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**IMPACT OF WTO
ON
MARKETING COOPERATIVES**



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FOREWORD

When GATT was set up, the issue of State Trading was on the agenda, primarily to address the needs of few member states which were centrally-planned economies. However, it received scant attention and the only provision to address the operations of the State Trading Organisations was in Article XVII. With the passage of time, many market-based economies such as Australia and Canada have introduced extensive State Trading operations, especially in agriculture, to achieve diverse socio-economic objectives.

In India, State Trading was conceived and used as an important instrument of trade policy between the 1960s and 1980s. State Trading enterprises were at the forefront to operationalise the government's strategy of product and market diversification in exports. These were also assigned responsibilities for undertaking import operations at the behest of the Central Government in larger public interest such as availability of essential consumer items at affordable prices.

Since State Trading has become quite pervasive in agriculture and China is already a member of the WTO and Russia negotiating for entry, it is inevitable that the issue of State Trading will come under closer scrutiny now. The mandated negotiations under Article 20 of the Agreement of Agriculture have State Trading as one of the topics for negotiations. We hope that this study will help clarify the issues and developing country positions for the forthcoming negotiations.

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NEW DELHI
January 2002

Impact of WTO on Marketing Cooperatives

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MARKETING Cooperatives come under the purview of the WTO only when these get covered under the ambit of Article XVII of the GATT 1994. This is the principal Article dealing with the operations of the State Trading Enterprises. The basic purpose of Article XVII is to ensure that such enterprises act in accordance with the general principles of non-discrimination in their purchases or sales involving either imports or exports. Further, their decisions on imports and exports are to be guided only by commercial considerations. The two major provisions of Article XVII are as follows:

- 1a. Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges, such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.
- b. The provisions of subparagraph (a) of this paragraph shall be understood to require that such enterprises shall, having due regard to the other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

In simpler terms, Article XVII imposes the following discipline.

- Observance of the principle of non-discriminatory treatment.

- Transactions are to be made solely in accordance with commercial considerations.
- Allows foreign enterprises adequate opportunity to compete in accordance with customary business practice.
- Negotiates to limit or reduce trade obstacles which may be the result of the operations of the STEs.
- Sends notification on STE operations to GATT, provides information on import mark-ups and resale prices and if asked for, gives information on STE operations, though confidential information which may impede law enforcement or be prejudicial to public or legitimate commercial interest need not be disclosed.

Scope

Article XVII.2 limits the application of the Article to only commercial purchases:

“The provision of paragraph 1 of this Article shall not apply to import of products for immediate or ultimate consumption in Government use and not otherwise for resale or use in the production of goods for sale”.

The ad article clarifies that the term "goods" is limited to products as understood in commercial practice, and is not intended to include the purchase or sale of services. Secondly, paragraph 1(a) of the interpretative notes to Article XVII provides “Governmental measures imposed to ensure standards of quality and deficiencies in the operation of external trade, or privileges granted for the exploitation of national natural resources but which do not empower the Government to exercise control over the trading activities of the enterprise in question, do not constitute exclusive or special privileges”.

Other Relevant Articles

The GATT/WTO disciplines on state trading are contained, in addition to Article XVII, in

Article 2:4	-	Market access
Article XI	-	Quantitative restrictions
Article XII	-	Restrictions to Safeguard the BOP

Article XIII	-	Non-discriminatory administration of QRs
Article XIV	-	Exceptions to rules of non-discrimination
Article XVIII	-	Govt. assistance to economic development.

The interpretative note clarifies that the terms "import restrictions" or "export restrictions" include restrictions made effective through state trading operations.

Article 2:4 imposes an important obligation on STEs. It provides that they should not grant import protection above the bound tariff schedules under GATT Article II.

Article II

If any contracting party establishes, maintains or authorises, formally or in effect, a monopoly of the importation of any product described in the appropriate Schedule annexed to this Agreement, such monopoly shall not, except as provided for in that Schedule or as otherwise agreed between the parties which initially negotiated the concession, operate so as to afford protection on the average in excess of the amount of protection provided for in that Schedule. The provisions of this paragraph shall not limit the use by contracting parties of any form of assistance to domestic producers permitted by other provisions of this Agreement.

