated that it gave subsidies worth $6.31 billion which amount to 13.7% as against the permitted 10%.

Implementation of Domestic Support

Implementation seen largely from the perspective of the US and the EU.

- US had increased its spending on the Green Box" measures. EU, the share of "exempt" subsidies, i.e. "Green" and "Blue" Boxes put together, went up. Both have considerable flexibility in their use of production related subsidies in the WTO because of the high proportion of the subsidies that are not subjected to reduction commitments.
- Farmers in these countries enjoy Extremely high levels of subsidies farmers enjoy as compared to their counterparts in the developing countries. These countries have exercised considerable flexibility in the granting of subsidies, with a view to enhancing their market dominance.
- In US, producers of the subsidised crops have been able to sell their produce well below the economic costs of production as well as the international prices.

> The subsidies have thus provided the US producers two sets of benefits. First, with US domestic prices staying below the international prices for the subsidised crops, the US producers have been provided protection from the competitors who would be selling only at the international prices. Secondly, US producers could dispose off their produce at prices lower than the international prices, thus gaining unfair advantage over their competitors.

EXPORT SUBSIDIES

- It includes provisions regarding members' commitment to reduce Export Subsidies.
- Developed countries are required to reduce their export subsidy expenditure by 36% and volume by 21% in 6 years, in equal instalments (from 1986 –1990 levels). For developing countries, the percentage cuts are 24% and 14% respectively in equal annual instalments over10 years.

India

- **In India, exporters of agricultural commodities do not get any direct subsidy**. The only subsidies available to them are in the form of (a) exemption of export profit from income tax under section 80-HHC of the Income Tax Act and this is also not one of the listed subsidies as the entire income from Agriculture is exempt from Income Tax per se. (b) subsidies on cost of freight on export shipments of certain product.
- India has not been a traditional user of export subsidies. The country did not extend any export subsidy during the period 1986-1990 that have been considered as the base years for the export subsidy discipline.
- Hence as per the provisions of the AoA, India cannot resort to export subsidisation in future though developed countries especially the US and the EU who had been providing extremely large export subsidies could continue with the same after meeting the reduction commitments.
- India, however, benefits from the S&D measure which allows developing countries to provide subsidies for internal transport, freight charges on export shipments, handling, upgrading and other processing costs relating to exports.

Implementation of Commitments relating to Export Competition

Issues: (i) export subsidies, (ii) International food aid and (iii) Export credit and guarantees. AOA has clear disciplines in respect of export subsidies, while other two not covered by effective discipline.

Subsidies

- EU has used export subsidies relatively more extensively to gain additional market access as compared to the US. However, EU has decreased the use of its export subsidies by more than 60% during 1995-96 and 2000-01, the US has increased this form of subsidies, mainly three products, viz. poultry meat, skim milk powder and cheese.
- Use of export subsidies by the US had the potential to cause very large uncertainties in the international markets since the surplus that it was disposing varied quite considerably across years.

Food aid

- Surplus disposal became easy option for WTO Members in the absence of an effective discipline on food aid. USA used it for disposing off its farm output most extensively.

Justification by Developed countries

- Subsidised exports of food grains are beneficial to the net food-importing developing countries (NFIDCs) as they get access to cheap imports.

Argument by developing countries

- **Trade promotion through export subsidies causes increasing food insecurity in developing countries.**
- Heavy dependence on imports of subsidised food can cause serious financial difficulties due to a more vulnerable balance-of-payments situation, regardless of the price of food.
- Food aid mechanism mainly protects the immediate objectives of the donor countries while ignoring the longer term interests of the recipient. It affects the incentive to carry out the policies that would foster agricultural development in the recipient countries.

Effective Solution

- The domestic production capacities must be strengthened in the import- dependent countries. WTO member countries need to facilitate technical and financial assistance to the least developed countries (LDCs) and NFIDCs so as to '**improve their agricultural productivity and infrastructure'.**

Export Credit and Export Credit Guarantee Program

- It provides support for agricultural exports to other countries through**provisions of credit guarantees to importers who seek defer payments for the goods received.**
- It boosts exports of country giving credit guarantees by creating more incentive for the importing country to import. As per the AoA only the funding and scope of direct subsidy programs are subjected to the limits.

Critical view of AoA

- The fact that developing countries need appropriate instruments to address the **twin issues of food security and livelihoods concerns** has been highlighted by India along with several other countries in theWTO negotiations on agriculture.
- AoA proved ineffective to rein in the subsidies granted by the developed countries, evident from the manner in which the US and the EU have implemented their Uruguay Round commitments.
- **Developed countries kept their subsidies level at 20-25%.**The market distorting subsidies used by the two major players in the markets for agricultural commodities even after the implementation of their AoA commitments have put downward pressures on the prices of several commodities.
- Developed countries also manipulated subsidy regime by **shifting many subsidies towards 'Green box' and 'Blue box'.** There istendency of distortion in the 'non-trade distorting subsidies'.

