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Version

WTO Membership: Opportunities and Challenges for SMEs in Nepal

Edited By

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List of Acronyms

AB	Appellate Body
ADA	Anti Dumping Agreement
AoA	Agreement on Agriculture
APPPC	Asia Pacific Plant Protection Commission
ASCM	Agreement on Subsidies and Countervailing Measures
BoP	Balance of Payment
BSE	Bovine Spongiform Encephalopathy
CAC	Codex Alimentarius Commission
DDA	Doha Development Agenda
DDT	Dichloro Diphenyl Trichloromethane
DSB	Dispute Settlement Body
DSP	Dispute Settlement Panel
EC	European Commission
EU	European Union
FDI	Foreign Direct Investment
FMD	Foot and Mouth Disease
FNCCI	Federation of Nepalese Chambers of Commerce and Industry
FNCSI	Federation of Nepalese Cottage and Small Industries
FNSt	Friedrich Naumann Foundation
FTAA	Free Trade Area of the Americas
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product

GI	Geographical Indication
GSP	Generalised System of Preferences
HACCP	Hazard Analysis and Critical Control Point
HMG	His Majesty's Government
IAF	International Accreditation Forum
ILO	International Labour Organisation
IMF	International Monetary Fund
IOE	International Office of Epizootics
IPPC	International Plan Protection Convention
IPRs	Intellectual Property Rights
ISO	International Organisation for Standardisation
IT	Information Technology
ITC	International Trade Centre
LAP	Legislative Action Plan
LDC	Least Developed Country
LPG	Liquefied Petroleum Gas
MFN	Most Favoured Nation
MNCs	Multinational Companies
MRA	Multilateral Recognition Arrangement
NBSM	Nepal Bureau of Standards and Metrology
NCS	Nepal Council of Standards
NS	Nepal Standard
NTB	Non-Tariff Barrier
PIC	Prior Informed Consent
ppb	parts per billion
ppm	particles per million
PSI	Pre-shipment Inspection
QR	Quantitative Restriction

ROO	Rules of Origin
S&DT	Special and Differential Treatment
SAFTA	South Asian Free Trade Area
SAWTEE	South Asia Watch on Trade, Economics & Environment
SME	Small and Medium Enterprise
SMEDP	Small and Medium Enterprises Development Project
SMI	Small and Medium Industry
SPS	Sanitary and Phytosanitary
TBT	Technical Barriers to Trade
TRIMS	Trade Related Investment Measures
TRIPS	Trade Related Aspects of Intellectual Property Rights
TRS	Technical Regulations and Standards
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
US	United States
WHO	World Health Organisation
WIPO	World Intellectual Property Organisation
WTO	World Trade Organisation

Preface

In any developing economy, small and medium enterprises (SMEs) hold tremendous potential for sustained growth. They generate huge employment making use of the locally available resources and endowments. SMEs in Nepal account for an overwhelming proportion of economic activities, making a notable contribution to trade, employment and national income. The SME sector's performance is very encouraging. However, a lot more could have been achieved through some supportive programmes and focused collective effort of the stakeholders. To support the SME sector's growth endeavour in Nepal and enhance a competitive market economy, Friedrich Naumann Foundation (FNSt) has joined hands with Federation of Nepalese Chambers of Commerce and Industry (FNCCI) and has been supporting meaningful focused programmes through Small and Medium Enterprise Development Project (SMEDP). For the past seven years, SMEDP has been extending programme support and conducting activities, both at the policy and micro levels, to enable the SME sector in Nepal to grow and raise its competitiveness level as well as create wealth and provide employment.

We at FNSt highly welcome Nepal's move to become a member of the World Trade Organisation (WTO) as it comes with the obligation to implement necessary reforms, which will pave the way for development of market economy and rules-based trading system. Nepal's WTO membership will bring opportunities as well as threats. A new vision would be required to counter the challenges confronted by the Nepalese SME sector. It is equally essential that the SME sector is made aware of the new trends and issues. We are glad that the national seminar organised by SMEDP in close collaboration with other agencies has contributed in developing awareness about the implications of WTO membership and sharing of information for preparedness in the multilateral trading arrangement. FNSt highly appreciates such timely organisation of the seminar and is happy to provide its support.

I would like to extend my sincere thanks to FNCCI, South Asia Watch on Trade, Economics & Environment (SAWTEE), Federation of

Nepalese Cottage and Small Industries (FNCSI) and SMEDP, and to all those involved in organising the seminar in the most opportune time. SMEDP and SAWTEE have done a commendable job by compiling, editing and translating the seminar papers and documents in this book. I would particularly like to thank Mr Govinda Dev Pandey, Mr Ratnakar Adhikari, Mr Navin Dahal, Mr Bhaskar Sharma and their colleagues. I earnestly hope this publication will be of immense use to existing and potential small entrepreneurs, business institutions and chambers, students and those interested and concerned with the WTO and the SME sector.

Hubertus von Welck
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Foreword

We are all aware of the important contribution made by the small and medium enterprise (SME) sector to the Nepalese economy. The sector constitutes more than 96 percent of the total industrial establishments, contributes about 83 percent in the industrial employment generation by the industrial sector, and shares about 80 percent of the industrial sector's contribution to the national gross domestic product (GDP). Yet, the Nepalese SME sector today is confronted with multiple barriers and challenges, which have been a concern to all. With Nepal's recent accession to the World Trade Organisation (WTO), the rules-based multilateral trading system, the sector is likely to be in a more vulnerable situation. Though Nepal's membership to the WTO is likely to bring opportunities in many areas, there may appear new forms of challenges as well. This clearly necessitates that the Nepalese SMEs are given high priority, and adequately provided with proper safety nets so that they survive within the multilateral trading order. At the same time, high priority should also be given to make timely reforms in policies and working strategies in order to improve the competitiveness of the SME sector.

A National Seminar on "WTO Membership: Opportunities and Challenges for SMEs in Nepal" was organised on 21-22 December 2003 in Kathmandu by Small and Medium Enterprise Development Project (SMEDP), a partnership project of Friedrich Naumann Foundation (FNSt), Germany and Federation of Nepalese Chambers of Commerce and Industry (FNCCI), Kathmandu, in joint collaboration with South Asia Watch on Trade, Economics & Environment (SAWTEE), Kathmandu and Federation of Nepalese Cottage and Small Industries (FNCSI), Kathmandu. This timely seminar provided a meaningful platform to the Nepalese SMEs, government authorities, policymakers, civil society organisations, development workers, and media to understand and discuss various vital issues emanating from the accession to the WTO. The seminar helped develop a common agenda on SMEs and for this I am thankful to the organisers.

I would like to convey FNCCI's pledge to work on the resolution adopted. The recommendations made during the seminar are of vital importance with regard to future plan of action, not only for FNCCI but also for other organisers, participants and other concerned stakeholders. The papers presented in the seminar are also important in this regard. Indeed, the outcome of the seminar could be utilised as important tools to lobby with the government and other concerned so that the SME sector could be enabled to compete not only at the domestic market, but also at the international market. Realising the importance of these materials, we came up with an idea to publish this book. I am hopeful that the entrepreneurs, the government authorities, policymakers and planners, development activists and other concerned stakeholders will find the materials contained in this book interesting and beneficial. I would like to extend my sincere thanks to the officials of FNSt in India and Nepal for providing encouragement and support to publish this book. Many thanks and appreciation go to Mr Govinda Dev Pandey, Executive Director, SMEDP and his colleagues and officials and rapporteurs of SAWTEE for their contribution in organising the seminar and also preparing the seminar report. Also, we are indebted to the editors of this book, who not only put in their efforts to compile the materials and edit them, but also made significant contributions in enriching the quality of the papers.

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Chapter - I

Introduction

Navin Dahal

Over the years, the focus of discussion on Nepal's accession to the World Trade Organisation (WTO) has shifted from 'what if' and 'what after' to 'what now'. Accession into the WTO brings with it both opportunities and challenges. The membership opens doors to new and prosperous markets and subsequently can result in more investment, both national and foreign. But one should not forget that WTO membership could also result in enhanced competition in the domestic market. The lowering of tariff and removal of non-tariff barriers will mean that the Nepalese enterprises will face increased competition from foreign producers. What will be the impact of the changes brought by WTO membership on the Nepalese enterprises, particularly small and medium enterprises (SMEs)? This is a question confronted not just by SMEs, but also the policymakers and other stakeholders. Any deliberation on the possible impacts of the country's membership to the global trade regime on the Nepalese SMEs requires a thorough analysis of relevant WTO provisions. The vulnerable sub-sectors of SMEs likely to be adversely affected by Nepal's WTO membership need to be identified, which should be followed by deliberations on possible ways and means to assist them in thwarting the negative impacts. At the same time, the opportunities offered by WTO membership must be tapped.

For this very purpose, a national seminar on "WTO Membership: Opportunities and Challenges for SMEs in Nepal" was organised jointly by Federation of Nepalese Chamber of Commerce and Industries (FNCCI), Kathmandu, Federation of Nepalese Cottage and Small Industries (FNCSI), Kathmandu, Small and Medium Enterprise Development Project (SMEDP), Kathmandu and South Asia Watch on Trade, Economics & Environment (SAWTEE), Kathmandu on 21-22 December 2003. The seminar aimed to create awareness among various stakeholders on the impact of Nepal's WTO membership on the SME sector. The seminar made recommendations relating to various policy and legal measures that could be taken for improving the competitiveness of the Nepalese SMEs and harnessing their

Introduction

potentials, taking into account the challenges posed and opportunities offered by WTO membership. This book is a compilation of six papers presented during the seminar. It also contains the resolution adopted during the concluding session of the seminar.

Mr Govinda Dev Pandey in his paper "Problems and Prospects of SMEs in Nepal" looks closely at the impact of the country's WTO membership on the domestic SMEs. He begins by stressing on the importance of SMEs in the Nepalese economy. He highlights that SMEs form more than 96 percent of the total industrial establishments and contribute 83 percent to the industrial employment generation, while share about 80 percent of the industrial sector's contribution to the national gross domestic product (GDP). He makes his analysis by closely looking into the problems of the Nepalese SMEs. He argues that traditional management, undeveloped entrepreneurial culture, outdated production technology and poor marketing skills make it difficult for SMEs to face global challenges. He adds that inability to increase the quality and technical standards of products will diminish the competitiveness of SMEs. He asserts that the development of SMEs is important not only from the perspective of balanced economic development, but also from the perspective of maintaining peace and tranquillity, and social harmony. He recommends that the government and the private sector must work together to identify products and services having comparative advantage at the international level. He also adds that the government should provide support at the field level to assist SMEs in the identification of new trading opportunities. He also suggests that the government should support and initiate special mechanisms like strategic alliance and networking between SMEs and large firms, and promotion and establishment of export trading houses and free trade and export processing zones. He concludes by advocating on the need to use various trade remedy measures and subsidies to protect SMEs and provide them space to compete globally.

Mr Prachanda Man Shrestha in his paper "Multilateral Trading Regime: Implications on the Nepalese SMEs" dwells on why Nepal decided to join the WTO and focuses on how the Nepalese SMEs could benefit from WTO membership. He argues that Nepal cannot remain aloof from the rest of the world and adds that WTO

membership will help Nepal integrate with the global trading system. He adds that special provisions of the WTO will guarantee a predictable and stable trading environment for the Nepalese SMEs. The two fundamental principles of the WTO, namely "most favoured nation (MFN)" and "national treatment", will enhance the export potential of Nepalese products and services. Under the MFN clause, the Nepalese products and services will get access to global markets at equal or no less terms than being enjoyed by other WTO members. Similarly, the national treatment provision guarantees that the Nepalese goods and services will receive the same treatment as the goods and services of the importing country. He, nonetheless, cautions that WTO membership will bring not only opportunities, but also challenges. He warns the sanitary and phytosanitary (SPS) measures that allow a member country to impose trade barriers to protect plant, animal and human health can be used arbitrarily. This requires that the Nepalese SMEs meet the quality requirements prescribed by the developed countries. But this could be a daunting task given the poor technological base and resource constraints of the Nepalese SMEs. The provisions in the Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement are likely to increase the cost of acquiring the much needed technology for SMEs. He suggests that given the challenges confronting SMEs, the government must devise measures for SMEs' development in industrial and economic policies. In particular, the government must help SMEs in the areas of technology transfer and upgradation of their production systems. He concludes by highlighting the importance of raising awareness amongst SMEs on different WTO issues.