To sum up, the GATT/WTO regime does not disallow STE operations. But to be WTO-compatible, it must observe the following practices:

- (i) It must be non-discriminatory in its transactions. It can practice discriminatory pricing strategy but it must be based on legitimate commercial considerations. This may be based on the market power of an STE and may also distort trade but it will not violate WTO rules.
- (ii) Political and other strategic considerations should not be the basis of commercial transactions of STEs.
- (iii) Imports are to be treated no less favourably than national products.
- (iv) Disciplines relating to export and import restrictions include STE operations.

It should be noted that the GATT discipline on STEs is more of an attempt to influence their behaviour rather than specific constraints and commitments.¹

What Is an STE?

The GATT 1947 had, however, not provided any definition of what constitutes State Trading. In the Uruguay Round, the member countries negotiated a WTO Understanding on the interpretation of Article XVII. Paragraph-I of this Understanding provided a working definition of what may constitute a State Trading Enterprise. Paragraph-I of the Understanding is as follows:

“Government and non-government enterprises, including Marketing Boards, which have been granted exclusive or special rights or privileges including statutory or constitutional powers in the exercise of which they influence through their purchases or sales the level or direction of imports and exports.”

This definition has three fundamental elements:

- (i) A governmental or non-governmental entity, including Marketing Boards;
- (ii) The granting to the enterprise of exclusive or special rights or privileges; and
- (iii) A resulting influence, through the enterprise's purchases or sales, on the level or direction of imports or exports.

It is clear from the above definitions that the State Trading Enterprise as defined in Article XVII need not be a government entity. A Working Party constituted on the basis of para-5 of the Understanding of Article XVII has prepared an illustrative list of possible relations between an enterprise and a government which may indicate existence of State Trading.

The following types of relationships giving rise to a State Trading Enterprise are identified:

The enterprise which is granted exclusive or special rights or privileges in the exercise of which it influences through its purchases or sales the level or direction of imports or exports is:

- (a) a branch of government or a government-owned or partially owned enterprises; or

- (b) entirely separate from government i.e. neither a branch of government nor fully or partially owned by the government, whether established to carry out government mandated policies or programmes subject to legislated controls, or whether established for commercial purposes; this includes entities which are established and maintained under legislation and financed and controlled by the producers of the products over which they have marketing authority.

In addition, the enterprise purchases or sells a given product or group of products, either directly or indirectly through third parties under contract or transfer of right; and one or more of the following applies:

- (i) The enterprise is specially authorised or mandated by the government to do one or more of the following:
- Control and /or conduct import or export operations
 - Distribute imports
 - Control domestic production, processing, or distribution
- (ii) All or part of the “enterprises” activities are started by government in one or more of the following ways and the support provided is specific or more favourable to the enterprises and not generally available to other entities or is not warranted by purely commercial considerations.
- budget allocation
 - interest rate/taxes concessions
 - guarantees (e.g. for loans or against business failure)
 - revenue from the collection of tariffs
 - preferential access to foreign exchange
 - any off-budget support or assistance.

However, it is the right of a member government to decide whether a particular entity should be treated as an STE.

Activity Profile of STEs

The activities of an STE as defined under the Understanding are diverse and may include the following:

- (i) Controls or conducts imports or exports;
- (ii) Administers multilaterally or bilaterally agreed quotas, tariff quotas or other restraint arrangements, or other import or export regulations;
- (iii) Issues licence/permits for importation or exportation;
- (iv) Determines domestic sales prices of imports;
- (v) Enforces the statutory requirements of an agricultural marketing scheme and/or stabilisation arrangement;
- (vi) Authorises or manages domestic production and/or processing of domestic production;
- (vii) Determines the purchase price and/or sales price of domestic production;
- (viii) Manages domestic distribution of domestic production and / or imports;
- (ix) Undertakes purchases and sales of domestic production based on pre-determined floor and ceiling prices (intervention purchases/sales);
- (x) Issues credit guarantees for producers, processors, exporters, or importers;
- (xi) Engages in export- and support-related activities such as storage, shipping, processing, packaging, and insurance;
- (xii) Controls or conducts marketing or distribution of processed products through subsidiaries or joint ventures in import markets;
- (xiii) Exercises quality control functions for imports or domestic production, including for export;
- (xiv) Engages in promotional activities for exports and/or domestic consumption;

- (xv) Procures and maintains emergency stocks of certain strategic and/or agricultural goods;
- (xvi) Negotiates or administers long-term bilateral contracts (including government-to-government) for exports and /or imports; and
- (xvii) Undertakes purchases or sales necessary to fulfil contractual obligations entered into by the Government.

