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SUBJECT I

LIBERALISATION, DOMESTIC PRICE POLICY AND AGRICULTURAL GROWTH

Trade Liberalisation and Agricultural Price Policy in India Since Reforms*

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A BRIEF LOOK AT POLICY EVOLUTION

In the early 1980s, India began to liberalise external trade, but it was only in 1991 that the process of liberalisation got accelerated. Prior to 1991, India pursued a system of complicated and highly regulated trade regimes. In July 1991, India introduced radical policy reforms in various economic sectors, including external trade. There was a 19 per cent devaluation of the rupee in 1991. The rupee was also made partially convertible that year. Though trade restrictions on agricultural products were left mostly untouched in the 1991 reforms, subsequent trade policy changes gradually lifted most of the restrictions on both exports and imports of agricultural products. The policy measures introduced during this period can be summed up as follows:

1. The role of canalising agencies in agricultural trade was greatly reduced. Except for a few sensitive imports for a few commodities like cereals, oilseeds and edible oil, import of all other agricultural items was decanalised. Exports of all agricultural items except a few such as onion, niger seeds, etc. were also decanalised.
2. Quantitative restrictions on agricultural imports were removed. Import licensing for all products, except those on the banned, restricted, and state monopoly lists, was abolished. The process got accelerated due to India's losing the case in World Trade Organisation (WTO) to use the balance of payments cover under Article 18:B.
3. During the first half of 1990s, however, agricultural exports were subjected to less radical reforms. Exports of coconut, copra, oil cakes, pulses, paddy, rice bran and vegetables continued to be under licensing. Natural rubber and cottonseed cakes were under quantitative ceilings; exports of a number of other agricultural items were subject to minimum export prices or other quantitative restrictions.

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4. Almost all the export incentive schemes were abolished following the devaluation of the rupee.

The move towards trade liberalisation was triggered both by external developments such as the WTO-UR (Uruguay Round) Agreements as well as internal policy assessments.

India signed the Uruguay Round Agreement on 15th April 1994 at Marrakesh. This treaty introduced agricultural trade in the WTO for the first time. The aim of this Agreement was to liberalise agricultural trade by replacing physical controls by bound tariff rates. It was further agreed that these tariff rates would be gradually reduced over a period of time. The overall objective was to provide a framework for the long-term reform of agricultural trade. The Agreement on Agriculture came into effect from 1 January 1995. This marked the beginning of a new era of agricultural trade policy in India. In the post-WTO period, the degrees of freedom available to the policy makers of a country are theoretically fewer than in the previous era.

Independent of the WTO, the Eighth Five Year Plan (1992-97) called for directing India's trade policy regime "towards greater openness and to reap the full benefits of international trade" (Government of India, 1991). This has been sought to be achieved through (i) a reduction of the "negative" list of imports and exports, (ii) a gradual reduction in the level of tariff rates, and (iii) other trade policy reforms. The Ninth Five Year Plan (1997-2002) recognised that a viable external sector was an important component of a successful development strategy. This plan paid considerable attention to the export policy and concluded "...exports can no longer be viewed merely as an exogenous variable determined outside the planning system and would have to be planned for in a careful and realistic manner during the Ninth Plan" (Para 2.168, Ninth Plan) (Government of India, 1998).

The Approach Paper to the Tenth Five Year Plan (2002-2007), also emphasises the importance of the external sector but recognises that the period of very high growth in world trade is coming to an end. To meet the challenge of a recessionary global economy, the paper advocates that India should accelerate its domestic reforms to create conditions for competitive advantage by domestic and foreign-invested enterprises (Government of India, 2001). However, what seems to be a major shift from India's long standing objective of self-reliance in foodgrains, the Approach Paper suggests:

"Announce a policy renouncing the use of export restrictions on agricultural commodities. Domestic shortages should be met by imports, but not by imposing export controls." (p. 31).

The National Agricultural Policy (NAP) has also given emphasis to agricultural exports (Government of India, 2002 a). It observed that a favourable economic environment and supportive public management system would be created for promotion of agricultural exports. The NAP also provides that diversification of agricultural produce and value addition will be promoted with a view to providing the

farmers incremental income from export earnings. Apart from price competitiveness of agricultural products, other factors affecting export performance such as quality, choice, health and bio-safety will also be addressed. Export of horticultural produce and marine products have received particular emphasis in this policy.