The agricultural sector plays an important role in the Nepalese economy. Dr Deva Bhakta Shakya in his paper "Agreement on Agriculture: Challenges and Opportunities for the Nepalese Agricultural Sector" examines the effect of Nepal's WTO membership on this sector. He states that the Nepalese agricultural trading regime is already very liberal as Nepal does not impose any kind of trade restrictive measures such as quantitative restrictions (QRs) and provide trade distorting domestic and export subsidies. He adds that customs duties on most agricultural products are less than 15 percent. He states that various WTO agreements such as SPS, TRIPS, Technical Barriers to Trade (TBT) and Agriculture will have both positive as well as negative impact on the Nepalese agricultural

sector. He suggests that a host of opportunities exist for the sector under the WTO regime. However, he says that to translate the opportunities into actual gains, Nepal will have to improve the transportation linkages between the farm and the market, reduce costs of production, and acquire and utilise enhanced technology. He also suggests that to gain from initiatives like the European Union's (EU's) "Everything but Arms" offer, Nepal should immediately work to identify and market products that have export potential. Towards the end, however, he expresses his worry over the poor translation of the work plan on agricultural trade negotiations as set out in the Doha Development Agenda (DDA).

In the WTO regime, intellectual property right (IPR) protection has been ensured through the TRIPS Agreement. Dr Hirmani Ghimire in his paper "SMEs under the TRIPS Regime" looks into the TRIPS Agreement and analyses its impact on the Nepalese SMEs. The TRIPS Agreement sets out the minimum standards of IPR protection. While examining the impact of the TRIPS Agreement on the Nepalese SMEs, he cautions that the use of reverse engineering will be restricted. He also observes that the use of Geographical Indication (GI) protection for promoting some of Nepal's unique products abroad could be more difficult than assumed. He adds that pharmaceutical companies and providers of health services will be adversely affected by the TRIPS Agreement. TRIPS will also affect the agro-based industries as it has the potential to weaken farmers' position in relation to plant breeders. He suggests that special measures will have to be put in place to protect "farmers' rights". The fact that more than 70 developing countries have not been able to fully implement the TRIPS provisions necessitates that Nepal seeks external technical and financial assistance. He also suggests that Nepal should collaborate with other least developed countries (LDCs) and work closely to protect the interests of SMEs within the framework of the multilateral IPR regime. In the domestic front, Nepal should utilise the flexibility in the TRIPS Agreement to protect the interests of SMEs.

Though the goal of the WTO is to liberalise international trade by removing tariff and non-tariff barriers, agreements relating to technical regulations and standards (TRS) are, more often than not, having trade distorting impacts. Dr Posh Raj Pandey in his paper "Standards Related WTO Agreements: Opportunities and Challenges

for SMEs” examines the TRS related agreements of the WTO and sheds light on their impacts on the Nepalese SMEs. The TRS related agreements include the agreements on SPS and TBT. The WTO as such does not develop TRS on its own, but gives due recognition to measures adopted by member countries as long as they are based on scientific evidence and do not restrict international trade. He cautions that the cost of complying with standards of importing developed countries could be very high and out of reach for the Nepalese SMEs. This could even nullify the market access opportunities provided by other WTO agreements. He adds that Nepal will have to enhance its infrastructural and institutional facilities in order to be able to comply with international TRS. He warns that due to the vague definition of TRS under the WTO regime, developed countries have been using the TRS related agreements to impose stringent norms and standards to curtail imports. He suggests that remedial actions need to be taken at the national, regional and international levels to overcome barriers imposed by TRS and help the Nepalese SMEs participate effectively in the world trading system.

As any developing country, Nepal is worried that WTO membership might bring unfair foreign competition. The WTO has made provisions for trade remedy measures to deal with such practices. Mr Ratnakar Adhikari in his paper “Trade Remedy Measures as Means to Promote SMEs” looks into the trade remedy measures available within the WTO framework. He indicates that there are three direct and two indirect trade remedy measures. Direct measures include anti-dumping, countervailing measures and safeguards. Balance of payment (BoP) cover and special safeguard in the case of agriculture are the indirect trade remedy measures. Anti-dumping measures are taken to protect domestic enterprises against unfair practices of foreign private companies, while countervailing measures are taken against the subsidy provided by the foreign governments. Similarly, safeguard measures are taken to remedy the problem of import surge. He, however, cautions that it will be difficult for a country like Nepal to actually utilise these measures as it is necessary to first enact laws, put in place institutional mechanisms and prove that dumping has caused serious injury to the domestic enterprises in order to be eligible to use these measures. He, thus, suggests that the government should immediately start to work to enact the required legislation, develop and put in place the necessary institutions and train human resources to handle trade remedy measures.

Chapter - II

Problems and Prospects of SMEs in Nepal

Govinda Dev Pandey

2.1 Introduction

Small and medium enterprises (SMEs) play an important role in creating self-employment opportunities, mobilising and using local resources, and raising the income of the rural populace. During the year 2001, SMEs accounted for 96 percent of total industrial establishments, contributed 83 percent in employment generation by industrial sector, and shared about 80 percent in the industrial sector's contribution to national gross domestic product (GDP).

Cumulative statistics of registration show that the number of 'micro and cottage' units between fiscal year 1992¹ and fiscal year 2000 reached 50,000, while that of 'small industrial' units during the same period crossed over 90,000. However, the total cumulative and updated information about the number of units in existence and in operation is not available. Informal knowledgeable sources maintain that more than 60 percent of the registered units are not in operation and more than 50 percent of those in operation are characterised by underutilisation of capacity and sickness.

As per the Population Census of 2001, about 840,000 families were involved in small income generating activities, with most of them working in the unregistered and informal sector. These activities ranged from production of household items, utilitarian goods, handicrafts, textile fabrics, food and daily consumer goods, timber and non-timber based products, retail, trading, to mining and quarrying.

Since the late 1980s, Nepal has shifted from a protectionist regime to an open market regime. As a result of this shift, barriers to

international trade have been removed or substantially reduced. The Nepalese SMEs have been affected by this change and find it increasingly difficult to compete with international products both in the domestic as well as international markets. Nepal's development plans and other commerce related policies have been promising different incentives for SMEs, but lack of awareness, lapses in policy declaration and hassles in actual implementation of the policies have largely prevented SMEs from getting any significant benefit.

2.2 SMEs in Nepal

Most of the Nepalese SMEs are involved in processing and manufacturing of food items, consumer and household goods, and textiles and related products, both for exports as well as the domestic market. Rice, pulses, oil and flour mills, dairy, aerated soft drinks, fruit juices and processed products, noodles, biscuits and light snack products, chocolates and candy, mineral water, dried vegetables, and some other household utilitarian and consumption goods have dominated SMEs activities in Nepal.

Other areas of SMEs' involvement include forest fibre based industries, wooden and metal handicrafts, handmade paper and products, apparels and garments, woollen carpets, pashmina shawls and rugs and leather. Metal and plastic household utensils, wooden, plastic and metal furniture, printing press, polythene pipes, utensils, jute products, poultry products, livestock products, wire drawing, nail and iron rod, sheet metal, gig and black pipes, rubber tyres and tubes, plywood and boards, colour paint products and zinc oxide are other sectors where SMEs' engagement is high.

In addition, investment in the modern agro-business sector like tea, off-season vegetables and horticulture products, dairy and milk products, animal husbandry and floriculture, among others, have also been seen during the last decade. Due to the opening up of investment for infrastructure development to the private sector, investment in micro hydropower, and tourism resorts and complexes have also been witnessed in some regions.

At the micro, cottage and family level, a sizeable number of unregistered enterprises operate off-farm on a seasonal basis. A

majority of these unregistered units are reliant on agro-based and forest-based raw materials and produce household and consumption goods, particularly food items, handicrafts and household utility articles. Since almost all of them operate during the off-seasons and on a part time basis, they are unable to effectively use the available resources, resulting in irregularities in production, lower quality products and non-commercial operation.

2.3 Problems of the Nepalese SMEs

In general, SMEs in Nepal have traditional management practice, undeveloped entrepreneurial culture, low capital base, outdated and less efficient production process and technology, and poor knowledge and information about business opportunities and marketing.

Obviously, the challenges for the Nepalese SMEs are mounting. The challenges have become more profound due to the recent trends of globalisation and economic liberalisation, which if not addressed properly will result in a situation where the Nepalese SMEs will lose out miserably to the global players.

Marketing constraints is observed to be very high on the list of disadvantages faced by the Nepalese SMEs. Besides, given their size and limited access to resources, their production capacity is limited and hence are unable to execute large orders. SMEs are also not able to approach organised markets due to their high production and transaction costs. Fear of commercial disputes arising from delayed delivery, improper packaging, unforeseen costs, poor quality and failure to meet technical specifications also prevents them from approaching organised export markets.

On the financial front, SMEs, more often than not, are unable to generate enough credit to carry out relatively larger volume of work. The lack of awareness on the part of entrepreneurs regarding financial institutions that may give them credit is one reason for their inability to raise financial resources. The other reason for their inability to generate funds is the practice of the financial institutions to provide credit on the basis of relationship rather than based on feasibility of the projects. Even when SMEs manage to get credit, the

relatively short time for repayment and high interest rates do not help their cause.

On the product development and production front, SMEs require facilitation in the right choice of technology, as well as in acquiring technology suited to their specific needs and amenable to periodic upgrading. Lack of access to technology is having a major impact on the export capability of most SMEs. This also prevents SMEs from meeting different environmental regulations requirement of the export market.

2.4 SMEs in the WTO context

The basic objective of the WTO is to facilitate the free movement of goods and services across the globe through mutually negotiated agreements. The WTO-led liberalisation will, in a way, force the Nepalese SMEs, especially operating in the rural areas, to think global in terms of quality, marketing and pricing of products and services. The WTO opens a new market, and provided that necessary government support is maintained, it will be possible for the Nepalese SMEs to make better incomes from international markets.

Once the WTO and globalisation norms take deep roots, one should expect increased import from other countries. No doubt, the Nepalese market will have better quality products, but the products being manufactured by the Nepalese SMEs will face greater competition. Obviously, in the face of such competition, domestic SMEs may not be able to survive. Likewise, the Nepalese SME products in the foreign markets can also be edged out due to stiff competition.

An obvious challenge posed by the WTO is the quality and technical standards of products. Lack of awareness or lack of technical know-how has greatly dampened the prospects of many Nepalese SME products. The case of milk and milk products produced by the country's small dairy and household milk producers is one example (See Box 2.1).

2.5 Conclusion and Recommendations

SMEs will have to enhance their technology and improve the quality of their human resources in order to benefit from Nepal's membership to the WTO. The development of SMEs in the present scenario needs to be seen not merely from the perspective of balanced economic development and for direct attack on poverty at the grassroots level, but also from the perspective of maintaining peace and tranquillity, social harmony and environment protection.

All this calls for increased focus on productivity, competitiveness and efficiency as well as the need to explore new frontiers of business opportunities brought by information technology and digital revolution. The focus now should be on how to make best use of WTO membership to serve the interest of SMEs. In the process, it should always be remembered that WTO membership does not force Nepal to remove barriers on all products. Nepal can still protect selected sectors in which SMEs have a competitive advantage.

Traits such as flexibility, adaptability, inventiveness and innovativeness, which are inherent in SMEs, can go a long way towards helping them to become globally competitive. However, this sector needs to be nurtured and backed by conducive policies and effective support mechanisms if it is to survive the challenges of globalisation and realise the benefits and opportunities put forth by Nepal's membership to the WTO.