STEs in Agriculture

STEs engaged in international trade are to observe the disciplines of the Agreement on Agriculture. Article 4:2 on Market Access provided that the non-tariff barriers which are to be converted into tariff equivalents include non-tariff measures maintained through STEs. Further, the member countries are required to provide information on the administration of market access commitments. If such commitments are administered by STEs, details about the enterprise and its relevant activities are to be submitted. The export subsidy commitment includes subsidies provided by the STEs. Export subsidy not subject to reduction cannot be operated in a manner which may allow a member government to circumvent to commitments to reduce export subsidies including subsidies provided to or by STEs. The obligation with regard to AMS includes budgetary support and revenue forgone by the STEs.

The Agreement on Agriculture (AoA) does not mention specifically State Trading in relation to circumvention of commitment on export subsidy reduction. Some member countries have recently expressed concern about practices of some Commodity Boards which have the effect on export subsidy but are allowed by the WTO. If the export subsidies which are subject to reduction under Article 9 of the AoA, are received by an STE, the reduction commitment will apply. Article 10 provides that export subsidies not indicated in Article 9 should not be applied in a manner which may result in circumvention of export subsidy commitment. It has been observed that some Marketing Boards and STE exporters do not release information on their export sales and therefore, it is not possible to find out whether any export subsidisation and circumvention is involved. The lack of transparency is normally sought to be justified on the ground of confidentiality required for successful export operations.

STEs in Mandated Negotiations

STE operations had never been in the mainstream activity of GATT. The recent focus on STE operations is attributed to three major reasons.

- (i) WTO commitments and obligations might be circumvented through the STEs which can administer tariff quota system and which might adversely impact market access, either explicitly or implicitly.
- (ii) STEs can use their monopoly power to distort trade and create unfair competition.
- (iii) The accession of Russia and China to the WTO, where STEs are still important, raises the need for a proper and transparent discipline for STE operations.

The major concerns currently being expressed with respect to STE operations can be classified into two broad categories:

- Issues relating to transparency
- The market-distorting capacity of some types of STEs.

As to the former, the notification requirements under Art XVII and the understanding has not resulted in a transparent database on how STEs operate and even what makes an entity or STE.

The current level of discipline of the WTO relating to STEs is fairly weak and the monitoring is done through the notification system which gives the right to the member-states to decide which agency is to be notified. Art XVII provides for the following to be notified:

- an enumeration of STEs
- the reason and purpose of STE operations
- functional description, e.g. whether the STE is engaged in exports/imports, whether private parties are allowed, formula for calculation of mark-ups, etc.
- data on total exports and imports and STE shares.²

The issue of transparency is also linked to the question of circumvention. For example, if an STE operates or controls the procurement and sale of the product, it can easily subsidise exports

over domestic sales. The URAA has not specifically linked the export-marketing practices of STEs to the discipline of URAA.³

Since some export marketing practices of agricultural STEs are not categorised as export subsidies under URAA, it may be possible to circumvent the export subsidy commitments through STE operations.⁴

The second issue is of market power of STEs which can affect trade prospects and market access of competitors. In US terminology, what in India is termed as canalising agencies, is known as single-desk buyers and sellers. USA which is at forefront of reforming the STE operations in international trade has identified the distortions that can be created by such entities. The single desk sellers, i.e. having monopoly right to export, quite often get benefits from the government either directly or indirectly. As these are mostly government/government supported agencies or undertake the export/import operations at the instance of the government, their operational losses can be reimbursed by the government. Single desk sellers, if granted also the exclusive right of purchase domestically, can operate like a monopsonist. It may, therefore, impose a price of its choice on the producers. This can theoretically help an STE to charge lower prices in the export markets or go for price discrimination across several markets. While lower prices charged for exports by an STE can increase consumer welfare, it can lead to increased imports in the partner countries. In extreme cases, the power price discrimination may also lead to predatory pricing practices which means a single desk seller lowers its price to a level which drives out other competitors and then, it itself raises the price.⁵

