A dialogue on trade and development in South Asia
Vol. 2, No. 3, 2006

# TRADE insight

# Trade and poverty

## CASES FROM SOUTH ASIA

VULNERABILITY AND SMALL LDCs | OECD FARM SUPPORT AND NEPAL | ASIAN DRIVERS

A dialogue on trade and development in South Asia Vol. 2, No. 3, 2006

TRADE insight

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editors' note

# Need to link trade liberalisation in South Asia with poverty reduction

SRI Lanka was the first country in South Asia to pursue economic reform as early as 1977. Bangladesh, India, Nepal and Pakistan followed suit during the late 1980s and early 1990s. Trade liberalisation measures are an important element of economic reform implemented by these countries and consist of reduction and rationalisation of tariffs, elimination of import license and quotas, introduction of flexibility in the exchange rate and implementation of full convertibility of their currencies in the current account, among others.

These countries have not only seen expansion in exports but have also achieved impressive economic growth in the post-reform period. In Bangladesh, gross domestic product (GDP) growth in the 1980s was 3.5 percent as against 4.8 during 1990-2004. In Nepal, liberalisation resulted in accelerated growth in the non-agricultural sector with growth rate averaging 7 percent during 1986-1995. India's growth also rose following the reforms in the early 1990s and reached 8.5 percent during 2003-04. Pakistan witnessed fluctuations in GDP growth, mainly due to exogenous factors. The GDP growth rate, however, peaked after 2003 and has averaged around 7 percent thereafter. Sri Lanka's GDP growth rate averaged 5 percent in the decades following liberalisation.

With poverty levels ranging from 23 percent in Sri Lanka to 50 percent in Bangladesh, poverty remains the prime development challenge in South Asia. A pertinent question is: has trade liberalisation contributed to poverty reduction in these countries? The answer to this query is not easy; it is difficult to differentiate between the impacts of internal reforms and external trade liberalisation measures. This is exacerbated by the fact that many exogenous factors (e.g., economic sanctions, natural calamities, unfavourable international trade rules and armed conflict) also affect growth and poverty.

The process of assessing the impact of trade liberalisation on poverty itself is not an easy task. An option is to assess poverty levels before and after the reforms. On this account, it can be observed that trade liberalisation has not led to substantial poverty reduction in South Asia. In Bangladesh, poverty declined by 16 percentage points between 1991 and 2004, wherein the incidence of poverty was as high as 42 percent in 2004. Similarly, poverty in India was as high as 26 percent in 2000, which is a decline of only 13 percentage points in a span of 13 years. Nepal too has achieved a one percentage point decline in poverty per annum since 1985 and the poverty ratio stood at 31 percent in 2004. The case of Pakistan is complicated by the changes in the measures to assess poverty level but with poverty ratio at 24 percent in 2005, as compared to 29 percent in 1987, it is the worst performer among South Asian economies. In spite of the early start, Sri Lanka too saw a very low level of poverty reduction with a mere 3 percentage points change in poverty from 26 percent to 23 percent between 1990 and 2002. In addition, poverty reduction is also urban biased in these countries.

Based on the experiences so far, South Asian governments need to implement 'complementary policies' along with trade liberalisation measures to ensure that trade contributes to high economic growth and broad-based poverty reduction. ■

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The views expressed in the articles published in *Trade Insight* are those of the authors and do not necessarily reflect the official position of SAWTEE or its member institutions.




## SAWTEE NETWORK

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1. Associates for Development Initiatives (ADI), Dhaka
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2. Sustainable Development Policy Institute (SDPI), Islamabad

**SRI LANKA**
1. Law & Society Trust (LST), Colombo

## Excellent complement

I am a regular reader of *Trade Insight*. I consider this magazine very interesting and useful because it offers a good mixture of facts, explanations and opinions on different trade and development issues from South Asian perspectives.

This is truly an excellent complement to the analyses that are produced and circulated in Geneva.

*Steffen Grammling, Program Officer (Trade and Development), Friedrich-Ebert-Stiftung (FES), Geneva, Switzerland*

## Highlights a path to South Asia

I read your magazine (Vol. 2, No. 2, 2006) that focused on whether or not there exists any room for South Asian countries to form common positions on issues of the Doha Round of multilateral trade negotiations. The magazine has comprehensively highlighted that there are issues of divergences as well as convergences among South Asian countries. Given that each country has its own interests and development priorities, and would want to gain individually from the Doha Round, arriving at a common regional position on different issues of the World Trade Organization (WTO) may not be easy. Nevertheless, it is still feasible and as your articles state, South Asian countries too can follow the two-track approach adopted by Association of South-east Asian Nations (ASEAN) – the


first track for developing positions on issues of convergence and the second track for making issue-based alliance with other countries or groups of countries on issues of divergence. This could, indeed, be a possible path for countries in South Asia to pursue.

*Janaka Wijayasiri , Research Economist, Institute of Policy Studies (IPS), Colombo, Sri Lanka*

## Addresses the overriding issue

I have gained much knowledge on trade issues by reading *Trade Insight*. Your magazine addresses the overriding issues of current trade practices and rules. Articles such as 'Regional Trade Agreements and the WTO' (Vol. 2, No. 2) and 'General Agreement on Tariffs and Trade' (Vol. 2, No. 1) in Understanding WTO section are very informative and elegantly presented. However, some articles are too formal and technical.

Your endeavor would be more enriching if you could publish a glossary of trade terms and macroeconomic indicators of South Asia.

*Udbodh Ushakar Rijal, Research Officer, Institute for Integrated Development Studies (IIDS), Kathmandu, Nepal*

## Has created a unique place

*Trade Insight* has created a unique place for itself within a short period of time. I do not think there is any other source where one can get such news and views on trade issues affecting South Asian countries in such a lucid language and in a comprehensive manner. It is also heartening to note that the articles written are from truly South Asian perspective. I would be glad if the magazine can bring some analytical articles on two issues: First, on the impacts of various trade agreements and liberalisation measures on the people at the grassroots level. This has of course been covered in some articles on farmers' rights but there could be more. Second, various trade agreements that South Asian countries are signing or negotiating with countries or blocs outside the region (like China-Pakistan FTA or discussion on EU-India FTA) should be given more attention as they can have far reaching implications.

*Nitya Nanda, Policy Analyst, CUTS International, Jaipur, India*

## REQUEST FOR CONTRIBUTIONS AND COMMENTS

*Trade Insight* is a quarterly publication of SAWTEE. The organisation invites scholarly contributions on trade and development issues, preferably from South Asian country perspectives. Articles are invited on issues relating to international trade, multilateral trading system, regional cooperation, regional trade agreements, and Millennium Development Goals. We also request our valued readers to send comments on the magazine and letters for Readers' Forum.

All contributions and letters should be addressed to: The Editor, *Trade Insight*, SAWTEE, PO Box: 19366, Kathmandu, Nepal. Contributions and letters by email should be sent to sawtee@sawtee.org, mentioning *Trade Insight* in the 'Subject'. All contributions and letters should have the writer's full name and address.

# Thailand to break HIV drug patent

**THE** Public Health Ministry of Thailand has announced that it will break the patent of the drug Efavirenz due to its high price. This life-saving drug is needed by thousands of people living with HIV/AIDS, yet only a small number can afford it. The so-called government 'compulsory licensing' took effect immediately following the announcement and the Government Pharmaceutical Organization (GPO) is expected to start mass production of a generic version of the drug in six months. While preparing to produce the drug, the GPO will import a generic version of Efavirenz – presumably from India – for use until the GPO could start producing its own generic drug.

Although the compulsory licensing would be valid for only five years, the move was recorded as a first in Thailand's history since the Drug Patent Act was passed 27 years ago. It allows compulsory licensing to be enforced by the state in the case of certain drugs critically needed to save people's lives that the state is unable to afford. According to the Public Health Ministry, there are about 500,000 HIV-infected people who need anti-retroviral treatments. The compulsory licensing of Efavirenz is expected to enable the National Health Security Office to increase the number of HIV-infected people who can avail the drug to about 100,000, from the current 25,000. The locally-made version would cost half that of the original drugs sold in Thailand.

Efavirenz is a second-line drug used to save the lives of HIV-infected people who were resistant to the six first-line drugs or basic regimens available in the country. Compared to another second-line drug Nevirapine, Efavirenz is much better in terms of effectiveness and side-effects and it has only a 5 percent chance of side effects, compared to 25 percent in the former.

The Ministry has also sent a letter to Merk Sharp and Dohm, the United States (US) company that owns Efavirenz, as well as the Department of Intellectual Property and other concerned organisations. The company will receive compensation equivalent to 0.5 percent of the sales in Thailand. However, Merck said that the Thai government had made no attempt to consult the company. The company also said that it made no profit on the drug in Thailand. But health campaigners argue that not enough poor people have gained access to life-saving drugs since the World Trade Organization (WTO) granted the special patent exemption in 2001. They accuse the US and other rich nations of bullying developing countries to impose stricter patent rules in order to perpetuate drug monopolies.

The Ministry has stated that the decision to produce the generic version of this expensive drug does not break any rules; the state is simply using a discretion in the Thai law and the provisions of the WTO's Agreement on Trade Related Aspect of Intellectual Property Rights (TRIPS). Thailand is not the first country to do this; Brazil and even the US and Canada had used compulsory licensing *(Compiled from news posted on www.nationmultimedia.com)*. ■

## Doha Round: Much remains to be solved

**GENEVA-BASED** trade diplomats have stepped up the pace of talks at the World Trade Organization (WTO) after receiving the green light from Director General Pascal Lamy to resume discussions on all issues in the troubled Doha Round negotiations. The chairs of most of the negotiating groups have been consulting with delegations but no breakthrough in the talks has become visible, as Members have not explicitly come forward with changed bargaining positions.

Delegates had been meeting informally since July, when work in the various negotiating groups ceased with the suspension of the talks last July. In his speech to Members on 16 November, Lamy left it to the negotiating group chairs to decide how to move forward, "bearing in mind the different circumstances" of their respective committees. The WTO chief also said that "full-fledged negotiations" — especially those at the ministerial-level — would remain premature until Members come forward with concrete new proposals, particularly for expanding agricultural market access and cutting farm subsidies *(BWTND, 29.11.06)*.■

## Vietnam gets WTO membership approval

**VIETNAM** is set to become the 150th Member of the World Trade Organization (WTO), following a decision made by the General Council on 7 November 2006 to approve its membership. This South East Asian country now has to ratify the deal and it will become a member 30 days after it informs the WTO of its decision.

This will end over 11 years of preparation, including eight years of negotiations. The working party of Members negotiating with Vietnam was set up on 31 January 1995 and met 14 times between July 1998 and October 2006 *(WTO, 07.11.06)*.■

# India and EU plan trade agreement

**INDIA** and the European Union (EU) took the first step towards an ambitious trade agreement during Indian Prime Minister, Dr. Manmohan Singh's visit to Helsinki, Finland in the second week of October. Both countries hope that the agreement will clear barriers to growing trade and investment between the two countries. They agreed to start negotiations on a deal to reduce tariffs on most goods (covering 90 percent of tariff lines) with the likely exception of some agricultural products.

India wants EU investments in building its infrastructure and the EU, already the biggest source of foreign investment in India, looks forward to more lucrative business opportunities. It has been stated that a zero-tariff pact would supplement a deal at the World Trade Organization (WTO) where talks have stalled since last July. The EU, however, must seek approval from its 25 nations before negotiations begin for the agreement. Reportedly, a deal could be in place by 2009 at the earliest, although it might take much longer. India expressed its willingness to reform its bureaucracy to attract foreign investment. The country needs an extra US$ 320 billion to improve transport and other facilities over the next five years or US$16 billion in foreign capital annually, which currently stands at US$ 12 billion. Bilateral trade between India and the EU will reach US$ 63 billion in 2006 and is estimated to reach US$ 88 billion by 2008. India imported US$ 26.4 billion worth of goods from the EU in 2005. Indian investments in the EU reached US$ 752 million in 2004 whereas EU investments in India were US$1.03 billion *(AP, 14.10.06)*.■

# China and Africa to strengthen trade ties

**CHINA** and several African countries have agreed to expand trade and investment flows, as well as other forms of bilateral cooperation. During the third conference of the Forum on China-Africa Cooperation, held on 4-5 November in Beijing, senior officials from 48 of the 53 African countries, including 35 heads of state, adopted a declaration, proclaiming the establishment of a "new type of strategic partnership" between China and Africa, calling for enhanced "South-South cooperation and North-South dialogue to promote balanced, coordinated and sustainable development of the global economy." The declaration also urges rich countries to boost foreign aid spending, honour commitments to open markets and expand debt relief in order to help African countries reduce poverty, control desertification, and achieve the Millennium Development Goals. Governments vowed to double trade volumes between Africa and China to US$ 100 billion by 2010. The volume of bilateral trade is projected to reach US$ 50 billion in 2006 *(BWTND, 09.11.06)*. ■

## *More free trade agreements*

**AS** prospects for resumption of the Doha Round of trade negotiations remain uncertain, World Trade Organization (WTO) Members have shown their increasing interest in pursuing free trade agreements (FTAs). While China and Pakistan signed an FTA on 24 November, the United States signed an FTA with Columbia on 27 November. Besides these, some other FTAs have also been concluded or are being negotiated.

### China and Chile

The FTA between these countries, which is expected to exempt 97 percent of all traded goods from import tariffs, came into effect on 1 October 2006. China will lift tariffs on 2,834 products imported from Chile, including copper. Chile will give duty-free status to 5,891 commodities from China, including vegetables, fruits and mechanical and electrical equipments. China has agreed to maintain tariffs on 7,391 products imported from Chile, while 7,750 exported products will be charged levies by Chile.

### China and the Republic of Korea

Both countries have agreed to start negotiations on an FTA. They are negotiating medium and long-term trade cooperation, focusing on environmental protection, energy preservation and high-tech cooperation. The two sides have also pledged to promote trade facilitation, expand investment and bring economic cooperation to a new level.

### Singapore and Peru

These countries have concluded their third round of negotiations for an FTA, which includes discussions on rules of origin, investment, e-commerce and dispute settlement. The negotiations on trade in goods, customs procedures, trade in services, government procurement and technical barriers to trade are near completion and only a few outstanding issues are left to be resolved.

### Vietnam and Japan

Both have agreed to start talks next year on an FTA that they hope would almost double their trade by 2010. The two sides decided to facilitate favourable conditions for business to expand two-way trade volumes. Vietnam promised to create favourable conditions to investment from Japan in various fields, including high-tech industries *(CEN, 02.10.06; CV, 13.10.06; CNA, 29.09.06; 19.10.06; BWTND, 30.11.06)*. ■

# BIMSTEC to have permanent secretariat

**BAY** of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), an economic grouping of seven countries from South and Southeast Asia, has initiated exercises to establish a permanent secretariat to expedite and facilitate the bloc's operations. The bloc, which came into being in 1996, lacks a permanent secretariat. Office of Bangkok Working Group, an *ad hoc* body consisting of ambassadors of respective Member countries, currently keeps track of its functions and operations.

The Member countries – Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand – held the Second Meeting of the Inter-Governmental Group on the establishment of a BIMSTEC Permanent Secretariat in Bangkok during 26-27 October 2006. The meeting discussed the key elements of the Permanent Secretariat, including rationale and scope, organisational structure, location and physical facilities, financial contribution formula and timeline to operationalise the Secretariat. Members decided that the final decision on the location and the formula of financial contribution would be made at the second BIMSTEC Summit, scheduled for 8 February 2007 in India *(TBP, 28.10.06)*. ■

# APEC Summit adopts Hanoi Declaration

**THE** 14th Asia-Pacific Economic Cooperation (APEC) Economic Leaders' Meeting was held during 18-19 November 2006 in the Vietnamese capital, Hanoi. The Hanoi Declaration, adopted at the end of the meeting, calls for a timely conclusion of the Doha Round of trade negotiations, among others. The leaders called for the troubled negotiations to "resume without further delay". Heads of state from 21 Pacific Rim countries have said they are willing to offer fresh concessions to break the deadlock in the Doha Round trade talks – so long as governments "in other regions" do the same.