Technical assistance and business support services in the form of business and market information dissemination, skill upgradation, minimum regulation and hassle free facilitation from the government agencies, and alliances and networking arrangements between and amongst the smaller enterprises as well as larger producers and exporters can greatly help the small producers in enhancing their capacities.

There is a need to focus on the expansion of SMEs in high value and labour-intensive activities. Areas that have the potential to grow include horticulture, agro-based and non-timber forest products, information and knowledge based technology services, educational institutions, modern agro-based products and services sector, among others. To develop these products and services, it is important to

Box 2.1: Nepal's Poor Dairy Industry

Quality in milk refers to the level of bacterial count, something that the Nepalese producers are careless about and consumers not really aware of. In Nepal, only the fat content is tested for measuring the quality of milk, and the bacterial count is neglected.

It is reported that the current level of bacterial count in one millilitre of milk, when it reaches the processing plant from small dairy or household is generally in the range of 1.5-3 million. After pasteurisation, the bacterial level comes down to 30,000-50,000.

The imported milk from New Zealand or Holland, among others, however, has a very low bacterial count. Bacteria in milk produced in Nepal too can be lowered once the small milk producers are provided with the necessary technical inputs and financial support.

This involves a process of empowering SMEs, not only by providing information and training, but also by motivating them to initiate reforms in their production system.

Apart from technical standards, lack of adequate state support in the face of increased competition is also hitting the agro-based SMEs hard. For example, in the name of deregulated and open market system for a healthy regime, the Nepalese government revoked most state support programmes for the agricultural sector. However, the flooding import of cheap agro-products from India, which still continues to subsidise most agricultural inputs, has hit Nepal's agro-based SME sector hard.

Despite some incentives offered to SMEs under different policies, SMEs have not benefited much. The Nepalese SMEs in the past have suffered due to a wide array of factors. The weaknesses need to be identified and mitigated and policy reforms carried out keeping in mind the WTO regime.

ensure an enabling environment for SMEs. Otherwise Nepal will have to continue with the present trade practice of exporting unprocessed agriculture and forest based raw products and importing finished products for domestic consumption.

To conclude, the following are some suggestions for developing an enabling environment in the country for facilitating and improving the capacity of SMEs in order to face the challenges of globalisation and benefit from new opportunities offered by the WTO:

- The government and the SME related federations/associations should work together to identify products/services having comparative and competitive advantage at the international level. They also need to work in close collaboration to facilitate and enhance the capability to achieve and retain competitive edge. The government should provide financial and technical support to undertake need focused training programmes, business and market promotion activities and other business development services for SMEs.
- One of the fundamental weaknesses of the Nepalese SMEs is the lack of awareness relating to information on market opportunities and their inability to allocate sufficient management and financial resources to exploit these opportunities effectively. Though a vast amount of trade related information is available at the central level, most SMEs continue to rely heavily on private contacts for market related information. The government should support SMEs to identify market opportunities.
- For the development of the scattered micro and informal producer groups, special mechanisms need to be initiated and supported by the government in collaboration with different private sector associations/federations. The programmes should encourage and support strategic alliances and networking; promote export trading houses; facilitate the establishment of export production villages, free trade and economic development zones; and facilitate SMEs' participation in specialised trade fairs and marketing missions.

- Given the weak financial management of the SMEs, different banks and financial agencies need to play the role of a development partner to facilitate the growth of SMEs as only with the growth of the industrial and services sector will the financial sector grow. On the other hand, SMEs also need to infuse transparency in financial operation and adopt standardised accounting and auditing practices. In order to help improve the competitiveness of SMEs, banks and financial agencies should ease access to working capital and export financing, they should also enlarge pre- and post-shipment credit facilities as well as export credit guarantees.
- Nepal's WTO membership will put the SME sector in a highly vulnerable position. Keeping watch on global trade practices, application of various trade remedy measures and protection and subsidies for SMEs will be required to make them competitive.

Endnote

¹ Fiscal year 1992 means fiscal year 1991/92, year ending mid-July. Subsequent references of fiscal years are to be understood accordingly.

Chapter - III

Multilateral Trading Regime: Implications on the Nepalese SMEs

Prachanda Man Shrestha

3.1 Background

In its quest to move along with global economic development, the Nepalese government realised that it cannot remain aloof from the waves of globalisation. Consequently, it applied for the membership of the General Agreement on Tariffs and Trade (GATT) in May 1989 and was subsequently given an observer's status. The World Trade Organisation (WTO) succeeded GATT from 1 January 1995. Nepal applied for WTO membership in December 1995. During the accession process, Nepal submitted the memorandum of foreign trade regime and responded to questions raised by WTO members. Several rounds of Working Party meetings and bilateral consultations were held in the years 2000 and 2002. Nepal conducted bilateral negotiations with several countries, including Japan, Australia, New Zealand, Canada, India, Malaysia, the European Union and the United States.

The last Working Party meeting was held on 15 August 2003 in Geneva. Nepal's membership to the WTO was formally endorsed by the fifth Ministerial held at Cancun, Mexico on 11 September 2003. Nepal's accession package has been termed as the best accession package so far by United Nations Conference for Trade and Development (UNCTAD). Nepal now awaits the ratification of WTO membership assured during the Cancun Ministerial. The ratification has to be done before 31 March 2004.

With Nepal set to become the 148th member of the WTO, in depth analysis is required to identify the possible opportunities and threats of WTO membership to various sectors in the country. This paper looks into the impact that the various provisions under the different

WTO agreements would have on thousands of small and medium enterprises (SMEs) operating in the country.

Nepal opened its economy to the outside world in the early 1950s following the end of the century-old feudal Rana regime. Yet after half a century, the Nepalese economy continues to remain largely traditional, underdeveloped and backward with 80 percent of the population dependent on agricultural employment. Although only 20 percent of the land is arable, the contribution of the agricultural sector to the gross domestic product (GDP) stands at almost 40 percent. The contribution of the manufacturing and industrial sector stands at hardly 10 percent. The industrial base hence is underdeveloped and trade imbalances are a persistent feature of the economy.

With trade to GDP ratio of about 50 percent, an average tariff rate of 14 percent, and virtually no quantitative restrictions (QRs), Nepal is among South Asia's most open and trade-dependent economies. Despite its significant geographical constraints and policy and institutional weaknesses, Nepal has comparative advantage in a number of labour-intensive manufacturing and agricultural products.

Wide-ranging trade liberalisation and substantial reforms in industrial policy were initiated through the Trade Policy and the Industrial Enterprises Act, 1992. The reforms encompassed privatisation, deregulation, de-licensing, export and import liberalisation and evolution towards current account convertibility. Against the backdrop of these reforms, economic policy aimed at the development of entrepreneurship in order to achieve higher economic growth. The vast majority of entrepreneurs have informal micro and small enterprises. Only a few enterprises have successfully progressed to formal medium-sized or large enterprises. Such enterprises could actually make significant contribution to national productive capacity.

Agriculture provides only seasonal employment for the rural population. Hence, off-season and off-farm activities such as weaving, knitting, basketry, teashops and roadside shops complement rural incomes. A large number of informal rural micro-enterprises supply goods and services to local manufacturers using traditional technologies. Micro and small enterprises constitute a

major source of income in the urban areas. As of fiscal year 2001¹, SMEs accounted for 96 percent of the total industrial establishments, contributed 83 percent in employment generation by industrial sector, and had a share of about 80 percent in the industrial sector's contribution to national GDP. Hence, the importance of SMEs needs no exaggeration.

3.2 SMEs in the WTO Context

Countries around the globe, including the developed ones, have been encouraging the growth and development of SMEs through stipulation and enforcement of policies and measures, which provide incentives and assistance to SMEs. Retrospectively, SMEs have served, and continue to serve in developing and least developed economies, as a base for further industrialisation². Nonetheless, irrespective of the varying degrees of industrialisation and social and economic structures, SMEs represent the backbone of all economies, even in this age of liberalisation and globalisation.

There is a growing recognition worldwide that SMEs have an important role to play in the present context given their potential to achieve greater resource-use efficiency, capacity for employment generation, technological innovation, promoting inter-sectoral linkages, raising exports and developing entrepreneurial skills. Their locational flexibility is an important advantage in reducing regional imbalances. Given their strategic importance, the impact of policy reforms on SMEs is a major concern.

For developed, developing as well as least developed countries - SMEs play an important role in the economy. Furthermore, despite the small size of the investments made, SMEs are embedded, directly or indirectly, in the international trading system. As such, they will be affected by trade policy changes, and Nepal's WTO membership.

Trade policy changes affect SMEs in the areas of costs, access and strategic planning. Most SMEs are not equipped to deal with these issues on their own. Usually, SMEs are not even aware of the trade policy changes, let alone taking measures to mitigate threats that may arise due to such changes. In some instances at the international level, the relevance of trade policies to SMEs has been

recognised in trade negotiation forums. For example, the US-EU Transatlantic Business Dialogue³ has a permanent SME working group. Likewise, the Free Trade Area of the Americas (FTAA) negotiations has a forum for addressing SME interests.

However, the WTO does not have any focal point for SMEs. It, therefore, appears timely to consider advocating for the establishment of an institutional system, which can put forward the interests of SMEs at the multilateral level. In an organisation that already has the membership of 146 countries accounting for more than 95 percent of the world trade, the absence of a point of advocacy severely limits influence and reduces the visibility of SMEs.

3.3 SMEs in Nepal

SMEs are defined based either on fixed investment or on the number of employees. In 1988, the World Bank defined SMEs as those enterprises, which had an estimated US\$ two million equivalent value of their assets, chiefly as working capital. On the other hand, UNCTAD uses the employment measure as the basis for defining SMEs. The threshold of investment or employment that is taken as a benchmark to identify SMEs, however, differs from country to country depending on their level of development and advancement.

Table 3.1: Definition of SMEs

Policy	Small Industries	Medium Industries
Industrial Enterprises Act, 1961	Capital investment of Rs 50,000	Investment between Rs 50,000 and Rs 0.5 million
Industrial Enterprises Act, 1974	Fixed capital investment between Rs 0.2 million to Rs one million	Fixed capital investment between Rs one million and Rs five million
Industrial Policy, 1981	Fixed capital investment of up to Rs two million	Fixed capital investment between Rs two million and Rs 10 million
Industrial Policy, 1992	Fixed capital investment not exceeding Rs 10 million	Fixed capital investment between Rs 10 million and Rs 50 million
Industrial Policy, 1997 (amended)	Fixed assets not exceeding Rs 30 million	Fixed assets between Rs 30 million and Rs 100 million

Compiled from Industrial Enterprises Act and Industrial Policies

SMEs in Nepal are defined based on the investment made and this definition does not consider the number of employees (see Table 3.1). Their definition has been made by the use of the term small and medium industries (SMIs). The terms SMEs and SMIs are, however, used interchangeably, and essentially mean the same set of small and medium business as well as manufacturing firms.

3.4 Common Features of SMEs

Nepal's SMEs share the characteristics that are usually common in SMEs of developing countries and LDCs. Kyermaten⁴ (1993) presented these characteristics in the African case. Many of these characteristics are relevant in the Nepalese context as well. The common characteristics as propounded by Kyermaten are:

- Very often, SMEs are family-level enterprise set up with family savings and sometimes supported by kith and kin.
- The ownership and management are combined to the same individual(s) with extensive powers and control over all issues of the enterprise.

- Since personal and family savings are the major sources of equity capital, credit worthiness of SMEs is low, which impedes their development.
- Managerial competence requirements are perceived as unimportant and whoever manages the enterprise relies on his/her self-entrepreneurial skills and initiatives.
- Recruitment of staff often formalises without job description. Even if staff are competent, they are rarely delegated with authority and power to decide on their own.
- The technology used is usually locally innovated, limited in capacity and efficiency, and breaks down frequently - a condition, which causes high wastage.
- Most SMEs produce only for local markets and export-oriented SMEs are few. Those that are export-oriented are not able to expand due to various inherent constraints.
- Access to institutional credit for SMEs, despite provisions for the same, is limited due to individual entrepreneur's inability to contribute to equity capital and collateral security.

