Chapter-IV

THE W.T.O. AGREEMENT - IMPLICATIONS FOR INDIAN TOBACCO SECTOR

This chapter is an attempt is made to examine the World Trade Organisation (WTO) its implications on Indian manufactured and unmanufactured tobacco exports. The international trade environment, the Uruguay Round agreement (1986-94), free and fair competition among WTO member countries. Assess the background of Tobacco exports from India, review of world tobacco trade, discussion of the Uruguay Round Agreements on Agriculture and its implications for World tobacco trade and prices.

WTO established on 1st January 1995, is mandated to administer multilateral trade agreements negotiated by its members, pertaining to trade in goods, General Agreement on Trade and Tariffs (GATT), General Agreement on Trade in Services (GATS), and Trade Related Intellectual Property Rights (TRIPs). The basic underlying philosophy of the WTO is that non-discrimination and global competition in international trade is conducive to the pareto-optimal welfare of all nations. The WTO is essentially not concerned the behaviour of private business. It deals only with the actions of governments establishing disciplines on trade policy instruments such as tariffs, quotes, subsidies etc. Thus, the WTO is a regulator of the regulatory actions of governments that affect trade.

The earlier round of negotiations in Geneva (1947), Annecy (France) in 1949, Torquay (U.K) in 1951, the Dillon Round (1960-61), the Kennedy Round (1963-67), and the Tokyo Round (1973-79) dealt with mainly tariff reductions and disciplining non-tariff measures. The Uruguay Round (1986-94) led to a further liberalisation of international
trade. In addition to policies affecting trade in goods, measures affecting investment, trade in services, and intellectual property were also negotiated.

4.1 THE INDIAN AGRICULTURE SECTOR AND WTO

In the area of agriculture, India has highlighted the need for developing countries with predominantly agrarian economies to have sufficient flexibility with regard to domestic support and market access commitments in order to adequately address their issues relating to security and rural employment.

With regard to tariff rate quotas, which are a predominant feature of international trade in agriculture, India has stressed the importance of making the tariff rate quota administration more transparent, equitable and non-discriminatory in order to allow new/small scale developing countries exporters to get market access.

In this context, the focus of the present study is some external sector developments. The international trade environment in general has changed following the Uruguay Round Agreement (1986-94) and its entry in to force from 1st of January 1995. Now, they have better multilateral rules to discipline erring WTO (World Trade Organisation) member countries. Therefore, expects free and fair competition among WTO member countries, although various countries have devised ways to circumvent GATT and WTO rules. The present study, first assesses the background of Tobacco exports from India (Section-I) followed by a review of world tobacco trade (section-II). Next follows a discussion of the Uruguay Round Agreements on Agriculture (Section-III) and its implications for World tobacco trade and prices (Section-IV), the Section-V deals with the polices of some leading tobacco trading countries. The other developments in
the international trade environment also impinge on tobacco, that is, other than Uruguay round Agriculture. These other issues are discussed in Section-VI.

4.2 Section I: TOBACCO EXPORTS FROM INDIA

Tobacco has been an important product in India export market. The share of tobacco in India’s export market was 4 per cent during the mid-1999. This share increased to 8 per cent in the early 2008. India is the second largest producer of tobacco after China. But, India’s share in world tobacco exports is in significant.

Table 4.1
India’s percentage of share in world Tobacco Exports
(Million Kgs.)

<table>
<thead>
<tr>
<th>Year</th>
<th>Un-manufactured Tobacco</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>World</td>
<td>India</td>
<td>Percentage Share</td>
<td>Rank</td>
</tr>
<tr>
<td>1999</td>
<td>2071</td>
<td>111</td>
<td>4</td>
<td>7th</td>
</tr>
<tr>
<td>2000</td>
<td>1968</td>
<td>102</td>
<td>5</td>
<td>4th</td>
</tr>
<tr>
<td>2001</td>
<td>2107</td>
<td>89</td>
<td>4</td>
<td>7th</td>
</tr>
<tr>
<td>2002</td>
<td>2096</td>
<td>103</td>
<td>5</td>
<td>6th</td>
</tr>
<tr>
<td>2003</td>
<td>2089</td>
<td>117</td>
<td>6</td>
<td>6th</td>
</tr>
<tr>
<td>2004</td>
<td>2103</td>
<td>138</td>
<td>6.5</td>
<td>5th</td>
</tr>
<tr>
<td>2005</td>
<td>2100</td>
<td>147</td>
<td>7</td>
<td>3rd</td>
</tr>
<tr>
<td>2006</td>
<td>2100</td>
<td>159</td>
<td>8</td>
<td>3rd</td>
</tr>
<tr>
<td>2007</td>
<td>2100</td>
<td>203</td>
<td>8</td>
<td>3rd</td>
</tr>
<tr>
<td>2008</td>
<td>2100</td>
<td>210</td>
<td>8</td>
<td>3rd</td>
</tr>
</tbody>
</table>

Source: United States, Department of Agriculture and Tobacco Board, 2010.
Because most of India’s tobacco production is not suitable in the world market and also produces low quality of tobacco. These are the main reasons why India occupies fewer shares in the world tobacco market. In world tobacco exports, India occupied 7th rank in 1999, from 2005-08 its rank is stagnated around three. It can be understood why India’s rank is stagnated in the world tobacco exports.

Figures 1 and 2 are based on Table 4.1. Barring some fluctuations, Chart 4.1 indicates stagnation in tobacco exports the volume of tobacco and tobacco exports, over the period of 1998-99 to 2008-09. The Chart 4.2 also indicates an increase in the value of export earning in rupees. The suggestion is that export volumes have stagnated and so have export unit value realisations. In large part, this was determined by what was happening to the former market in the erstwhile; Russia was a major destination for India’s exports of unmanufactured tobacco and tobacco products.