In their annual two-day meeting chaired by Vietnam's President Nguyen Minh Triet, Leaders of 21 APEC economies discussed the theme "Towards One Dynamic Community for Sustainable Development and Prosperity" in two umbrella topics – advancing trade and investment in a changing world; and fundamentals ensuring dynamism, growth, and sustainable development in APEC. Australia will host the next APEC Summit in 2007 *(www.apec.org, 21.11.06 and BWTND, 23.11.06)*. ■

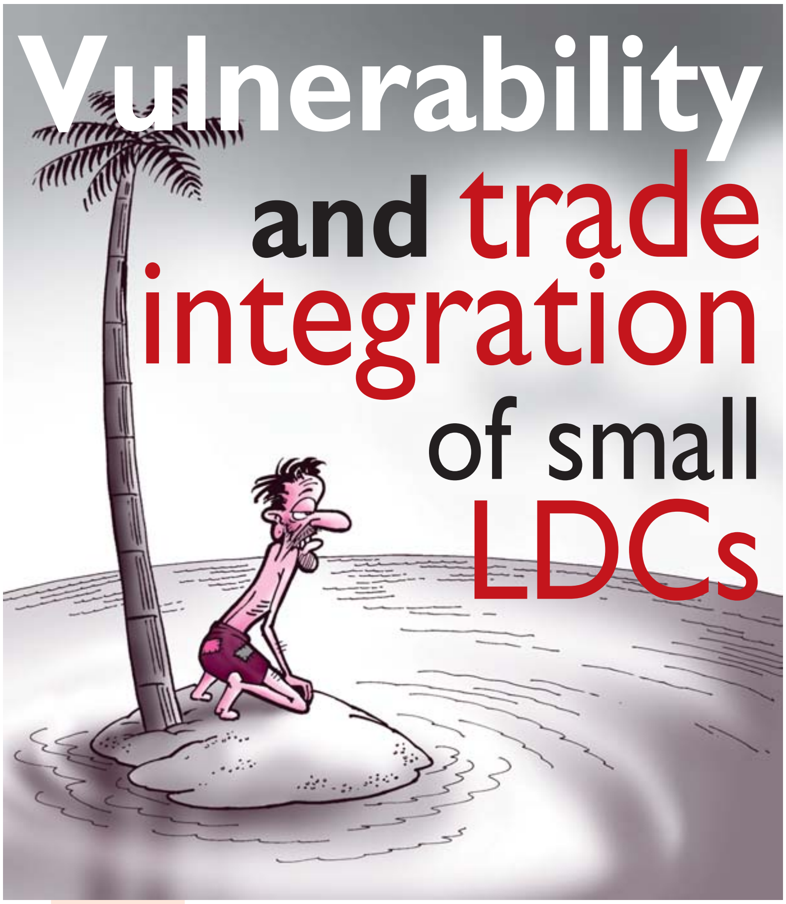
## India to set up 14 land customs hubs

**INDIA** will invest Rs. 850 crore over the next three years to develop 14 land customs stations. These include eight along the Bangladesh border, four along the Nepal border, and one each along the borders with Pakistan and Myanmar. Of this, Indian Rs. 70 crore will be invested at Moreh customs station in Manipur, the only functional land customs station through which trade across the land route along 1,600 km of the Indo-Myanmar border takes place. Indo-Myanmar border trade currently exceeds Rs. 2,000 crore. At present, only 22 items are exchangeable under the bilateral border trade agreement. Moreh project specifically is a part of India's 'look-east' policy, which envisages closer integration of the economies of the northeastern states of India with south-east Asia. The Commerce Ministry has proposed to the Central Government that restrictions on Indo-Myanmar trade be removed and that trade takes place without any commodity restrictions at Moreh, as also with Bangladesh and Nepal. The Moreh project will be launched shortly and will be completed by mid-2008 *(FE, 30.09.06)*. ■

## NEWS SOURCES

AP: Associated Press
BBC: British Broadcasting Corporation
BWTND: Bridges Weekly Trade News Digest
CEN: China Economic News
CET: China Economic Times
CNA: Channel News Asia
CV: China View
FE: Financial Express
TBP: The Bangkok Post
WTO: World Trade Organization

# Vulnerability and trade integration of small LDCs



> Since vulnerability impairs the development prospects of small LDCs, they should be treated differently and supported with measures to enable them to benefit from trade integration.

**Ratnakar Adhikari**

## Vulnerability and small LDCs

The United Nations Economic and Social Council (ECOSOC) has determined three criteria for the inclusion of countries in the list of the least developed countries (LDCs) – low per capita income, low human assets index and high economic vulnerability index. According to this, countries may cross the threshold of per capita income but they continue to remain in the LDC list as is evident from the example of many Pacific Island countries. Similarly, others may remain vulnerable but are not considered LDCs if they have achieved a per capita income level above US$ 1,000. The ECOSOC's approach of taking only 'economic vulnerability' as the criteria of vulnerability, therefore, does not seem comprehensive. Besides economic vulnerability, environmental, social and institutional vulnerabilities also matter, if the categorisation of countries is for 'developmental objective' (see the box).

The LDCs, from all aspects, are among the most vulnerable economies in the world. Their vulnerability is a major bottleneck in their development efforts. In the globalised world, trade integration is considered an important policy measure for economic and social transformation of the LDCs. Yet, the benefits of trade integration should not be overstated as there are host of domestic issues that determine whether such economies can reap the benefits from trade integration.

Most LDCs fall into the text book definition of 'small economies'. Standard general equilibrium trade theory portrays small size as a distinct advantage, which appears under the rubric of "importance of being unimportant". Since small economies are 'price takers' in the global market, they can potentially trade at the outer-boundary limit of profitable international relative price ratios or terms of trade.[1] While this results in static gains from trade, the dynamic gains, at least in theory, are enormous.[2] Small economies with well-diversified economic structure and capacity to take advantage of the opportunities can be those with the high per capita incomes such as Luxembourg and Lichtenstein. Whereas small economies, which are unable to diversify their economies by getting locked into exports of primary commodities and basic manufactures such as apparel and footwear, are unlikely to prosper. Most LDCs fall into the second category.

## Trade integration and small LDCs

Trade integration, despite the 'win-win' theory propounded by many, produces both winners and losers. For example, countries that are well-endowed with natural, human, financial and technological resources tend to win but those that lack one or many of these critical resources often lose out. The problem is more severe in the case of small LDCs. While they are too small to make any impact on the international market, they are affected by any change in the international market. The typical problem of price volatility of commodities is one such example.[3]

Limited capacity to absorb international shocks means that small LDCs are destined to lose in the face of intense global competition. A glaring example is the devastation caused by the phasing out of the Agreement on Textiles and Clothing (ATC) in December 2004. Among the countries in the Asia-Pacific, where readymade garments constitute a major share in total exports, the loss of export markets due to lack of competitiveness is clearly visible in the case of two LDCs - Nepal and the Maldives - which are either small or remote or both. Whereas Bangladesh and Cambodia, despite being LDCs, were able to achieve remarkable success even in the aftermath of the ATC expiry.[4]

Many LDCs 'autonomously' reduced their tariffs and non-tariff barriers (NTBs), as part of their acceptance of the policies sponsored by the Bretton Woods institutions, ostensibly to achieve stabilisation and economic growth. Their trade regimes are now more liberal than most developing economies and if the theoretical argument of free trade is to hold true, they should have overcome their economic woes by now. However, the results seem to have gone into other directions than predicted, mainly due to the following reasons:

First, the theory rejects the 'infant industry' argument that espouses protection of nascent industries for a certain period before becoming globally competitive. Most developed and newly industrialising economies achieved economic transformation through trade protection, which were gradually dismantled as they grew richer. To enhance market access for their goods and services, the same countries are forcing the developing countries (including the LDCs) to unconditionally open up their markets.[5]

Second, it blindly follows the notion of comparative advantage, assumes existence of perfect competition and full employment and fails to take into account adjustment costs while assuming that market failures do not occur and resources adjust quickly in sectors with high returns.[6]

Third, each country is assumed to have a well managed social security programme in place in the form of unemployment insurance and/or retraining/retooling facilities. In reality, most LDCs neither have the resource nor expertise and capacity to handle such complex social security programmes.

Fourth, the revenue implications due to unilateral tariff liberalisation are immediate and severe, particularly for countries with high dependence on trade for government revenue. For example, trade constitutes 45 percent of total revenue in the Maldives, 48 percent in Nepal and 40 percent in Vanuatu.

Fifth, the identification of comparative advantage with a view to smoothen the adjustment process does not imply guaranteed market. Most LDCs are dependent on a limited number of commodities, and trade barriers are usually the highest for these products. For example, tariff rates imposed by the United States on woven garments imports to an LDC in 2005 was 19 times higher than what was paid by Canada and 33 times higher than what was paid by Mexico.[7] Similarly, in 2002, 40 percent of LDC exports were subject to NTBs whereas the corresponding figure for the developing, transition and developed economies was 15 percent.[8]

Finally, despite various 'positive discrimination' in favour of the LDCs in terms of market access initiatives, their 'take up' rates have been extremely poor due to two main reasons. First, the stringent and cumbersome rules of origin requirements – which suit the priorities of donors and do not take into account the stage of industrialisation of the recipient – means that the LDCs end up paying most favoured nations tariffs on their exports to the developed countries. Second, the LDCs face severe supply side constraints – including institutional, governance, infrastructure and resource related – implying their inability to competitively supply the products despite the availability of preferences.

In 2002, 40 percent of LDC exports were subject to non-tariff barriers whereas the corresponding figure for the developing, transition and developed economies was 15 percent

## Types of vulnerability and small economies

| | |
|---|---|
| Economic vulnerability | The greater than average risk faced from exogenous shocks that adversely affect income, employment, domestic production, distribution, markets, consumption, and the stock of wealth, and their limited capacity to deal with these. |
| Environmental vulnerability | The greater than average threat of calamities induced by natural or human made factors. While small island states are often hit by droughts, floods, hurricanes, volcanoes and earthquakes, mountainous countries are prone to flashfloods, volcanoes and earthquakes. |
| Social vulnerability | The greater than average risk posed by both internal and external factors that undermine social cohesion, introduce systemic social pathologies and erode social capital. In small states, these factors have a high 'recurrence rate' even as we recognise the restricted capacity of these states to respond. |
| Institutional vulnerability | The greater than average risk posed by the limited capacity of domestic institutions, including the state, to respond to the complexity and intensity of pressures flowing from globalisation. |

*Source:* Adhikari, R. 2005. Vulnerability, trade integration and human development. *Background Paper for Trade on Human Terms, Asia Pacific Human Development Report. Colombo: UNDP Asia Pacific Regional Centre; adapted from Thomas, C. Y. 2005.* Making Global Trade Work for People: The Concerns of Small States in the Global Trade Regime. *New York: United Nations Development Programme.*

## How special is S&DT?

One of the possible means to help the LDCs take advantage from trade integration is through the effective operationalisation of the special and differential treatment (S&DT) provisions, contained in the multilateral trading system – the World Trade Organization (WTO) – either as cross-cutting provisions or as agreement specific. While a detailed analysis of such provisions has been made elsewhere[9], suffice it to mention that nothing is 'special' about S&DT. First, the differential treatment provided to the LDCs should not be considered as a 'charity' but a 'right' because these countries have no capacity to benefit from the multilateral trading system, should they be forced to follow the same rules as their developed counterparts. Second, most of the seemingly useful S&DT provisions are merely best endeavour clauses and not legally binding.

Out of the several 'measures' in favour of the LDCs, three are particularly important.

The first relates to transitional period and reduced level of commitment, which are almost invariably automatic. The second concerns demand side issues such as providing better market access to the LDCs. Although various countries have provided market access concessions, which are 'deeper' than those extended to developing countries, none of them have been 'bound' at the WTO. The decision at the Hong Kong Ministerial Conference (HKMC) in December 2005 to provide duty-free and quota-free market access to the LDCs on the 97 percent of import tariff lines by developed countries falls far short of the demand of the LDCs because sectors of commercial interest for the LDCs such as clothing, footwear, sugar, banana, rice and processed food within the remaining three percent margin, can be excluded. The third issue relates to supply side constraints for which Enhanced Integrated Framework and Aid for Trade initiatives agreed at the HKMC could provide an impetus but the actual outcomes depend on how multilateral trade talks on these issues will shape up. In addition to this, the suspension of the Doha Round negotiations could seriously undermine the achievements made during the HKMC.

## Role of national actors

Before drawing any inference on the vulnerability and trade integration aspects of small LDCs, it is necessary to understand the following two fundamental issues. First, trade liberalisation alone cannot be blamed for the continuing poverty in and underdevelopment of these economies. In fact, there is no systematic evidence confirming that protectionism leads to growth.[10] Second, vulnerability – whether natural or human made – cannot be addressed through international initiatives alone and domestic reforms have an equally important role to play.

Among the various supply side constraints, it might be difficult for the domestic actors to make investment in creating infrastructure due to resource scarcity. However, improving governance, reforming customs administration, improving access to finance, investing in trade support services and providing fiscal incentives for research and development require more of political will than resources. Vulnerability should be no excuse for not initiating these reforms. Moreover, the tendency towards 'monopoly of wisdom' which is widely prevalent in the trade policy making and negotiation process must be checked. Consultation with stakeholders – private sector, non-governmental organisations, academia, media, consumer groups, farmers' groups, trade unions etc. – can help governments prepare sound policies and/or sustainable negotiating positions.

## Conclusion

If vulnerability impairs the development prospects of any economy, they should be treated differently by the international community. Most LDCs, which are not only vulnerable but also fall into the category of small economies, have not benefitted from trade liberalisation, defying all the theoretical assumptions. If they wish to truly gain from trade liberalisation, serious efforts are needed both from the international as well as domestic actors. However, there is a yawning 'sincerity deficit' on the part of both the actors, with blame game galore. A serious introspection is necessary to reverse this trend. ■

*Mr. Adhikari is Programme Specialist at the UNDP Regional Centre in Colombo. The opinions expressed in this article are personal.*

## NOTES

1 Thomas, C. Y. 2005. *Making Global Trade Work for People: The Concerns of Small States in the Global Trade Regime*. New York: UNDP.

2 Adhikari, R. 2005. *Vulnerability, trade integration and human development*. Background Paper for Trade on Human Terms, Asia Pacific Human Development Report. Colombo: UNDP Asia Pacific Regional Centre.

3 Adhikari, R. 2005. Above note2.

4 See Adhikari, R. and Y. Yamamoto. 2006. *Sewing Thoughts: How to Realise Human Development Gains in the Post-Quota World*. Tracking Report, April. Colombo: UNDP Asia Pacific Regional Centre.

5 See Chang, H. 2006. 'Policy Space in Historical Perspective – with Special Reference to Trade and Industrial Policy', *Economic and Political Weekly*. 18-24 February 2006. Vol. XLI, No. 7; and Rodrik, D. 2001. *The Global Governance of Trade as if Development Really Mattered*. Background paper for Trade and Sustainable Human Development Project. New York: UNDP.

6 See Stiglitz, J. 2006. 'Social Justice and Global Trade', *Far Eastern Economic Review*. March 2006, 169 (2): 18-22 for further details.

7 See Adhikari, R. and C. Weeratunge. 2006. 'Textiles & Clothing Sector in South Asia: Coping with Post-quota Challenges', *South Asian Yearbook on Trade and Development* (forthcoming) New Delhi: Centre for Trade and Development.

8 Laird, S. and L. Puri. 2005. *Notes on Special and Differential Treatment with a special focus on LDCs*. Paper presented at International Policy Dialogue Doha Development Round: Present Situation and Prospects for Success. 7-8 June. Berlin. Organised by Development Policy Forum of InWEnt Capacity Building International, Germany on behalf of the Federal Ministry for Economic Cooperation and Development and in cooperation with the Federal Ministry of Economics and Labour.

9 Adhikari, R. 2005. Above note2.

10 See Salinas, G. and A. Aksoy. 2006. *Growth Before and After Trade Liberalization*. Policy Research Working Paper 4062. November 2006. Washington, D.C: The World Bank.

# Agricultural support in OECD countries

## SOME POLICY IMPLICATIONS FOR NEPAL

Binod K. Karmacharya

The differences between key World Trade Organization (WTO) Members in resolving widely debated issues of agricultural market access and domestic support led to the suspension of the Doha Round of trade negotiations on 24 July 2006. If the impasse remains, it will result into the continuation of agricultural support in developed countries. This article assesses the impact of agricultural support in Organisation for Economic Cooperation and Development (OECD) countries on a least developed country (LDC) like Nepal.

There is considerable debate as well as confusion on the implications of agricultural support in developed countries on the LDCs. Thanks to the advocacy of a few pressure groups and many international institutions, a near universal consensus exists that the agricultural support policy of developed countries hurts the LDCs. Agricultural subsidies and price supports allow developed countries to sell their agricultural products in world markets at prices below production costs.[1] Critics claim that these policies inflict harm on the LDCs by depressing world commodity prices.

It is argued that the subsidies increase the volatility of commodity prices since support policies that are counter-cyclical with respect to domestic prices or shocks provide incentives for increased production when world prices are low. Further, these policies are likely to hurt the poorest residents of the LDCs because poor people in these countries are often farmers. Thus, eliminating support for developed country farmers will raise world prices and the incomes of the poor. The LDCs can become net-exporters once world prices increase as a result of elimination of agricultural support in developed countries. However, some liberal economists are skeptical about the above arguments. According to Jagdish Bhagwati, agricultural subsidies are certainly undesirable but the claim that removing them will help the poorest counties is "dangerous nonsense" and a "pernicious fallacy".

The case study of Nepal provides compelling reasons to reject the mainstream view advocated by many international organisations and the media that subsidies in developed countries hurt the poorest countries. This conclusion is reached by assessing the impact of agricultural liberalisation in OECD countries on products of Nepal's interests such as paddy rice/milled rice, maize, wheat, sugarcane/sugar and on household welfare.[2] The study finds that Nepal is adversely affected by higher commodity prices that would result from agricultural liberalisation in OECD countries due to the following reasons. First, the price transmission mechanism from the world to Nepal is estimated to be not only very low but also slow – only about 20 percent to 30 percent of increase in world price is transmitted to Nepal. Moreover, that takes place after five years.[3] This result is unsurprising given Nepal's landlocked status and limited transport infrastructure. More importantly, since India has a major influence on Nepal's economy, its policies with the rest of the world influence the extent to which Nepal can be integrated with the rest of the world.[4] Combined together, they prevent Nepal from integrating with the global market. Thus, agricultural liberalisation in OECD countries matters very little for Nepal in terms of its effect on its domestic prices. Second, Nepalese households, in general, are net consumers/buyers of most of the agricultural products. Third, Nepal is a net-importer of these food products.[5] As a result, household welfare in Nepal declines from agricultural liberalisation in OECD countries

**Contrary to the popular belief that agricultural liberalisation in OECD nations benefits farmers in developing and least developed countries, Nepal is adversely affected by such reform.**

(see the table), both in the short and the long-run and under all policy scenarios. This is also true for both poor and non-poor households.

In sum, the case study for Nepal supports the hypothesis of Panagariya (2005)[6] and others[7] that agricultural support in developed countries is not necessarily harmful. This conclusion of the study has global, regional, and national policy implications.