- At the time of signing of GATT agreement, developing countries got the impression that reduction in AMS would imply reduction in overall support for agriculture. These countries were not quite familiar with support in different forms of direct payment to producers, infrastructural services, pest control, environment programmes, inspection and market intelligence, which is clubbed under the green box and is exempt from reduction commitments.
- With the implementation of the WTO agreement, several member countries realised the seriousness of green-box subsidies, level of export subsidy and AMS in developed countries' agriculture.
- Developed countries shifted support from non-exempt categories to exempt category, which is providing their produce advantage over the produce of developing countries.

"The experience of the 1990s clearly demonstrates that far from trade liberalisation dampening the performance of agriculture, the lack of public investment and effort has been responsible for failure to benefit from trade liberalisation by stepping up and diversifying agricultural output in a cost-effective way." C H HANUMANTHA RAO

***High Farm Support in Developed Countries*:**

- Major issue in Uruguay round about high domestic support being provided to agriculture in the developed countries, especially the European Union and Japan.Apart from tariff and NTB on farm imports, this support consisted of measures such as high support prices for farm produce and export subsidies, which are now shifted to direct measures for income support under the Blue Box, such as deficiency payments in the US, and compensations to farmers in the European Union.
- The developed countries did agree to a modest reduction in the domestic support, but the implementation of reduction commitments has been tardy, as evidenced by a significant rise in the share of advanced countries in global exports.

But why do the developed countries have a tendency to subsidise agriculture?

- US first in the 1950s and1960s, then came Japan and the EU and then the Republic of Korea.
- The fears of Thomos Malthus – a contemporary of David Ricardo – in regard to population growth outpacing the growth in food output were first proved wrong in Europe on account of technological changes and rise in agricultural productivity.
- It appears that the very processes which helped to overcome the Malthusian pessimism led to the growth of interest groups which are coming in the way of the operation of Ricardo's principle of comparative advantage.

Genesis of support price to farmers in developed countries

- **Low income elasticity and increase in farm outpu**t: Demand for farm products at higher levels of income responds little to changes in incomes and prices and asmall increase in farm output results in a more than proportionate fall in its price.
- Thus **farm incomes declined very often in the developed countries like the US despite, and indeed owing to, the rise in farm output**.
- The problem was mitigated to some extent by finding markets for the export of foodgrains.

Genesis of export subsidies to farmers in developed countries

- The **rising support prices perpetuated high-cost agriculture primarily because there was little incentive to shift resources away from agriculture.**
- Deterioration in the **relative productivity of labour in agriculture in developed countries on account of high farm support**.
- High cost food surpluses of the farmers not competitive in the export market without heavy subsidies on exports.

Other factors for farm support by developed countries

- The sheer ability of these rich countries to foot the bill.
- As agriculture in these countries is highly input-intensive, a large complex of agro-industries having backward linkage with agriculture as input suppliers constitute the highly organised and vocal sections of these farm lobbies.
- These countries are, in any case, incurring huge expenditures on social security for the unemployed in the rest of the economy. The difference is that in the case of the farm sector, these payments take the form of compensation for lower farm prices, thus providing incentive for committing resources beyond what would otherwise have been allocated if farm prices were allowed to be determined by the market forces.

Shift towards Green &Blue Box subsidies

- Due to pressures from the members of the WTO, developed countries marked shift away from support prices and export subsidies, which are considered highly trade distorting.
- They shifted towards direct payments in the form of deficiency payments and compensations considered minimally trade distorting' and hence placed under the 'Blue' and 'Green' boxes which are exempt from reduction commitments.
- However these are not fully delinked or decoupled from the use of inputs. **Green or blue box subsidies do influence the allocation of resources. In the absence of such payments, fewer resources would be committed to agriculture, leading to lower output, higher prices, and smaller export surpluses.**

Scope for decreasing agriculture cost in developed countries: Technology

- In EU there is a significant scope for reducing unit costs through the wider application of known technologies.
- There is considerable scope for reducing labour costs by enlarging average farm size and thus reaping economies of scale.
- There is also a large potential for reducing unit costs through vertical integration of agro- processing industry.
- Biotechnological revolution.
- If some of these cost-reducing technologies have not already been adopted extensively, it is primarily because of heavy farm subsidies which dampen the incentives for cost reduction.
- It is likely that the observed trend of a secular decline in the real prices of farm products would be reinforced due to such reforms in the west, which has the requisite technological know-how, as well as to the unilateral pursuit of reforms in certain developing countries towards trade liberalisation by doing away with discrimination against agriculture.

Lesson for India

- A country like India **needs to prepare itself for competing with low-cost farm products rather than expecting a significant rise in their prices via reform-induced reduction in the export surpluses from the developed countries.**
- This scenario dispel fears that those of the least developed countries which are net importers of food stand to lose heavily on account of the rise in the prices of food following the reduction of farm support in the developed countries.