The High Level Committee on Long Term Grain Policy has also looked at several crucial issues, including the issue of food security and Minimum Support Price (MSP) (Government of India, 2002 b). The Committee is of the view, given the fact that India accounts for about 15 per cent of world consumption, that world production and trade in grains are highly distorted that the vulnerability of the Indian poor is high, 'policies to encourage and assist the production and distribution of foodgrains, especially cereals, remain integral to the development strategy of the country.' After reviewing the various projections on cereals demand, the Committee concluded that even to meet the middle-level projections of demand for cereals in 2020, amounting to a total of 260 million tonnes of cereals for food and feed, there has to be an improvement in yield.

Export Import Policies

The WTO Agreement on Agriculture (AoA) became effective from January 1995 which required the conversion of all non-tariff barriers into tariffs. For this conversion, India opted for 'Bound Ceiling Rates': 100 per cent for primary agricultural products, 150 per cent for processed foods and 300 per cent for some edible oils. India had quantitative restrictions (QRs) on 2714 items, which included a number of agricultural items on Balance of Payments ground. However, India lost the case before the Dispute Settlement Board (DSB) and had to remove all QRs, including those on agricultural products, with effect from April 1, 2001.

The EXIM Policy for 2001 (Government of India, 2002 c) and subsequently for 2002-07 have taken a number of measures to prevent any negative impact of QR removals on agriculture sector. Import of agricultural products like wheat, rice, maize, other coarse cereals, copra and coconut oil has now been placed in the category of State Trading. Only the nominated State Trading Enterprises (STEs) are allowed to import these products. Imports of a variety of food products are to comply with a number of domestic food standards and regulations. Also to ensure that import of agricultural products do not lead to infiltration of diseases and pests in the country, imports of primary products of plant and animal origin are now subject to Sanitary and Phyto-Sanitary (SPS) permits to be issued by the Government of India. Also for a number of products like milk, skimmed milk powder, spelt wheat, maize, rice, millet, sorghum, rape and mustard oil, the tariff rates were raised through negotiations under GATT Article XXVIII. Tariff has also been imposed on some other agricultural and horticultural products, which previously were on the free import list. (Government of India, 2001). Due to these measures, it was expected that India might not face any import surge of agricultural goods, in the short to medium term.

In the recent years, agricultural exports have received special attention from the Government since it is believed to be the area which has the greatest potential for raising farm incomes and earning foreign exchange. While presenting the EXIM Policy of 2001, in his speech, the Commerce Minister, highlighting the beneficial aspects of trade in agriculture, says:

"If 'Internationalisation' of our agriculture takes place it will have several implications: The terms of trade, which have for long been in favour of industry, are expected to shift in favour of agriculture. It is estimated by some economists that every one per cent switch will divert about Rs. 8,500 crore additionally in favour of agriculture and that about US \$20 billion (over Rs. 60,000 crore) will be transferred to the agriculture sector from the non-agriculture sector in the next few years."

The impetus for accelerated growth in agricultural exports is envisaged through enhanced infrastructure support and by building up a conducive policy environment. In recent years, though most of the export promotion measures carried out prior to 1991 have been abolished, a number of other policy changes have been introduced to make agricultural exports more viable. Market determined exchange rate policy has removed the constraint of overvalued exchange rate and increased the competitiveness of Indian agricultural exports. Lowering of import duties on capital goods particularly for greenhouse equipment and plant and machinery necessary for food processing industries as well as easier availability of credit for exports have also helped. Box 1 shows some export promotion schemes currently given by the government. After 1991, export restrictions on most of the agricultural items have been gradually removed. Except for some restrictions on export of wheat and wheat products, coarse grains, sugar and pulses in bulk, almost all other agricultural products are freely exported (Government of India, 2000).

Also a Market Access Initiative scheme has been launched for promoting export enhancement studies. The objectives of this scheme includes, *inter alia*:

- (a) Supporting Export Promotion Councils (EPCs)/Trade Promotion Organisations for market survey/studies for selected products in the chosen countries to generate data for promotion of exports from India.
- (b) Assist exporters and EPCs for participation in international departmental store promotion programmes, intensive publicity campaigns and participation in international trade fairs, seminars, buyer-seller meets for a few selected focus products in focus countries.
- (c) Assist the exporters and EPCs in promotion of India, Indian products and Indian brands in the international market.
- (d) Assist projects for research and product development.
- (e) Assist any other activity, appropriate for promoting chosen product(s) on country-product focus approach basis.

- (f) Supplement State Government efforts in carrying out export potential survey of the State for identified product groups.