First, when the LDCs, promised huge gains from liberalisation find that they will be adversely affected, they could be disillusioned about the benefits of trade. That could be fatal to the cause of future liberalisation.

Second, without recognition of the adverse effects of liberalisation in developed countries on the LDCs, it will be difficult to design the compensation and adjustment programmes that such countries will need to adapt to liberalisation. Unlike rich countries, the LDCs lack necessary resources for their own safety nets and depend on international transfers bilaterally or through multilateral institutions.

Third, one also needs to recognise the merits of liberalisation not only by liberalisation in developed countries but also in developing countries. This is true especially for India in the context of Nepal. Given the reality that Nepal has a long and virtually open border with India, Indian agricultural policies[8] have long been a powerful source of disincentive for most Nepalese farmers. The huge subsides and farm support programmes accorded to major agricultural produce in India provide cost advantages to Indian farmers. While some of the Indian subsidies on traded inputs (e.g., fertiliser) 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[9], exposing Nepalese farmers to artificially low border prices, due to heavy subsidisation of agricultural produce in India. Nepalese farmers are adversely affected even more by the bilateral free trade agreement between the two countries, which exempts basic customs duties and quantitative restrictions on imports of agricultural primary products on a reciprocal basis.[10]

Fourth, unless South Asian countries accelerate their regional initiative to reduce transaction costs of doing business with its neighbours and the world, Nepal will not be able to overcome the disadvantage of being landlocked.[11] Accordingly, there is a need for the deepening and widening of integration through the elimination of non-tariff barriers, improved trade facilitation and physical infrastructure such as transport, communication and transit agreement. Regional and inter-regional economic integration schemes such as Agreement on South Asian Free Trade Area (SAFTA)[12] and Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)[13] should deepen and widen such integration.

Finally, on part of the poor countries like Nepal, it is also important that they realise that opening just the developed country markets will not be enough. In order to benefit from access to the developed country markets, they must generate the proper supply response by addressing their significant domestic or 'behind the border' constraints. These include, but are not limited to, improvement in the following areas:

The case study for Nepal supports the hypothesis that agricultural support in developed countries is not necessarily harmful

**Impact of OECD agricultural liberalisation on household welfare in short and long-run by household income groups in Nepal under different policy scenarios (%)**

| Household Income groups | Short-run | | | Long-run | | |
|---|---|---|---|---|---|---|
| | Domestic support removal | Import tariff and export subsidy removal | Full reform | Domestic support removal | Import tariff and export subsidy removal | Full reform |
| Poor | -1.04 | -1.76 | -2.80 | -3.15 | -5.87 | -9.13 |
| Non-poor | -1.16 | -3.96 | -5.12 | -3.58 | -10.64 | -14.53 |
| Total | -2.20 | -5.72 | -7.93 | -6.73 | -16.51 | -23.66 |

*Source:* Karmacharya, B.K. 2006. *Impact of OECD Countries' Agricultural Liberalization on Household Welfare in Nepal* - A study conducted for Global Development Network.

- capacity building in agriculture-related agencies;
- facilitation of border transactions;
- infrastructure to promote commercialisation; and
- enforcement of quality standards and sanitary and phytosanitary requirements at both farm and processing stages.

This calls for implementing 'aid for trade', which is firmly grounded in national development strategies and independent of the progress on the Doha Round. In addition, countries like Nepal also require adequate 'policy space' and other appropriate 'special' measures so that they are not only able to develop sound national development strategies but also provided with additional international support to implement them. ■

*Dr. Karmacharya is an economist. This contribution is based on the study,'Impact of OECD Countries' Agricultural Liberalization on Household Welfare in Nepal', which was carried out with the financial support of the Global Development Network (GDN). The views expressed in this paper are those of the author and do not necessarily represent the position of GDN.*

Poor countries require 'aid for trade', which is grounded in national development strategies and independent of the Doha Round progress

## NOTES

1 Transfers to agricultural producers from consumers and tax payers as a result of income and price support policies amounted to US$ 21,000 per farmer in the US and US$ 16,000 per farmer in the EU during 1998-2000. This is almost one hundred times greater than the per capita incomes of the LDCs.

2 The study examined the impact of OECD agricultural liberalisation in two steps: (i) by simulating the extent of price transmission from world prices to local markets for the major agricultural products of Nepal's interests (paddy rice/ milled rice, maize, wheat, sugarcane/sugar); and (ii) by carrying out simulation of short-run and long-run impact of changes in world prices in these products on household welfare. For the short-run analysis, the study assumes the first-order effects on household welfare through the changes only in the price of commodities, assuming that the households cannot change their activities in response to a price change in the short-run (quantities consumed and produced are assumed unchanged). For the long-run analysis, the study takes into account the second-order effects for consumption (both the adjustment in the expenditure basket as well as the changes in income of the household) and that for production (substitution effects). The effect of changes in world prices on household welfare is estimated by employing farm household model, which recognises dual role of most households in developing countries in terms of being both producers and consumers at the same time. See Singh, I., L. Squire and J. Struass (eds.). 1986. *Agricultural Household Models: Extensions, Applications and Policy.* Washington, DC: The World Bank and The John Hopkins University Press.

3 See above note 2.

4 Karmacharya, B.K. 2003. 'Trade Policy Regime, Growth and Poverty: The Nepalese Experience' in K. Sharma (ed.) *Trade Policy, Growth and Poverty in Asian Developing Countries*. Routledge Publications.

5 Nepalese households are, on average, net consumers/ buyers of rice, wheat, and sugar while they are net producers of maize.

6 Panagariya, A. 2005. 'Agricultural liberalization and the least developed countries: Six fallacies'. *The World Economy.* Blackwell Publishing.

7 McMillan, M. A; P. Zwane, and N. Ashraf. 2005. 'My policies or yours: Does OECD support for agriculture increase poverty in developing countries?' Working Paper 11289. Cambridge, MA: National Bureau of Economic Research.

8 Several price interventions and subsidies distort producer incentives in Indian agriculture (See Srivastava, D.K. et. al. 2003. *Budgetary Subsidies in India: Subsidizing Social and Economic Services*. New Delhi: National Institute of Public Finance and Policy; Gulati, A. and S. Narayan. 2003. *The Subsidy Syndrome in Indian Agriculture*. Oxford University Press). The Central Government provides subsidies to all major purchased inputs (e.g. fertiliser, seed, and pesticides). Irrigation water from surface schemes is heavily subsidised, along with power subsidies for irrigation pumps. State governments also supplement subsidies provided by the Centre. The farm gate prices for major commodities are influenced by state trading agencies at fixed procurement prices. Likewise, India's recent decision to release food stocks (e.g., rice) from the Food Corporation of India to private traders at a subsidised rate has also exposed Nepal's rice market to dumping by Indian exporters.

9 Studies suggest a strong correlation of prices in Nepal, India and the neighbouring states of Bihar, Uttar Pradesh and West Bengal. In particular, the domestic prices of imported goods in Nepal are solely influenced by India. See the World Bank. 2005. *Nepal Development Policy Review: Restarting Poverty Growth and Poverty Reduction*, Report No. 29382-NP, Washington, DC: The World Bank; Yelten, S. 2004. 'Choosing the Correct Currency Anchor for a Small Economy: The Case of Nepal'. IMF Working Paper WP/04/ 142, Washington, DC: International Monetary Fund.

10 Cheap rice import from India in 1999/2000 is estimated to have depressed its domestic price in Nepal by about 13 percent resulting in a loss of Rs. 5415 million to Nepalese farmers accounting for about 13 percent of the value of their rice production. See Karmacharya, B.K. 2004. 'Informal Trade and Nepal-India Economic Cooperation: The Nepalese Perspective' in Nepal-India Economic Cooperation. Kathmandu: Nepal Council of World Affairs.

11 The nearest port for access to global markets is more than 900 km away from Nepal's border.

12 SAFTA is a free trade agreement among Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka.

13 BIMSTEC is a free trade agreement among Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand.

# Will Trade Liberalisation Reduce Poverty?

Trade liberalisation does create some losers, some of whom may be poor or pushed into poverty but such poverty should cause us to be careful and to protect the poor but not to stop liberalising our trade regimes.

**L. Alan Winters**

This article is about how we might think about the effects of international trade liberalisation on poverty, how we might measure them, what the results of such measurement efforts have been, and what these results might teach us about public policy.[1] The basic argument is that trade liberalisation generally stimulates medium term economic growth and that this generally alleviates poverty. But it does create some losers, some of whom may be poor or pushed into poverty. On public policy, I argue that such poverty should cause us to be careful and to protect the poor but not to stop liberalising our trade regimes. There is room to debate exactly what we mean by poverty, but for the sake of this note, I shall define it as having very low real income – sometimes as low as one dollar per day in 1985 prices.

## Indirect effects: Growth, productivity and volatility

Economic growth is the key to sustained poverty alleviation, usually directly by raising the incomes of the poor, but also by giving governments scope for financing investment, complementary or redistributive measures to help them.

Economic theory offers many reasons to expect a country's own trade liberalisation to stimulate its economic growth for a significant period by specialising in goods for which world prices exceed those that would be available at home, reaping economies of scale, improving performance in the face of new competition, and benefiting from better inputs and technologies available from abroad. But none is guaranteed, so ultimately whether trade does stimulate growth is an empirical matter. Over the 1990s, several highly visible global cross-country studies argued that openness was good for growth but all face severe technical challenges.[2]

First, once one comes inside the boundary of near autarchy, measuring trade stances is difficult; for example, tariffs need to be aggregated, quantitative restrictions assessed and then aggregated, and the levels of credibility and enforcement measured. Second, causation is difficult to establish. Actual openness, usually measured by imports plus exports relative to gross domestic product, is almost certainly a result of growth as well as a possible cause. But there is also a concern that even policy-based measures, for example, average tariffs, could face the same problem because growing countries might be more willing to liberalise. There are technical fixes for this problem, but they leave, at least, some doubt.

The third challenge is that, while liberal trade policies are likely to be somewhat beneficial under any circumstances (because they enlarge the set of opportunities for economic agents), a quasi-permanent effect on growth almost certainly requires combination with other good policies and sound institutions. This makes it difficult to isolate the individual effects of trade reform. Indeed, it raises the question of whether it is even worth trying to do so if policies always come in packages. Recent work[3] suggests that if labour regulation is too restrictive – so that the economy cannot respond to new incentives; opening up could damage growth, while under more flexible regimes, trade liberalisation could stimulate growth. The situation becomes even more complex if openness causes improvements in other policies and institutions. For example, countries with simple open trade regimes appear to be less corrupt, and open economies have less inflation (and plenty of evidence shows that high inflation is bad for the poor).

One can also think about growth via the link between openness and productivity. Everyone agrees that improved productivity is necessary for sustained economic growth and the evidence from country, sectoral

and firm level studies strongly suggests that opening up trade stimulates it. At a sectoral level, exporting allows more efficient firms to grow faster than less efficient ones and import competition to pick off the weaker domestic firms. Such rationalisation effects might explain short-term poverty concerns about openness, for clearly failing firms are likely to harm their workers. But in the long-term, progress equally clearly requires adaptation and adjustment, so that higher productivity can become the norm and generate higher incomes throughout a sector. Despite the econometric difficulties of establishing beyond all doubt that openness enhances growth, the weight of experience and evidence seems strongly in that direction. Even the critics concede that there is no coherent evidence that openness is bad for growth.

Economists have long argued that economic growth tends to reduce absolute poverty. This is not the same as saying that income inequality is not affected by trade or trade liberalisation. The latter is asserted by some scholars to be true on average if one measures relative inequality (i.e., incomes relative to mean income), although, of course, if all incomes increase by the same percentage, richer individuals receive larger absolute amounts and so absolute inequality increases. But even the constancy of relative incomes has been challenged.[4] These results suggest that for low income countries, trade liberalisation could be unequalising. This probably arises because only the relatively well off are equipped with the skills or locational advantages to take advantage of the opportunities that trade opens up. But these results do not necessarily mean that the poor actually get poorer; all incomes could be rising.

## Direct effects

I turn now to the direct effects of trade shocks on households and markets. Treating the household as the basic unit over which poverty is defined, I ask how trade reforms impinge on poor households. This is primarily a matter of how the price changes generated by the reforms affect their consumption and sources of income. I want to briefly distinguish three channels of causation – role of taxation and government expenditure, the prices of goods and services, and the market for labour.

### *The government account*

Critics of trade liberalisation frequently argue that it will reduce government revenue. The share of trade taxes in total revenue is higher for poorer countries, so this is potentially a major issue at low levels of economic development. But, in fact, there is no simple link between trade reform and tariff revenues. In many cases, tariff reductions increase revenues since they are associated with reductions in exemptions, less evasion and an enlargement of the tax base as trade increases. But, of course, as tariffs fall towards zero, revenue eventually falls to zero. But whether this translates into worse services or higher taxes for the poor is essentially a political decision as to how the decline is accommodated, albeit one constrained by a country's administrative capacity.

### *Prices and markets*

A more interesting link is between world prices and trade policy and the prices of the goods that poor households consume and produce. The bulk of the world's poor are self-employed in either low level agriculture or the informal sector of the econ-

omy. Thus, their incomes are directly affected by price changes induced by international trade. An increase in the price of something that the household sells (labour, good, service) increases its real income, while a decrease reduces it. Equally important for households that buy goods and services, (nearly all) price rises of those goods are harmful.

Thus, an important question is whether trade policy changes on the border get transmitted into price changes for the poor or nearly poor households. This depends on factors such as transport costs and other costs of distribution; the structure of markets; and domestic taxes and regulations. Price transmission is likely to be particularly ineffective for poor people living in remote rural areas and could even be zero. Such isolation saves the poor from negative shocks emanating from the international economy but it also prevents them from experiencing positive shocks or the secular benefits from openness. Their problem is too little globalisation, not too much. Thus, governments should pursue complementary reforms such as building infrastructure or human capital accumulation to try to connect the poor to the border, remembering, of course, that competition could hurt some people, especially in the short-run.

A household's ability to adjust to a trade shock – say, to switch production towards goods whose prices have risen – clearly affects the size of any impact it suffers. For many of the poor, a major constraint on improvements in agricultural productivity following the external liberalisation has been shown to be the absence of key productive assets (draft animals, implements), capital, credit, or information. These studies again highlight the importance of complementary policies targeted at small farmers to enable them to benefit fully from new trading opportunities; for instance in fostering asset accumulation, improving access to credit, and providing good quality extension services.

Adjustment is also the mechanism by which shocks in one market spill over into another. If these spillovers are deep and narrow, they can be significant locally. For example, a major attraction of liberalising small-scale agriculture is argued to be that the direct beneficiaries – farmers – spend much of their extra income on goods and services provided locally by other poor people such as construction, personal service and simple manufactures.

## *Factor markets*

For the self-employed, the main determinant of income is the prices commanded by their output and paid for their inputs, but for employees, it is factor prices (wages) or employment opportunities. If wages increase, it matters whose and by how much. Are labour markets sufficiently integrated so that a large number of people benefit, albeit by small amounts, or are they segmented so that those in the affected industry bear all the costs as benefits themselves? Some evidence[5] suggests that the latter is significant in India. If wages are fixed, adjustment will be via employment and the lucky people who get the new jobs created by trade liberalisation are likely to get big increases in incomes. Thus, who gets the jobs becomes an important issue. Sometimes they will be the poor but other times they will go to additional workers in households that already have formal employment or to more skilled workers. Typically, labour market responses will contain a mixture of wage and employment effects, sometimes the formal sector showing the latter and the informal sector the former.

## Whose liberalisation?

I have talked so far only about a country's own liberalisation but what about other countries' liberalisations? Don't developing countries really need the developed countries to liberalise their imports? The answer is "yes", but the benefits a country reaps from its partners' liberalisations are commonly less than those it reaps from its own. It is the latter that can stimulate an economy sufficiently to take full advantage of the former. Moreover, while developed countries manifestly still have trade restrictions and these are generally biased against developing countries, these countries are certainly not closed to trade. The trading regimes of rich countries are relatively even-handed across developing countries, and yet different developing countries have had very different rates of export growth. This leads one to conclude that developing countries' own policies are a very large part of the explanation. Trade policies are part of this – as I argued before, openness almost certainly begets growth. Additionally, of course, developing countries now sell a lot to each other, so developed countries are not the only markets.

## Winners and losers

Recent research[6] shows that global liberalisation has different effects on poverty in different countries depending on a huge variety of factors such as the goods/services they import and export, the structure of their labour markets and how governments replace any revenues lost by trade liberalisation. In the short-term, some countries will have small increases in poverty, particularly if developed countries eliminate agricultural export subsidies, but in the longer run we expect net gains nearly everywhere. But that does not mean that there are no losers – there will almost always be some.

Thus, if one's criterion for judging trade liberalisation is to condemn any shock that causes even one individual to suffer a reduction in income, it is unnecessary to carry out any analysis. Given the heterogeneity of households and the strongly redistributive nature of trade policy, all policies will fail this test. Rather we do sometimes have to make trade-offs between households or over time and we also have to think how losers in one area may be compensated in another. Thus, there are distributional reasons as well as efficiency ones for including trade liberalisation in a policy package and of making it broad-based; both will help to spread its benefits over wider constituencies. It is also one of the advantages of world trade talks that other countries' liberalisations help to generate opportunities that ease adjustment for the people who may lose from their own country's.

One common response to the fear that trade liberalisation will cause poverty for some is "don't do it", but liberal trade is an important part of the cocktail of policies to stimulate incomes and reduce poverty. It should clearly figure in the poverty-conscious government's armoury.