3.5 Significance of SMEs

The importance of SMEs in job creation is now widely accepted in both developed and developing countries. Their development can deepen the manufacturing sector and foster competitiveness. It can also help achieve more equitable distribution of the benefits of economic growth, thereby helping alleviate some of the problems associated with uneven income distribution. Available evidence suggests that SMEs have played a major role in the growth and development of all leading economies in Asia.

The Asian experience clearly shows that it is mainly the growth-oriented medium-sized enterprises among SMEs that have a high propensity to apply technology and training and serve specialised niche markets. Among the factors that have contributed to the

success of such SMEs is a high incidence of cooperative inter-firm relationships, which has rendered individual firms less susceptible to risks, fostered mutual exchanges of information and know-how between firms and created a rich pool of collective knowledge.

Though there still is a dearth of highly competitive and growth-oriented SMEs in Nepal, the importance of existing SMEs to the national economy cannot be undermined. This is testified by the fact that SMEs comprise almost 95-98 percent of the total business establishments in Nepal. They have grown as a critical sector of growth providing employment and income to many. This becomes very important in the light of the fact that there is pervasive poverty and lack of employment opportunities in Nepal.

The SME sector is the largest employer in Nepal outside the agricultural sector. This sector is a prime mover of economic dynamism. During the period 1985 to 2001, the annual registration of SMEs increased from 910 to 6587⁵. Though latest employment figures are not available, data show that the number of people employed by 9,990 SMEs registered in 1998 alone crossed over 89,000. This invariably shows the role that SMEs have been playing in poverty alleviation, which is the overarching goal of the government's plans and policies, not just in the short term but in the longer run as well. One of the reasons why much importance has been laid on SMEs is because they are widespread and have high employment intensity.

While there is no dispute that there is a dearth of fast growing SMEs in Nepal, dynamic SMEs provide competitive edge in two ways - as leading subcontractors and as venture firms in their own right. They also create jobs, thus multiplying their impact on economic growth. One of the most important features of SMEs is the strong backward linkage that they have. A sustained growth in the activities of SMEs would have a positive impact on the local backward linkage areas of SMEs.

SMEs in Nepal have provided the foundation for private sector growth. The growth in trade and output seen by Nepal, especially since the government adopted liberal economic policies, is a strong testimony to this assertion. Figuratively speaking, during the 1990s, manufacturing exports in the US dollars terms grew at an average annual rate of 20 percent compared to 15 percent overall export

growth, though with considerable volatility. The share of certain products in the world markets increased two-10 times, reaching seven percent in the case of carpets and 0.12 percent in the case of garments, while overall share of exports doubled. And a large chunk of the output came from SMEs, under which most carpet as well as garment industries fall.

One of the important significance of SMEs arises by virtue of investment. Large industrial enterprises create just one job on an average for an investment of not less than Rs 300,000, while SMEs generate a job with investment of not more than Rs 10,000⁶. This is an indication of the degree of importance that SMEs hold in the Nepalese context. Furthermore, this is also a testimony to the fact that for an intensive industrial expansion, promotion of small and medium scale industries is essential.

3.6 Positive Implications of WTO Membership

Nepal's intent to join the WTO was not without reasons. First, Nepal cannot remain aloof of the globally changing trade paradigm. Second, growth and economic development cannot take place in isolation. The WTO offers a host of opportunities for Nepal, which is one of the 49 LDCs in the globe. In order to bring LDCs on board and integrate them into the multilateral trading system, the WTO has set special provisions. Higher transition period for the implementation of different agreements, lower commitments under certain agreements, technical support, due restraint on disputes involving LDCs, and special treatment while liberalising services sector are some of them.

Trade liberalisation is the main objective of the WTO. This liberalisation can be beneficial for countries like Nepal because this will also increase the opportunities for export expansion and reduce economic risks. For example, due to Nepal's excessive reliance on three export markets, namely India, Germany and the US, the country's foreign trade has become extremely vulnerable. However, after Nepal joins the WTO, it can also explore other destinations for exporting its products. This should be seen as an opportunity to go beyond limited trading activities and diversify external trade.

In addition, as Article I of the GATT mandates all member countries to follow the principle of "most favoured nation (MFN)", Nepal will potentially get unfettered access to global market at equal or no less terms than being enjoyed by other members. Hence, extended market access for Nepalese SME products can come as one of the most important opportunities. Besides, because Nepal is an LDC, it would also be entitled to get special and differential treatment (S&DT) from developing and developed nations. As such, WTO membership would come as an opportunity for the marketing of some of the globally competitive Nepalese SME products.

Similarly, Article III of the GATT mandates member countries to treat foreign goods or services no less favourably than domestic ones (a concept known as "national treatment"). This implies that the Nepalese goods or services will receive the same treatment as the goods and services of the importing country.

Nepal's major trading partners, especially India, currently grant the Nepalese exporters better than MFN access. But nothing prevents them from withdrawing such access at any time, as long as Nepal remains outside the WTO, or from imposing barriers that would otherwise violate WTO rules. The same holds true for transit rights through India and Bangladesh. Membership to the WTO will provide Nepal the protection of international rules. This is likely to bring an environment of predictability, and ensure market for products of the Nepalese SMEs.

As the WTO is a rules-based multilateral trading body, its membership will certainly ease the bilateral pressures from trading partners. Besides, due to the creation of an environment of competitiveness, the country will become conscious and active in identifying the areas of competitive advantage. Liberalisation of some services sectors is likely to bring foreign investment and employment opportunities.

A large number of SMEs operating in Nepal are catering to just the local needs, and are not export-oriented in nature. WTO membership increases the likelihood of competition in the domestic market against products that originated in foreign lands. With an accession

deal that was termed by UNCTAD as the best so far, Nepal may be in a position to safeguard and protect its market against the flood of competing foreign goods. Some of the measures that Nepal can resort to include higher tariff, safeguard measures and targeted subsidies.

By introducing a regime of rules-based trade policy, WTO membership increases transparency and reduces uncertainty in doing business. Not knowing what tariff would be applied when a product crosses borders may in itself discourage trade from occurring. Reinforcement of the rule of law in the application of trade policy by all WTO members can make the trading environment for the domestic SMEs a conducive one. This can encourage the export of even those products that were not earlier exported.

3.7 Challenges Faced by the Nepalese SMEs

Despite the importance and the contribution of the SME sector to the Nepalese economy, the sector itself is encountering serious adjustment problems under a changing and dynamic environment, especially in the context of liberalisation and globalisation. The twin processes of globalisation and liberalisation are creating new dynamics of production, enterprise development and international competition. Nepal's existing enterprise development strategies may no longer be effective in the light of these changes.

Statistical records indicate that the Nepalese SMEs are finding it hard to survive in the new environment ushered in by increased competition. Government figures show that the registration of SMEs in Nepal is on a downward trend. While a total of 9,650 SMEs were registered with the Department of Industry during the fiscal year 1998, the number of registration in the fiscal year 2001 slumped to 6,587. Domestic conflict may have a role to play, but certainly, with exports waning and the performance of the industrial sector on the downturn, possible adverse impact of the globalisation and liberalisation cannot be ruled out.

In the Nepalese context, while the capital resource needs of SMEs are mostly met locally, they largely depend on raw materials from India, and in some cases, from China and other countries. The SMEs

that source raw materials from the neighbouring countries, especially India, are technically better off because they can be assured of regular supplies. However, liberalisation has not resulted in better access to inputs for SMEs and Nepal's entry into the WTO does not guarantee that either. Domestic firms have found themselves doubly affected - by increased competition from foreign goods and by rising costs of production. Most Nepalese entrepreneurs thus find it difficult to compete with products from India where the costs of production are lower. Goods produced in Nepal utilising Indian raw materials are seldom able to compete with similar goods imported from India.

In Nepal, the enterprise sector shows a distinct dual structure. At one extreme, there exist a few large modern capital-intensive, resource-based, import-dependent and assembly-oriented enterprises, while at the other, there are small and informal sector enterprises that use very simple and traditional technologies and serve a limited local market. The number of medium sized enterprises is relatively less. This structural imbalance has arisen despite many SME promotion programmes of the government.

Some of the more apparent threats from WTO membership come from some WTO agreements, particularly Sanitary and Phytosanitary (SPS) Measures and Trade Related Aspects of Intellectual Property Rights (TRIPS). Developed countries may impose various trade barriers in the name of protecting plant, animal and human health. Since a substantial proportion of SMEs' output emanates from agriculture, there is always a risk that importing nations would restrict imports citing different SPS measures. Agro-exports from Nepal to existing trade partners are subjected to quarantine checks, which have created difficulty and given rise to delays and losses in transits. One of the recent examples of how the Nepalese traders can suffer due to SPS measures is that of the Nepalese honey exporters. Norway banned the import of the Nepalese honey under its Hazard Analysis and Critical Control Point (HACCP) regulations stating that the Nepalese honey is unfit for human consumption⁷.

The TRIPS Agreement is one of the most contentious agreements ever framed under the WTO regime. The agreement allows the patenting of ideas, expressions, innovations, creations, and technology. Nepal needs to abide fully by the provisions of the TRIPS

Agreement from 1 January 2007. This agreement can potentially inflate the price of technologies that are critically important for upgrading the production facilities of the Nepalese SMEs. Apart from TRIPS and SPS, a major challenge faced by the Nepalese SMEs, at least those that are export-oriented, would be in the form of standards. High technical standards set by the importing countries may act as barriers for the Nepalese SME products.

3.8 The Way Forward

Given the inherent difficulties of small enterprises, it is quite clear that a dynamic SME sector cannot be established without external assistance. In its pursuit of open investment and trade policies, Nepal needs to integrate measures aimed at SME development into its general industrial and economic policy.

Technology is becoming an issue of strategic importance to the development of industries, whether small, medium or large. Large firms usually have the resources to manage the transfer of technology through various means but the same cannot be said of SMEs. While appropriate government policies are a must for facilitating technology transfer to SMEs, a proper networking and linkage with domestic and foreign investors, as well as multinational companies, is also necessary. As a starter, nexus between large domestic companies and SMEs can be set up to facilitate the transfer of knowledge. These can be done better at the initiation of the government, than that of the entrepreneurs managing SMEs.

Standardisation of products manufactured by the Nepalese SMEs comes as one of the most important issues in the context of the WTO. In the absence of domestic standards that are at par with international standards, the Nepalese SME products are at risk of being rejected in the international markets. There is no effective system of certification of products, and the Nepal Bureau of Standards and Metrology (NBSM), the institution that issues the Nepal Standard (NS) quality mark, is poorly equipped, not just in terms of technology, but also in terms of human resources.

A critical mass of domestic enterprises in the middle range that are internationally competitive and capable of penetrating global chains

of production is lacking in Nepal. The East and South-East Asian experience with export-orientation shows that the majority of small enterprises perform poorly in the world market. Those most likely to survive are the ones with export potential, and which, in addition, grow from small into efficient medium-sized firms.

One of the important points raised frequently is the level of awareness amongst the Nepalese SME entrepreneurs on the possible implications of WTO membership. The SME entrepreneurs should be equipped with necessary knowledge and skills to counter the threats posed by the country's WTO membership and take advantage of the benefits offered. Awareness raising should be a continuous process. The government and the private sector have to work together to identify products that have comparative and competitive advantage, not just for the purpose of exports, but for the purpose of survival in the domestic market as well.

Endnotes

- ¹ Fiscal year 2001 means fiscal year 2000/01 ending mid-July. Subsequent mention of fiscal year is to be understood accordingly.
- ² Maskey, Bishwa Keshar. (ed). 1999. *Small and Medium Enterprises: Through Local Capacity Building*, Centre for Development and Governance, Kathmandu
- ³ Yerram, Dr B. Raju. 2002. *Small and Medium Enterprises: Issues in the changing global economic environment (part IV)*
- ⁴ Kyermaten, Alan J. 1993. "Small and Medium Enterprises in Ghana and Selected African Countries" In Chakradhari Agrawal (ed), *SMEs Towards 2000*, Beijing
- ⁵ Statistical Pocketbook of Central Bureau of Statistics, 2002
- ⁶ Khatiwada, Yuba Raj. 2001. "Issues in the development of SMEs in Nepal" in Maskey, Dr Bishwa & Dr Narayan Manandhar (eds) *Small and Medium Enterprise Development in Nepal: Proceedings of National Conference*, FNCCI and Centre for Development and Governance, Kathmandu.
- ⁷ Progressive Regional Action and Cooperation on Trade monthly e-newsletter. Vol 1 Issue 2 December 2003. "The case of Nepalese honey." Published by SAWTEE.