BOX 1

EXPORT PROMOTION SCHEMES AND MARKETING ASSISTANCE
FOR AGRICULTURE BY THE GOVERNMENT

Scheme (1)	Activity (2)
Indian Brand Equity Fund	Promoting the image and marketing of generic Indian exports
Extreme Focus Product	Promoting commodities with high export growth potential
Indian Trade Promotion Organization	The main government organization in this area. Promoting exports and imports and upgrading technology, undertaking publicity, organizing export development programmes etc
Six Statutory commodity boards	Producing, developing and exporting coir, tea, coffee, rubber, spices and tobacco
Twenty Export Promotion Councils	Performing export promotion and development of particular product and service groups.
Marine Products Export Development authority	Developing the marine products industry with special reference to exports
Agricultural and Processed Food Products Export Development Authority	Focusing on agricultural and horticultural exports, including marketing of processed food in value added form
Market Development Assistance	Funds used for, <i>inter alia</i> , market research, product promotion and participation in trade fair.

Source: Adopted and Updated from WTO (1998).

Apart from the measures mentioned above, the current EXIM Policy has introduced the following policy incentives to the agricultural sector:

1. The Department of Commerce would give primacy to promotion of agricultural exports as the ongoing negotiations at the WTO present opportunities for agricultural exporters.
2. The Department of Commerce would supplement the efforts of State Government in facilitating agricultural exports based on specific products and specific geographical area.
3. The EXIM policy schemes like Duty Exemption Scheme and the Export Promotion Capital Goods Scheme (EPCG) have been made applicable to the agricultural sector.
4. Information will be provided to the farmers on prices, demand, quality standards, etc. to enable them to respond to the international situation.
5. The farm to port approach in the Agri-Economic Zones and the proposed Agri-Export Policy are expected to give boost to agricultural exports.

Academic Response to Policy Liberalisation

The agricultural trade liberalisation carried out in the 1990s has evoked mixed reaction among economists. Gulati (1998), Gulati and Pursell (1996), Parikh *et al.* (1996) were of the opinion that the liberalisation of agricultural trade would be beneficial for the economy. Gulati (1998) observed:

“Thus, in conclusion, globalization of the economy, including agriculture, offers an opportunity to correct the bias in Indian trade policies that have in existence since the 1950s. With this, the hidden implicit taxation on agriculture would go down and the agricultural sector would get an opportunity to respond favourably to these signals.” (p. 144)

However, some other economists have a different perspective. Nayyar and Sen (1994) point out that larger participation by India in a number of crops like rice and cotton would worsen its terms of trade and unless the volumes are adjusted quickly there would be a decline in the balance of trade. They also point out that the real export potential from agriculture does not lie in the major crops but it is in the development of horticulture and food processing. According to them, for these commodities, improved marketing, quality control and logistics are the real drivers and not trade policy restrictions.

Vyas (1994) also argued for a careful approach towards agricultural exports. He pointed out that India should continue with its policy of self-sufficiency in foodgrains. According to him, trade in foodgrains should be of secondary importance over domestic requirements and this sector should be protected from the international competition for the time being. However, for commercial crops, export orientation is justified, if these satisfy three conditions, viz., (a) there is a genuine and growing surplus after meeting domestic requirements, (b) ratio of export to domestic prices is favourable, (c) there is a growing international demand. He also advocates prioritisation of crops where India has comparative advantage. In his view cotton, tea and tobacco exports should be emphasised, whereas exports of sugar should be de-emphasised. Vyas also agreed with Nayyar and Sen (1994) that fruits, vegetables, flowers, herbs, etc., could be important export products for India.

Rao (2001) was of the view that trade liberalisation would not affect India's food security. “If the prices of foodgrains at the moment are out of reach of the poor, it is not due to the rise in exports but to the steep rise in procurement and issue prices”.

Academics also expressed fears regarding imported instability due to higher price fluctuations in the international commodity market. One study (Bhattacharyya and Pal, 1999) calculated price instability using Coppock's formula (Coppock, 1962) for the period December 1994 to December 1998. The results are presented in Table 1.

TABLE 1. INSTABILITY INDICES

Commodity (1)	India (2)	World (3)
Rice	1.13	6.44
Wheat	3.66	6.00

Source: Bhattacharyya and Pal (1999).

Theoretically it was anticipated that due to liberalisation, the depth of the world market would expand and this would, in turn, reduce the intensity of price fluctuations. But a limited exercise done so far do not support the hypothesis. The data in Table 2 reveal in fact an opposite trend.