A second response is "don't do it all; while everyone is in favour of liberalisation in general, certain sectors or products should be exempt". In fact, all countries have such exceptions – for example, agriculture in Europe and clothing in the United States – but that does not make good economics. There undoubtedly are cases where an isolated intervention in trade would be beneficial to immediate economic welfare and/or to poverty alleviation. However, given the difficulty of identifying these cases, of preventing their capture by special interest groups and of avoiding the systemic signal that lobbying for protection pays, the best general rule is probably one that precludes any but the most obvious and important interventions. Thus, while one does not need to progress all the way to free trade to reap the benefits of liberalisation, the case for maintaining extensive exceptions is weak.

A third response is "don't do it now". This is more useful. For example, trade reform in the midst of recession seems likely to suffer worse transitional unemployment than reform in a boom, where investment is necessary to allow the production of export quality goods; time may be desirable to permit it to occur. There is, however, a world of difference between committing to policies with long adjustment periods and postponing liberalisation because "the time is not ripe." The key is credibility that reform will actually occur, for without that credibility, neither current nor potential future activities will look desirable and there will inevitably be a diversion of effort into lobbying. Adjustment costs may be lower if adjustment can be spread through time, but they are enlarged if adjustment is resisted in the hope that the threat of liberalisation will go away.

Even more constructive is "do some more". Trade liberalisation is likely to be more effective in conjunction with other policies – for example, to permit investment, to ensure stable macroeconomic conditions and to boost human capital. It is also likely to be more equitable in such company too. If there are concerns about poverty for certain sections of society, these should be addressed directly with targeted compensatory or complementary policies, not by manipulating trade policy.

A liberal trade regime is not sufficient for sustained poverty alleviation but it is almost certainly necessary. No country has succeeded without relatively open borders. The principal need is for developing countries' own liberalisation, supplemented with complementary policies to stimulate/permit adjustment and flexibility. There will be some losers, but not many and not for long if the package is well founded, and for them the need is for safety nets and adjustment help. Especially in a fairly closed region like South Asia, there is little to gain by waiting for other countries to move before liberalising themselves. The bulk of the gains will be self generated. ■

*Dr. Winters is Director, Development Research Group, World Bank, Washington, D.C. The findings, interpretations, and conclusions expressed in this paper are entirely those of the author and do not necessarily reflect the views of the Board of Executive Directors of the World Bank or the governments they represent.*

## NOTES

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# Trade Liberalisation and Poverty

# The case of Bangladesh

**Institutional reforms and appropriate safety net measures for the poor are the pre-conditions for making trade liberalisation effective in Bangaldesh.**

**Mohammad A. Razzaque**

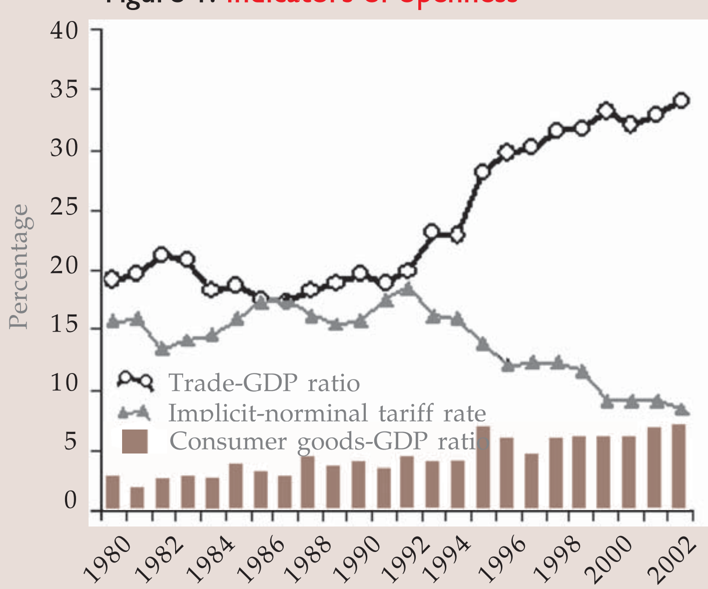
Bangladesh pursued an import substitution industrialisation strategy after its birth as an independent state in 1971. This strategy was relied upon to ease the balance of payments situation and achieve economic growth and reduce unemployment. However, even after a decade of a highly protected trade regime, budget and trade deficits continued to worsen. It was against the backdrop of serious macroeconomic imbalances that stabilisation and structural adjustment programmes were undertaken.

The liberalisation process towards removal of quantitative restrictions (QRs) began in 1985 following which the number of Harmonised System (HS) 4 digit trade related banned items were reduced from 275 to 5. In 1987-88, 40 percent of all import at the HS 4 digit level was subject to trade related QRs but these restrictions have been reduced to less than 2 percent. Import tariffs have also been cut drastically. The highest tariff rate was brought down from 350 percent in 1992 to 25 percent in 2004-05. The number of tariff slabs (including zero) has come down from 24 in the 1980s to only 4, thereby greatly simplifying the tariff structure.

Liberalisation of the import regime contributes to the reduction of anti-export bias by curtailing the protection granted to the import competing sector. The unweighted customs duty has fallen from 57.2 percent in 1991-92 to only 12 percent in 2003-04, with the import weighted rate registering a decline from 24 percent to 12.4 percent. One unusual aspect about Bangladesh's tariff regime has been the recent increase in the discriminatory use of supposedly trade-neutral taxes, such as supplementary duties and value added tax (VAT). Consequently, these taxes now have some protection contents over and above customs duties. Nevertheless, the total protective rate has declined significantly. The mean effective rate of protection for the tradable sectors has declined from 76 percent in 1992-93 to 24 percent in 2000.

Until the early 1980s, Bangladesh maintained an overvalued and fixed exchange rate system, later replaced by a 'managed' floating system. An additional exchange rate for attracting remittances and providing incentives to the exporters of non-traditional items was put in place. Due to the conditionalities imposed by the International Monetary Fund (IMF), reforms of the exchange rate regime were undertaken in the early 1990s, including unification of the exchange rates, convertibility of the *taka* in the current account, and relaxation on foreign exchange transactions. The government introduced the free float of the *taka* in 2003. Another element of trade policy reform includes subsidised rates of interest on bank loans, duty-free import of machinery and intermediate inputs, cash subsidy and exemption from domestic taxes. Many exporters have also benefited from trade preferences granted by other trading partners, most notably by the European Union (EU). The country also benefited from opportunities arising out of the Multi Fibre Arrangement quotas. As Figure 1 shows, Bangladesh's trade to gross domestic product (GDP) ratio rose from 17 percent in the mid-1980s to 36 percent in 2005. The ratio of imports of consumer goods to GDP has increased from 2 percent to 6 percent. The implicit nominal tariff rate – total customs revenue divided by total imports – has de-

Figure 1: Indicators of openness

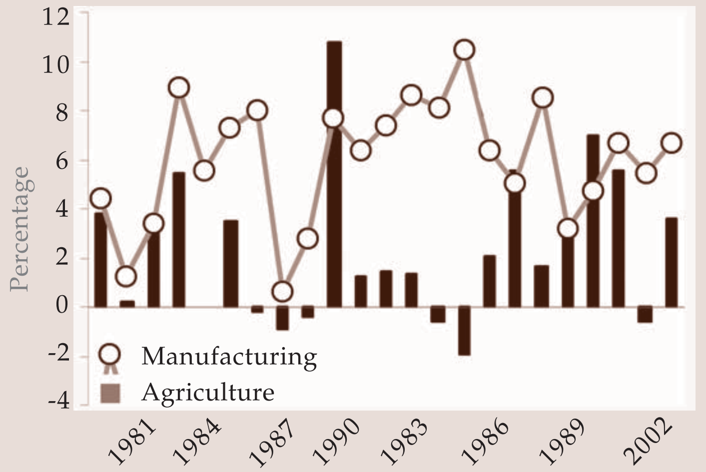


clined from more than 18 percent in the early 1990s to less than 8 percent in 2005.

## Impacts of trade reforms

A simple way of assessing the effectiveness of trade reforms is to compare the growth of GDP in pre and post-liberalisation periods. The trend growth rate of GDP in the 1980s was 3.51 percent as against 4.81 percent during 1990-2004. The difference between the two trend rates indicates a better economic performance in the post-reform period. This simple approach is seriously flawed as it does not take into account the sources of growth. It is unclear whether after controlling for traditional sources of growth, liberalisation would have any distinctive effect. In the absence of such an analysis, skeptics could argue that the increased rate of growth in the post-liberalisation period arose irrespective of reform measures (or, higher growth 'despite' rather than 'because of' liberalisation). Another problem is the specification of one particular point in time as the separator between the pre and post-reform regimes. Many reforms were implemented during the 1980s and the existence of such a break point is unrealistic.

Figure 2: Growth of manufacturing and agriculture




To overcome such problems, sophisticated regression methods have been employed to explain the growth performance using time varying indicators of liberalisation measures along with other variables. When the traditional neo-classical and endogenous growth models are extended by incorporating such measures, none of these indicators are found to be exerting statistically significant effect on growth. For the manufacturing sector, using a panel data of 27 industries over a period of 22 years, regression results fail to find any significant effect of liberalisation on growth.

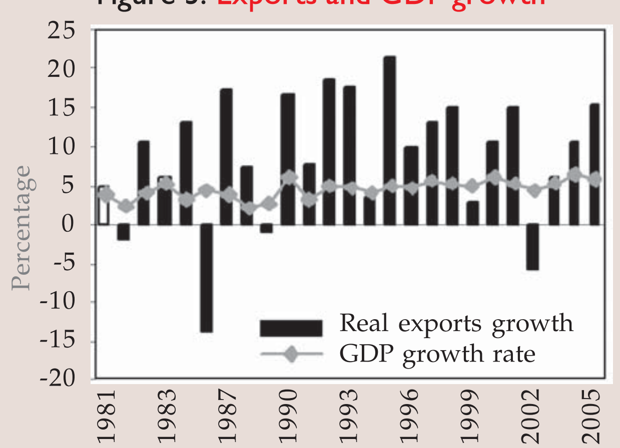
The impact of trade reforms on the manufacturing sector has attracted much attention. Although compared to the 1980s, the sector achieved an annual average growth 1.5 percentage points higher in the 1990s, the reason for the latter period's superior growth is attributed entirely to the export oriented readymade garments (RMG) sector. The non-RMG sector has declined in the post-liberalisation period. Some observers point out that opening up has resulted in deindustrialisation especially when the growth of the RMG industry is unlikely to be a result of liberalisation. Moreover, agriculture did not show dynamism in the post-reform period. The trend growth rate for agricultural output during 1991-2003 is found to be not significantly different from that of the 1980s (Figure 2).

Bangladesh has been successful in energising exports through trade reforms. In 1979-80, the country's total exports stood at US$ 913 million, which increased to US$ 1.5 billion by 1989-90 and rocketed to US$ 10.2 billion in 2005-06. Exports to GDP ratio more than doubled from less than 6 percent in the 1980s to about 14 percent in 2004.

The robust export performance has led analysts to justify the export-led growth (ELG) hypothesis, which postulates a causal effect of exports on GDP. Econometric investigation fails to corroborate the ELG hypothesis for Bangladesh. There is a convincing reason to explain this empirical finding. While GDP is a measure of 'value added', a significant proportion of exports are intermediate inputs. Considering just the domestic value added in exports, the share of RMG in GDP increased from 4.4 percent in 1991 to 8 percent in 2005. This share is perhaps too small to turn the export sector into an engine of growth. It is striking that even towering growth rates of exports are associated with only slight changes in GDP (Figure 3).

The response of other export items has been very weak. Of the 17 percent annual average growth in exports during 1990-96 and of 10 percent during 1997-04, the contributions of non-RMG items were respectively 1.31 percent and 0.11 percent. This dismal performance of non-RMG items suggests that trade reform measures may not have been successful in stimulating export response.

Figure 3: Exports and GDP growth




There is no *ex post* econometric studies analysing the link between trade policy and households through changes in prices of goods and services, distributional channels and government reve-

**Incidence of poverty in Bangladesh**

| Year | Proportion of population below the poverty line (%) | | |
|---|---|---|---|
| | Rural | Urban | Total |
| 1991-92 | 61.2 | 44.9 | 58.8 |
| 1995-96 | 55.2 | 29.4 | 51.0 |
| 2000 | 53.0 | 36.6 | 49.8 |
| 2004 (provisional) | - | - | 42.0 |

nues. In their absence, impact on poverty is assessed on the basis of the observation of trends. The comparable poverty estimates for the 1990s show some significant decline in poverty incidence from about 59 percent in 1991-92 to 50 percent in 2000 (see the table). Most of this decline took place by 1995-96. Between 1995-96 and 2000, absolute poverty fell by 1.3 percentage points only (0.3 percentage points per annum). A provisional estimate for 2004 shows a decline in the headcount poverty ratio to 42 percent. The reason for this relatively rapid reduction in poverty rate between 2000 and 2004 is not clear, particularly when there has hardly been any difference between the average economic growth during 1995-2000 and 2000-2004. The inequality in the distribution of private per capita expenditures has increased throughout the 1990s. Currently, the nature and extent of liberalisation effects on poverty incidence and inequality, is not known.

Employment expansion during the 1990s (2.1 percent per annum) has been much slower than that during the 1980s. Manufacturing employment fell from 5.9 million in 1990-91 to 4 million in 1999-2000, despite the robust growth of the employment intensive RMG sector. Therefore, the available data seem to suggest that the manufacturing sector has shrunk following liberalisation. The growth of real wages of unskilled workers in manufacturing, agriculture, and construction also declined during 1990-2000.

Although *ex post* poverty impact analysis using an analytical framework is unavailable, efforts have been made to simulate the likely consequences of trade reforms utilising computable general equilibrium (CGE) models. One recent influential study finds that the complete elimination of all tariffs results in adverse welfare consequences in the short-run, which are ultimately more than offset by long-run gains. A great deal of caution is required in analysing the CGE results. While the model structures, underlying assumptions, use of calibrated parameters and questionable elasticities have long been the subjects of criticism, more limitations often emanate from the design of adjustment mechanisms. In these models, liberalisation in one sector leads to rapid and automatic reallocation of resources according to the relative static comparative advantage of the sectors involved. In reality, because of inertia and rigidity, such reallocation may not be as straightforward. For example, turning ploughs and tractors into garment machineries is something that has to go much beyond the automatic adjustment process. Furthermore, how the lost revenues will be recouped is also likely to affect the simulation results. The assumption that the government can readily access alternative sources of revenues is to be regarded as a serious limitation. When public expenditures benefit the poor, any shortfall in government revenues following tariff cuts could deteriorate the poverty situation despite the overall positive welfare effects. Total tariff elimination is no pragmatic policy option for any government and there is no guarantee of obtaining positive welfare gains for partial liberalisation scenarios. CGE simulation exercises cannot depict what has actually happened. Therefore, when it comes to the evaluation of the trade poverty nexus, *ex post* exercises are more useful.

## The way forward

One of the most critical challenges facing Bangladesh is to make liberalisation effective. While the donors strongly recommend a more vigorous across the board trade reforms, others are in favour of a gradual and pro-active analytical policy regime so that effective support to the growth of activities with significant poverty alleviation effects can be provided. Sometimes, no distinction is made between trade policy and trade liberalisation, which is unrealistic. Rather, trade liberalisation should be considered just as one component of the whole set of policy options. When exercising a pro-active trade policy, careful attention should be given so that sectors that are unlikely to achieve dynamic gains are not chosen for policy support. Identifying such sectors is also a difficult task. As losers from liberalisation and protection seekers are active while those who gain are generally passive, there is a risk of assessing the situation from a wrong perspective. As trade reforms are likely to generate disproportional distributional consequences, appropriate safety net measures are required to help the poor. Institutional reforms are increasingly considered to be a pre-requisite for successful trade liberalisation programmes, which have, so far, not been given much attention in Bangladesh. By sending clear signals to economic agents, ensuring law and order, regulating anti-competitive behaviour, enforcing property rights and insitutionalising rules of the game, efficient institutions facilitate the participation of the poor in the growth process. Trade liberalisation is a complicated process and policies to influence it need to be carefully designed, delicately managed, intensively monitored, and methodically evaluated. ■

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# Trade Liberalisation and Poverty

# The case of India

India's achievements in the post-reform period are wide-ranging and impressive as far as economic performance is concerned but initiatives are still needed to transfer the benefits of growth to the backward and poor sections of the society.

**Pranav Kumar and Prashmita Ghosh**

India chose a strategy of import substitution as a means of industrialising the economy in the immediate post-independence period. To facilitate import substitution, India maintained high tariff walls, complicated system of licenses and quantitative restrictions. The inward-looking strategy was in practice till 1980. The import substitution strategy helped in creating a reasonably large industrial and financial sector base led by public sector enterprises. Since the mid-1980s, India gradually shifted the focus of its developmental strategy towards export-led growth. Full-fledged radical reforms started only in 1991, when India was confronted with severe macroeconomic and balance of payment crisis. To deal with its external payments problems, the Government of India requested a stand-by arrangement from the International Monetary Fund (IMF) in August 1991. The IMF support was conditional on an adjustment programme featuring macroeconomic stabilisation and structural reforms.

The economic reforms of the last one and a half decades has brought positive results in terms of expansion in exports and increase in gross domestic product (GDP) growth rate from an average rate of 3.5 percent (the so-called 'Hindu rate of growth') to 5-6 percent in 1980s and 1990s, touching an all time high of 8.2 percent in 2003-04. However, the impact of higher economic growth on employment and poverty reduction is not very encouraging.