Table 4.2
Year wise Exports of unmanufactured Tobacco and tobacco products during 1998-1999 to 2008-2009

<table>
<thead>
<tr>
<th>Year</th>
<th>Quantity (Tonnes)</th>
<th>Value (Rs. in crores.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998-99</td>
<td>1,01,323</td>
<td>806.19</td>
</tr>
<tr>
<td>1999-2000</td>
<td>1,36,221</td>
<td>1,050.22</td>
</tr>
<tr>
<td>2000-01</td>
<td>1,15,390</td>
<td>903.38</td>
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<tr>
<td>2001-02</td>
<td>1,02,086</td>
<td>888.52</td>
</tr>
<tr>
<td>2002-03</td>
<td>1,27,557</td>
<td>1,095.95</td>
</tr>
<tr>
<td>2003-04</td>
<td>1,50,962</td>
<td>1,175.63</td>
</tr>
<tr>
<td>2004-05</td>
<td>1,62,933</td>
<td>1,362.18</td>
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<tr>
<td>2005-06</td>
<td>1,66,869</td>
<td>1,413.47</td>
</tr>
<tr>
<td>2006-07</td>
<td>1,80,988</td>
<td>1,723.42</td>
</tr>
<tr>
<td>2007-08</td>
<td>2,03,399</td>
<td>2,020.93</td>
</tr>
<tr>
<td>2008-09</td>
<td>1,97127</td>
<td>2,713.28</td>
</tr>
</tbody>
</table>

Chart 4.1
Tobacco and Tobacco Product Exports (in Tonnes)

Tobacco and Tobacco Product exports (in Tons)


Chart 4.2
Tobacco and Tobacco Product Exports (Rs. in crores)

Tobacco and Tobacco Product exports (Rs. Crores)

4.3 Section-II: REVIEW OF WORLD TOBACCO TRADE

43.1 INTERNATIONAL TRADE IN TOBACCO

A comparison of the world production and trade in table 4.3 shows that around 30 per cent of tobacco produced in the world is traded. While tobacco production is concentrated, depending on the agro-climatic conditions, the consumption of tobacco is well distributed throughout the world. In aggregate world trade the import to production figures have not changed much over the years. In the 1970s, imports the of tobacco production per cent was 28, while the corresponding figure was 29 in the 90s in 2008 imports as per cent 30 per cent of tobacco production. This indicates that the recent spate of trade liberalisation throughout the world has had no significant effect on world trade in tobacco, at least not yet. The reason may be that world trade in tobacco was already somewhat liberalised, even in the 1970s.

Table 4.3

World Supply and distribution of unmanufactured tobacco in selected years

<table>
<thead>
<tr>
<th>Years</th>
<th>Opening stocks</th>
<th>Imports</th>
<th>Production</th>
<th>Total supply</th>
<th>Consumption</th>
<th>Exports</th>
<th>Total Distribution</th>
<th>Closing Stocks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
<td>(6)</td>
<td>(7)</td>
<td>(8)</td>
</tr>
<tr>
<td>1970</td>
<td>6.6</td>
<td>0.8</td>
<td>2.8</td>
<td>10.2</td>
<td>2.8</td>
<td>0.8</td>
<td>3.6</td>
<td>6.6</td>
</tr>
<tr>
<td>1980</td>
<td>5.7</td>
<td>1.4</td>
<td>3.8</td>
<td>10.9</td>
<td>3.7</td>
<td>1.4</td>
<td>5.1</td>
<td>5.8</td>
</tr>
<tr>
<td>1990</td>
<td>6.5</td>
<td>1.7</td>
<td>6.5</td>
<td>14.7</td>
<td>6.6</td>
<td>1.7</td>
<td>8.3</td>
<td>6.4</td>
</tr>
<tr>
<td>1996</td>
<td>5.8</td>
<td>2.0</td>
<td>6.4</td>
<td>14.2</td>
<td>6.3</td>
<td>2.0</td>
<td>8.3</td>
<td>5.9</td>
</tr>
<tr>
<td>1998</td>
<td>6.7</td>
<td>1.9</td>
<td>6.1</td>
<td>14.7</td>
<td>6.0</td>
<td>1.9</td>
<td>7.9</td>
<td>6.8</td>
</tr>
<tr>
<td>2004</td>
<td>6.8</td>
<td>1.9</td>
<td>5.9</td>
<td>14.6</td>
<td>5.9</td>
<td>1.9</td>
<td>7.8</td>
<td>6.2</td>
</tr>
<tr>
<td>2008</td>
<td>3.9</td>
<td>1.8</td>
<td>6.0</td>
<td>11.7</td>
<td>5.9</td>
<td>1.8</td>
<td>7.7</td>
<td>4.0</td>
</tr>
</tbody>
</table>

Production of different varieties of tobacco takes place in different pockets depending on the agro-climatic situations. For instance, Oriental variety of tobacco is concentrated around the Mediterranean Sea, in countries like Turkey, Greece, Bulgaria, Yugoslavia and the Commonwealth Independent States (CIS) countries. The production for Burley tobacco is less concentrated than the Oriental, and is produced in USA, Malawi, Brazil, China and Italy. The production of FCV tobacco is more evenly distributed than the other varieties of tobacco. Major FCV tobacco producing countries are China, India, Brazil, Zimbabwe and Malawi.

4.4 Section-III: THE URUGUAY ROUND AGREEMENT ON AGRICULTURE

4.4.1 The Uruguay Round Agreement (URA) 1986-94

The URA has several different agreements that directly or indirectly impinge on the tobacco sector. In this section, we will concentrate on the agriculture agreement, which has direct implications. Other elements of the Uruguay Round agreement will be discussed in subsequent sections.

The agreement on agriculture imposed disciplines on many policies that have historically been used to protect farmers and farm income. Some of these policies are import quotas, variable levies and export subsidies. Certain types of income support to farmers are subject to no restrictions. Under the agreement, non-trade distorting direct income support can be used to help farmers to survive more open competition countries. The Uruguay Round Agreement on Agriculture require two kinds of disciplines, those on border measures (i.e., concerning exports and imports) and those on domestic measures.
On border measures, all quantitative restrictions on imports must be converted to tariffs (the tariffication requirements) and there must be a subsequent reduction in those tariffs by an average of 36 per cent for developed countries and 24 per cent for developing countries. Minimum tariff reduction of 15 per cent is also required for reduction of each tariff line is 10 per cent. This time frame begins from January 1st 1995, when the Uruguay Round agreement entered into force.