Chapter - IV

Agriculture within the WTO: Challenges and Opportunities for Nepal

Dr Deva Bhakta Shakya

4.1 Introduction

Negotiations in the World Trade Organisation (WTO) in the area of agriculture trade have been very complex. The resulting agreement is one of the most complicated amongst the different WTO agreements. Agreement on Agriculture (AoA) aims at strengthening market-oriented agricultural trading system and reducing distortions that may come in the way of international agricultural trade promotion. The Agreement marks a significant policy departure in modern economic history. It sets out a programme for progressive liberalisation of trade in agriculture. The Uruguay Round (UR) saw agricultural protectionism as a factor for trade distortions and included agriculture in the agenda for negotiation.

AoA requires WTO Member countries to undertake a number of measures towards liberalising agricultural trade. There are three major areas of commitment, namely market access, domestic support and export competition. These are also known as the three pillars of AoA and they focus on:

- *Market access*: increasing market access of agricultural products by tariffication of non-tariff barriers (NTBs) and bringing the tariff to the minimum possible level;
- *Domestic support*: reducing domestic support, including grants and subsidies, to the agricultural sector to create a level playing field; and
- *Export competition*: reducing support that aim at artificially increasing the competitiveness of the agricultural products in foreign markets.

4.1.1 Market Access

Key elements of the market access commitments are 'tariffication' (calculating tariff equivalents of non-tariff import barriers and adding them to fixed tariffs), tariff reduction, and binding of tariffs. During the negotiations, it was realised that tariffication alone would not lead to better market access opportunities. Many countries at that time were imposing quantitative restrictions (QRs) to limit the volume of import of particular commodity groups. These were included in each country's tariff rate quotas (TRQs), which would allow low tariff imports up to a certain amount.

The tariffication package of the Agreement, which has led to very high tariff equivalents of non-tariff barriers, requires countries to maintain existing access opportunities. For products with no existing market, minimum access commitments are offered. However, countries may take special safeguard action under specified conditions in order to appropriately respond to sudden increases in imports. However, countries, which have not been a part of the tariffication process, including Nepal, enjoy no such right.

4.1.2 Domestic Support and Subsidies

The emphasis of the domestic support provisions is on limiting the effects of trade-distorting measures. Domestic subsidies may distort trade, however, not all subsidies do so. Therefore, the Agreement divides subsidies into three groups (See Box 4.1). The Agreement establishes a ceiling on the total domestic support, commonly referred to as 'Aggregate Measurement of Support' (AMS). The green and blue box subsidies are exempt from inclusion in AMS.

Export subsidies are considered trade distorting. The Agreement bans their use unless they qualify under some exceptions. Many developing countries can hardly pay export subsidies. This is affordable only by the developed countries.

Box 4.1: The Multi-Coloured 'Boxes' of Subsidies

Subsidies are classified into three groups to determine whether or not they need to be reduced and action can be taken against them under the WTO's dispute settlement mechanism. They are:

1. The Green Box: Supports to agriculture, which are deemed to be non-, or minimally, trade distorting. They do not need to be reduced under the Agreement.
2. The Blue Box: Direct payments under 'production-limiting' programmes. They need not be cut but may be actionable by other WTO Members.
3. The Amber Box: Export subsidies that are considered trade distorting. They are not allowed, and are open to challenge by other countries.

Source: Ghimire H. and R. Adhikari (2001), *Agricultural Liberalisation and Its Impact on South Asia*, SAWTEE, Kathmandu & CUTS, Jaipur.

The Agreement also contains *de minimis* provisions, which exempt from reduction supports that are less than 5 percent (10 percent for developing countries) of production value. Similarly, the Agreement contained a 'peace clause' that shield some of the domestic support policies and export subsidies from remedial actions by other countries. In other words, this limited challenges to subsidies permitted under AoA. However, the 'peace clause' expired in 2003. Its expiry made some subsidies - notably many of the EU's - vulnerable to petitions for WTO dispute settlement.

Recognising that subsidies can distort markets to great extent, AoA has tried to address this problem. It contains provisions that seek to reduce the level of government support in agricultural trade (See Box 4.2). Article 9.1 of AoA deals with export subsidies and emphasises on:

- direct subsidies granted for the purpose of the agricultural exports;

- subsidies granted to deflate prices in the foreign market to a level below that in the domestic market;
- any payment as reward in lieu of exports to exporters through a government sponsored programme;
- subsidies granted to ancillary business such as transportation and cargo handling; and
- special facilities and subsidies granted to exporters on domestic cargo and transportation.

4.1.3 Support and Tariff Reduction Commitments

Countries agreed to reduce tariffs and subsidies by fixed percentages during the Uruguay Round. The complex pattern of direct and indirect subsidies may be sorted into two categories: Consumer subsidies, which refer to indirect transfers from consumers to producers through artificially high prices, usually induced by supply restrictions (such as tariffs and quotas on imports and domestic production) and Producer or taxpayer subsidies, which include direct and indirect transfers from government to producers. The Agreement on Agriculture foresees cuts, which affect both types of subsidy. Developing and least-developed countries enjoy preferential status in terms of tariff reduction (See Box 4.2).

Box 4.2: The Tariff and Subsidy Cuts

Tariffs

Industrial states must reduce tariffs by 36 percent over six years, while developing countries have to do so by 24 percent over 10 years. Least developed countries do not need to cut their tariffs.

Production subsidies

Aggregate producer subsidies are to be cut by 20 percent by industrialized countries over six years, and by 13.3 percent by developing countries over 10 years, but not by least developed countries.

Export subsidies

Developed countries must reduce by 36 percent the value of their direct export subsidies and by 21 percent the quantity of subsidised exports over six years. The cuts for developing countries are set at two-thirds this level over 10 years. No cuts need to be made by least developed countries.

4.2 Status of Agriculture in Nepal

Nepal's new government formed after the political change in favour of multiparty democracy in 1990 reversed the trade policies pursued within the framework of an approach to industrialisation based on import substitution. All successive governments have emphasised economic liberalisation, including financial deregulation, trade liberalisation, and fiscal reforms. In the area of trade liberalisation, elimination of quantitative restrictions and import licenses as well as reduction and rationalisation of tariffs have been the major achievement. As a result, the peak tariff rate has been reduced from over 400 percent in the 1980s to 80 percent in 1999. This has improved trade performance in general.

However, the encouraging trends seen in the initial years of reforms could not be sustained. The overall economic performance has been deteriorating after the mid-1990s. The year 1998 saw a growth rate of 1.9 percent, the lowest in more than a decade. And, the agriculture sector particularly performed badly. The government wants to bring improvements in the situation through the implementation of the Agricultural Perspective Plan, introduced in 1995 with a vision for the next 20 years. Its success is critical for achieving a better performance of the national economy. However, the progress made so far is dismal.

The agricultural trading regime in Nepal is very liberal. Only a few products falling under the negative list are barred from being traded. Agricultural trade is characterised by a very low duty structure. Only a few products attract customs duties of over 15 percent. Most of the countries have higher duties on agricultural products than Nepal. Besides, Nepal does not impose any kind of

trade restrictive measures such as QRs, and provide trade distorting subsidies though the costs of productions in the country are comparatively higher. Most subsidies in agriculture had been scrapped by mid -2000 (See Box 4.3).

Between 1996/97 - 2000/01, the total agricultural subsidies have amounted to about 1.3 percent of the agricultural gross domestic product (AGDP). The share of government expenditure on agriculture has fallen from 15 percent of the total in 1995 to 10 percent in 2001. The total government expenditure in the agriculture sector was Rs 6,319 million in 2001. In fiscal year 2001 the government expenditure on agriculture proper was Rs 2,795 million. In fiscal year 2001 the government expenditure in irrigation was Rs 3,524 million. Expenditure on research has been 2.5 to 5.5 percent of total agriculture expenditure. In the year 2000, Rs 1,524 million was spent on agriculture extension and development support programme. Between 1997-2001, Rs 270 million was spent for the construction of agricultural roads. Cost of subsidising food grain distribution has been Rs 225 million annually in recent years. The government has no product specific price support programme. The government completely removed the price subsidy on fertilizers in 1999.

Box 4.3: Nepal's Agricultural Support and Subsidy Regime

Nepal's total estimated agricultural production in the year 2001 was almost Rs 120 billion. The extent of support and subsidies stood almost negligible compared to other countries. Considerable subsidy was earlier provided on fertilisers and installation of Shallow Tube Wells (STWs).

However, the Nepalese government revoked them under pressure of the Asian Development Bank (ADB). The last phase of subsidy revocation was completed in July 2000.

The government does not spend much on the agricultural sector. During the year 2001, the Nepalese government spent hardly eight percent of the total budget on the agricultural sector. This expenditure was approximately 4.5 percent of the value of agricultural production.

The only major subsidy that the government continues to provide is in the transportation of food grains to food deficient districts. Over 40 districts in Nepal, out of 75, face serious food shortage each year. An amount of Rs 225 million had been allocated in 2001 for food grain transportation to food deficit districts.

Though Nepal is sandwiched between two agricultural giants, namely India and China, and is itself an agrarian economy, lack of market oriented infrastructure and weak competitive capacity have largely limited the growth of the agricultural trade sector. The agricultural sector's performance in the trade front is far from satisfactory. During the fiscal year 2003¹, out of the country's total foreign trade of Rs 156 billion, agro-trade comprised only Rs 20.4 billion. Furthermore, agro-trade deficit alone during the year stood at Rs 9.3 billion.

Apart from the lack of competitiveness, Nepal's market for agricultural exports is very concentrated. India is Nepal's main agro-trade partner accounting for over 80 percent of total agricultural trade. Almost 80 percent of all agricultural imports into Nepal are made from India. Likewise, over 85 percent of Nepal's agro-exports are directed to India.

Table 4. 1: Import and export of some agricultural products in 2001
Rupees in millions

Items	Overseas		India		Total	
	Export	Import	Export	Import	Export	Import
Birds	0.0	14.8	32.3	232.2	32.3	247.0
Dairy/honey	9.8	52.3	12.7	294.2	22.5	347.5
Flowers	1.3	1.3	56.1	-	47.4	1.3
Vegetables	220.1	312.5	999.1	1043.3	1219.2	1355.8
Fruits/betel nuts	0.0	818.7	-	129.3	0.0	948.0
Tea/coffee/spices	114.8	515.8	632.1	355.8	746.9	874.6
Food grains/products	15.8	300.4	85.5	318.3	166.1	569.4
Oil	35.0	309.7	83.0	-	118.0	309.7
Forest products	3.9	43.9	368.8	-	390.7	69.4
Veg/animal oil/fat	0.0	7407.7	7044.0	-	7044.0	7407.7
Sugar/ confectionery	0.0	79.9	583.4	194.4	583.4	274.3
Tobacco & products	0.0	60.2	-	446.8	0.0	507.0
Raw hide	0.0	0.0	157.0	-	157.0	0.0
Silk	0.0	166.7	-	-	0.0	166.7
Jute	2.6	184.8	1630.1	-	1632.1	184.8
Cotton	-	15.0	-	50.9	-	65.9

Source: Research Division, Nepal Rastra Bank

4.3 Nepal's accession commitments on agriculture

As the WTO is a "single undertaking", members have to comply with all rules and regulations under the WTO. Tariffs have to be negotiated by all those countries which accede the WTO. Nepal is no exception. During the course of accession to the WTO, Nepal engaged in negotiations with a number of countries. The fifth Ministerial of the WTO at Cancun, Mexico approved Nepal's WTO membership. Nepal would become a formal member of the WTO once the government ratifies the accession deal.