The pace of employment growth slowed down during the 1990s. Poverty incidence declined, both in absolute and percentage terms, but it falls short of projections. Moreover, the export-led growth did not leave much impact on the major pockets of poverty, in states such as Assam, Bihar, Orissa and Uttar Pradesh. This has further accentuated regional disparities. In this context, this article tries to investigate the impact of trade-led growth on poverty and employment generation in India.

**Table 1: Average annual growth in GDP**

| Indicator | 1981-82 to 1990-91 | 1992-93 to 2001-02 | 1992-93 to 2002-03 | 1997-98 to 2001-02 | 1997-98 to 2002-03 | 2003-04 | 2004-05 | 2005-06 |
|---|---|---|---|---|---|---|---|---|
| GDP (%) | 5.6 | 6.1 | 5.9 | 5.5 | 5.3 | 8.5 | 6.9 | 6.5-7.0 |
| Agriculture | 3.8 | 3.3 | 2.7 | 2.0 | 2.0 | 9.6 | 1.1 | 2.0 |
| Industry | 7.0 | 6.3 | 6.4 | 4.6 | 4.6 | 6.5 | 8.3 | 8.5-9.0 |
| Services | 6.7 | 7.8 | 7.8 | 8.1 | 8.1 | 8.9 | 8.6 | 8.5-9.0 |

*Derived from India Development Report 2004-05, Oxford University Press.*

**Table 2: Indicators of trade openness**

| Indicators (%) | 1980 | 1990 | 2000 | 2005 |
|---|---|---|---|---|
| Exports/GDP | 4.6 | 5.8 | 9.8 | 11.8 |
| Imports/GDP | 8.7 | 5.5 | 13.0 | 17.1 |
| Exports of goods and services/GDP | 6.2 | 7.3 | 14.0 | 20.2 |
| Imports of goods and services/GDP | 9.7 | 9.9 | 16.6 | 22.4 |

Source: The World Bank. 2002. *World Development Indicators 2002*. Washington, D.C.: The World Bank.

## Performance of key sectors

India's economic growth has accelerated since the early 1990s. Real GDP growth is estimated to be 8.4 percent in 2004-05. Services, industry and agriculture accounted for 50.7 percent, 26.6 percent and 22.7 percent of GDP respectively. The services sector has been the principal driver of GDP growth during the 1990s. The industrial sector is going through a process of restructuring, consolidation, adaptation of cost-cutting measures, foreign collaboration and technological upgrading. Industries like pharmaceuticals and automobile have already become quite competitive in the world market. Although a huge restructuring took place in the industrial sector, on the whole the performance of the industrial sector during the post-reform period 1992-2002 was not as satisfactory as in the pre-reform period, 1982-90. The agricultural sector has also performed poorly. Table 1 gives the average annual growth in GDP and of the key sectors of Indian economy.

Export growth has picked up significantly after the initiation of reforms, particularly in merchandise. India's share in total world exports reached 0.8 percent in 2004 from 0.5 percent in the 1980s. The ratio of total exports of goods and services to GDP nearly doubled between 1990 and 2000, rising from 7.3 percent to 14 percent and further to 20.22 percent in 2005. Table 2 indicates the percentage of trade openness for India.

As far as the composition of exports and imports is concerned, there has been a steady decline in the share of primary products in total exports from 26 percent in 1987-88 to 16 percent in 2001-02. On the other hand, the share of manufactured exports rose from 67 percent in 1987-88 to 76 percent in 2001-02. In 2004-05, manufactured exports declined to 73.7 percent.


## Impact on employment

Productive employment generation is the common objective of any economic growth model. Economic reforms are undertaken to raise growth rates of different sectors within the economy, generate productive employment opportunities and reduce poverty. In the case of India, though reforms led to high growth rate, its impact on employment generation had been minimal. The elasticity of employment that measures percentage growth in total employment with a 1 percent growth in GDP, registered a consistent decline in 1990s. The low employment elasticity in the 1990s reflects the fact that employment growth decelerated in this period while GDP growth accelerated. The total employment growth decelerated from 2.04 percent per annum during 1983-94 to 0.98 per annum during 1994-00. Much of the slowdown in total employment growth was due to developments in agriculture (including forestry and fishing), community, social and personal services. Accounting for almost 70 percent of total employment, these sectors experienced no growth in employment in the period 1993-94 to 1999-00.

Agriculture accounts for roughly 60 percent of total employment and absence of growth in this sector will have significant impact on the overall employment situation in the economy. The primary sector has traditionally served as a residual employer, and is, therefore, characterised by considerable underemployment, disguised unemployment, seasonal variation in employment and relatively low real wages. The long-term employment strategy should aim at absorbing surplus labour in the non-agricultural sector, thus reducing the pressure of labour on land and thereby tightening the labour market so that incomes per head in farming and real wages of agricultural labour rise significantly. A robust growth in the manufacturing sector would draw additional labour from the agricultural sector and increase urban wages. However, the growth of the manufacturing sector has fallen sharply in the last seven years of reforms. The growth story of the Indian economy is being driven by the services sector that needs skilled and educated people. A majority of Indians are still uneducated and low skilled. Given this difference in the structure of the labour force and the sector that is leading to higher GDP growth rate, unemployment remains a major issue not addressed by the reforms. Improvement in agricultural productivity supported by increased employment opportunities in manufacturing industries will lead to the migration of surplus labour from unproductive agricultural activities to the productive industrial sector.

## Impact on poverty

Economic liberalisation has an important role to play in alleviating poverty through higher growth. Job creation leads to rising purchasing power of the poor with the endowment of land and non-land assets and generates wide scale employment opportunities in the economy. The proportion of people living below the poverty line remained above 50 percent with no declining trend till the mid-1970s. It declined thereafter in the late 1970s and 1980s from 51 percent in 1977-78 to 39 percent in 1987-88. The intensity of poverty also declined considerably both in the rural and urban areas. During the 1990s, the slowdown in rural employment growth and slowdown in the growth momentum of rural non-agricultural activities affected the pace of decline in rural poverty and aggravated rural-urban disparities. Almost 260 million Indians (193 million in rural and 67 million in urban India) remained below the poverty line in 1999-00 (Table 3).

Even with the reduction in the poverty level, absolute poverty level in India in income terms remained unacceptably large. The composition of the poor has been changing and rural poverty is getting mostly concentrated in agriculture-labour and artisan households while urban poverty is present in the casual labour households. The magnitude of multiple deprivations of the people in India is very high. A survey of human development in India by National Council for Applied Economic Research (NCAER) has also revealed that 50 percent of the population suffers from capability poverty.

There is also evidence that shows discrimination against women in the labour and wage market, particularly in rural and unorganised sectors. While all members in a poor household may suffer, it is possible that women and girls in the family suffer disproportionately and that while a household may not be counted among those suffering from poverty, the female members may display all the characteristics of poverty and deprivation. Female-headed households registered higher poverty rates than the general population for most states.

The true benefits of trade liberalisation cannot be realised unless it makes a positive contribution in addressing poverty gaps between different sections of the society. In India's case, it is important as a majority of poor are dependent on agriculture for their subsistence. As of 1999-00, India's poverty was predominantly rural although rural poverty has declined faster than urban poverty over the last 25 years. Moreover, the decline in national poverty seems to have been driven mostly by the decline in rural poverty — not surprising given that 74 percent of India's population lives in rural areas.

The decline in the incidence of poverty during the period 1993-94 to 1999-00 cannot be wholly attributed to trade liberalisation measures undertaken by India. Poverty alleviation programmes such as self-employment schemes, wage employment programmes, nutrition programmes and social security programmes also contributed to poverty reduction.

**Table 3: Estimates of poverty incidence in India**

| Year | Poverty ratio (%) | | | No. of poor (million) | | |
|---|---|---|---|---|---|---|
| | Rural | Urban | Combined | Rural | Urban | Combined |
| 1977-78 | 53.1 | 45.2 | 51.3 | 264.3 | 64.6 | 328.9 |
| 1983 | 45.7 | 40.8 | 44.5 | 252.0 | 70.9 | 322.9 |
| 1987-88 | 39.1 | 38.2 | 38.9 | 231.9 | 75.2 | 307.1 |
| 1993-94 | 37.3 | 32.4 | 36.0 | 244.0 | 76.3 | 320.3 |
| 1999-00 | 27.1 | 23.6 | 26.1 | 193.2 | 67.1 | 260.3 |
| 2007* | 21.1 | 15.1 | 19.3 | 170.5 | 49.6 | 220.1 |

*Poverty projection for 2007

*Derived from Tenth Five-Year Plan, Government of India.*

## Conclusion

India's achievements in the post-reform period are wide-ranging and clearly impressive as far as economic performance is concerned. Post 1991, India had a significant acceleration in its growth rate. However, trade expansion in India has not helped in reducing poverty and generating employment as expected. Effective liberalisation measures along with supportive policies are needed to transfer the benefits of growth to the backward and poor sections of the society. ■

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## Trade Liberalisation and Poverty

# The case of Nepal

The benefits of Nepal's trade reforms have been confined to a few manufacturing industries and urban populations and has not helped in the transformation of the agricultural sector.

**Shiv Raj Bhatt and Puspa Sharma**

Prior to the 1980s, Nepal's trade policies were dominated by inward-looking and state-led development strategies. Protection to domestic industries, import substitution, state-led industrialisation, and government monopolies in major industries/sectors, were the main policy measures. Through the structural adjustment programme, Nepal initiated economic reforms since 1984/85. Liberal and market-oriented trade policy was one of the key components of the reform. The reform process was intensified after the restoration of multi-party democracy in 1990.

The key features of liberalisation included devaluation and introduction of flexibility in the exchange rate, elimination of import license and quotas, rationalisation of the tariff structure, reduction in the average level of tariffs, implementation of full convertibility of the rupee in the current account, liberalisation of foreign investments, privatisation and institutional reform of state-owned enterprises, market-based pricing of agricultural inputs and outputs, and reduction of subsidies on credit and irrigation.

These reforms targeted high and sustained growth through market-based resource allocation, infusion of competition in the economy, and reduction of state domination and encouragement of private participation in economic activities.

The recent developments in the trade arena – Nepal's accession to the World Trade Organization (WTO) and signing of regional trade agreements - South Asian Free Trade Area (SAFTA) and Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) – are expected to contribute to further acceleration of the trade liberalisation process.

### Trade performance in the post liberalisation era

After 1990, Nepal's trade liberalisation brought significant changes in the trade sector. During 1990-00, both exports and imports as percentage of gross domestic product (GDP) grew sharply, albeit with a decline after 2000. In 1990, while exports and imports as percentage of GDP were 5 percent and 17.7 percent respectively, the same figures for 2000 were 13.1 percent and 28.6 percent, and for 2005, 11 percent and 25 percent.

Regarding trade deficit, Nepal did not observe any improvement due to trade liberalisation. Trade deficit increased from 12 percent of GDP in 1990 to 21 percent in 1995, and 14 percent in 2005.

Nepal's trade structure also experienced sharp decline in the share of primary goods exports and increase in manufactured goods exports. Share of primary goods decreased from 56.2 percent in 1985 to 17 percent in 1990 and 12.9 percent in 1995. However, due to decline of manufactured exports between 1995-2005 (85.2 percent in 1995 to 70.7 percent in 2005), the share of primary goods exports increased (from 12.9 percent in 1995 to 22.5 percent in 2005).

Growth rates in manufactured exports are largely attributed to carpets and readymade garments industries; the two industries contributing nearly two-third in Nepal's overseas exports.

### Implications of trade liberalisation on poverty

There has been much debate on whether or not trade liberalisation benefits the poor. In fact, the link between trade liberalisation and poverty is extremely complex. However, there is no denying that trade liberalisation affects the poor and poverty. Trade liberalisation can affect poverty through a number of ways.

Table 1: Average GDP growth (at constant prices)

| Period | GDP | Agricultural GDP | Non-agricultural GDP |
|---|---|---|---|
| 1980 -1985 | 4.70 | 5.21 | 3.77 |
| 1986 -1990 | 5.22 | 3.57 | 6.95 |
| 1991-1995 | 4.88 | 1.85 | 7.31 |
| 1996 - 2000 | 4.73 | 3.69 | 5.47 |
| 2001- 2005 | 2.02 | 2.85 | 2.63 |

*Compiled from various Economic Surveys, Ministry of Finance, Government of Nepal*

Indirectly, it can affect poverty through its effect on economic growth, and directly through its effect on factor markets (income and employment), product markets (prices and availability of commodities) and government capacities to implement pro-poor policies (government revenue and expenditure). Hence, one option to assess the implications of trade liberalisation on poverty is to analyse the pattern of changes in these variables. However, it should be noted that changes in these indicators depend on many factors, and trade liberalisation is one among such factors.

### *Economic growth*

Nepal is historically a low growth country with GDP growth rates averaging less than 5 percent since the 1980s (see Table 1). There has not also been any significant improvement in per capita GDP. For instance, per capita GDP at constant prices was US$ 120 in 1980, which reached US$ 330 in 2006.[1] Average annual growth in per capita GDP was only 2.6 percent during the pre-reform period (1980-85), which reached 4.6 percent during early reform period (1986-90) and 5.2 percent during mid-reform period (1991-95). However, this growth rate could not be sustained after 1996 (4.8 percent during 1996-00 and 3 percent during 2001-05).

The growth pattern of GDP suggests that the reform process complemented by the political change in 1990 – from the party-less Panchayat system to multi-party democracy – led to some positive changes in the economy. However, these changes were mostly confined to the non-agricultural sector, which is evident from Table 1. Whereas the growth of the agricultural sector, in which a majority of Nepal's poor depend for livelihood, was slower than the growth of the non-agricultural sector. Since the reform in the agricultural and non-agricultural sectors did not contribute to sustainable and pro-poor growth but led to sharp increase in rural urban inequalities, the overall impact on poverty reduction cannot be claimed to be positive or pro-poor and broad-based. Moreover, due to low growth in agriculture, living standards in rural areas did not improve as envisaged.

Witnessing the slow growth in the agricultural sector, it can be said that Nepal's trade liberalisation process did not favour the country's overarching goal to use agriculture as a means to poverty reduction. The liberalisation package for the reform in the agricultural sector consisted of withdrawal of state subsidies, opening up of agricultural input markets as well as tariff reduction on both intermediate and final products, among others. The aim was to allow agricultural output prices to rise, which would raise rural incomes. However, small and vulnerable farmers faced higher production costs, once input subsidies were withdrawn, along with competition from imported products. The growth rates of major crops such as paddy, maize, wheat, oil seeds and pulses have witnessed decline while there has been some increase in the growth rate of cash crops such as sugarcane and tea.

Unlike the agricultural sector, as indicated above, the impact of trade liberalisation on Nepal's manufacturing sector has been positive. Manufacturing output grew sharply immediately after the reforms. Growth that averaged around 5 percent per annum during the 1980s rose to 14 percent during 1991-95. However, this high growth rate was mainly because of the growth of readymade garment and carpet industries. This growth decelerated sharply after the phasing out of the quota system in the garment industry and emergence of standards-related problems in the carpet industry. For instance, the average growth of manufacturing sector declined to 7.6 percent during 1996-00 and to 0.1 percent during 2001-05. In addition to quota phase out and standard related problems, armed conflict and poor supply-side response also affected the growth of the manufacturing sector, ultimately leading to adverse consequences in the performance of the overall economy.

### *Government revenue*

Despite several measures to widen the domestic tax base following trade liberalisation, international trade still accounts for nearly 50 percent of revenue in Nepal. The Nepalese government depends heavily on trade-related taxes for its regular and developmental expenditures. Generally, it is argued that tariff reduction would lower revenue, negatively affecting the government's capacity to finance pro-poor programmes (e.g., related to health, education, drinking water). In the case of Nepal, government revenue in the post-reform period has increased; trade-related taxes alone contributed around 60 percent in total tax revenue during 1996-05. The growth of tax revenue increased from 15.9 percent in the pre-reform period (1981-85) to 18.5 percent in the early reform period (1986-90). However, it declined to around 11.1 percent in the mid-reform period (1996-01) and to 10.4 percent in the recent period (2001-05),

**Table 2: Poverty trends in Nepal**

| | MPHBS | NLSS | NLSS |
|---|---|---|---|
| | 1985 | 1995/96 | 2003/04 |
| Nepal | 42.5 | 41.8 | 30.9 |
| Urban | 19.2 | 21.6 | 9.6 |
| Rural | 43.2 | 43.3 | 34.6 |
| Nominal per capita consumption | | | |
| Nepal | | 6,802 | 15,848 (133) |
| Poorest 20 % of population | | 2,571 | 4,913 (91) |
| Richest 20 % of population | | 15,243 | 42,236 (177) |
| Nominal per capita income | | | |
| Nepal | | 7,690 | 15,162 (97) |
| Poorest 20 % of population | | 2,020 | 4,003 (98) |
| Richest 20 % of population | | 19,325 | 40,486 (110) |

*Note: Figures in parentheses represents percentage changes.*

*Derived from Multi Purpose Household Budget Survey (MPHBS), Nepal Rastra Bank, 1985; and Nepal Living Standard Survey (NLSS), Central Bureau of Statistics, 1996 and 2004.*

mainly due to low economic growth and poor performance of the export-oriented manufacturing sector in this period. So far, the negative impact of tariff reduction due to trade liberalisation has been offset by higher revenue base created by higher imports, wider income tax base, introduction of value added tax (VAT) system, and upward revision of VAT rate.

### *Labour markets*

Despite high unemployment and underemployment, there has been some improvement in wage rates during the last two and half decades. However, real wage increased unequally in agriculture (around 1.7 percent) and industrial (around 2.5 percent) sectors during 1981-05. As most of the workers are in the unorganised sector and self-employed (78 percent self-employed and 22 percent wage-workers), trade liberalisation in the labour market has not benefitted the rural poor and only covered a limited and small segments of society, that too in the urban areas, leading to rural urban inequalities.