If tariffs after tariffication are very high to start with, the reduction of 36 per cent will not be sufficient to reduce protection adequately. That apart, tariff reductions will not begin immediately from January 1st 1995, but will bite only after some time. There is a minimum market access commitment. This means that the countries that maintain quantitative restrictions on agricultural imports must provide for minimal imports at low custom duties. The minimal threshold is defined as 3 per cent of domestic consumption to be provided for each product, increasing to 5 per cent over a period of six years, the time frame beginning in January 1995. This clause should not be misinterpreted. It does not say that 3 per cent or 5 per cent of domestic consumption must be imported. It says that 3 per cent or 5 per cent of domestic consumption must be available for imports after payment of necessary duties. That is the percentage must be on Open General License (OGL) to use the relevant Indian phrase and cannot be on quantitative restrictions. This minimum market access stipulation does not apply and Article XVIIIIB is an issue and it will come back later.

Finally, on border measures, there are restrictions on use of export subsidies for agricultural products. Export subsidy outlays in budgets must be reduced by 36 per cent
for developed countries, and 24 per cent for developing countries, that is the value of export subsidies must be reduced by this amount. The volume of exports receiving subsidies must be reduced by 21 per cent per product or group of products for developed countries and by 16 per cent for developing countries. The time frame for reductions is five years (beginning January 1995) for developed countries and ten years for developing countries.

Now move on to domestic support measures. Broadly speaking, internal support levels must be reduced according to category. All non-trade distorting support, including support per hectare and/or animal was placed in the so-called “green box”, and all trade distorting support was placed in the so-called “amber box”. The “blue box” covered the United States system of deficiency payments and the European Union’s direct income payments. All domestic support (the amber box) has to be quantified according to a specified formula and this is known as the Aggregate Measurement of Support (AMS). The benchmark for reduction is 10 per cent for developing countries and 5 per cent for developed countries. Above the benchmark, developed countries must reduce it by $13\frac{1}{3}$ per cent (over ten years). This reduction and computation is done simultaneously at two levels, a product specific level and a non-product specific or aggregate level.

There are two agreements that indirectly bring to environment. These are the agreements on Sanitary and Phyto-Sanitary (SPS) measures and Technical Barriers to Trade (TBT). Of particular relevance for the tobacco sector is the SPS agreement, the intention is being to ensure that such measures do not amount to Non-Tariff Barriers (NTBs). Thus, Sanitary and Phyto-Sanitary (SPS) regulations imposed must be subject to scientific criteria so that they do not serve as disguised protectionist measures. The SPS
agreement encourages governments to base their national requirements according to the recommendations of international organisations like Codex Alimentarius Commission (CAC). However, it should be noted that the SPS agreement does allow importing countries to impose SPS norms that are higher than such international standards, provided that these are imposed in accordance with scientific criteria. In this as in other areas, there is special and differential treatment for developing countries.

Specifically, for the tobacco sector, the following points need to be noted. Tobacco and tobacco based products are defined as Chapter 24 of the Harmonised System.

Commitments can be implemented in a calendar year marketing or financial year basis, as specified in a country’s individual schedule.

Exemptions from tariffication are permitted for temporary border measures under Article XVIIIIB (balance of payment) and “special treatment” provisions under agriculture text.

Countries can also use the special safeguard clause (on a tariff line basis) of the agriculture text, provided that this has been mentioned in the individual country schedule. The special safeguards clause permits temporary deviations from WTO commitments. This clause cannot be invoked for imports within tariff quotas. There are only a few countries like Poland that have mentioned the possible use of the special safeguard clause for the tobacco sector.

Developing countries generally have ad valorem duties; developed countries generally have specific duties.
India does not provide any product specific support for tobacco, benchmarked up to maximum of 10 per cent of the value of production of tobacco. For non-product specific support, the benchmark is also 10 per cent of the value of total agricultural production. Instances of non-production specific support are subsidies in agricultural inputs like fertiliser, electricity and irrigation water. Several people have worked out these figures and they invariably show that India’s AMS (both products specific and non-product specific) was far below than 10 per cent benchmark in the base period. The Ministry of Commerce’s calculations for the base period of 1998-99 are as follows. The total value of agricultural production (annual average) was Rs.1,13,000 crores, and 10 per cent of this is Rs.11,300 crores. The average annual non-product-specific subsidy was Rs.5,300 crores. The average annual product specific subsidy calculated as the difference between international reference and the domestic support price multiplied by the volume of production was not even positive. It was a negative subsidy to the extent of Rs.25,161 crores. The resultant aggregate measure of support has a negative value of Rs.19,861 crores. On domestic support, India has no reduction commitments. In subsequent periods, other than the base period, the figures tend to be somewhat different. But the AMS (both products specific and non-product specific) continue to be below the 10 per cent benchmark.

Among border measures are requirements on binding and reduction of tariffs, other market access commitments and requirements on export subsidies. In India, various export incentive schemes are available to facilitate exporters.
Again profit from exports is exempted from income taxes. Exporters also obtain a rate of interest on export credit that is lower than that on domestic credit.

There is an agreement on subsidies and countervailing duties in the Uruguay Round agreement that applies to exports of manufactured products. This agreement divides export subsidies into three categories red, amber and green. Red subsidies are prohibited under WTO norms and are also actionable by the trading partner. Amber subsidies are permissible under WTO norms, but are actionable the trading partner. And green subsidies are permissible under WTO norms and are not actionable by the trading partner. In the illustrative list of prohibited or red export subsidies one finds “excessive” duty drawback, a rate of interest on export credit that is lower that domestic credit and income tax exemption on export profits and indirect subsidies. However, the prohibition on such export subsidies does not apply to countries that have a per capita income lower than 1,000 US dollars and India is covered under this. There is an additional caveat. For any specific export product, if a country is export competitive in the world market in that particular product group, prohibited export subsidies will have to be phased out in that product group regardless of whether per capita income is more or less than 1,000 US dollars. “Export competitive” is defined as accounting for more than a 3.25 per cent market share in the world market in that product, product being defined as a Section Heading of the Harmonised Customs Nomenclature. The sole course of the issue on export subsidies is “excessive” duty drawback. On this, a dispute is pending with the European Union (EU) and this dispute may surface before the WTO. The essential problem here is the inefficient and non-transparent indirect tax structure in India, which makes it extremely difficult to argue that any particular duty drawback is legitimate and
not excessive. If duty drawback turns out to be excessive, then countervailing duties can be levied on exports that benefit from unwarranted export subsidies. The solution to handling such problems is to progressively move towards a transparent Value Added Tax (VAT).