TABLE 2. COEFFICIENT OF VARIATION OF MONTHLY PRICES

Commodity (1)	January 1990 to December 1994 (2)	January 1995 to July 2001 (3)
Non-Fuel Commodity prices index	6.36	12.25
Wheat: US number 1 HRW, fob Gulf of Mexico	12.15	25.48
Maize: US number 2 yellow, fob Gulf of Mexico	7.81	26.28
Rice: 5 percent broken, nominal price quote, fob Bangkok	12.91	21.70
Soybean; US cif Rotterdam	5.81	17.41
Soybean Meal; 44 per cent, cif Rotterdam	5.58	23.60
Soybean Oil; Dutch, fob ex-mill	15.27	23.74
Palm Oil; Malaysia and Indonesian, cif NW Europe	24.90	28.83
Coconut Oil, Philippine/Indonesia, cif Rotterdam	25.50	24.17
Fishmeal, 64/65 per cent, any orig. cif Rotterdam	12.95	20.91
Groundnut Oil, US runners, cif European	20.10	14.69
Sugar: International Sugar Agreement price	18.67	26.25
Sugar: US, import price contract number 14 cif	3.46	6.82
Sugar: EC import price, cif European	7.04	9.37
Coffee, Other Milds, El Salvador and Guatemala, ex-dock New York	42.57	33.11
Coffee, Robusta, Uganda and Cote d'Ivoire, ex-dock New York	53.93	38.41
Cocoa, ICO price, cif US and European ports	13.36	21.53
Tea; From July 1998, Kenya auctions, Best Pekoe Fannings. Prior, London auctions, cif, UK warehouses	11.15	17.93
Cotton, Liverpool Index A, cif Liverpool	16.98	23.27

Source: Price data from IMF, authors' calculation.

A recent study (Sekhar, 2003) has looked at a longer period: 1970-2001 for international prices and 1980-2001 for domestic prices. The comparison revealed that inter-year variability is generally lower in the domestic markets than in international markets. A regression analysis on the determinants of price volatility found international prices to be significant in some cases while output fluctuations were observed to be insignificant.

Impact of QR removals

Subsequent to removal of quantitative restrictions, the Government of India introduced a monitoring system of sensitive imports. Quotas were removed on 416 agricultural products at HS six digit code in pursuance to the WTO Panel decision, w.e.f., 1 April 2001 (WTO, 2002, p. 101).

The monitoring system covered 120 agricultural products at 8 digit HS code level in 2000-01, the number increasing to 151 in 2001-02. The number declined in 2002-03 to 143, the reason being eight products imported in 2001-02 were not imported in 2002-03. Total imports of the monitored items are shown in the Table 3.

TABLE 3. AGGREGATE IMPORT VALUE OF SENSITIVE AGRICULTURAL ITEMS
(Rs. crores)

Year (1)	(2)
2000-01	8,028
2001-02	7,839
2002-03	10,595

Source: Estimates from data in MOC website.

The data reveal that immediately after the QRs were removed, total imports in fact declined, despite the fact that the coverage of products rose by 31 items. However, during 2002-03, there was resurgence in imports to the extent of Rs. 2,756 crores. A close scrutiny of data reveals the following: (i) Bulk of imports is accounted for by edible oils. Their shares in the total imports of sensitive agricultural products were 76 per cent in 2000-01, 60 per cent in 2001-02 and 64 per cent in 2002-03. (ii) The rise in aggregate imports in 2002-03 was mostly accounted by rise in edible oil imports to the extent of Rs. 1,490 crores. (iii) During 2002-03, an appreciable increase in imports was observed for fruits and vegetables, including common varieties such as fresh apples. (iv) There was also marked increase in import of spices, especially raw cashew-nuts and pepper.

So far as increase in cashew nuts is concerned, the rise is closely linked to export performance and therefore, does not cause any alarm. As to pepper, there are trade reports that a large volume of the product is being imported for being re-exported, after relabelling and/or adulterating with Indian premium pepper. This reported fact, if found to be correct, calls for strengthened customs administration and surveillance, if free trade regime is to operate effectively. Since import of edible oils essentially reflects the mismatch between demand and supply positions, the only product category which can cause some worry is fresh fruits and vegetables. While some amount of import of exotic varieties is expected, a large scale import of common varieties will not be desirable. But on the whole, the experience since the withdrawal of quantitative restrictions do not cause any alarm. The conclusion is reinforced if

the aggregate data on India's agricultural exports and imports are considered (Table 4).