### *Micro level effects: Household income and consumption*

At the time Nepal initiated economic reforms, 42.5 percent of Nepalese were below the poverty line, with a headcount ratio of 19.2 and 43.3 percent in urban and rural areas respectively (Table 2). The results of Nepal Living Standard Survey (NLSS) survey 1995-96 show that there was no marked progress in poverty reduction during 1985-95. The proportion of the urban and rural population living below the poverty line even increased marginally.[2] This shows that initial reform measures did not succeed in reducing poverty during 1985-96. Encouragingly, the headcount ratio declined from 41.8 percent in 1995-96 to 30.9 percent in 2003-04. During this period, urban poverty reduced from 21.6 percent to 9.6 percent (56 percent reduction), whereas rural poverty decreased from 43.3 percent to 34.6 percent (20 percent reduction). Surprisingly, this reduction took place when there were low GDP growth (less than 4 percent, refer to Table 1) and high population growth (around 2.3 percent) rates. Therefore, the achievements cannot be credited to trade liberalisation alone because poverty was reduced when there was low GDP growth. NLSS has credited remittance transfers; rising agricultural and non-farm wages; enterprise incomes; urbanisation and share of economically active population ratio as the major contributing factors for such reduction.

During 1996-04, nominal per capita household income and consumption also rose annually by 9 and 11 percent respectively. But growth in per capita consumption of poorest 20 percent of population is half than that of the richest 20 percent (see Table 2). Most of the growth in income comes from the non-agricultural sector and non-wage employment, indicating that non-agricultural sector activities facilitated by liberal industrial and trade policies have had an impact on income, employment and poverty.

## Conclusion

Trade liberalisation in Nepal was expected to contribute to high and sustained growth and poverty reduction. But evidences suggest that the benefits of Nepal's trade reforms have been confined to a few manufacturing industries and urban populations. Moreover, trade liberalisation did not help to promote the agricultural sector, including rural farmers and populations. The low supply response of the agricultural sector has resulted in low agricultural growth and hence, slow growth in rural incomes. To conclude, it can be said that Nepal's reform process affected urban and rural households differently and its positive impact increases with income levels. ■

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## NOTES

1. IMF. 2006. *World Economic Outlook Database 2006.* Washington, D.C.: International Monetary Fund.
2. This surprising result (decreased overall poverty and increased rural/urban poverty) may be due to the declaration of many village development committees as municipalities.

# Trade Liberalisation and Poverty

# The case of Pakistan

Pakistan has made rapid strides in stimulating economic growth and reducing poverty although inflation, exogenous shocks and protectionism could derail the liberalisation process.

**Akhtar Mehmood and Farkhanda Sohail**

Pakistan's trade policies until the 1970s were characterised by high levels of protection, whose main purpose was to protect infant industries from foreign competition. These policies misallocated resources by encouraging import substitution. From the late 1980s, tariff rates started falling and from 1987 onwards, trade liberalisation gathered pace. In 1988, the initiation of the structural adjustment programme under an agreement with the International Monetary Fund (IMF) introduced a number of reforms. By 1990, significant measures toward privatisation, deregulation and trade liberalisation were introduced.

A review of the key economic indicators shows that Pakistan's economy has performed well after the introduction of trade reforms. Due to exogenous shocks, economic growth registered a downward trend in the late 1990s to 2002. From 2002-03 onwards, gross domestic product (GDP) growth picked up significantly, and was on average, 6.8 percent between 2002-03 and 2005-06, reaching a peak of 8.6 percent in 2004-05. Per capita income grew at an average rate of 4.8 percent per annum during the first six years of the 1990s. From 1996-97 to 2001-02, per capita income fell by an average of 3.1 percent per annum. During 2002-05, the per capita income has registered a phenomenal average growth rate of 13.6 percent per annum, rising from US$ 582 in 2002-03 to US$ 669 in 2003-04 and further to US$ 742 in 2004-05. Pakistan's per capita income in 2005-06 reached US$ 847[1].

## Effects of trade liberalisation on the economy

Trade liberalisation affects economic growth through various channels. It may lead to increased level of productivity by encouraging countries to specialise in the production of goods in which they have comparative advantage. Productivity may be further enhanced by technology transfer, knowledge spillovers, economies of scale, increased competition and greater reliance on market signals. The increases in productivity and efficiency also lead to a rise in employment in the efficient sectors of the economy, which can contribute to reduce poverty. A reduction in import barriers could lead to higher level of investment. Trade liberalisation may benefit consumers as they have access to a variety of goods at competitive prices.

As Table 1 shows, meaningful and substantial trade liberalisation started in 1987, and since then Pakistan has eliminated virtually all of its non-tariff barriers such as licensing procedures, quantitative restrictions, and its system of foreign exchange quotas. Since 1987, Pakistan has reduced its tariffs substantially. The average applied tariff is now about 17 percent, and its maximum tariffs (except its tariffs relating to the automotive sector) have come down from 125 percent in 1987-88 to 25 percent in 2002-03. The dispersion of its tariff slabs has also been reduced drastically. In 2005, Pakistan had only four slabs – 5, 10, 15, and 25 percent, as compared to 17 slabs in 1987-88.

Pakistan's exports are highly concentrated in few items, viz. cotton, leather, rice, synthetic textiles and sports goods. After the trade reforms of the 1990s, Pakistan's export composition has changed significantly. There is a sharp decline in the shares of primary and semi-manufactured exports but increase in the share of manufactured goods (Table 2). As far as Pakistan's share in world exports is concerned, it remained roughly at 0.15 percent[2]. However,

**Table 1: Tariff reforms in Pakistan**

| Year | Slabs | Maximum |
|---|---|---|
| 1987-88 | 17 | 125 |
| 1994.95 | 13 | 65 |
| 1997-98 | 5 | 45 |
| 1998-99 | 5 | 35 |
| 2000-01 | 4 | 30 |
| 2001-02 | 4 | 25 |
| 2002-03 | 4 | 25 |
| 2003-04 | 4 | 25 |

*Based on sources of National Tariff Commission, Government of Pakistan.*

**Table 2: Composition of exports (% share)**

| | Primary commodities | Semi manu-factured | Manufactured goods | Total |
|---|---|---|---|---|
| 1990-91 | 19 | 24 | 57 | 100 |
| 1994-95 | 11 | 25 | 64 | 100 |
| 1999-00 | 12 | 15 | 73 | 100 |
| 2004-05 | 11 | 10 | 79 | 100 |

*Derived from Economic Survey of Pakistan 2005-06. Government of Pakistan.*

this implies that Pakistan's export growth has kept pace with world export growth and it has not lost its market share in world exports.

Table 3 depicts the trend in trade deficit, net private transfers and current account deficit after trade liberalisation. During the last three years (2002-05), strong economic growth has led to a surge in investment spending, which resulted in increased volume of imports (average percentage increase in imports from 2003 to 2005 was 25.9 percent). During the same period, strong and sustained growth in the world economy has benefited the country's exports; average growth rate for the last three years is 16.4 percent. After trade liberalisation, the downward trend was observed in the trade deficit to GDP ratio until 2002-03. However, the surge in imports over the last two years has led to a sharp increase in the trade deficit and this trend has continued in 2006. From 2000 onwards, a positive trend is observed in net private transfers, which include remittances, floatation of bonds, foreign direct investment (FDI) flows and privatisation proceeds. The current account balance was negative in 2004-05 and 2005-06 due to higher cost of oil imports, inflated shipping charges, growth in personnel travel etc.

## Poverty and income inequality

Trade affects poverty directly through its impact on the cost of living, jobs, and wages, as well as government revenue, and indirectly through its effect on the development and utilisation of productive capacity of a society. Higher capacity utilisation is an important indicator of expansion in international trade. In Pakistan, the highest increase in capacity utilisation has been observed in electronics and automobiles. Other industries that have done well are fertiliser, paper and paper board, tractors, industrial chemicals, and steel.[3]

In order to monitor progress on poverty reduction towards the achievement of the Millennium Development Goals (MDGs), the Planning Commission of Pakistan established its poverty line in 2000-01. This poverty line was calculated on the basis of 2,350 calories per adult equivalent per day at Rs. 748.57 per capita per month at the prices of 2000-01 and minimum non-food requirements.

Table 4 shows that the incidence of poverty fell during 1987-88 and 1990-91 from 29.2 percent to 26.1 percent, and then rose continuously in the 1990s until it reached 32.1 percent in 2001-02. This increase in poverty was the result of the severe exogenous shocks such as economic sanctions by the United States (US) – following nuclear explosions by Pakistan in 1998 – and drought. In this decade, Pakistan's GDP grew at about 4 percent compared to 6.5 percent in the 1980s. Inequality (measured by the Gini Coefficient) did not change but there was a rise in the absolute number of the poor.

In 2005, the poverty line was raised to Rs. 878.64 per adult equivalent per month to incorporate the relatively high inflation rate (9.3 percent in 2004-05). Table 5 shows that the percentage of the population living below the poverty line has fallen from 34.46 percent in 2001 to 23.9 percent in 2004-05. During 2000-05, urban poverty has declined from 22.69 percent to 14.9 percent whereas rural poverty fell from 39.26 to 28.1 percent.

The substantial reduction in poverty in 2005 indicates that the impressive growth performance of Pakistan during the last four years is the major contributing factor towards poverty reduction. Strong economic growth generated numerous employment opportunities. According to Labour Force Survey 2005, since 2003-04 to the first half of 2005-06, 5.82 million new jobs have been created as against an av-

**Table 3: External balance (% of GDP)**

| | Trade deficit | Net private transfer | Current account balance |
|---|---|---|---|
| 1990-95 | 4.1 | 3.9 | 4.1 |
| 1995-00 | 3.1 | 3.7 | 4.3 |
| 2000-05 | 1.4 | 6.1 | 1.2 |
| 2000-01 | 1.8 | 5.5 | 0.7 |
| 2001-02 | 0.4 | 5.9 | 1.9 |
| 2002-03 | 0.5 | 7.0 | 3.8 |
| 2003-04 | 1.3 | 6.4 | 1.4 |
| 2004-05 | 3.1 | 5.7 | -1.6 |

*Derived from Economic Survey of Pakistan 2005-06. Government of Pakistan.*

**Table 4: Percentage of population below the official poverty line**

| | 1986-87 | 1987-88 | 1990-91 | 1992-93 | 1993-94 | 1996-97 | 1998-99 | 2000-01 |
|---|---|---|---|---|---|---|---|---|
| Pakistan | 29.1 | 29.2 | 26.1 | 26.8 | 28.7 | 29.8 | 30.6[a] | 32.1[b] |
| Urban | 29.8 | 30.3 | 26.6 | 28.3 | 26.9 | 22.6 | 20.9 | - |
| Rural | 28.2 | 29.3 | 25.2 | 24.6 | 25.4 | 33.1 | 34.7 | - |
| Poverty Gap | - | - | - | 4.2 | 5.1 | 4.1 | 6.4 | 6.8 |

*Based on the reports of Planning Commission, Government of Pakistan.*

a. Poverty Line: Rs. 673.54 per adult equivalent per month at the prices of 1988-99
b. Poverty Line: Rs. 748.56 per adult equivalent per month at the prices of 2000-01

erage job creation of 1.0-1.2 million per annum. As a result, unemployment rate declined from 8.3 percent in 2001-02 to 6.5 percent in 2005. The major employment generating sectors are agriculture, housing and construction, information technology, telecom, and small and medium enterprises.

## Conclusion

In view of the above facts, it is evident that the Pakistani economy has started reaping the fruits of liberal trade policies. The positive impact of trade liberalisation on Pakistan's economy has manifested itself in terms of rising GDP, per capita income, employment opportunities, and trade volume. The most encouraging impact of liberalisation on poverty implies that economic growth has 'trickled down' to the poor.

Though Pakistan has made much progress in liberalising its trade and reducing poverty, there are many challenges ahead, some of which are:

**Table 5: Percentage of population below poverty line (2001 and 2005)**

| | 2001 | 2005 |
|---|---|---|
| Pakistan | 34.46 | 23.90 |
| Urban | 22.69 | 14.90 |
| Rural | 39.26 | 28.10 |
| Poverty line (Rs. per adult equivalent per month) | 723.40 | 878.64 |

*Derived from Economic Survey 2005-06. Finance Division, Government of Pakistan.*

- During the last three years, Pakistan has improved its export to GDP ratio, but to a modest extent compared to imports to GDP ratio. There is a need to direct FDI towards export promotion.
- A high rate of inflation, particularly inflation in food prices, is a constant danger to the well being of the poor. There is no doubt that the present high rate of inflation (8 percent in 2005-06), if not checked effectively, will undo most of the effects of the pro-poor policies of the last four years.

Besides, it should also be noted that an adverse exogenous economic or political shock might weaken the resolve of the government to continue with its trade reform and poverty reduction policies. A shift in the domestic balance of power could not only stop further liberalisation but even reverse the progress already made. It is, therefore, important for a liberalising government to estimate carefully the protectionist power of a coalition which comprises: a traditional bureaucracy reluctant to lose its power to intervene in economic activities as a result of deregulation and liberalisation; the interests clustered around import substitution industries; and trade unions. Coalitions of this kind do not have sufficient power by themselves to block liberalisation but, when combined with spurious economic nationalism, they can become a serious threat to the forces that seek greater integration with the world economy. The Pakistani government must be ready to exercise leadership, initiate educational and capacity building programes, and where necessary, introduce adjustment assistance measures to reduce the costs of adjustment. ■

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## NOTES

1 Government of Pakistan. 2005. *Economic Survey of Pakistan 2005-06.*

2 WTO. 2005. *World Trade Data 2005.* Geneva: World Trade Organization.

3 State Bank of Pakistan. 2004. *The State of Pakistan's Economy. Third Quarter 2004-05.*

## Trade Liberalisation and Poverty

# The case of Sri Lanka

**In the post-reform period, Sri Lanka experienced rapid industrial and export diversification and an improved rate of GDP growth although it was less successful in addressing poverty and inequality.**

**Dushni Weerakoon and Jayanthi Thennakoon**

Sri Lanka was the first South Asian country to adopt an economic liberalisation programme in 1977-78 by adopting many of the standard reforms of a structural adjustment programme. A key component of the reforms was directed at liberalisation of trade, but also included rationalisation of public expenditure, de-control of prices and interest rates, promotion of private sector development, foreign investment promotion and financial sector reforms.[1]

While Sri Lanka has made measured progress in gross domestic product (GDP) growth – posting an annual average GDP growth of 5 percent and per capita income growth of over 3 percent – there has been limited headway in poverty reduction. Trade liberalisation has seen a boost in export earnings and a reorientation of the country's export structure away from primary exports commodities to trade in industrial goods. The national poverty headcount ratio at 22.7 percent is relatively high for a country with a per capita income of over US$ 1,000. In recent years, there is also increasing evidence to suggest that income inequality has been increasing. Improved trade performance and GDP growth in Sri Lanka has, by no means, been a sufficient condition for poverty reduction.

### Key elements of trade reforms and export performance

The trade reforms introduced in 1977 included specific measures aimed at promoting manufactured exports. Nearly all the non-tariff barriers on imports – such as licensing requirements used to restrict imports since the early 1960s – were abolished. Quantitative restrictions were replaced by tariffs as the principal restraint on imports with tariffs ranging from zero percent on essential goods to 500 percent on 'luxury' consumer items. These tariff rates were rationalised and reduced progressively over two decades to bring the top tariff rate down to 28 percent by 2005. The exchange rate regime was liberalised; the rupee was allowed a nominal depreciation of over 45 percent against the US dollar in 1978 and subject to a 'managed' float thereafter. The nominal devaluation tended to reduce the bias against the export sector that prevailed under the pre-reform period. Institutional reforms included the establishment of free trade zones (FTZs) to create a climate conducive for attracting foreign direct investment (FDI), which was seen as a key element in promoting export growth. A Board of Investment (BOI) was set up to attract FDI by offering an attractive incentive package, including infrastructural and support facilities, tax holidays and exemptions and other benefits. Sri Lanka has also made considerable progress in deepening its integration with the global economy through the multilateral trading system as well as through initiatives to foster closer economic cooperation within Asia vis-à-vis regional and bilateral trade agreements.

Export performance improved dramatically with export earnings growth consistently outstripping GDP growth (exports as a percentage of GDP rose to an average of 25 percent in the 1980s from an average of 15 percent prior to liberalisation). The mainstay of export earnings in the post-reform period has been an impressive acceleration of industri-

**Table 1: Post-reform trade pattern**

| | | 1980 | 1990 | 2000 | 2005 |
|---|---|---|---|---|---|
| Imports | % of GDP | 51.0 | 33.5 | 46.5 | 37.6 |
| Exports | % of GDP | 26.4 | 24.7 | 35.7 | 27.0 |
| Agriculture | % of total exports | 61.8 | 37.7 | 18.2 | 18.2 |
| Tea | % of total exports | 35.1 | 25.9 | 12.6 | 12.8 |
| Industrial | % of total exports | 33.0 | 54.2 | 77.6 | 78.0 |
| Garments | % of total exports | 10.4 | 31.7 | 49.1 | 43.3 |
| Others | % of total exports | 5.2 | 8.1 | 4.3 | 3.8 |

*Compiled from various issues of Annual Reports, Central Bank of Sri Lanka.*

al production while Sri Lanka's traditional export crops – tea, rubber, and coconut products – experienced sluggish growth for much of the post-reform period. The most striking feature was the rapid growth registered by the garments export sector, which overtook tea as the highest gross export earner from 1986 onwards.