As mentioned earlier, the market access stipulation only applies to countries that maintain quantitative restrictions that are inconsistent with GATT or WTO norms. As long as India has balance of payment problems, under Article XVIIIIB, India’s quantitative restrictions are not GATT or WTO - inconsistent. However, it has become increasingly clear that India will no longer be able to invoke Article XVIIIIB for balance of payment purposes and these are India, Pakistan, Sri Lanka, Bangladesh, Turkey and Nigeria. Ever since the Philippines gave up Article XVIIIIB is no longer justified. As on today, Article XVIIB cover still exists, but the pressure is evident, both from the WTO and from trading partners. In bilateral negotiations with trading partners like the EU and Australia, India has announced a phase-out of quantitative restrictions on imports over a period of six years (beginning April 1997), ending on March 31st 2003. Although negotiated bilaterally by the MFN (Most Favoured Nation) principle phase-out will have to extend to all WTO signatories. With the United States, the controversy over India’s use of quantitative restrictions on imports could not be resolved bilaterally and ended up before the WTO’s dispute resolution body. Effectively, India lost this dispute, although the phase-out and time frame will have to be decided through bilateral consultations with the United States. Beyond March 2003, there cannot be quantitative restrictions on imports barring a very small negative or prohibited list, banned on environmental or religious grounds.
If we assume that India no longer has balance of payment problems and use of Article XVIIIB, the minimum market access clause will indeed be relevant. But there is no compulsion that 3-5% of consumption needs must be imported. The requirement is that 3-5% of consumption needs must be opened up for imports, that is, on Open General License (OGL) list. In India, the imports of unmanufactured tobacco are allowed at a basic customs duty of 40 per cent. The imports of unmanufactured tobacco are minor as Indian tobacco is price competitive. If we consider the category Harmonised System (HS) 24, which included manufactured as well as unmanufactured tobacco as single commodity group. The minimum market access requirement is already fulfilled for tobacco, therefore not something one need to worry about.

Imports of manufactured tobacco like cigarettes are restricted through licensing. As mentioned above, licensing cannot continue beyond March 2003. However, this does not mean duty free imports. For manufactured products, the Uruguay Round agreement on tariffs has a binding on reduction commitments. A binding agreement is a commitment to agree on a ceiling for tariffs. That is tariffs will not be raised above that rate. In terms of India’s market access schedule, the bound rate for cigarettes is 40 per cent. In parallel with binding commitments, there are also reduction commitments. These are commitments to reduce tariffs. India’s present reduction commitment is 30 per cent on the 1990 base, but does not extend to cigarettes (manufactured tobacco), interpreted as consumer goods. Incidentally, both, reduction and binding commitments are on the basic customs duty and do not extend to additional duties or countervailing duties. For unmanufactured tobacco, India has agreed to a bound rate of 100 per cent.
But this is subject to negotiations and may be brought down when the agriculture agreement is reviewed.

In a developing country like India, sanitary and phytosanitary issues in agroexports have become important. In Indian tobacco, the Dichloro Diphenyl Trichloro Ethane (DDT) residue level is 1-2 Particles Per Million (PPM). This is within the permissible level, as the permissible limit of DDT in tobacco according to international Co-operation Centre for Scientific Research relative to Tobacco (CORESTA) standards is 6 PPM. As mentioned, the Uruguay Round agreement on SPS, however, allows member countries to fix their quality standards above the international standard. Accordingly, USA and Japan insist on a level of 0.4 PPM of DDT in unmanufactured tobacco. The nicotine and tar content in cigarettes, as specified by EU, is 1.5 mg and 15 mg respectively. This will be further reduced to 1.2 mg of nicotine and 12 mg of tar.

4.5 Section-IV : IMPLICATIONS OF THE URUGUAY ROUND AGREEMENT

4.5.1 The International Tobacco Market following URA

The commitment of WTO member countries concerning URA is available through an Integrated Database maintained by WTO. The available information shows that all tariff lines for agricultural products will now be subjects to bindings. This has also been the case for tobacco in all WTO member countries. Zimbabwe being the least-developed country is an exception. Market access through URA is also going to increase through reductions in tariff. Tariff in most developed countries have bound with reductions. As a rough indication, developed countries have agreed to reduce tariff on tobacco products by 36 per cent, compared to a 37 per cent reduction for all agricultural
products. The rate of tariff in the initial year of URA implementation phase is lower than the specific duties while developing countries generally impose ad-valorem duties. There are few exceptions to this principle like Indonesia. The specific duty in developed countries indirectly helps high tobacco producers like Brazil and USA.

Export subsidies on agricultural products in developed countries are now estimated to be worth around 21 billion US dollars. That is export subsidies amount to around 20 per cent of developed country exports of agricultural products. In tobacco, the base period (1986-90) export subsidies by developed countries amount to 146 million US Dollars. Individual country-wide quantitative commitments offered by developed countries on reduction of export subsidies on tobacco. The Uruguay Round Agreement also requires countries to notify the number of state trading enterprises that deal in specific sectors.

Prima facie, the liberalisation in agriculture proposed in URA suggests an increase in global prices and a reduction in production, even though liberalisation in the URA is not as much as originally had been proposed in the Dunkel text.

4.5.2 Impact of URA on world Tobacco Prices and Trade

Once domestic support and export subsidies are withdrawn, prices of agricultural commodities are expected to increase. There have been studies to assess the impact of URA on world commodity trade and prices, usually based on Computable General Equilibrium (CGE) models. These studies are based on different assumptions. Therefore, the results also vary. However, most studies agree on one proposition that due
to liberalisations following URA, none of these studies have specific results to likely increase in world prices of tobacco following URA.