TABLE 4. INDIA'S AGRICULTURAL TRADE

(\$ million)			
Year	Exports	Imports ^a	BOT
(1)	(2)	(3)	(4)
1999-2000	5,608	2,693	2,915
2000-01	6,003	1,858	4,145
2001-02	5,871	2,294	3,577
2002-03 ^b	3,489	1,483	2,006

Note: a. bulk consumption goods + cashew nuts.

b. April – October 2002.

Source: Government of India (2002c) and Handbook of Statistics of India's Economy.

Internationalisation of Indian Agriculture

What is more important than sudden and short-term import penetration is the long-term trend that can be discerned with respect to the increasing openness of the Indian economy. Table 5 provides data on India's agricultural exports, imports and agricultural gross domestic product (GDP) and some ratios. The data brings out several important trends:

TABLE 5. TRADE ORIENTATION OF INDIAN AGRICULTURE

(million US \$)					
Year	Agricultural exports	Agricultural imports	Total of agricultural exports and imports	Agricultural GDP (US\$ million)	Agricultural trade/total agricultural GDP (per cent)
(1)	(2)	(3)	(4)	(5)	(6)
1990-91	3,354.4	631.2	3,985.6	81,220.53	4.91
1991-92	3,202.5	382.9	3,585.4	69,774.86	5.14
1992-93	3,135.8	636.6	3,772.4	62,397.79	6.05
1993-94	4,027.5	480.6	4,508.1	70,724.35	6.37
1994-95	4,226.1	1,364.3	5,590.4	81,274.24	6.88
1995-96	6,081.9	1,196.9	7,278.8	83,063.08	8.76
1996-97	6,862.7	1,407.7	8,270.4	94,092.68	8.79
1997-98	6,626.2	1,689.8	8,316.0	95,113.68	8.74
1998-99	6,034.5	2,754.5	8,789.0	1,00,603.03	8.74
1999-00	5,608.0	2,693.4	8,301.4	1,02,444.56	8.10
2000-01	6,002.8	1,642.8	7,645.6	-	-

Source: CMIE India trade data base.
Economic Survey.

UN: IFS.

(i) In value terms, both agricultural exports and imports have increased consistently over the last decade - the growth rates are, however, widely divergent: 79 per cent for exports and 160 per cent for imports. The higher growth rate of imports is partly due to a lower base.

(ii) As a consequence, the ratio of agricultural exports to imports has consistently deteriorated over the period.

(iii) What is most significant, however, is the rising share of agricultural exports and imports to agricultural GDP. This is what reveals the extent of openness due to trade policy reforms. The ratio has shot up from about 5 per cent to 8 per cent during the period. It is exactly similar to the overall trade/GDP ratio of the Indian economy.

Agricultural Price Policy in Post-Import Liberalisation Period

As observed earlier, liberalisation of agricultural imports in terms of removal of quantitative restrictions came as a result of India losing the case in WTO to maintain QRs under Article 18: B (balance of payments considerations). To counter the effect of QR removals, it was felt that appropriate adjustments in tariffs might be required. However, even before the QR removals began, tariff rates on selected agricultural products were raised. It was observed that agricultural tariffs for all, except 231 tariff lines at HS six digit code level, have been raised since 1997. WTO has estimated that the simple average applied tariff rate has gone up from 35 per cent in 1997-98 to 41 per cent in 2001-02. However, it was also estimated that due to reduction in peak tariff rates, despite selective increases, the average tariff rate on agriculture would be 37.5 per cent in 2002-03 (WTO, 2002, p. 100). On a micro basis, tariff rates were raised in 37.5 per cent of tariff lines in which QRs had been removed. Tariff quotas are also maintained on maize, milk powder; refined rape/mustard and sunflower oil.

Under the Uruguay Round, India has bound all its agricultural tariffs: 100 per cent for primary products, 150 per cent for processed products and upto 300 per cent for edible oils. India has also renegotiated some tariff rates under Art XXVIII:1, which included grains, edible oils and dairy products. The tariff bindings under the Uruguay Round (UR) was estimated at an average bound rate of 115.7 per cent in 2005 (WT/TPR/S/100, P. 28).

Use of Variable Tariffs as Control Instrument

Despite the recent upward adjustments in applied tariff rates, there are still substantial gaps between bound rates and applied rates for many agricultural products. Some relevant data are presented in Annexure Table. The gaps indicate the degree of freedom currently available to adjust the tariff rates to manage imports. However, the mandated negotiations on agriculture, if successful, will take away a substantial part of this flexibility.