Table 1 depicts that the commodity composition of exports has undergone a major transformation. The share of exports of the industrial sector, which accounted for 15 percent of total export earnings in 1978, accounted for more than 75 percent of total exports by the mid-1990s. Garments alone made up more than half of Sri Lanka's export earnings by the mid-1990s.

**Table 2: Key employment statistics**

| | Unemployment (%) | Sectoral profile of employment | | |
|---|---|---|---|---|
| | | Agriculture | Manufacturing | Services |
| 1978/79 | 14.8 | 52.0 | 12.5 | 29.3 |
| 1981/82 | 11.2 | 50.5 | 12.3 | 30.4 |
| 1986/87 | 15.5 | 47.7 | 13.4 | 31.3 |
| 1990 | 15.9 | 46.8 | 13.3 | 34.5 |
| 1995 | 12.3 | 36.7 | 14.7 | 41.6 |
| 2000 | 7.6 | 36.0 | 16.6 | 40.3 |
| 2005 | 7.7 | 30.7 | 18.4 | 44.8 |

*Compiled from various issues of Annual Reports, Central Bank of Sri Lanka.*

## Trade reforms and linkages to poverty reduction

The key channel through which trade liberalisation affects both absolute and relative poverty is through its impacts on employment levels. Economic growth in the post-reform period was accompanied by a consistent decline in the rate of unemployment in the country. Data suggest that the rate of total unemployment fell from 24 percent in 1973 to 14.8 percent in 1979. By 1982, the rate had fallen further to 11.2. From the mid-1980s, Sri Lanka experienced rising unemployment as the growth momentum slowed down. By 1990, the unemployment rate was estimated at 15.9 percent. With the resumption of higher economic growth in the 1990s, unemployment has been on a downward trend for the most part, declining to 7.7 percent by 2005 (Table 2).

Attempts to reduce unemployment may be deemed to have been successful in the initial aftermath of the reform programme. Thus, contrary to the expectations of an increase in unemployment following significant liberalisation, Sri Lanka was able to reduce unemployment. However, there are many reasons – both endogenous and exogenous – to account for this decline, which had little to do with the reform programme *per se*.

In the post-reform era, there was a surge in migration of workers seeking employment – particularly to the Middle East – with the easing of restrictions on foreign exchange payments. A second impetus came from the repatriation of Indian nationals, mostly from the estate plantation sector in Sri Lanka. A third inducement for increased employment came from the government's massive public investment programme initiated in 1978, following the escalation of the civil conflict from the mid-1980s, recruitment to the armed forces and ancillary services was also another avenue of employment generation. Thus, the initial spurt in the reduction in the unemployment rate was largely due to factors that had little to do with the liberalisation programme.

Despite the general decline in the unemployment rate, the 1977 reform package adversely affected many small-scale and rural industries, particularly the domestic textile sector. It is estimated that the handloom sector employed around 150,000 people in the 1970s but that by the 1990s, employment in this sector had fallen to less than 25,000.[2] A certain amount of re-employment of displaced labour took place in the post-reform period, particularly in the rapidly expanding export-oriented garment industry. The garment industry created direct employment of around 300,000. However, it was largely con-

**Table 3: Incidence of poverty and inequality in Sri Lanka**

| | | | | Gini Coefficient of per capita expenditure | |
|---|---|---|---|---|---|
| | 1990-91 | 1995-96 | 2002 | 1990-91 | 1995-96 |
| National | 26.1 | 28.8 | 22.7 | 0.34 | 0.42 |
| Urban | 16.3 | 14.0 | 7.9 | 0.37 | 0.44 |
| Rural | 29.4 | 30.9 | 24.7 | 0.30 | 0.39 |
| Estate | 20.5 | 38.4* | 30.0 | 0.24 | 0.33 |

*Notes: * Comparability for estate headcount for 1995-96 with that for other years may be affected by the fact that the 1995-96 survey was sampled differently for the estate sector.*

*Derived from World Bank, 2004 and Sri Lanka Development Policy Review.*

fined to raising the level of female labour force participation in the manufacturing sector. Thus, the generation of employment after 1977 has been biased towards women, primarily in the low paid, low skilled category. Women benefited from new opportunities created by export industries to move out of traditional economic activities. However, these are concentrated in the trade zones, which are mostly in the urban sector along with a bias towards low skilled female workers. Another sector which has benefited is the retail and wholesale trade sector and the number of females employed in the commercial, mercantile and service sectors has increased. The employment opportunities generated in these sectors have the greatest impact on low income groups.

While the Sri Lankan economy did experience an improved outcome in terms of export growth, employment and overall GDP growth, the overall poverty situation may not have changed much. While Sri Lanka has made measured progress in raising per capita income growth to over 3 percent per annum, on average, poverty reduction has not made a headway. Any reduction in the incidence of poverty was offset by population growth, leaving the absolute number of the poor relatively unchanged. The national poverty headcount[3] ratio at 22.7 percent has shown only a modest decline from 26.1 percent in 1990-91 (Table 3).

Evidence also suggests that income inequality has increased with

significant inequities in poverty reduction across sectors of the country. During 1990-91 to 2001-02, the poverty gap between the urban sector and the rest of the country widened while there was also a significant increase in poverty in the estate sector (primarily the tea plantation crop export sector).[4] The decline in rural poverty from the mid-1990s was a result of the recovery of agriculture from a severe drought in 1996 (which may also have affected the survey results of 1995-96) and the gradual positive trend in per capita agricultural production thereafter.

Sri Lanka has witnessed wider regional disparity in the incidence of poverty. The Western Province, which accounts for nearly 50 percent share of national GDP, registered the lowest rates of poverty in the country. Increasing inequality over the decade is also reflected by the Gini Coefficients (Table 3), which increased by 24 percent between 1990-91 and 2002, including an increase of 19 percent for the urban and 30 percent for the rural sectors. Analysis of the links between poverty reduction, growth and inequality suggests that had inequality not increased during the decade, Sri Lanka would have experienced higher reduction in poverty.

## Conclusion

Empirical studies establishing linkages between trade policy reforms and poverty in Sri Lanka remain fairly limited and inconclusive in terms of broad conclusions. Attempts to assess direct linkages between trade reforms and poverty also remain fairly complex given that trade reforms were implemented as part of a broader package of structural adjustment policies and because the country has undergone a civil conflict over the same period.

Direct impacts of trade reforms are clearly evident in certain manufacturing sectors. The textile and handloom industry is one of the biggest losers of tariff policy changes as import tariffs on inputs for the rapidly expanding export-oriented garments sector was liberalised. While the textile and handloom industry saw significant losses in employment, the garment industry created additional employment, supported by an inflow of FDI into the sector. Nevertheless, there is clear evidence to suggest that while Sri Lanka experienced rapid industrial and export diversification and an improved rate of economic growth in the post-reform period, it was less successful in translating this success to address poverty and inequality. ■

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## NOTES

1 A 'second wave' of reforms was initiated in 1990-91 to consolidate on the earlier efforts.

2 Government of Sri Lanka. 1991. *Review of Activities 1989-91*. Ministry of Handloom and Textiles.

3 Based on official poverty lines.

4 A decrease in income earners per estate household during the period is likely to explain part of the increase in poverty in this sector.

# Suspension of the Doha Round
# How has it affected
## Millennium Development Goals

**Kamalesh Adhikari**

The suspension of the Doha Round talks has raised fears that the potential 'global gains' from the trade reforms under the Round will be lost. Instead, if the suspension turns out to be prolonged or permanent, an increase of disputes in a number of areas of international trade – which could have been addressed within the Doha Round – is imminent. Also, there is a greater possibility that many developing and least developed Members will have to compromise with their 'policy flexibility' and 'development space' since developed Members often tend to squeeze them through bilateral and regional trade deals.

The suspension of negotiations should not, therefore, be seen only from the perspective of adverse effects it will bring in international trade. The impasse has also generated additional challenges, mainly for developing and least developed Members, in attaining the Millennium Development Goals (MDGs).

### MDGs and Doha Round

MDGs embody partnership between developed and developing countries. The Millennium Declaration is an historic agreement, in which developing and least developed countries have committed to work to maintain sound economies, address human and social needs and ensure development; and developed countries have agreed to support developing and least developed countries through aid, trade and debt relief. The eighth development goal – MDG 8 (Global Partnership for Development) – identifies ways through which developed countries are required to help developing and least developed countries in achieving the other seven goals. This Goal calls for more official development assistance; measures to ensure debt sustainability in the long-term; an open, equitable, rules-based, predictable and non-discriminatory multilateral trading and financial system; and measures to address the special needs of least developed, landlocked and small island developing states.


The Doha Round had, indeed, generated aspirations and shown indications that the 'development dimension' of the Round would help developing and least developed Members to use trade as a means to achieve their development goals. The United Nations World Summit in September 2006, while reviewing the progress made towards achieving MDGs by 2015, had also highlighted the importance of the 'development dimension' of the Doha Round in attaining MDGs. The Summit had emphasised that the Round needs to "produce rules that tackle long-standing unfair and unbalanced trade practices by improving market access for poor countries; focus on agricultural trade and reduction in agricultural subsidies; and revisit agreements and negotiations that limit the policy space available to developing countries".

### Resumption of Doha talks

The Doha Round negotiations are critical in reaching agreements on issues such as agricultural protectionism, market access, Mode 4 (movement of natural persons) liberalisation, access to medicine, access to and transfer of technology, special and differential treatments, etc. The indicators under Goal 8 also call developed countries to make development-friendly decisions on these issues. Ever since the launch of the Round, some initiatives have been taken to address these issues. For example, some notable decisions on the issue of patents and access to medicine have been made in favour of poorer Members. At the Hong Kong Ministerial also, decisions were made on market access for the least developed countries and 'aid for trade' for developing and least developing countries. However, the suspension of the talks has now made it difficult to hold formal discussions and come to consensus on issues, which could help poor Members achieve MDGs. The resumption of the Doha Round negotiations is, therefore, urgent not only to move forward the multilateral trade reforms but also to 'establish global partnership for development' and enable countries to meet the millennium development targets. ■

# ASIAN DRIVERS

# opportunities and challenges

**The rise of the 'Asian Drivers' requires other developing and least developed countries to review their industrialisation strategies to minimise the emerging risks and maximise the benefits.**

**Shyamal Krishna Shrestha**

The term 'Asian Drivers' refers to two dynamic economies – the People's Republic of China and the Republic of India – that owe their newfound strength to their own rapid economic growth, size and growing competitiveness.[1] Both economies grew within a range of 7-10 percent annually in the last decade. In 2005, the Asian Drivers accounted for 38 percent of the global population, 7 percent of global gross domestic product (GDP), 8 percent of world trade and 14 percent of world exports (both merchandise and services). The International Monetary Fund predicts that China will displace the United States (US) as the world's largest economy by 2040 while India will stand a close third.[2] The table presents China's and India's economic performance during 1990-2005.

What impact will the Asian Drivers have on the developing world? The rapid growth of China and India offers great opportunities as well as challenges. Both countries have liberalised their trade regimes, providing access to developing countries and least developing countries (LDCs) alike. The emergence of China and India as major competitors, buyers and investors is evident in their dominance in certain sectors and rapid growth in raw material consumption and investment in other parts of the globe. Production and trade flows are among many vectors through which the Asian Drivers affect the growth and distribution prospects in developing countries, including the LDCs.

## Opportunities

China's and India's growing requirements for intermediate inputs have led them to seek suppliers around the globe. As rising demand for raw materials provides a net boost to global demand, it has made a positive impact on commodity prices and contributed in raising the terms of trade for the exporting countries.

China alone accounts for one-third of the increase in world oil consumption and one-quarter of world metal consumption since 2000, mostly imported from sub-Saharan Africa, now a prime foreign direct investment (FDI) destination. Sub-Saharan Africa's trade with China has risen from 1 percent to 10 percent of its total trade between 1995 and 2005. China's drive to buy African oil and other commodities has led to a big increase in bilateral trade, worth US$ 42 billion in 2005.[3] China's FDI flows to sub-Saharan Africa rose by

### Asian Drivers: Economic performance during 1990-2005

| Indicators | China | India | Total |
|---|---|---|---|
| Share of world population, 2005 | 20 | 18 | 38 |
| Share of world GDP, 1990 | 1.7 | 1.5 | 3.2 |
| Share of world GDP, 2005 | 5.0 | 1.7 | 6.7 |
| Share of world trade, 1990 | 3.0 | 0.7 | 3.7 |
| Share of world trade, 2005 | 6.75 | 1.05 | 7.8 |
| Share of world exports, 1990 | - | - | - |
| Share of world exports, 2005 | 10.4 | 3.23 | 13.6 |
| Average annual GDP growth, 2000-05 | 9.6 | 6.9 | - |
| Trade/GDP, 1990 | 32 | 16 | - |
| Trade/GDP, 2005 | 63.8 | 36.7 | - |

*Source:* The World Bank. 2006. *World Development Report 2007: Development and the Next Generation. Washington, D.C.: http://stat.wto.org/CountryProfiles*

300 percent in 2003-04 although the region comprises just 5 percent of China's total FDI outflows.

Similarly, India's rapid industrialisation requires increasing dependence on energy. India's current 3 percent share of global oil demand is set to rise to 10 percent by 2030; and the country may have to import all of its energy needs by 2020.[4] Apart from investment in the oil sector in sub-Saharan Africa, India is looking overseas for energy, notably the Middle East.[5] It imports hydroelectricity from Bhutan, which constitutes 45 percent of the latter's export revenues and contributed 12 percent of GDP in 2004.[6] The implications for other LDCs such as Nepal, which is yet to complement India's energy demand, are amply clear.

## Challenges

Most LDCs now specialise in manufactured exports coinciding with sectors in which the Asian Drivers are prime exporters. Imports from China and India also threaten domestic producers specialising in industrial products. The productivity and economies of scale of the Asian Drivers in the textiles and clothing sector became evident after the expiry of the Agreement on Textiles and Clothing on 31 December 2004. Imports of Chinese textiles into the US and the European Union rose by 46 percent in 2005 as compared to 2004. This surge came at the cost of other LDCs such as Lesotho and Nepal, which faced closure of factories and job losses. Many LDCs import consumer goods from the Asian Drivers. While consumers benefit due to competition and lower prices, producers may be displaced in the absence of upgrading in production processes and products. Likewise, the high volume of imports from the Asian Drivers without matching export performance is likely to deepen dependency for the LDCs.

## Way forward

Developing countries and the LDCs facing challenges from the Asian Drivers have to reorient their industrial policies to limit the extent of the damage caused by competition arising from the two Asian giants. First, they could emerge as reliable suppliers of commodities that the Asian Drivers demand, thus starting a process of deeper trade relations ensuring rapid income growth. As the Asian Drivers continue to grow rapidly, their demands for intermediate inputs will rise. Second, as both China and India become competitive in manufacturing and are likely to threaten industrialisation prospects in most LDCs, the Asian Drivers could become sources of co-ordination, FDI and rule changes in global value chains. Third, developing countries and LDCs could also tap new technology and markets in the Asian Drivers.

In conclusion, it can be said that an inter-dependent global economy has intensified competition. One of the frameworks for realising the opportunities requires the developing world to embrace 'deep integration' besides 'shallow integration'. Prefential trade agreements with the objective of tariff reduction do not go far enough to encourage inter-firm linkages between countries, and promote 'agglomeration'/'clustering' whereby 'collective efficiency' leads to spillovers and productivity gains. Open trade policies, adequate infrastructure and a sound business environment would extend domestic production frontiers outwards. Catching up with the Asian Drivers has become imperative for the developing world. ■

## NOTES

1 Kaplinsky, R. (ed.). 2006. *Asian Drivers: Opportunities and Threats.* IDS Bulletin. Vo. 37, No. 1. University of Sussex: Institute of Development Studies.

2 Emerging economies are 'the new titans', whose share of global population, GDP, foreign exchange reserves, energy consumption and exports, have experienced a rapid rise and are projected to overtake today's rich countries by the middle of 2025. As percentages of world totals, emerging economies accounted for 80 percent of population, 50 percent of GDP, 70 percent of foreign exchange reserves, 50 percent of energy consumption and 40 percent of exports; in 2005. See *The Economist*. 2006. 'Surprise: The power of the emerging world'. September 16-22.

3 See 'Trade to top China-Africa Summit'. BBC News. http://news.bbc.co.uk/2/hi/asia-pacific/6112360.stm; see also R. Jenkins and C. Edwards. 2006. 'The economic impact of China and India on sub-Saharan Africa: Trends and Prospects', *Journal of Asian Economics*, Vol. 17, Elsevier Inc.

4 Vaswani, K. 'Soaring energy demand sparks Indian fears'. BBC News. http://news.bbc.co.uk/2/hi/business/4715980.stm

5 Talks over the US$ 17 billion gas pipeline from Iran through Pakistan to India may be seen in this light.

6 See US Energy Information Administration. 2004. 'South Asian Regional Overview'. www.eia.doe.gov/emeu/cabs/nepal.html

# special and differential treatment

## issues of developing and least developed countries

Formulating, incorporating and implementing S&DT based on the notion of 'positive discrimination' will not only help the vulnerable Members but will also add to the objectives of the WTO.

**Shivendra Thapa**

There are significant differences between World Trade Organization (WTO) Members. Most developing and least developed Members are characterised by weak institutions, poorly diversified industries, under-developed markets, insufficient infrastructure, geographical constraints, limited access to health and education, and lack of access to information and communication technologies, among others.

Since developed and advanced developing Members supersede most of these constraints and are in a better position to reap the benefits of trade liberalisation, a need to provide special and differential treatment (S&DT) to the developing and least developed Members was an agenda since the period of the implementation of the General Agreement on Tariffs and Trade (GATT), 1947. Although not known as S&DT, there was acknowledgement among GATT Members regarding the 'special needs' of developing and least developed Members.

