India's Agriculture Trade Policy Reform under WTO Agreements: Poverty Implications in Nepal

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1. Summary

With a per capita income of US $ 250 per year, Nepal is one of the poorest country in the world and the poorest in South Asia. Poverty remains widespread, with 42 % of the population living below the poverty line. As stated in the Nepal Poverty Reduction Strategy Paper, international trade could help Nepal grow faster and reduce poverty. The importance of agriculture as the single most important provider of livelihood for 90 % of Nepal's population implies that the trade competitiveness of agriculture will have a decisive effect on poverty reduction. The proposed study aims to examine the impact on Nepalese poor of India's trade policy reforms in agriculture sector following the same in developed countries, that may result under existing WTO commitments, as well as commitments expected under new rounds of WTO negotiations of improved market access in agriculture.

2. Background and Issues

Integration into global market offers the potential for more rapid growth and poverty reduction. But market barriers in developed countries to some key developing country exports have made it harder for them to make full advantage of this opportunity.[1] Agricultural markets are among the most heavily distorted.[2] OECD countries have recently agreed to reform their agriculture, although developing countries would still confront challenges seeking to use WTO negotiations to promote their economic growth and performance.[3]

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[1] See Jon D. Haveman and Howard J. Shatz (2004), Developed Country Trade Barriers and the Least Developed Countries: The Current Situation, Journal of Economic Integration, Volume 19, Number 2: 230 – 270.

[2] On agricultural exports to OECD countries, developing countries face tariffs that exceed those on typical inter-OECD exports (of all products) by factors of 10 or more. Including subsidies, OECD agriculture received support amounting US$ 311 billion or a.3 percent of GDP in 2001. See T. Geither et.al (2002) and S. Laird ((2002).

[3] Hoekman, B. (2004), Developing Countries and the WTO Doha Round: Market Access, Rules and Differential Treatment, Journal of Economic Integration, Volume 19, Number 2: 205-229; Mattoo, A. and A. Subramanian (2004), The WTO and the Poorest Countries: The Stark Reality, IMF Working Paper No WP/04/81, International Monetary Fund.

India's agricultural policies[4], which heavily protect their farmers, are prompted partly by those of OECD countries, and have been major issues for Nepal. Both Nepal and India liberalized their agriculture trade regime during the second half of 1990s. While the overall domestic policy environment for agriculture in Nepal currently presents only few distortions and anomalies, India still applies high tariff, quantitative restrictions and tariff rate quotas on imports. Several price interventions and subsidies also distort producer incentives in agriculture. The Central Government provides subsidies to all major purchased inputs (fertilizer, seed, and pesticides).[5] Irrigation water from surface schemes is heavily subsidized, along with power subsidies for irrigation pumps. State governments also supplement subsidies provided by the Center. The farm gate prices for major commodities are influenced by State trading agencies at fixed procurement prices.

Given the reality that Nepal has a long and virtually open border with India, competitiveness of Nepal's agricultural products have been constrained by Indian agriculture policies. The large subsides and farm support programs accorded to major agricultural produce in India provided important cost advantage to Indian farmers. While some of the Indian subsidies on traded inputs (e.g., fertilizer) tend to benefit Nepalese farmers located in close proximity to Indian borders, most interior input markets are not well integrated into Indian markets, limiting such spillover benefits. On the other hand, output markets appear to be better integrated, exposing Nepalese farmers to artificially low border prices, due to heavy subsidization of Indian agriculture. Despite better performance of exports relative to imports in recent years, Nepal suffers from chronic deficit in both formal and informal agricultural trade.[6]

Despite heavy subsidization of inputs, the Aggregate Measure of Support (AMS) for Indian agriculture was negative during the 1990, as it pursued a policy of balancing high AMS for a few cereal products with negative AMS for most of hem. As a result, under the current WTO agreements, India is not required to make any further reduction in domestic subsidies. The next round of WTO negotiations will address the issue of domestic support and State Trading Enterprises (STEs), two areas in which commitments from WTO members including India could have positive benefits for Nepalese farmers through enhanced market access of their exports and increased international (and hence domestic) prices of their produce although they would also harm Nepalese food consumers.

3. Objectives of the Study

The specific objectives of the proposed study are as follows:

i. Review of agricultural trade policies in Nepal and India;

[4] See The World Bank (2003), Trade Polices in South Asia, 2003

[5] D. K. Srivastava et al (2003, Budgetary Subsidies in India: Subsidizing Social and Economic Services, National Institute of Public Finance and Policy, New Delhi.

[6] The extent of informal trading in agricultural produce is estimated to be much higher than that of formal trade between Nepal and India. See Karmacharya, B.K. (2002), Informal Trade in the SAARC Region: Nepal's Informal Trade with India, Country Report prepared by NECDER under aegis of SANEI; Tanjea, N. (2002), Informal Trade in the SAARC Region: India's Informal Trade with Sri Lanka and Nepal, Country Report prepared by ICRIER under aegis of SANEI.

ii. Assess the implication on Nepal's poverty from India's trade policy reform in selected major agricultural products in terms of eliminating agricultural subsidies/supports and selected trade barriers.

4. Methodology

To assess the implications of India's trade policy reform in agriculture on Nepal's poverty, the study will follow the methodology developed by Porto (2003). The theoretical links that form the basis of the methodology developed by Porto are as follows. The policy induced changes in the prices of traded goods that Nepalese consumers and farmers face generate a change in the relative demand of different factors of production, particularly labor. As a result, wages and household income react and poverty is affected.

Following Porto (2003), the estimation of poverty impacts of India's agricultural trade reforms will comprises three steps. Firstly, changes in the domestic prices of imports and exports in Nepal induced by agricultural trade reforms in developed countries and hence in India will be assessed. Secondly, wage price-elasticities will be estimated that will measure the response of Nepalese wages to the price changes. Finally, simulated policy-induced price changes and the estimated wage price-elasticities will be used to predict the labor income that would hypothetically be earned by each Nepalese household after the reforms. To study the poverty impacts, pre- and post-policy head count ratios will be computed.

5. Data Sources

Various studies have been carried out to estimate the pass-through of foreign trade liberalization to prices of agricultural goods. Hoeckman, Ng, and Olaregga (2003) have used econometric method to estimate the response of equilibrium of agricultural products in international markets. Beghin et. al. (2002) perform a CGE study of the response of international prices of agricultural goods to a foreign trade reform that includes the elimination of both trade protection and domestic support. The findings of these studies will be used to estimate the extent of pass-through of foreign trade liberalization to prices of agricultural goods in India and hence in Nepal.

The Central Bureau of Statistics in Nepal has been carrying out nation-wise household survey termed as Nepal Living Standard Survey (NLSS) – the first one in 1996 and the second one in 2001. They will be used to estimate wage price-elasticities. Alternatively, time series data on wage and agricultural price collected by Nepal Rastra Bank will be also used to estimate wage price-elasticities. The NLSS data also provide poverty profile.

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