This raises a fundamental problem. All government pronouncements and many experts have focused upon tariffs as the primary instrument for providing protection

to farmers from the potential adverse effects of import liberalisation. The National Agricultural Policy states:

'In order to protect the interest of farmers in the context of removal of quantitative restrictions, continuous monitoring of international prices will be undertaken and appropriate tariffs protection will be provided' (NAP Para 27).

The CACP Report for 2001-2002 makes the following recommendation:

'Government should continuously monitor the changes in global prices of edible oils and fix *variable tariff rates* accordingly in time to minimise the adverse impact of open trade policy on the domestic oilseed sector' (Government of India, 2002 f, p. 199).

In fact, the recommendation on finetuning tariff rates to manage imports runs through the CACP report on almost all major crops.

In the post-Doha period, several problems can be identified with respect to this approach.

First, for the commodities where the water content in tariff rate are not high, any substantial reduction in ad valorem bound rates may create a situation where the new bound rates would be lower than the current applied rates, for example fresh fruits and vegetables, some varieties of edible oil and some dairy products, as well as some types of rice.

Second, where the water content is very high, while the new bound rates may not be lower than the applied rates, the margin may nonetheless come down substantially, keeping very little freedom for tariff rate adjustments, for example tea, coffee, copra, etc.

Third, price volatility in the international commodity market is high. Tariff rate adjustments can work quite effectively if there is a trend behaviour in prices, either upward or downward. But if the market is characterised by short-term volatility, the tariff is difficult to be used, because continuous tariff changes are not possible.

Fourth, such variable tariffs may be, considered as equivalent to 'variable levy' extensively used by the European Union (EU). There is a strong possibility that variable tariffs may be perceived to be inconsistent with the WTO discipline.

Fifth, India's current institutional capacity to collect international price data and forecast with an acceptable margin of error for a large variety of agricultural crops may be inadequate. In the absence of such capacity, variable tariffs can be used only on post-facto basis, thus severely limiting the effectiveness of the instrument in limiting damage due to law priced or dumped imports.

Finally, should there be always policy intervention to neutralise the effect of cheaper imports? Just as government has the farmers as stakeholders, consumers are stakeholders as well. While policy intervention is justified where dumping is involved and a separate WTO regime is available for that eventuality as well as sudden surge in imports, the logic of always disallowing the benefits of lower global prices to consumers is not self-evident.

Issues Relating to MSP

The primary focus of agricultural price policy has been to reduce the impact of output fluctuations on prices with a view to protecting the interests of both farmers and consumers, in conjunction with the public distribution system. Procurement price/MSP was required to operationalise the green revolution so as to minimise the risk perception of the farmers who had to increase their outlays from the anticipated impact of increased output level. The problems arose over the years over the blurring of the distinction between the minimum support price and the procurement price. Additional complications arose out of the recommendatory nature of the advice given by the Commission on Agricultural Costs and Prices. The Government quite often found it politically expedient to fix procurement prices at levels fixed by the CACP (Table 6).

TABLE 6. PROCUREMENT PRICES FOR FAIR AVERAGE QUALITY WHEAT AND PADDY

Crop year	Paddy		Wheat	
	CACP (2)	Government (3)	CACP (4)	Government (5)
1990-1991	205	205	200	215
1991-1992	235	230	225	225
1992-1993	260	270	245	250
1993-1994	310	310	305	330
1994-1995	340	340	350	350
1995-1996	355	360	360	360
1996-1997	370	380	380	380
1997-1998	415	415	405	475
1998-1999	440	440	455	510
1999-2000	465	490	490	550
2000-2001	510	510	550	580
2001-2002	520	530	580	610

Source: Parikh *et al.* (2003).

The ever increasing procurement prices sustain the not-so-virtuous circle of over production which initially brought out the socially desirable outcome of food-sufficiency. High procurement prices create incentives for additional production through increased usage of fertilisers and other inputs. However, since higher prices would reduce market demand, there has to be in place a mechanism to ensure that market prices do not crash. While this policy mix takes into account the supply side of food economy, it does not take into consideration the demand side. Earlier it was considered that the PDS off-take would address this issue but as the experience has since shown that it was not a perfect solution. Public Distribution System (PDS) can, however, be a more effective solution, if its coverage and operational efficiency are improved.