Nepal has made no commitments in the areas of export subsidy. Nepal's total AMS needs to be below 10 percent of AGDP. Green box support measures and measures that can be classified as support to Low Income Resource Poor (LIRP) farmers is not included in the AMS calculation. However, Nepal's support is already much lower than what the WTO mandates. Nepal has bound its agricultural tariff at 51 percent to be reduced to 42 percent by 2006. Bound rates of India, China and Nepal on some of the major crops are presented in Table 4.2.

Table 4. 2: Tariff bound by India, China and Nepal

Items	Bound Tariff (in percent)		
	China	India	Nepal
Wheat/maize/rice	74.0	0.0	50-60
Sugar (from sugarcane)	71.6	100-150	60
Unprocessed palm oil	63.3	300	40
Soya bean oil	63.3	45	50
Milk and milk products	6-35	40-150	45-60
Meat and meat products	16-31	35-150	40
Fruits	15-33	100-150	40
Tea	24	150	40
Soft beverages	40-60	150	100
Ginger/turmeric	15	150	50
Vegetables	13	35-150	60
Cardamom	3	150	50

Source: Schedules of Concessions submitted to the WTO.

4.4 Agro-Enterprises in Nepal

Small and marginal farmers operate 90 percent of the 2.7 million agricultural holdings, the average size of which is less than one hectare. Almost 80 percent of the population depend heavily on the agricultural sector for income and employment. Seventy-six percent of the labour force is involved in agriculture and women constitute 60 percent of the agricultural work force. Given the extent of population involved in the sector, it naturally arises that a vast majority of the small and medium enterprises (SMEs) are agro-based.

In Nepal, the number of agro-industries is gradually on the rise. To a greater extent, these industries are absorbing local agricultural produces as their raw materials or for value addition activities, besides maintaining rural connections. However, as the process of opening up of new and closing of unsustainable units is more or less in a similar stage, accurate statistics of small and medium enterprises (SMEs) is not available. But the enterprising focus is mainly in the area of bakery, dairy, candy, pickles, chips, ketchup/squash/jam, noodles, confectionary, bamboo products, herbal/medicinal plants, honey processing, floriculture nurseries, Nepali paper, etc.

However, in recent years, more diverse and bigger enterprises have emerged to produce sugar, milk products, tea, beer, animal feed, vegetable ghee, tanned leather, lentils, fruits and vegetables, cigarettes, etc. These industries are catering not just to the local needs, but are also export oriented. Most of these industries, except for soft drinks, brewery, vegetable ghee, etc, are using locally grown primary produce as raw materials to the extent available to them.

In recent years, dilemma has surfaced as the country is all set to enter the WTO. Influx of primary produces (rice, mustard seeds, wheat, apples, garlic, ginger, etc) and semi-finished agricultural raw materials like pulps, juice concentrates, crude oils, sugar, wheat flour, silk yarn, etc, at relatively cheaper price from different countries with domestic in-built subsidies have started creating visible negative impact on the domestic production and market. This trend is expected to get stronger in future if proper measures to make the internal production system competitive are not taken.

The agro-based SMEs of the country are plagued by high costs of production, technology backwardness, poor marketing and communication systems, and poor backward and forward linkages. Clearly, given these shortcomings, it is imperative that the exportable products of the agro-based SMEs will face serious challenge in the international markets in this globalised world. Nonetheless, techno-economic studies and commercial trails conducted in the past have identified some agro-based businesses to have high potential. However, many pre-conditions have to be met before these businesses can really deliver to their true potential. While backward and forward linkages are one such precondition, competitiveness by way of ensuring effective linkage to the markets is another.

4.5 Opportunities under the WTO

A host of opportunities exist for the Nepalese agricultural sector under the WTO regime. However, to translate the opportunities into actual gain, there is a dire need for technical knowledge and assistance, reduction in costs of production, improvement in transportation linkages and export promotion programmes, among others. Given Nepal's financial constraints, development on these fronts will significantly depend upon external financial assistance. Nonetheless, Nepal can benefit from WTO membership by:

- Enhancing the productivity of the Nepalese agricultural sector and harvesting globally marketable high-value agro-produce through greater value addition.
- Enhancing the quality of products with proper attention paid to production processes as well so as to make them acceptable in the global market.
- Increasing private and foreign investment to upgrade production systems and diversify agro-production.
- Promoting the establishment of large commercial farms with better transportation and market connectivity.

- Increasing value addition in final agro-produce that can help realise better market and prices for the poor farmers.
- Increasing the market access of the Nepalese agro-produce by taking advantage of various duty- and quota-free privileges provided by the developed countries.

Box 4. 4: Special Provisions for LDCs

The WTO grants least developed countries (LDCs) with special concessions. Some concessions give LDCs longer time frame to gradually scale down tariff rates, domestic subsidies, and even export subsidies. Besides, with a view to help LDCs better integrate themselves into the global trading system, several multilateral institutions, including the World Bank, the International Monetary Fund (IMF), the WTO, United Nations Conference for Trade and Development (UNCTAD), United Nations Development Programme (UNDP) and the International Trade Centre (ITC) launched the Integrated Framework for Trade Related Technical Assistance (IF) in 1997. LDCs are given technical assistance under the IF not just to enhance their capacity to meet WTO obligations, but also to increase their export competitiveness.

The European Union (EU) also provides special concessions to LDCs through its 'Everything but Arms' initiative. Except arms and ammunitions, all products originating in LDCs are granted duty- and quota-free access to the European markets. Similarly, Japan, Australia, Singapore and Norway have also been providing such facilities to LDCs. Besides, LDCs have been given longer transition period for the full implementation of different WTO agreements.

One of the facilities provided to the developing and least developed countries is the Generalised System of Preferences (GSP), which is a system of tariff preferences accorded by the developed countries under the Enabling Clause.

Nepal can also enjoy a considerable policy space under the WTO regime. As Nepal's average bound rates, which presently stand at 51 percent to be reduced to 42 percent by 2006, are considerably higher than the applied rates, Nepal can raise the applied rate up to

the bound level without breaching WTO commitments in case cheap imports from international markets pose threats to the domestic farmers and agro-based SMEs. The use of tariffs can be one of the important means to protect domestic agro based SMEs. Besides, trade remedy measures can also be taken to regulate unfair competition (discussed in Chapter VII).

At 1.3 percent of agricultural GDP, Nepal's agriculture subsidy is way below the permissible 10 percent. As such, the government can give product specific support such as minimum farm price. This kind of support for any product, however, cannot exceed 10 percent of the value of production of the commodity supported. Based on the 1999-2002 values, paddy farmers in Nepal can be subsidised through a minimum farm price or other schemes up to a level of Rs 3,233 million, the limit is Rs 185 million for sugarcane and Rs 10 million for tea.

Besides, the government can give unlimited green box support to the agricultural sector, as the WTO puts no limit on these. Green box support measures include non-product specific support such as agricultural research, extension and development services, agricultural roads, domestic food aid that does not include direct price support to the producers, and relief programme. As a landlocked and least developed country, the AoA allows Nepal to give subsidy on transport and marketing for exports of selected products.

4.6 Challenges

One of the major impediments faced by the Nepalese agricultural sector is the lack of effective means of transportation. Due to poor transport linkages between markets and the agricultural production areas in different parts of the country, farmers and traders find it hard to deliver the agro-produce to markets. Besides, the difficulty in transportation also results in degradation in the quality of agricultural produce, and subsequently leads to lowering of demand and prices. Technological upgradation in the agricultural sector is very limited, which has resulted in high costs of production and limited value addition.

Likewise, Nepal significantly lags behind in physical and technical infrastructure that are necessary to ensure quality of the agricultural products at the international level. As a result, the Nepalese agricultural products are finding it difficult to make sustainable presence in foreign markets. Besides, inadequate physical infrastructure and delays in transportation have restricted the growth of large production farms and distribution networks. Above all, Nepal's agricultural products are finding it hard to meet even the minimum quality standards prescribed by importing nations and global standard setting institutions.

The country's agricultural sector does not receive any direct subsidies from the government. This is in contrast to what China in the North and India in the South are doing. Both neighbours are directly subsidising the export of some agricultural products and providing substantial domestic support to their respective agricultural sector. This is proving challenging to Nepal.

4.7 Conclusion

Despite all apparent threats of Nepal's WTO membership on SMEs, there is actually enough policy space with the government to safeguard their interests. However, it has to be understood that support and subsidies cannot be continued for long given the fiscal constraints the government faces. As such, the government should seek the support of international organisations and donor institutions to provide financial and technical assistance to SMEs to improve their production systems, expand marketing and communication linkages and enhance competitiveness. However, at the same time, SMEs themselves also should strive to raise their internal capacities to be able to survive in the multilateral trading system.

Chapter - V

SMEs under the TRIPS Regime

Dr Hiramani Ghimire

5.1 Introduction

Intellectual property rights (IPRs) belong to the core mandate of the World Trade Organisation (WTO). The Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) governs them. The term 'intellectual property' refers to creative ideas having commercial value. IPRs thus recognise ownership over ideas and provide legal protection. Intellectual property is a form of knowledge, which enjoys specific rights. An owner of intellectual property may claim legal protection for it in the same way as he/she may claim protection for physical property such as land and buildings. Individuals are granted IPRs for their creative works. This means that no one can use them without authorisation derived mostly through compensation.

The history of IPRs goes back to 1883 when the Paris Convention was signed to provide protection to industrial property. It was followed by the Berne Convention (1886), which provides protection to literary and artistic work. These Conventions have been amended several times and still form the backbone of the global IPR system. In order to coordinate all IPR-related conventions and treaties, the UN system created the World Intellectual Property Organisation (WIPO) in 1967.

When the Uruguay Round of multilateral trade negotiations began, the inclusion of IPRs in negotiations became a contentious issue. Developed countries were in favour of bringing the IPR regime into the fold of the WTO. Many developing countries and least developed countries (LDCs) were against it. The reasons were obvious. The developed countries wanted to cash on their technologically advanced position. Developing countries had to resist it as they were weak in terms of commercialising their intellectual capabilities. At

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the end, TRIPS became a part of the WTO. The developed countries managed to get it through, as is always the case in international negotiations.

5.2 Scope of TRIPS

IPRs covered by the TRIPS Agreement are divided into seven categories. They are:

- Patents: granted for novel, non-obvious, and industrially applicable inventions
- Copyrights and related rights: protection in respect of literary, scientific, and artistic works
- Trademarks: distinctive signs for particular goods or services offered by a company
- Geographical indications (GI): product characteristics attributable to a particular geographical area
- Industrial design: original ornamental features of a product (e.g., shapes, lines, motifs, and colours)
- Layout designs of integrated circuits
- Undisclosed information: trade secrets with commercial value

The Agreement sets out minimum standards of protection. Countries are allowed to provide higher degrees of protection. Articles 7, 8, 65 and 66 of the Agreement are very important for developing countries. They provide for transition period, technology transfer, special arrangements for protecting public interest, and competition.

There is a broad recognition that the TRIPS Agreement can play a significant role in stimulating research and development in poor countries. The subject of IPR protection is also associated with the promotion of foreign investment, technology transfer, and joint

research programmes focused on the local needs of developing countries and LDCs. There are, thus, four major arguments in favour of TRIPS. They refer to:

- Flow of foreign direct investment (FDI) into countries with stronger IPR protection systems
- Transfer of technology from the North to the South
- Promotion of innovation (also in developing countries)
- Protection of consumers' interests (especially against counterfeit products)

5.3 Nepal's Position

With Nepal's successful bid to join the WTO, the TRIPS Agreement has become a reality. During the accession negotiations, Nepal agreed to implement the TRIPS provisions by 1 January 2007. In fact, Nepal wants to be "integrated" into the global economy. It requires, among others, that global rules on IPRs be respected.