Single desk buyers, i.e. monopoly buyers, can also act in a manner which can restrict import trade. They are non-transparent regarding their purchases and this lack of information creates hurdles for exporters to do legitimate business. They can impose import conditions in such a way that imports will get restricted. Single desk importers can be used by the government to attain other policy objectives such as restrictions of certain types of imports. They can take their purchase decisions based on government criteria and not on commercial considerations.⁶

While these are economically valid arguments in general, they do not apply to all STEs. It is, therefore, necessary to identify those STEs

that can distort trade more than others and, therefore, need to be liberalised.

Dixit-Josling have developed a framework which classifies STEs according to their potential for trade distortions. The classification scheme is mentioned in the table.⁷

TABLE
CLASSIFYING STEs BASED ON THEIR CONTROL OF
DOMESTIC MARKETS AND TRADE

<i>Type</i>	<i>Trade controls</i>	<i>Domestic market controls</i>	<i>Potential for trade distortion</i>
Type I	No	No	Negligible
Type II	No	Yes	Low
Type III	Yes	No	Moderate
Type IV	Yes	Yes	High

Source: State Trading in Agriculture: An Analytical Framework, International Agricultural Trade Research Consortium Working Paper No. 97-4.

Following the Uruguay Round Agreement on Agriculture terminology, the Types I and II can be placed in the green category, Type III in the amber and Type IV in the red category. It is evident that in mandated negotiations, the focus should be only on Types III and IV types of STEs, possibly only on Type IV.

Submissions before WTO

More than 10 submissions have been made on how the STE regime and discipline need to be reformed. A synoptic view of the submissions can be had from Annex 1. USA has made the strongest demand for the elimination of exclusive export rights. Its principal aim is to neutralise the operations of Australian and Canadian Wheat Board. Most other submissions focus on transparency and the need to avoid circumvention through STEs. Given the fact that some developed and developing countries will find STE operations useful for various societal reasons, it is highly unlikely that US demand will find a favourable response. But it is equally clear that the discipline for both notifications and circumvention will be negotiated with stricter norms.

In the context of WTO negotiations, the two most important issues concerning STEs are:

- For export-oriented STEs, whether the URAA discipline on subsidies is being circumvented.
- For import-oriented STEs, the question is whether these impose non-tariff barriers through their operating practices, thereby negating the market access gained under tariff negotiations.

In the Indian context, appraisal of STEs, broadly-defined to include any entity enjoying any special privileges, reveals that the basic objective is not trade but other social objectives, such as price support measures or to provide marketing support to the weaker section of society, as in the case of Niger seeds. Trade operation is the consequence rather than the *raison d'être* for those entities. The trade operations of organisations such as NAFED and TRIFED are not really directed to export maximisation and therefore, their impact on trade distortions may be minimal. This will be more so, because their domestic operations are contestable, i.e., private parties are also allowed to participate in the domestic segment of the trade. Further, the commodities handled by such agencies are hardly of any consequence to global trade in terms of value. India in its submission on food security has emphasised the right to livelihood. It is possible to justify STE operations of marketing societies citing this argument.

The real problem may arise with the Export Import Policy provision of 2001-02 which has technically removed the word canalisation and substituted by the terminology of state trading and on the face of it, made import/export of some items under STEs, consistent with the provision of Art XVII. This will automatically bring these listed entities under the notification system. As a result, these will also be subject to negotiations on strengthening the notification process and transparency in operations. (Annexure 2)

Another major issue will be the circumvention. To take an example, wheat is being sold to STEs and other entities at a price predetermined by the Government of India which is lower than the domestic price, Indian wheat is currently not price competitive in the global market. But since the purchase price through this mechanism has been kept low, it has become possible to export some quantities of wheat. The

issue is whether this would be considered as circumvention of the export subsidy discipline.