MAJOR ISSUES WITH RESPECT TO AGRICULTURAL PRICE POLICY

Keeping the WTO-mandated negotiations in mind as well as the rather embryonic ideas on domestic agricultural policy reforms, the following issues need consideration:

(i) There is a problem of sequencing of policy reforms. This is a generic problem which has been faced by all countries going for liberalisation. In India, this has been raised with respect to what should have come first: domestic policy reforms or external trade policy reforms. As is well known, for reasons which are partly fire-fighting, partly political, India opted for external sector policy reforms to begin with. As observed earlier *en passant*, efforts were made to keep agricultural trade out of the reforms package. Despite the Government's best efforts, India was forced to open up due to WTO regime. As a consequence, India has now a quasi liberal agricultural trade policy in the sense of not having quantitative restrictions, a fairly high bound rates, a moderately high applied rates and a distinct possibility of reduction in the tariff profile in the near future. But there has been no change in the domestic agricultural trade policy, including price policy. Most economists might have preferred a sequencing which focused on domestic agricultural reforms to be followed by trade policy reforms. However, since there is no way now to reverse the sequencing, the issue is: can a domestic agricultural price policy of the current persuasion be consistent with a liberalised trade policy regime?

The liberalised trade regime essentially allows the price mechanism to work. It is immaterial whether that observed price is determined in a competitive or an oligopolistic market. What is important is only the set of relative prices, i.e., global market price and the domestic price. Assuming an autarchic economy, the administered price (e.g., MSP the procurement price) is, by definition, not the market-clearing price. The higher is the administered price, the greater will be its ineffectiveness in terms of market clearing. Since this is a closed economy, the market will have to be cleared by the government procurement operations. In an open economy, if the administered price mechanism continues, it would introduce a new distortion - the relative prices in the global market will increasingly turn against the domestic prices. This will bring more imports and distort the market further. Compared to a closed economy, the open economy will allow the use of exports as a vent for the stocks it is holding. However, as the procurement price is out of line with global market prices, this will involve giving export subsidy. This, however, is impermissible so far as India is concerned under the current WTO dispensation.

The impact of higher procurement prices of wheat on international competitiveness can be seen from the data in Table 7. What this brief analysis shows is the incompatibility of following a price policy which is administered and non-market clearing with another set of policies which is market-based and of market-clearing type.

TABLE 7. COMPARISON OF DOMESTIC AND INTERNATIONAL PRICES OF WHEAT

Year (1)	Domestic Prices ¹ (DP) (2)	International Prices ² (IP) (3)	Ratio of DP to IP ³ (4)
1995-96	-	-	0.61
1996-97	25.00	(-) 23.32	0.93
1997-98	7.37	(-) 22.41	1.23
1998-99	7.84	(-) 13.63	1.36
1999-2000	5.45	2.70	1.35
2000-01	5.17	8.90	1.24
2001-02	1.64	20.71	1.00
2002-03	0.0	1.15	0.97

Source: Calculated from RBI, Ministry of Agriculture and World Bank data sheets.

Notes: 1. Average percentage change Rs./metric tonne.

2. Average percentage change USD/metric tonne.

3. DP converted to USD by using annual average exchange rate.

The ratio would have been much worse had the rupee not depreciated by more than 45 per cent during the period. Unadjusted comparison shows a wider divergence in the price behaviour of the domestic and international prices (Figure 1).

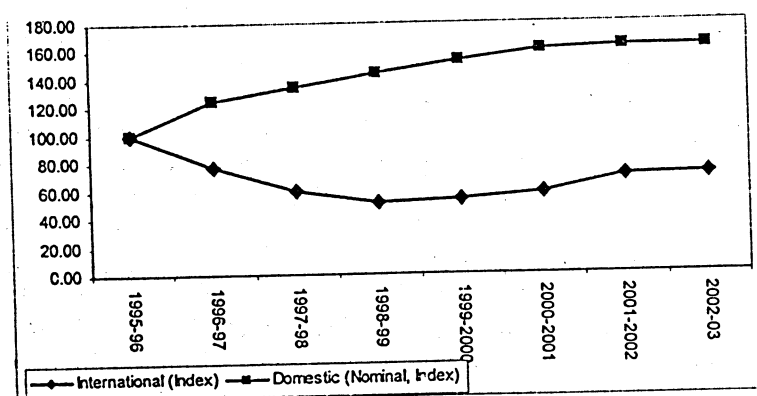


Figure 1. Index of Wheat Prices
(Procurement price in Rs./tonne, International price in \$/tonne)
(1995-96 is the base)

(ii) If global trade in agriculture gets more integrated in future as it does appear, it seems that there has to be considerable rethinking on how this problem can be addressed. While in the long-run there may not be much option but to get away from

the current policy regime, for the transitional period, several adjustments in the current policy regime can be considered:

- (a) The political element in the price fixation needs to be taken out. This is possible by making CACP's recommendations not advisory but statutory.
- (b) The current practice of announcing MSP for as many as 25 commodities can be reconsidered. In any case, except for rice and wheat, their effectiveness is of doubt.
- (c) CACP itself should reconsider what is the role of the MSP and procurement price. It should be open for debate whether the earlier distinction between MSP and procurement price needs to be recognised anew and whether MSP would be a better concept for future. One consequence of going towards MSP would be to go for cost concepts in price fixation which would be based on variable costs rather than full costs. This would obviously mean less security for the farmers but may go towards eventual delinking of providing security through an administered price mechanism in future.
- (d) If MSP has to go in future to make the domestic policy consistent with a liberalised trade policy, farmers' interests will have to be protected through market-based instruments such as forward trading and comprehensive crop insurance.
- (e) It should be accepted that in a policy regime which can only become more open than what it is at present, the issue of competitiveness of agriculture has to be addressed not by looking at measures at the border but within the border. This brings the issue directly to domestic policy reforms, ensuring public and private investments to agriculture, introduction of technology at post-harvest stage, conformity with SPS requirements, among others.

What is becoming clear is that in the coming years, the agricultural price policy has to be thought out within an integrated framework of all economic policies, both domestic and external. While the interests of the farmers should continue to be protected, the efficiency aspects would have to be accorded due recognition.

ANNEXURE
APPLIED AND BOUND TARIFFS ON MAJOR AGRICULTURAL COMMODITIES/GROUPS

Item description (1)	Applied tariffs as on April 1, 2002 (2)	Bound tariffs (3)
<i>(per cent)</i>		
I. Cereals and Pulses		
Pulses	10	100
Wheat (other than meslin)	50	100
Maize (corn) seed	50	70
Maize (corn) if imported under tariff rate quota (TRQ) upto an aggregate of 3,50,000 MT in a financial year	15	70
Maize (corn), if imports are not under TRQ	50	70
Rice in the husk	80	80
Husked (brown) rice; broken rice	80	80
Semi-milled or wholly milled rice whether or not polished	70	70
Millet, Jowar	50	70
Sorghum	50	80
Other cereals (rye, barley, buckwheat, canary seed etc.)	0	100
II. Cereals products		
Wheat flour	35	150
Wheat and potato starch	35	35
Roasted malt	35	100
III. Dairy products		
Fresh milk and cream	35	100
Butter, dairy spreads etc.	30	40/60
Cheese	35	40
Milk powder upto 10000 MT under TRQ	15	15
Milk powder (outside TRQ)	60	60
IV. Plantation crops		
Tea	100	150
Coffee	100	100/150
Coconut, dessicated coconut	70	100
Copra	70	100
Cloves, cassia and cinnamon	35	100/150
V. Meat and poultry		
Chicken leg (processed); sausages	100	150
Chicken leg (raw, processed);	100	100
Meat of poultry, not cut in pieces, fresh or chilled	35	100
Raw hams, pig fat; meat of bovine animals	35	100
VI. Sugar	60	150

(Contd.)

ANNEXURE (Concl'd.)

Item description (1)	Applied tariffs as on April 1, 2002 (2)	Bound tariffs (3)
VII. Horticulture		
Apples	50	50
Grapefruit, plums and sloes, prunes	25	25
Strawberries, dried apricots, etc.	35	100
Pears and quinces	35	35
Oranges; lemons and limes; fresh grapes	35	40
Fresh pomegranates, lichi, tamarind, custard apple	15	100
Fruit juices	35	35/85
Onions	Nil	100
Mushrooms, other vegetables (dried)	35	100
Potato	35	150
Sweet potato	35	150
Frozen vegetables-peas, beans, spinach, sweet corn, etc.	35	150
Planting materials of oilseeds	5	10/100
Oilseeds, miscellaneous grains, seeds of fruits, industrial or medicinal plants (other than seeds of a kind used for sowing and hop cones)	35	100/150
VIII. Edible oils (Crude)		
Soyabean oil	45	45
Palm oil	65	300
Groundnut oil	75	300
Sunflower/Safflower	75	300
Coconut oil	75	300
Rapeseed oil	75	75
Colza or Mustard oil	75	75
Castor oil/Tung oil	75	100
Other oils	75	300
IX. Edible oils (Refined)		
Soyabean oil	45	45
Palm oil	85	300
Groundnut oil	85	300
Sunflower/Safflower	85	300
Coconut oil	85	300
Rapeseed oil	75	75
Colza or Mustard oil	75	75
Castor oil/Tung oil	85	100
Other oils	85	300

Source: Government of India, (2002 d).

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