In the short run, the increase in world trade will primarily be due to the market access stipulations. Domestic consumptions of tobacco vis-a-vis imports have been studied in 40 leading tobacco trading countries. Interestingly, imports in most of the countries are well above 5 per cent of domestic consumption requirements. Imports as a percentage of domestic consumption are given in this table. This figure was more than domestic consumption for countries like Belgium-Luxembourg. These countries import unmanufactured tobacco and export manufactured tobacco products like cigarettes. Countries with imports less than 5 per cent of consumption requirements are India, Pakistan, Zimbabwe and China. Malawi is an occasional importer but, imports during a year (1997) are more than the average annual consumption during the review period (1995-98). Again Zimbabwe and Malawi are least developed countries; therefore, the minimum market access commitment does not apply to them. However, if we assume that all these countries import from China, imports in China will be the stipulations on market access, the expected increase in imports in China will be 96,034 MT. India may have to further allow imports of 23,282 MT. As a result, the expected increase in world trade will be around 1,22,896 metric tonnes.

Table 4.4

Imports during Pre-Uruguay Round (PUR) and Uruguay Round Implementation (URI) years and expected increase in imports in selected countries

<table>
<thead>
<tr>
<th>Countries</th>
<th>Imports ratio</th>
<th>Consumption</th>
<th>5% of domestic consumption</th>
<th>Average (URI)</th>
<th>Expected increase</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PUR</td>
<td>URI</td>
<td>Metric tonnes</td>
<td>Metric tonnes</td>
<td>Metric tonnes</td>
</tr>
<tr>
<td>China</td>
<td>0.3%</td>
<td>05%</td>
<td>1,07,182</td>
<td>11,148</td>
<td>96,034</td>
</tr>
<tr>
<td>India</td>
<td>0.02%</td>
<td>0.08%</td>
<td>23,643</td>
<td>361</td>
<td>23,282</td>
</tr>
<tr>
<td>Pakistan</td>
<td>0.01%</td>
<td>0.60%</td>
<td>158</td>
<td>52</td>
<td>106</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>2.0%</td>
<td>1.60%</td>
<td>158</td>
<td>52</td>
<td>106</td>
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</tbody>
</table>


4.6 Section-V: TOBACCO TRADE POLICIES IN LEADING TOBACCO-TRADING COUNTRIES

4.6.1 United States of America (USA)

In order to protect domestic farmers from unusual imports of tobacco the Federal Government of the United States enacted a Domestic Content Law in the year 1993. This was however found to be inconsistent with the Tariff Rate Quota (TRQ) of 1.5 lakh ton for countries other than NFTA (North American Free Trade Agreement). Imports over the quota attract a punitive tariff at the rate of 350 per cent. The Tariff Rate Quota (TRQ) has to be distributed amongst suppliers or exporting countries. These countries are categorised as principal supplier, substantial supplier and others. India has been placed in the category of other suppliers.
The allocation of quotas to different countries and quotas used by these countries is given in WTO. The allocation of quotas, allocated to Brazil has been too high. Brazil has rarely been able to use the allocated quota, while countries in the other group have insufficient allocation of TRQ. In fact, TRQ allocation has been based on imports during the year 1990-92. The selection of reference year for allocation of TRQ has been done arbitrarily to favour Brazil, as imports from Brazil were maximum during these years.

The allocation of TRQ and prohibitive tariffs beyond the TRQ does not violate any existing WTO stipulations. However, the WTO has a built-in agenda for future negotiations and this includes a review of the agriculture agreement beginning in 1999 and spilling over into 2000. In such negotiations, India can afford to be more aggressive about phasing out the TRQ system, since these principles are essentially against WTO’s emphasis on multilateral liberalisation, although the present agreement on agriculture does permit exceptions.

US trade policy has always been influenced by the desire to pry open markets abroad, while resisting domestic opening up during the period following World War II. In the 1980’s, the United States Trade Representative’s (USTR) office used that threat of trade sanctions to open up markets in Japan, Taiwan, South Korea and Thailand. The US-Thai dispute went before GATT and GATT ruling that Thailand could not maintain restrictions, although legitimate health concerns were permissible. Similarly in the tobacco sector, US trade policy is now primarily driven by a desire to pry open the Chinese market.
4.6.2 European Union (EU)

The EU stipulates a maximum guaranteed production quota of 1,25,000 tonnes for FCV tobacco covering growers in member countries. EU has been providing product-based subsidy audit was supposed to decline. The increase in subsidy has been maximum for flue cured Virginia tobacco. This is most widely traded variety of tobacco in the world and higher subsidies are primarily intended to distort tobacco trade in the world. At the aggregate level, the EU spent 1,022 million ECU or roughly about 1 billion US dollars in the 2008 to support tobacco farmers. These figures for consecutive years (if available) would provide an idea about EU’s adherence to commitments made in WTO. At the farm level, the subsidy works out to about US $ 3 per kg of tobacco produced in the country. Incidentally, in Argentina, the corresponding figure is US $ 1.3 per kg. This amounts of 45 per cent of average domestic price of tobacco in Argentina. In Argentina, there is another way of supporting farmers. The special market through domestic cigarette manufactures. A similar fund has been raised in other countries like Bulgaria.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Oriental</td>
<td>2.28 to 3.75</td>
<td>2.28 to 3.76</td>
<td>2.50 to 4.13</td>
<td>Increasing</td>
</tr>
<tr>
<td>Burley</td>
<td>2.17</td>
<td>2.17</td>
<td>2.39</td>
<td>Increasing</td>
</tr>
<tr>
<td>Fire cured</td>
<td>2.39</td>
<td>2.39</td>
<td>2.62</td>
<td>Increasing</td>
</tr>
<tr>
<td>Virginia-Flue Cured</td>
<td>2.17</td>
<td>2.17</td>
<td>2.98</td>
<td>Increasing</td>
</tr>
<tr>
<td>Dark Air/Sun cured</td>
<td>2.17</td>
<td>2.17</td>
<td>2.39</td>
<td>Increasing</td>
</tr>
</tbody>
</table>

The EU however, does not impose TRQs like USA, it also regulates imports from other countries, as the import duty differs according to the category of the countries. In order to promote imports from developing countries, a Generalised System of Preference (GSP) has been in effect (in its present form) since July 1996. The difference in the rates of MFN and GSP duties are given below.