Special and differential (S&D) treatment has not received much attention in the submissions. Only Mauritius has focused on the special role that STEs can play in economies where volume of trade is small. It appears in the context of India where STE operations in trade are at least in some cases, associated with social responsibilities such as minor forest products or price-support operations as in the case of onions, should also be proposed to fall under S&D provision.

Current negotiations may also attempt to provide clarifications on how to interpret Article XVII provisions. The major points are:

- Definition of enterprises to be covered
- What is meant by "commercial consideration"
- What is meant by "legitimate commercial interests"?
- What does constitute "exclusive or special privileges"?
- Must the enterprise make purchase or sales to be designated as an STE under GATT rules?

Exclusive or special rights or privileges can take various forms. These may be statutes or decrees establishing the STE as sole importer/exporter, authorisation to export government surpluses or import for government inventory building, authority to set producer or consumer prices in the domestic market or act as exclusive distributor of domestic production or imports. Privilege can also be financial such as government grants, loan guarantees, underwriting of operational costs or priority for obtaining foreign exchange. Given such diversity, it is extremely difficult to define STEs with respect to the criterion of special rights or privileges.

There can be agencies that do not actually get involved in purchase or sales but by using the authority granted to them, they can affect the level and direction of exports and imports. For example, an agency having the authority to disburse the import/export quota will have such an ability, even though it does not actually do buying and selling. The impreciseness in definition results in confusion as to which agencies

are STEs and, therefore, are to be notified to the WTO. As a result, analysis of notifications submitted to the WTO reveals that many identifiable STEs do not figure in the notifications.

Conclusions

It is evident from the above analysis that the ongoing negotiations on AoA can have a decisive impact on the marketing cooperatives, if their activities and their relationships with the Government are such that they could be designated as STEs under the working definition of understanding. Since the Marketing Cooperatives help achieve certain social objectives as formulated by the Government, it will be necessary to work out new types of modalities so that the institutions can go on functioning, as in the past, without being inconsistent with the emerging WTO obligations.

It is difficult to predict in what direction the WTO will move in terms of making the discipline more rigorous for the STEs. Some of the options identified are as follows:

- (i) To maintain the principle of freedom of operation but strengthen the behavioural rules for the enterprises, complimented by domestic enforcement mechanism,
- (ii) To seek agreement that certain types of STEs and policies are to be prohibited,
- (iii) To strengthen the ability of market participants to contest the exclusive rights granted to STEs, may be, through judicial intervention, and
- (iv) To introduce a necessity clause similar to those in Article XX of the GATT, i.e., granting of exclusive rights is necessary to the Government's objective and that the measure used is the least trade distorting method.

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ANNEXURE I

SUBMISSION ON STEs UNDER ARTICLE 20 NEGOTIATIONS

EU (W 34) (W 90)	EU is of the opinion that WTO rules and regulations applying to STEs should be strengthened. EU asks for increased transparency on the activities of STEs, stricter notification requirements regarding indirect subsidisation of exports and further disciplines to limit the anti-competitive effect of STEs in international trade of agricultural and food products.
	EU also proposes that in respect of the operation of STEs, cross-subsidisation, price-pooling and other unfair trade practices in exports should be abolished.
Norway (W101)	Norway is of the opinion that the subsidy element of all forms of export competition measures, such as direct export subsidies, export credits, state trading export enterprises and food aid, are treated equally in the continuation of the reform process
Poland (W 103)	The WTO Members should undertake negotiations to establish complete list of all forms of subsidies, including specific forms of food aid, exports credits and STEs' activities.
Mercosur (W 104)	Members should agree to discipline the activities of governmental and non-governmental enterprises and marketing boards which benefit from monopoly import/export rights, with a view to avoiding distorting effects on the market.
ASEAN (W 55)	In order to improve transparency with regard to the operation of STEs, the volume and price of exports and imports for respective trade partners should be notified.
Japan (W 91)	Since state trading has a significant impact on the market, appropriate disciplines should be established in order to improve its transparency and predictability.
	(1) It should be made mandatory to provide notifications about export and procurement prices, (2) financial assistance from government should be prohibited, (3) STEs should contribute to the stabilisation of international market through minimum exports and stock holding for unforeseen circumstances.