The concept of intellectual property is not entirely new to Nepal. Nepal's first Patent, Design and Trademark Act was promulgated as far back as 1936. The first Copyright Act came in 1965. While a TRIPS compliant Copyright Act has entered into force in 2002, its counterpart on the industrial property side is yet to be announced. A reincarnation of the industrial property legislation is now becoming an immediate reality. Relevant government agencies are already working on it. However, implementing the provisions of TRIPS can be a daunting task for Nepal as experiences elsewhere clearly show.

5.4 Implications for SMEs

SMEs are playing a very important role in the Nepalese economy. They are also important for international trade. They may be affected by the TRIPS Agreement in several ways, both positive and negative. For example, while the access to technology can become easier, the use of reverse engineering will be restricted. The

possibility of unauthorised use of traditional knowledge by 'outsiders' is a further challenge for SMEs in countries like ours. Let us examine more closely some of the opportunities and challenges associated with the TRIPS Agreement in the SME context.

5.5 Opportunities

From a commercial point of view, patent protection is probably the most important of all forms of protection. Performance of the Nepalese industries is very poor in this regard, with only about 70 patents registered in a 40-year period. SMEs will, therefore, be gaining most from copyright protection. Big winners include publishing, entertainment, and software development industries. Paintings, *thankas*, and other traditional art works will also benefit from copyright protection. As copyright protection covers both economic and moral rights, a culture of innovation and originality may develop among entrepreneurs.

Some observers are pinning high hopes on using GI protection for promoting some of Nepal's unique products abroad. This cannot be taken for granted. In fact, GI benefits are based not on proliferation but on high-value image of a given product. Even so, some of our agro-products can benefit from it. The mountain region offers greater advantages. Nepal's handmade paper is one example, while *seabuckthorn* is another.

'Traditional knowledge' is increasingly being recognised as intellectual property. This will cover the whole host of medicinal and aromatic plants in Nepal's different ecological zones. Local communities and indigenous people will benefit from this.

Carpets have occupied an important position in Nepal's exports. Since recently, they have been facing competition from products from other countries. Such competition is not always genuine. In this context, carpet industries can approach the government for design protection. The growing jewellery business is also in a position to benefit from design protection. Similarly, the designs of handicraft products with colour and imagery may also be protected.

Trademarks offer substantial advantages to the Nepalese SMEs. As they are already widely prevalent, it is sometimes assumed that the TRIPS Agreement will not increase the benefits in this field. But there is a possibility of using collective marks and protecting community rights. The "*Chirimoya Cumbe*" of Peru is a case in point. Another example is Melinda apples, which has also contributed to standardising production processes to meet customer expectations. On the other hand, reputed trademarks themselves can be traded.

If patents are too expensive, SMEs can protect their products through "trade secrets", of course, by having measures in place not to publish "undisclosed information". For example, fruit and vegetable preserves can benefit from this. When business grows, producers can be authorised to the manufacturing process against a royalty.

5.6 Challenges

The system of patent is posing severe challenges to SMEs. Pharmaceutical companies and providers of health services in Nepal will be affected. In the health sector, IPRs should primarily be used to support the healthcare system, not to promote the pharmaceutical industry. The TRIPS Agreement treats IPRs as economic or commercial rights. The main purpose is to protect the value of investments made in the production of such property. Protection of IPRs may be justified on several grounds; but more protection is not necessarily better. The socio-economic context needs to be taken into account. The move towards global harmonisation of IPR systems seems to have forgotten this.

The current IPR regime is encouraging commercialisation of health services. People's purchasing power is determining the availability of medicines in a given community. That is why less than five percent of the money spent on research and development for medicines goes for diseases that affect developing countries. The least developed among them get much less. A report of the UK-based Commission on IPR (2002) establishes that of the 1,393 drugs approved between 1975 and 1999, only 13 were specifically indicated for tropical diseases. Contrary to popular belief, the Commission concludes that, given widespread poverty, stronger IPR protection does not lead to an increase in research and development expenditure in developing

countries. A report (2001) of the WHO Commission on Macroeconomics and Health comes with similar findings.

Poor consumers even face the threat of exclusion from the opportunity to use a particular product or service. Patent protection for drugs is reported to increase prices by 12 to 200 percent in developing countries. This makes the possibility of exclusion stronger. When such exclusion refers to life saving medicines, it becomes a fatal blow. In this sense, it subjects basic human rights, such as the right to life, to commercial rights.

Protection of public health is not a developing versus developed country question. The onset of Anthrax in the US (2001) makes it vividly clear. The first reaction to Anthrax came from Canada. In response to potential outbreaks of Anthrax, Canada allowed a generic drug company to produce a million doses of Cipro apparently in contravention to the TRIPS Agreement. The patent to Cipro belongs to the German company Bayer. Canada did not even bother to declare an "emergency" to justify what is known as compulsory licensing in TRIPS. As expected, Bayer objected to the decision. The case was "resolved" when Bayer agreed to donate a large volume of the drug with a further assurance that it will deliver a million tablets of Cipro in case of an emergency. In the US, a breach of TRIPS was avoided through an understanding reached with Bayer that requires the company to sell Cipro at heavily discounted prices. This incident has shown that developed countries are as vulnerable to diseases as others.

TRIPS will also be a challenge for agro-based industries, as it will weaken farmers' position vis-à-vis plant breeders. While plant breeders will have their rights protected under a patent or similar regime, farmers will have no "rights" unless special measures are put in place. Patent protection for transgenic plants will also affect cropping patterns and biodiversity. Both are important for agro-based industries.

What the TRIPS Agreement has not been able to achieve in terms of strengthening the position of investors, or does not even purport to achieve, is being achieved by technological advancements. Restrictions put on the use of information available on the Internet through encryption is an example. Given that poor countries have

limited access to knowledge, the Internet can be seen as a less expensive solution. However, the “digital rights” of producers do not let it happen. In many cases, information on the Internet becomes more inaccessible than on the print media. In fact, this is posing a threat to the concept of “fair use” (right to use a copyrighted print material in certain circumstances).

The TRIPS Agreement is serving the purpose of big firms and multinational companies (MNCs). They can invest huge amount of money in R&D, which means the generation of knowledge. They are also politically influential. SMEs do not enjoy this access to policy. There is, therefore, the risk of SMEs being trampled by MNCs with regard to different forms of IPR protection. High costs associated with obtaining and enforcing IPR is yet another problem. The process is often cumbersome and takes time.

5.7 How to respond

The TRIPS Agreement is undergoing review, which is mandated in the Agreement itself. In this context, a pro-SME agenda needs to be agreed upon. Developing countries themselves are required to work it out. For an LDC like Nepal, it is very difficult to fully implement the provisions of the TRIPS Agreement. In fact, more than 70 developing countries have failed to implement the Agreement wholly. If developing countries themselves did not have the capacity to implement TRIPS within the agreed deadline, how can one assume that LDCs will be able to implement it? Keeping these issues in mind, Nepal needs to build coalitions with other countries in order to move them closer to protecting SMEs within the framework of any IPR regime. This does not mean that domestic efforts are adequate. Whatever flexibility the Agreement provides must be used productively. Protection of SME products through ‘utility models’ will, for example, provide an alternative to patent protection, which is too rigorous an exercise for SMEs. On the other hand, capacity building of SMEs should receive appropriate priority from the policymakers.

Chapter - VI

Standard Related WTO Agreements: Opportunities and Challenges for SMEs

Dr Posh Raj Pandey

The Challenge....

How unwillingly we think of things which powerfully injure our interests, wound our pride or interfere with our wishes ... (though) the world in which we live is chiefly shaped by the way we even look at it.

- Schopenhaur

... and The Answer

"...Strength, strength is what we need... we can do any thing and everything ... as the saying of Katha Upanishad.. 'Uthistha, Jagrata, Prapya varan nibodhata' ...Arise, Awake and Stop not till the goal is achieved."

-Vivekananda

6.1 Background

The fifth Ministerial of the World Trade Organisation (WTO) held on 10-14 September 2003 in Cancun, Mexico adopted the accession package of Nepal and paved the way for Nepal to become the 148th member of the global trade regime. Once Nepal ratifies the accession package and becomes a member of the WTO, it will be obliged to implement the technical regulations and standards (TRS) related agreements, albeit, with some transition period, as part of a 'single undertaking'. It includes the Agreement on Technical Barriers to Trade (TBT) and the Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures. These agreements define the international rights and obligations of member countries with respect to the development or application of standard-related measures that affect trade. The basic right of a member is to adopt TRS measures as long as they do not restrict international trade and are based on scientific evidence.

The institutional and technological capabilities of the Nepalese government agencies on the implementation of TBT and SPS agreements and enterprises to adopt or adapt international standards are significantly lower than that of other WTO members. At the same time, WTO members have used TRS as non-tariff barriers (NTBs). Therefore, TRS may become significant obstacle to access foreign markets not only at present but in the future as well. Against this background, this paper first provides an overview of TRS related agreements. The second section attempts to highlight Nepal's standard setting procedures. The third section presents an overview of SMEs in Nepal. The fourth section deals with the status of SMEs and the fifth section assesses the potential impact of TBT and SPS agreements on SMEs. The last section concludes the paper.

6.2 Standard Related WTO Agreements

From the perspective of international law, the right of a country to adopt TRS and enact any such measures is a matter of territorial sovereignty. It means that restrictions on international trade on the ground of TRS do not constitute a violation of international law, if there are no treaty obligations. But, it is the WTO agreement that mandates members to assume treaty obligations on TRS measures. The WTO as such does not develop or write TRS, rather it only recognises that it may impede trade. It encourages members to adopt TRS developed by international organisations to achieve legitimate objectives in a non-discriminatory manner.

The disciplines regarding the use of TRS are dealt in two agreements: SPS and TBT. It means the WTO endorses the TRS regime based on: (a) rule making, including the development of mandatory technical regulations and voluntary standards; (b) conformity assessment; and (c) accreditation. In principle, TRS may be desirable to optimise social welfare. But, they are by their very nature trade distorting, having direct and indirect effect on the free movement of goods. TRS, therefore, may constitute, depending upon the modalities of adoption, a *prima facie* infringement of the Article I (most favoured nation (MFN) treatment), Article III (national treatment) and Article XI (elimination of quantitative restriction (QR)) of the General Agreement on Tariffs and Trade (GATT).

6.2.1 Brief Review of the TBT Agreement

TBT is not a new issue. In fact, TBT was adopted under the 'Standards Code' drawn during the Tokyo Round of GATT negotiation and applicable among 47 signatories of the GATT. However, the TBT Agreement is significantly different from the Standards Code in the sense that it is a part of 'single undertaking', i.e., its provisions bind all WTO members, and any dispute arising under it will be governed by the WTO's dispute settlement rules. The Agreement covers all products, including industrial and agricultural, except purchasing specification prepared by government bodies. The adoption of the TBT Agreement, as the preamble indicates, was motivated by two broad conflicting policy considerations. First, TRS, including packaging, marketing and labelling requirements, as well as procedures for testing and certifying compliance with those regulations and standards, should not create unnecessary obstacles to international trade. Second, WTO members must nevertheless be able to protect national security, prevent deceptive practices and protect human health or safety, animal or plant life or health and the environment (Preamble).

The TBT Agreement, in general, covers all activities of the standard setting bodies, central government, local bodies and non-governmental bodies, as the case may be, with regard to the preparation, adoption and application of technical regulations¹, standards² and their conformity assessments³. For each of these activities, members are obliged to respect the basic WTO and GATT principles such as non-discrimination, transparency and consultation.

Technical regulations, standards and procedures for conformity assessment are to be applied to products imported from other WTO members in a manner no less favourable than that accorded to like products of national origin and to like products originating in any other country (Article 2.1). These regulations, standards and procedures should also not be prepared, adopted or applied with the intention of creating unnecessary obstacles to trade. For technical regulations, this requirement demands that they should not be more trade restrictive than necessary to fulfil legitimate objectives such as national security requirements, prevention of deceptive practices, protection of human health or safety, animal or plant life or health, or the environment (Article 2.2). Such regulations should, wherever

appropriate, be expressed in terms of performance rather than design or descriptive characteristics (Article 2.8). They should not be maintained if they are no longer needed, or if changed circumstances or objectives can be addressed in a less trade restrictive manner (Article 2.3).