Table 4.6

Ad-Valorem and Specific duties on tobacco for MFN and GSP countries during initial and final implementing year

<table>
<thead>
<tr>
<th>Country group</th>
<th>Ad-valorem (%)</th>
<th>Ad-valorem (%)</th>
<th>Specific duty (ECU/Quintal)</th>
<th>Specific duty (ECU/Quintal)</th>
</tr>
</thead>
<tbody>
<tr>
<td>MFN</td>
<td>23.0</td>
<td>18.4</td>
<td>28-30</td>
<td>22-27</td>
</tr>
<tr>
<td>GSP</td>
<td>17.9</td>
<td>-</td>
<td>21-23</td>
<td>-</td>
</tr>
</tbody>
</table>


India, being a developing country, gets the benefit of GSP, GATT and the WTO function on the basis of the favoured nation (MFN) principle. It must be remembered that with a progressive reduction in imports duties the relative value of GSP countries over MFN are limited because of various reasons. For instance, the extent of rebate under GSP depends on the products categorisation, sensitive with 30 per cent of rebate in MFN duty and semi-sensitive with 35 per cent of rebate. FCV tobacco, widely traded in the world, is under the very sensitive category. Therefore the effective discount for India with a GSP status is only 15 per cent on import duties from countries with MFN status.

2 Tobacco Board, 2008.
Imports from least developed countries like Zimbabwe and Malawi enter duty free in the EU, although tobacco in these countries is grown in huge farms at commercial levels, compared to peasant farms in India.

The EU also follows a Graduation or Modulation policy to regulate imports from the developed world. The ancillary graduation clause stipulated that the country whose exports of the commodity of production covered by the sub-sector in a given sector exceeds 25 per cent of beneficiary country exports to the EU in that sector, will graduate from the sector. The graduation or modulation policy is based on the criteria of specialisation in a sector, weighted by the level of development. This is designed to redirect benefits from more developed to less developed countries. The Specialisation Index is based on the ratio of beneficiary country’s share of total EU imports in all sectors. The larger the sectoral proportion compared with the general proportion the greater the specialisation. The Development Index of a beneficiary country is calculated on the basis of a country’s per capita income and the level of its exports, as compared with those of other countries.

Child labour is also an issue in the EU, although this is a more important issue for garments or carpets than for tobacco. Child labour issues may surface before the WTO through a social clause. But pending that, since the tobacco sector does not employ child labour (with the exception of beedis), a yearly confirmation on the state of adherence to labour laws should be sufficient.
4.6.3 Japan

Japan is the world's fourth largest importer of tobacco. Japan has however pulled out of the Indian market since 1988. This is ascribed to poor quality, more specifically DDT residues. Japan imposes a DDT residue limit of 0.4 PPM, while the DDT residue in India ranges between 1 to 2 per cent. This is well below the CORESTA standards (6PPM), but as was mentioned earlier, an importing country can impose standards that are higher than international standards. There are other reasons for negligible exports to Japan. Earlier, trade in Japan was dominated by Japanese export houses like Okura, Mitsubishi and Mitsui. Gradually, international leaf tobacco merchants like Dimon and Universal replaced the business of domestic export houses. The international merchants prefer tobacco from countries—where they have larger stakes.

4.6.4 CIS countries

The former Soviet Union has been a traditional market for Indian cigarettes. This has however dwindled in recent years. Most cigarette multinationals have either acquired cigarette factories or have established their production facilities in most CIS and East European countries. These companies produce more than local requirements. These companies have their associates in various countries. Therefore, they prefer to import from those countries rather than from India.

4.6.5 Imperfections in world Tobacco Trade

A reference was made earlier to State Trading Enterprises (STE). Import decisions of government monopolies often lead to lack of transparency. There are a large number of countries where government parastatals still operate in the tobacco sector. The
countries or country groups with government monopolies in the tobacco trade are South-
East and Middle-East Asian countries. There are some Central European and North
African countries too. Some countries from the developed world like, France, Spain and
Italy also practice government monopolies in tobacco trade. A large number of these
government parastatals make trade decisions without inviting international bidding
through tenders. STEs are regulated under Article XVII of GATT and Article XVII was
also tightened up in the course of the URA to make decisions more transparent.

However, these monopolies will remain and will not become truly transparent
until the government procurement code becomes a multilateral agreement. WTO draws a
distinction between multilateral agreements and pluri-lateral ones; the later is often also
described as the GATT- plus system. Multilateral agreements are mandatory on all WTO
members. Although negotiated under the GATT or WTO umbrella, pluri-lateral
agreements are open for signature to those countries that wish to do so. They are not
mandatory and the government procurement code is such a pluri-lateral agreement. This
was first negotiated in the course of the Uruguay Round agreement to cover services and
procurement by sub-regional entities. But, as of now, it is only a pluri-lateral 1
agreement.

Over the years, the influences of Multinational Companies have also grown in
international trading. This is true for most agricultural commodities. International trade
in unmanufactured tobacco is dominated by three transnational merchants, namely.
Dimon International, Standard commercial and Universal Leaf. These three merchants
corner more than 90 per cent of world trade in unmanufactured tobacco. Trade between
countries is influenced and determined by associate companies of these multinationals in a country often determine trade flows of that country. The emergence of Brazil, Zimbabwe and Malawi in recent years is attributed to the influence of the aforesaid multinationals in these countries.

Similarly, 35 per cent of the world cigarette market is dominated by a few multinationals like BAT, Philip Morris, imperial, and Japan Tobacco. Often, trade is among the associates of these multinationals. If a transnational does not have an associate company in a country, the chances of trade with that country will be lower. Above all, these cigarette manufactures largely buy unmanufactured tobacco from the various sources of the three leaf merchants mentioned above. Therefore, trade is between these multinationals. There is hardly any provision in the URA that regulates trade between such transnational companies.

There have been growing instances of bilateral negotiations, circumventing the principles of multilateral negotiations. Trading blocs and regional arrangements, which work between governments or states, are one example of this and will be discussed in section VI below. But at a private or commercial level, counter trade has been on the rise in recent years. Unless such agreements are at the state or country level, they are outside the purview the purview of GATT or WTO disciplines.

There are also inter-country bilateral agreements that are not violative of WTO provisions. For instance, the share of the United States in tobacco imports in Japan was only 30 per cent in the mid-80s. In recent years, the figure has risen to 95 per cent. This has been possible due to bilateral trade negotiations between these countries, since there
was hardly any increase in export competitiveness of US tobacco during the reference years. As long as MFN principles are not violated, such agreements are WTO-compatible.