Switzerland (W 94)	Disciplining export competition should include tax subsidies, State trading, price pooling and export credits.
Mauritius (W 96)	<p>STEs can have important role to play in an SIDS. Therefore should be carefully dealt with.</p> <p>All questions relating to STEs should be addressed under Article XVII of GATT 1994.</p>
Korea (W 98)	<p>More effective disciplines on export-related measures such as export subsidy, export credit, export restrictions, export tax and export STEs.</p> <p>Secure transparency in the operation of STEs and to prevent their circumventing of reduction commitment in export subsidy.</p>
USA (W 15)	<p>To end exclusive import rights to ensure private sector competition in markets controlled by single desk importers.</p> <p>To establish WTO requirements that increase transparency in the operation of single desk importers, including their decisions on quality and source of imports.</p> <p>To end exclusive export rights to ensure private sector competition in markets controlled by single desk exporters.</p> <p>To establish WTO requirements for notifying acquisition costs, export pricing, and other sales information for single desk exporters.</p> <p>To eliminate the use of government funds or guarantees to support or ensure the financial viability of single desk exporters.</p>
Mexico (W 138)	Disciplines should be established to regulate the activities of state trading companies to ensure that their operations do not cause distortions in international agricultural trade.

ANNEXURE 2

AGRICULTURAL ITEMS UNDER STE OPERATIONS

<i>Sl. No.</i>	<i>Exim. No.</i>	<i>Item description</i>	<i>Condition relating to Policy</i>
1. IMPORT ITEMS			
1.	10011000.20	Duram wheat (not seed)	FCI
2.	10019002	Wheat (not seed)	FCI
3.	10019003.90	Meslin (not seed)	FCI
4.	10020000.20	Rye (not seed)	FCI
5.	10040000.20	Oat (not seed)	FCI
6.	10059000.20	Maize (not seed)	FCI
7.	10061000.90	Other rice in husk (paddy or rough) (not seed)	FCI
8.	10062000	Husked (brown) rice	FCI
9.	10063001	Rice, parboiled	FCI
10.	10063002	Basmati rice	FCI
11.	10063009	Rice except parboiled (excluding basmati rice)	FCI
12.	100640.00	Broken rice	FCI
13.	10070000.20	Grain sorghum (not seed)	FCI
14.	10081000.90	Buck wheat (not seed)	FCI
15.	10082001.90	Jawar (not seed)	FCI
16.	10082003.90	Bajra (not seed)	FCI
17.	1008204.90	Ragi (not seed) (finger millet)	FCI
18.	10083000.90	Canari seed	FCI
19.	10089000.90	Other cereals (not seed)	FCI
20.	12030000	Copra	STC and HVOC

<i>S.No./ Code No.</i>	<i>Item</i>	<i>Name of agency</i>
2. EXPORT ITEMS		
1.0703	1. Onions (all varieties other than Bangalore rose onions and Krishnapuram onions)	Export through NAFED, KAPPEC, MASAMB, GAIC, AP MARKFED, NCCF, STCL, AP-State Trading Corporation & KSCMF as per notified ceiling subject to conditions laid by DGFT from time to time by Notifications.
	2. Bangalore rose onions and Krishnapuram onions	Export through KAPPEC and AP MARKFED without ceiling subject to conditions laid by DGFT from time to time by Notifications.
2.1207	Niger seeds	Export through TRIFED (to all permissible destinations other than USA) in accordance with the direction issued by the DGFT from time to time. For export of Niger seed to USA, the following canalising agencies may undertake exports directly or may register qualified exporters to whom permits may be granted for undertaking export of Niger seeds: 1. The National Agriculture Cooperative Marketing Federation of India (NAFED) 2. The National Dairy Development Board 3. The Madhya Pradesh State Cooperative Oil Seeds Grower Federation Ltd 4. The Karnataka State Agricultural Produce Processing and Export Corporation and 5. Bihar and Andhra Pradesh Government nominated agencies.
3.1301	Gum karaya	Export through the Tribal Cooperative Marketing Federation of India Limited (TRIFED), New Delhi

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