The 1979 Tokyo Round recognised "the importance of the application of differential measures in developing countries in ways which will provide special and more favourable treatment for them in areas of negotiation where this is feasible." Such ways were sought by conceptualising the notion of positive discrimination, which implies that developing and least developed Members should be encouraged to integrate into the multilateral trading system. The basic idea was to allow special and preferential treatments to such Members (e.g., in terms of market access, infant industries, non-reciprocity, commitments, etc.) even if it undermines the most favoured nation (MFN) principle. The special treatments given to developing and least developed Members since the GATT period are highlighted in the table.

S&DT is classified into five categories.[1] First, provisions aimed at increasing trade opportunities through market access. Second, provisions requiring WTO Members to safeguard the interests of developing Members. Third, provisions allowing flexibility to developing Members in rules and disciplines governing trade measures. Fourth, provisions allowing longer transitional periods to developing Members, and fifth, provisions for technical assistance.

Interestingly, these five categories of S&DT can further be classified into 'Binding' and 'Non-Binding' provisions. 'Binding' provisions can be unilaterally implemented and there are two sub-categories of provisions under this heading.

- Permitting developing Members to assume lesser obligations (such as 10 percent *de minimis* domestic (amber box) support as opposed to 5 percent for developed Members in the Agreement on Agriculture or lower reduction commitment in the case of tariffs (24 percent as opposed to 36 percent) and subsidies reduction (13.3 percent as opposed to 20 percent).
- Providing longer transition periods for developing Members.

'Non-binding' provisions are also known as best endeavour clauses and there are three sub-categories of provisions under this heading.

- Require WTO Members to safeguard the interests of developing Members.
- Require developed Members to provide technical assistance to developing and least developed Members.
- Require developed Members to enhance trade opportunities of developing and least developed Members.

Under these provisions, a number of schemes were also put forth. The first preferential scheme put in place by a number of countries was the Generalised System of Preferences (GSP)[2]. Other schemes include the African Growth and Opportunity Act (AGOA) and the Caribbean Basin Initiative of the United States and the European Union's 'Everything But Arms' initiative for the least developed countries (LDCs).

Despite these provisions, there is a widely held belief that the benefits from them have been outweighed by the increasing discrimination against developing Members by developed ones. Proponents of S&DT argue that the special circumstances of developing Members are such that they ought to be given the flexibility to pursue development

**Some S&DT provisioned in the multilateral trading system**

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|---|---|
| 1954-55 | Article XVII: Section A: flexible tariff structure. Section B: quantitative restriction for balance of payment. Section C: tariffs and quantitative restrictions to support infant industries. |
| 1964 | Part IV on Trade and Development in GATT introduced Article XXXVI: favourable market access for products of export interest to developing Members on non-reciprocity basis. Article XXXVII: elimination of restriction between primary and processed products. Article XXXVIII: international arrangements to improve market access for products of export interest to developing Members. |
| 1968-71 | GATT waiver from MFN obligations in 1971. Developing Members to grant preference among themselves. |
| 1979 | Enabling Clause[1] establishing principles of preferential market access for developing Members on a non-reciprocal and non-discriminatory basis; more favourable treatment in other GATT rules dealing with non-tariff barriers; preferential trade between developing Members and special treatment for the LDCs. |
| 1994 | Recognition of general interests in which WTO objective was reiterated to ensure that developing and least developed Members secure a share in the growth of international trade that is commensurate with their economic development needs. *The Committee on Trade and Development will periodically review the special provisions in favour of developing Members and in particular, the LDCs*[2]. |
| 2001 | Some WTO Members proposed a Framework Agreement on S&DT WT/GC/W/442. They agreed that all S&DTs shall be reviewed with a view to strengthening them and making them more precise, effective and operational. |

*Notes:*

1. *Is officially known as the "Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries" and forms the legal basis for the GSP. It also forms a legal basis for regional arrangements among developing countries and for the Global System of Trade Preferences (GSTP).*
2. *WTO document: Guide to the Uruguay Round Agreements: Part 5-Developing Countries in the WTO system.*

through trade policies even if these policies involve negative externalities for other countries, viz. through positive discrimination.

The alternate view places less confidence in markets and recognises a stronger role for governments in economic development. Opponents disagree and argue that these provisions undermine the core WTO principle of reciprocity and encourage protectionist trade policies in developing countries.

Since there have been numerous calls to give S&DT more clarity and specificity, a significant compromise on S&DT has been suggested at the WTO. The proposal suggests that vulnerable developing and least developed Members should have the Doha "Round for Free". In other words, in current and future negotiations, they should not be made to open up markets beyond their existing commitments and should also be able to benefit from increased market access offered by both developed and advanced developing countries.

Regarding this issue, there are two schools of thought.

One school of thought welcomes the proposal since they believe that the issue of S&DT is well-founded and should not be up for political debate. Though they welcome the offer, they are also cautious about a situation, in which, developing and least developed Members may be exempted from further commitments but it could also exclude them from key negotiations under the Doha Round, as was the case in previous rounds.

The second school of thought says that the "Round for Free" approach might actually turn out to be a disincentive for developing and least developed Members. They claim that if the most vulnerable Members of the WTO were required to do the least in negotiations yet still be able to retain veto rights over a Round, it would create a scenario where other Members would have little choice but to liberalise their trade outside the multilateral system. At worst, it will result in the proliferation of bilateral and regional trade agreements, undermining the scope and objectives of the rules-based multilateral trading system.

In this respect, what will be a more pragmatic option to pursue so that differences in circumstances and capacities are addressed? An option will be to follow the original notion of positive discrimination and implement S&DT accordingly. Formulating, incorporating and implementing S&DTs based on such notion will not only help the vulnerable Members but will also add to the objectives of the WTO. The moot question remains whether the developed Members intend to make S&DT precise, effective and operational. ■

## NOTES

1 WTO document: WT/COMTD/W/135 dated 5 October 2004.

2 Under the GSP, developed countries offer non-reciprocal preferential treatment (such as zero or low duties on imports) to products originating in developing countries. Preference-providing countries unilaterally determine which countries and which products are included in the schemes.

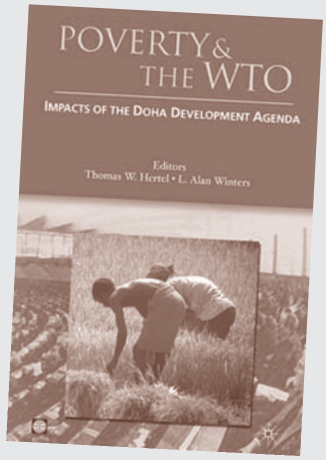
# Poverty and the WTO

**Selim Raihan**

**THE** volume and extent of global trade has increased considerably over the last few decades but some developing countries have gained relatively little from trade expansion. Despite the fact that manufactured exports is the key source of employment for many developing countries (including least developed countries), market access to the developed and advanced developing countries remains highly restricted. Also, for many poor developing countries, which export agricultural products, the problem is exacerbated by the massive government subsidies provided to farmers in developed countries.

Many studies point out that agricultural policies of developed countries are crucial in addressing poverty in developing countries. A majority of the poor are concentrated in rural areas, where agriculture is the main source of livelihood and employment. These facts highlight the potential influence that multilateral trade policies can have on poverty in the developing countries.

Poverty remains a major development challenge for most developing countries. However, there is considerable debate about the impacts of the Doha Development Agenda (DDA) on poverty arising from the implementation of multilateral trade agreements of the World Trade Organization (WTO). This book contributes to this debate by presenting comprehensive analyses of the impacts on national poverty levels due to specific multilateral trade reforms. It brings together the best scientific methods to bear on this question, taking into account the specific characteristics embodied in the DDA. Keeping in mind that the trade/poverty field is relatively new, different methods are utilised for the featured countries. The articles consider a range of complementary policies that might




Title: Poverty and the WTO: Impacts of the Doha Development Agenda
Editors: Thomas W. Hertel and L. Alan Winters
Publishers: World Bank and Palgrave Macmillan New York
First Published: 2006
ISBN: 0 8213 6314 X

enhance the poverty outcome of the DDA, permitting poor households to take better advantage of new opportunities that might arise from such multilateral trade reforms. In addition, the analysis of poverty impacts of the DDA on 10 countries, coupled with global analysis, allows the authors to draw more general conclusions about the poverty impacts of a prospective DDA. The countries covered are Bangladesh, Brazil, Cameroon, China, Indonesia, Mexico, Mozambique, the Philippines, Russia and Zambia.

Computable general equilibrium (CGE) analysis is the dominant methodology for the *ex ante* analysis of the economic consequences of both bilateral and multilateral trade agreements. This is the dominant methodology because no other approach offers the same flexibility for looking at prospective changes in trade policy while respecting the fundamental economy-wide consistency requirements such as balance of payments equilibrium and labour and capital market constraints that are important in determining the consequences of comprehensive trade reforms.

The liberalisation targets under the DDA have to be quite ambitious if the Round is to have a measurable impact on world markets and hence, on poverty. Assuming an ambitious DDA, the short-term poverty impacts are found to be mixed; some countries experience small poverty rises and others more substantial poverty declines. On balance, poverty reduction occurs under the DDA and this reduction is more pronounced in the long-run. Allowing minimal tariff cuts for just a small percentage of special and sensitive products virtually eliminates the global poverty reduction. The analyses suggest that deeper cuts in developing country tariffs would make the DDA more poverty-friendly. In this regard, the key determinants of the national poverty impacts include the incomplete transmission of world prices to rural households, barriers to the mobility of workers between sectors of the economy, and the incidence of national tax instruments used to replace lost tariff revenue. However, generating significant poverty reduction requires complementary domestic reforms to enable households to take advantage of new market opportunities made available through the DDA. Sustained long-term poverty reduction depends on stimulating economic growth. Here, the impact of the DDA on productivity is critical. To fully realise their growth potential, trade reforms need to be far-reaching, addressing barriers to services trade and investment in addition to merchandise tariffs. ■

*Dr. Raihan is an Assistant Professor, Department of Economics, University of Dhaka, Bangladesh.*

# Linkages between Trade, Development and Poverty Reduction

**CUTS** Centre for International Trade, Economics & Environment (CUTS-CITEE), Jaipur organised the "Regional Conference on Linkages between Trade, Development and Poverty Reduction" in Bangkok, Thailand during 24-25 November. The conference was organised as part of the "Trade, Development and Poverty Reduction (TDP)" Project of CUTS-CITEE, which the organisation is implementing in different countries of South and South East Asia and Africa.

The objective of the conference was to document various pro-poor trade policy initiatives taken in different countries so that the project could come up with recommendations for South and South East Asian and African governments to implement pro-poor development strategies. At the conference, participants discussed various measures through which trade could contribute to poverty reduction and overall development of developing and least developed countries. Participants, however, also cautioned that there is a need to properly develop a conceptual framework of how trade is linked to poverty and development before coming to any conclusions.

Representatives of project partners from eight South and South East Asian countries (Bangladesh, Cambodia, China, India, Nepal, Pakistan, Sri Lanka, and Vietnam) inter-governmental agencies, governments, civil society, and research organisations attended the conference. ■

# Export Diversification for Human Development

**SAWTEE** and ActionAid Nepal jointly organised the discussion programme "Export Diversification for Human Development in the Post-Quota Era" in Lalitpur, Nepal on 7 November.


The programme was organised to disseminate the findings of two research studies – Human Development Impact in the Post Agreement on Textiles and Clothing (ATC) quota period; and Export Diversification Strategy for Nepal – which the organisers conducted under a project of the United Nations Development Programme (UNDP) Regional Centre in Colombo.

At the programme, participants discussed Nepal's potential to diversify its exports in agricultural, industrial and services sectors. While highlighting the export potential in the garment sector, participants viewed that the government and the private sector need to review the performance of other garment exporting countries in order to take lessons on how to cope with the challenges, which have emerged due to the phase out of the quotas on textiles and clothing. At the same time, they stressed the importance of addressing human development concerns and suggested to put in place appropriate safety nets for workers.

Around 65 participants representing the government, private sector, civil society and academia were present at the meeting. ■

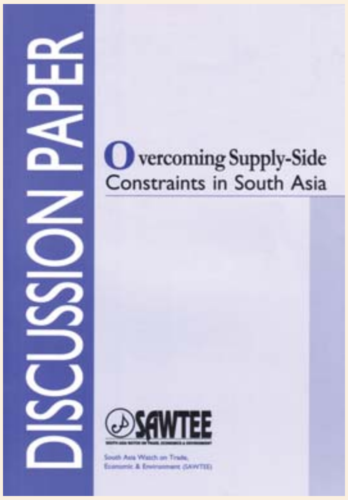
# Aid for Trade Identifying Nepalese Priorities

**SAWTEE** and ActionAid Nepal (AAN) organised the discussion forum on "Aid for Trade: Identifying Nepalese Priorities" on 12 September in Kathmandu, Nepal. The programme was the 20th bi-monthly forum held under the "Reform and Capacity Building Agenda in the Post WTO Accession Era (RECAB)" Project that AAN and SAWTEE have been implementing since 2004.

The forum was organised to discuss the priority sectors that could be developed utilising assistance under the 'aid for trade' package. Senior officials from Ministry of Industry, Commerce and Supplies, Ministry of Agriculture and Cooperatives, Department of Drugs Administration and Ministry of Education and Sports were the major discussants in the forum.

At the forum, participants highlighted the need to develop human resource and technology in different sectors of the economy. They stressed that as 'aid for trade' is not likely to cover all the sectors, there is a need to prioritise them based on their importance, role and core competency. Participants also discussed measures through which 'aid for trade' could be made effective. They viewed that the 'aid for trade' package needs to take into consideration the adjustment costs that countries like Nepal have to incur in the process of liberalisation. They also said that the package has to be demand-driven and assistance under the package has to be given without any conditionalities.

Besides these, issues concerning the ongoing negotiations on 'aid for trade' at the multilateral level were also discussed. Fifty participants from the government sector, private sector, media, development and research organisations, and academic institutions attended the forum. ■

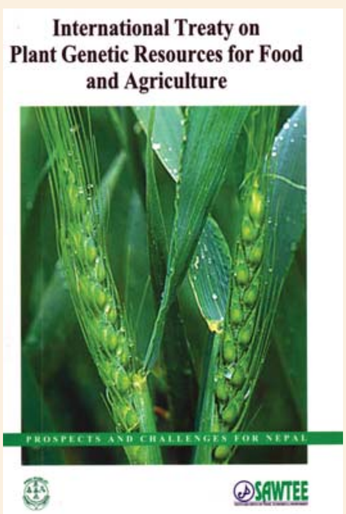



Title: Overcoming Supply-Side Constraints in South Asia
Publisher: SAWTEE
Author: Upali Wickramasinghe

# South Asia's Supply-Side Constraints

SUCCESSFUL integration of the South Asian countries in the international market depends on two factors: the ability of firms to produce goods and services required by the importing countries in the quality and quantity at competitive prices; and the availability of efficient mechanisms to ensure that these products and services reach markets on time. In this regard, the domestic policy environment should be conducive for undertaking business activities. This discussion paper highlights several critical factors that determine the supply-side capacity of firms in South Asia. They include: an enabling policy and regulatory framework, efficient institutions and good governance, and factors that improve productivity on the one hand and those that reduce transaction costs on the other.

The paper also points out a host of factors that constrain South Asia's exports such as political instability, inability to enforce the rule of law, low level of education, gender bias, poor management of human resources, and poor quality of public infrastructure. The paper argues that despite the common belief, South Asia's governance structure is not a major hindrance to business performance; South Asian economies need to address the most critical supply-side constraints to benefit from the global trade regime. The paper is divided into four sections, dealing with different aspects of supply-side constraints and measures to overcome them. ■




Title: International Treaty on Plant Genetic Resources for Food and Agriculture: Prospects and Challenges for Nepal
Publishers: SAWTEE and Pro Public
Authors: Madhusudan Upadhyaya and Devendra Gauchan

# ITPGRFA and Nepal

IN recent years, protection of farmers' rights in light of the rapid application of biotechnology in the agricultural sector has gained increased attention. In addition, the implications of the intellectual property right (IPR) rules under the Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement are also widely debated since they tend to restrict farmers' rights to livelihood, while promoting the IPR and commercial interests of the multinational companies and breeders. International Treaty on Plant Genetic Resources for Food and Agriculture (ITPGRFA) is a legally binding treaty that aims at the conservation and sustainable use of plant genetic resources for food and agriculture and fair and equitable sharing of benefits arising out of their use, in harmony with the Convention on Biological Diversity (CBD), 1992. The CBD is an international convention that provisions for access and benefit sharing (ABS) and prior informed consent (PIC) related to genetic resources and associated traditional knowledge (TK). As a WTO Member, Nepal has committed to comply with TRIPS through national legislation. The country is also enacting a law on ABS as part of its obligation as a Contracting Party to CBD.

Regarding ITPGRFA, the country has not acted upon it as yet. There have been discussions among stakeholders on its relevance for Nepal. Whether or not the country should sign and ratify the Treaty is still a matter of serious discussion. This book contains six chapters, dealing with the pros and cons of Nepal's membership in ITPGRFA. ■

Launched in December 1994 at Nagarkot, Nepal by a consortium of South Asian NGOs, South Asia Watch on Trade, Economics & Environment (SAWTEE) is a regional network that operates through its secretariat in Kathmandu and member institutions from five South Asian countries, namely Bangladesh, India, Nepal, Pakistan and Sri Lanka. Registered in Kathmandu in 1999, the overall objective of SAWTEE is to build the capacity of concerned stakeholders in South Asia in the context of liberalisation and globalisation.