4.7 Section-VI: OTHER URA ISSUES

4.7.1 Trading blocs and regional arrangements

There are innumerable trading blocs in the world. These blocs are at different stages of integration. Conceptually, there can be four different types of blocs - first, there are free trade areas that remove barriers to trade (tariffs as well as NTBs) among members; second, there are customs unions, which also adopt a common commercial policy vis-à-vis non-members; third, there are common markets, which also remove barriers to cross-border movements of factor inputs like capital and labour among members; and finally, there are economic unions that involve co-ordination of macroeconomic polices among members. All four types of trading blocs, particularly the first two, can be found across the globe.

Although trading blocs, given their inherently bilateral character, ought to be illegal under GATT/WTO principles, they are perfectly legal. This is because of a grandfather clause that incorporated erstwhile trading blocs into the GATT system when GATT was first set up in 1947. Therefore, trading blocs are sanctioned GATT/WTO, provided that two conditions are met (Article XXIV). First, barriers to trade among members of the bloc must be completely eliminated (usually over a period of ten years) and not reduced in the process of bloc formation. This is to ensure that trading blocs are not used as a means to violate the MFN principles. The second requirement concerns relations among bloc members and the rest of the world must not go up. Operationally,
however, neither of these restrictions has much meaning, especially the latter. These
days, major barriers to trade are in the form of NTBs rather than tariffs and NTBs are
impossible to quantify, monitor or enforce.

A non-member trading blocks in principle, can have both positive and negative
effects. Positive effects usually emerge as a result of increase in income from within the
bloc, associated with bloc formation because exploitation of economies of scale is often
involved. As income within the bloc goes up, the demand for imports form the rest of the
world. This is known as investment creation. As employment within the bloc goes up,
protectionist pressures decline. But in addition to the positive effects, negative effects are
also possible. For example, even though India is a more efficient producer of a good
service, imports may take place from some other country simply because that other
country is a member of the bloc. This is known as investment diversion.

The international trading system seems to be breaking up into a tri-polar world.
The first pole is the EU, which through a hub and spoke kind of system, is also likely to
spill over into Eastern Europe and lead eventually to a greater European Economic Area.
The second pole is centred in North America through the North America as well. The
contours of the third pole are not yet clear, but will be clearly centred on ASEAN
(Association of South East Asian Nations). India is not a part of any of these poles, nor is
it likely to be one. Therefore, issues of trade or investment diversion become important.

Whether it is the EU or NAFTA, trade diversion seems unlikely. Even if it
happens, it is unlikely for the tobacco sector (it is more likely in a sector like textiles and
garments). However, investment diversion is a different matter. With the EU, it is more
likely to happen for textiles and garments. But NAFTA is different matter and investment diversion is not only possible in sectors like automobiles and ancillaries, but also for tobacco. Both Philip Morris and British American Tobacco (BAT) have had increased investments in Mexico. Spurred by NAFTA, such investments and acquisitions are designed not only for domestic Mexican markets, but also for re-exporting to elsewhere in Latin American and Asia.

India, together with other parts of South Asia, is among the few countries in the world that is not a member of any effective trade bloc. The South Asian Preferential Trade Agreement (SAPTA) is yet to effectively take off and prospects of something happening in the Indian and Pacific Ocean (involving South Africa and Australia) are not too bright. Within SAPTA, there have been limited initiatives towards a south Asian Free Trade Agreement (SAFTA) and bilateral free trade agreements with Sri Lanka. If quantitative restrictions to trade within the region are eased, there is the question of arbitrage based on differences in import duties and indirect or direct taxes. Cigarette smuggling into Sweden from East Europe (Dennis Duncan 1998 or into Britain from Belgium are examples. With lower import duties in Nepal or Sri Lanka, rerouting of cigarette imports into India is possible since rules of origin requirements are always difficult to implement. Incidentally into India is possible, since rules of origin requirements are always difficult to implement. Incidentally, India does not have a policy on parallel imports, where imported duties were historically high and quantitative restrictions on imports existed, this was not an important issue. But with liberalisation, parallel imports have begun to take place in the consumer goods sector. Case law in the United States, EU and Canada indicates that it might be difficult to rule that parallel
imports are illegal. The answer therefore lies in rationalising and reducing domestic indirect taxes so that the pecuniary incentive of imports, parallel or otherwise, is removed.

4.7.2 Trade–Related Investment Measures (TRIMs)

The Uruguay Round was the first GATT negotiating round at which Trade Related Investment Measures (TRIMs) were discussed. TRIMs are measures on violate GATT/WTO norms on national treatment and prohibition of quantitative restrictions on imports. Such TRIMs are prohibited and the illustrative list of prohibited TRIMs includes local content requirements, trade balancing requirements, dividend balancing, foreign exchange balancing requirements and stipulations that link access to foreign exchange to foreign exchange receipts.

The Phased Manufacturing Programme (PMP) incorporated elements of local content requirements in India. Following reforms since 1991, local content requirements have been given up. They only exist now in the form of Memoranda of Understanding (MoU) imposed on automobile manufacturers. Another TRIMs that is included in the prohibited list is the dividend balancing requirement that is imposed for Foreign Direct Investments (FDI) in the consumer goods sector. At the moment, the prohibition on TRIMs does not apply to India, since a country that invokes article XVIIIB is freed from the prohibition. But as was mentioned earlier, India may not have recourse to Article XVIIIB for very long. Once that happens, these two TRIMs measures will have to be phased out. The time frame for phasing out is two years for developed countries and five
years for developing countries. Therefore, these TRIMs will have to be phased out by 2000, in which year, a review of the TRIMs agreement is also scheduled to take place.

As of today, the TRIMs agreement does not prohibit excluding certain sectors from FDI or imposing maximum foreign equity participation limits in such sectors. But these concerns the TRIMs agreement as it stands today. In future negotiations, the TRIMs agreement is likely to be amended further. For example, the Organisation for Economic Co-operation and Development (OECD) has been pushing the idea of a Multilateral Agreement on Investment (MAI). The MAI is not yet a part of the WTO negotiations, it is not clear that will be a multilateral agreement as opposed to a pluri-lateral one. If as and when the TRIMs agreement comes up for re-negotiations, the Indian strategy ought to be to link up free cross-border movements of capital with free cross-border movements of labour. The services agreement of URA already permits this *quid pro quo* for cross-border migration of temporary and skilled personnel. In addition, India can link this up with a WTO-administered competition policy to curb restrictive and unfair business practices indulged in by transnational companies. Following the Singapore Ministerial Meeting of the WTO in December 1996, the WTO already has working groups on trade and competition policy and trade and investment policies. The working groups have not however amounted to much yet, in concrete terms.

4.7.3 Trade-Related Intellectual Property (TRIPs)

As in the case of TRIMs, the Uruguay Round was the first GATT negotiating round at which TRIPs or trade-related intellectual property rights were discussed. Seven different forms of intellectual property are discussed in the URA—patents, copyrights,
trademarks and industrial. For each of these, certain norms are prescribed. There is also a period of transition as the norms do not necessarily have to be attained overnight. There are also requirements on better enforcement and stipulations that criminal remedies must be available (in addition to civil remedies) for infringement of intellectual property.

Barring patents, the Indian legislation is more or less in line with the URA provisions. The Copyright Act was amended in December 1994 and an amendment to the Trade and Merchandise marks Act is expected soon. The URA does not require specific legislation on geographic indications, integrated circuits or undisclosed information. It is enough that these be protected through some statute or the other. But there is draft legislation on geographical indications and integrated circuits, waiting to pass by parliament.

There are no clear links between the URA provisions on TRIPs and the tobacco sector for these six forms of intellectual property. Even for patents, the link is not very obvious. There are two elements to what is required under the patent provisions. As on today, the Indian patents Act of 1970 only permits process patents the patent applications and drugs and the duration is seven years from the date of filing shorter. In sectors other than food are chemicals and drugs, the present duration of product patents is fourteen years. The URA requires that product and process patents must uniformly be available in every sector for twenty years. Importation of a product into India will be regarded as equivalent to the working of a patent in India and the compulsory licensing provisions will be tightened up so that execution of compulsory licenses will no longer be that easy. These provisions are in line with the Paris convention, to which, India was not a

The required norms for patents do not have to be introduced overnight, that is, from January 1st 1995, when the Uruguay Round Agreement entered into force. A period of transition is permitted. This amounts to ten years, as one year is granted as a general exemption, four additional years are granted to developing countries and an additional five years are granted to countries that have to change their legislation. So India has till the year 2005 to bring about required changes. However, from January 1995, India should have begun to accept applications for product patents and granted Exclusive Marketing Rights (EMRs) for five years to such applicants. Since India failed to do this, India lost disputes before WTO with the United States and EU and required changes later introduced later through an ordinance.

4.7.4 Dumping and Subsidies

The agreements on export subsidies and unwarranted export subsidies can lead to the imposition of countervailing duties. Conceptually, the agreements on subsidies and countervailing duties and anti-dumping duties are similar.

Contrary to popular impression, dumping is not illegal under GATT/WTO norms. For dumping to be illegal, three conditions must be satisfied. First, there must be an act of dumping. Second, there must be injury to domestic industry. Third, there must be a causal relationship between the act of dumping and the injury. All three conditions have to be satisfied before anti-dumping duties can be imposed. Dumping is defined as
exporting a product at a price that is lower than the price at which it is exported to a third country or exporting a product at a price lower than the cost of production, with reasonable mark-ups for profits, marketing and distribution.

An investigation on dumping can be initiated if the application is supported by producers who account for at least 50 per cent of the value of domestic production. If some domestic producers are indifferent to the issue, 25 per cent of producers who are not disinterested will suffice. Anti-dumping investigations will be terminated if the margin of dumping is minimal. This means that the margin of dumping investigations will also be terminated if the share of dumped imports is less than 3 per cent of the total imports of a like product in the importing country (The only 3% share collectively account for more than 7% of imports of the like product in the importing country). In the process of anti-dumping investigations, consumers or consumer groups (who are likely to benefit from dumping) must be consulted. When anti-dumping duties are imposed, they can be equal to the margin of dumping or the margin of injury. Developed countries like the United States and EU normally impose anti dumping duties that are equal to the margin of dumping. In India, the lesser duty principle is followed. That is, the anti-dumping duty is equal to the lower of the two, the margin of dumping or margin of injury. There is a sunset clause. Without a fresh review, the duration of anti-dumping duties cannot exceed five years. In the implementation of the anti-dumping agreement, India faces severe systemic problems. Because of lack of personnel, anti-dumping investigations often take two years to complete, contrasted to two months in some developed countries.
Anti-dumping investigations are against a company. Anti-subsidy investigations are directed against exporters from a country if unwarranted or red export subsidies are used. Anti-subsidy investigations will be dropped if the margin of subsidy is de minimis, or less than 1 per cent for developed countries and less than 2 per cent for developing countries. A special clause for India makes this percentage less than 3 per cent until the year 2003. Anti-subsidy investigations against developing countries like India will also be dropped. If the market share in the importing country is less than 4 per cent, unless such countries collectively account for a market share of more than 9 per cent. And there is a sunset clause. Without further reviews, countervailing duties cannot continue for more than five years.

4.7.5 Safeguards

The safeguards clause permits a temporary deviation (normally not more than 4 years) from WTO principles, in the form of re-imposing or retaining quantitative restrictions or in the of deviating from requirements of tariffs. Because such measures are temporary, the proof requirements are weaker than anti-subsidy investigations. Any temporary import surge that hurts domestic industry will suffice. Under Article 5 of the URA on agriculture, there is a special safeguards clause with automatic triggered points in addition to the general safeguards agreement. The special safeguard clause is easier to invoke than the general safeguards clause, although India did not opt for using Article 5 when the Uruguay Round agreement was signed. The reasons for opting out are not very clear.
This chapter mainly discusses the WTO agreement and its implication on Indian Agriculture Sector, international trade in tobacco the Uruguay round agreement, the international tobacco market following Uruguay round agreement, impact of Uruguay round on world tobacco prices and trade, tobacco trade policies in leading tobacco trading counties and trading blocs and regional agreements. In addition this chapter also covered trade related investment measures, trade related intellectual property right, dumping and subsides, safeguards under WTO agreement.