6.2.1.1 Harmonisation

The TBT Agreement strongly revitalises efforts by WTO members to harmonise technical regulations, standards and conformity procedures so as to minimise obstacles to trade created by national differences. It suggests three approaches to harmonisation:

Acceptance of international standards: The Agreement encourages members to use relevant international standards or the relevant parts of them, as a basis for their technical regulations. However, it provides freedom to members to adopt their own TRS if they consider that international standards are ineffective or inappropriate means for the fulfilment of the legitimate objectives (Article 2.4). It means that there is no absolute requirement to use international standards.

Equivalence: Members are to give 'positive consideration' to accept the technical regulations of other members as equivalent to their own if such standards and regulations adequately satisfy the policy objectives of their own regulations.

Mutual recognition: The Agreement encourages members to negotiate agreements for mutual recognition of conformity assessment (Article 6.3). It calls on them to accept, whenever possible the result of conformity assessment procedures in other members. For this purpose, it suggests some criteria, including compliance with guidelines or recommendations issued by international standardising bodies (Article 6.1).⁴

6.2.1.2 Transparency

The TBT Agreement creates two transparency obligations so that the private sector has time to adjust to changing policies. The first obligation requires each member to ensure that a national Enquiry

Point exists to respond to all reasonable inquiries about its TRS adopted or proposed within its territory and their conformity assessment procedures (Article 10.1). The second obligation requires notification to the WTO Secretariat of the changes in TRS and procedures. If the proposed TRS for conformity assessment substantially deviates from the international standards and such standards have significant effect on the trade of other WTO members, they must be notified, generally, at least 60 days before adoption. Other members may then comment on them and the comments are to be taken into account before the regulations or procedures are adopted.

6.2.1.3 Code of Good Practice

The Agreement obliges members to accept and comply with Code of Good Practice for the Preparation, Adoption and Application of Standards. Members should ensure that local government and non-governmental standardising bodies within their territories accept and comply with this Code of Good Practice. In addition, such obligations also apply with regard to regional standardising bodies of which they or one or more bodies within their territories are members (Article 4.1).

6.2.1.4 Special and Differential Treatment

The Agreement recognises the difficulties developing countries face in complying with its provisions due to the lack of necessary infrastructure to develop and implement standards, conformity assessment procedures and technical regulations. Thus, it urges members to take into account the special development, financial and trade needs of developing country members in the preparation and application of TRS and conformity assessment procedures (Article 12.3). The Agreement also requests developed countries to give technical assistance to developing countries in any or all areas covered by the provisions (Article 12.7). Moreover, it provides provisions to grant, upon request, specified and time limited exceptions in whole or in part from the obligations (Article 12.8).

6.2.2 Brief Review of the SPS Agreement⁵

Trade related SPS measures, in general, include all measures that are applied by a country to ensure the safety of food for human consumption and prevent the spread of animal and plant pests and diseases. SPS measures are different from technical standards. SPS covers food and agricultural sectors and the issue relates to the level of microbial, toxic and physical contaminants, whereas TBT relates to technical standards covering all products, including food, and the issue is of product specification such as size, shape, weight and packaging material requirements, including labelling and safe handling.

The GATT, 1947 has provided an exception for SPS measures in Article XX(b) subject to two conditions. First, SPS measures must serve a legitimate domestic objective (i.e. protect human, animal or plant or health). Second, they should be non-discriminatory or should not constitute a disguised form of protectionism. However, what was 'necessary to protect human, animal or plant life or health' was left undefined and the implementation of such provisions became problematic.

In order to elaborate the rules for the application of SPS provisions in the GATT, 1947, the SPS Agreement was adopted as a separate agreement in the Uruguay Round. The Agreement, as GATT 1947, allows members to adopt and enforce measures to protect human, animal or plant life or health but makes the conditions more restrictive. It requires assessment of risk for human, animal or plant life and encourages members to use harmonised SPS measures based on international standards, guidelines and recommendations developed by relevant international organisations, including the Codex Alimentarius Commission⁶, the International Office of Epizootics (OIE)⁷, and the relevant international and regional organisations operating within the framework of the International Plant Protection Convention (IPPC)⁸. The key elements of the Agreement are outlined below.

Definition of SPS Measures: The Agreement has defined SPS measures as any measure applied:

- to protect animal or plant life or health within the territory of members from risks arising from the entry, establishment

or spread of pests, diseases, disease-carrying organisms or disease-causing organisms;

- to protect human or animal life or health within the territory of members from risks arising from additives, contaminants, toxins or disease-causing organisms in foods, beverages or foodstuff;
- to protect human life or health within the territory of members from risks arising from diseases carried by animals, plants or products thereof, or from the entry, establishment or spread of pests; or
- to prevent or limit other damage within the territory of members from the entry, establishment or spread of pests.

SPS measures include all relevant laws, decrees, regulations, requirements and procedures including, *inter alia*, end product criteria; processes and production methods; testing, inspection, certification and approval procedures; quarantine treatments, including relevant requirements associated with the transport of animals or plants, or with the materials necessary for their survival during transport; provisions on relevant statistical methods, sampling procedures and methods of risk assessment; and packaging and labelling requirements directly related to food safety (Annex A, para 1).

6.2.2.1 Basic Rights and Obligations

The Agreement has set out the basic rights and obligations of members in Article 2. It provides members the right to take SPS measures necessary for the protection of human, animal or plant life or health. However, the right of members to take SPS measures is not an absolute or unqualified right, rather it comes attached with obligations. The measures should be applied 'only to the extent of necessity' and that should be 'based on scientific principles' supported by 'sufficient scientific evidence'. Though the Agreement has not defined what should be construed as 'sufficient', the Appellate Body has established that there should be a rational or objective relationship between SPS measures and the scientific

evidence to meet sufficiency criterion.⁹ Other obligations include the principles of non-discrimination in the adoption of SPS measures.

6.2.2.2 Harmonisation

Harmonisation of SPS measures is envisaged to prevent the use of such measures for arbitrary or unjustifiable discrimination between members or as a disguised restriction on international trade, without preventing members from adopting or enforcing measures which are both 'necessary to protect' human life or health and 'based on scientific principle', and without requiring them to change their appropriate level of protection.¹⁰ Therefore, members are encouraged to participate in a number of international standard setting organisations, most notably Codex, OIE and IPPC, and to base their SPS measures on international standards, guidelines or recommendations. The Agreement also states that such standards, guidelines or recommendations are presumed to be necessary to protect animal, plant life or health (Article 3.2), implying that these measures enjoy the benefit of a presumption that it is consistent with the relevant provisions of the SPS Agreement and of the GATT, 1994. It is to be noted here that the Agreement requires the measures to 'be based on' international standard and not 'to conform with' international standard. In other words, members have the flexibility to incorporate 'only some, and not all elements of the standard' into their national standard.¹¹

Moreover, the Agreement also provides members the right to determine its own appropriate level of sanitary protection¹² that may result in a higher level of protection. However, this need to be justified scientifically (Article 3.3). In other words, flexibility is provided if the country determines, on the basis of appropriate risk assessment, that a higher level of protection would be necessary.¹³

6.2.2.3 Equivalence

Members are required to accept SPS measures of other members where they can be demonstrated that such measures achieve equivalent level of SPS protection (Article 4). Such equivalence helps protect exporting countries from unjustified trade restrictions, even when these products are produced under qualitatively different SPS requirement. Nonetheless, the exporting country is obliged to provide reasonable access for inspection, testing and other procedures upon the importing country's request. In practice, however, the right of

importing country to test imported products limits the effective right of equal treatment.¹⁴

6.2.2.4 Risk Assessment

Article 5.1 of the SPS Agreement imposes a specific obligation that SPS measures 'are based on an assessment, as appropriate to the circumstances, of the risks to human, animal or plant life or health, taking into account risk assessment techniques developed by the relevant international organisations'. Annex A para 4 defines risk assessment as 'the evaluation of the likelihood of entry, establishment or spread of a pest or disease within the territory of an importing member according to SPS measures, which might be applied, and of the associated potential biological and economic consequences; or the evaluation of the potential for adverse effects on human or animal health arising from the presence of additives, contaminants, toxins or disease-causing organisms in food, beverages or feedstuffs'. The assessment of risk should be with respect to risks to human life and health, a 'scientific' examination of data and factual studies, and it should 'not be a policy exercise involving social value judgement'.¹⁵

While assessing risk, the SPS Agreement requires members to take into account scientific and economic factors, including assessment of trade impact. Article 5.2 requires a member to take into account available scientific evidence; relevant processes and production methods; relevant inspection, sampling and testing methods; prevalence of specific diseases or pests; existence of pest- or disease-free areas; relevant ecological and environmental conditions; and quarantine or other treatment in the assessment of risks. Appellate Body in *EC - Hormones* argued that all matters were not susceptible to quantitative analysis by empirical or experimental laboratory methods associated with physical science and there was nothing to indicate that the listing of factors in the agreement that may be taken into account in risk assessment was a closed list. It, thus, upheld the view that the assessment of risk in human societies as they actually exist in the 'real world where people live and work and die' is not incompatible with the Agreement.

The Agreement obliges members to take into account the potential damage in terms of loss of production or sales in the event of the entry, establishment or spread of pest or disease, the costs of

control or eradication and the relative cost-effectiveness of alternative approaches to limiting risks (Article 5.3). It also necessitates members to have the objective of minimising negative trade effects compatible with technical and economic feasibility (Article 5.4). The inclusion of the word 'technical and economic feasibility' recognises that a less trade restrictive measure may involve substantially higher regulatory or compliance cost, or might be impractical to implement in developing countries.¹⁶

'In cases where relevant scientific evidence is insufficient', Article 5.7 of the SPS Agreement allows for an exception to the obligation to base sanitary measures on risk assessment. In such an event, 'a member may provisionally adopt SPS measures on the basis of available pertinent information'. In *Japan-Agricultural Products II*, the Appellate Body identified four requirements imposed upon a member having recourse to this provision. Member may provisionally adopt an SPS measure if this measure: (a) is imposed in respect of a situation where relevant scientific information is insufficient; (b) is adopted on the basis of available pertinent information; (c) is imposed until additional information necessary for a more objective assessment of risk are available; and (d) will be reviewed within a reasonable period of time. Whenever one of these four requirements is not met, the measure at issue is inconsistent.

6.2.2.5 Transparency

The Agreement establishes procedures for enhanced transparency in setting SPS standards amongst members. Members are obliged to publish and notify the WTO of all SPS measures proposed and implemented. This information is relayed via the 'Notification Authority' within each member government. Moreover, members are required to establish an 'Enquiry Point' which is the direct point of contact for any other members regarding any questions about SPS measures or relevant documents. However, members are exempted from the requirement to disclose 'confidential information which would impede the enforcement of SPS legislation or which would prejudice the legitimate commercial interests of particular enterprises' [Annex B, para 11(b)].

6.2.2.6 Adaptation to Regional Conditions and Area Freedom

The Agreement recognises that SPS risks do not correspond to national boundaries, and that there may be areas within a particular country that have lower risk than others. Based on geography, ecosystems, epidemiological surveillance, and the effectiveness of SPS controls, members may declare pest- or disease-free areas and areas of low pest or disease prevalence (Article 6.2).

6.2.2.7 Dispute Settlement

Both the GATT and the SPS Agreement are subject to the Dispute Settlement Understanding concluded during the Uruguay Round. However, significant difference exists on the burden of proof. Under the GATT, the onus was clearly on the complainant to establish that the respondent's SPS measures constituted a breach of Article I, III, and/or XI of the GATT. It then fell on the respondent to prove that the measures fell within the Article XX(b) general exception. Under the SPS Agreement, as interpreted by Appellate Body in EC - Hormones, the complainant bears the onus of proving a *prima facie* case that SPS measures were inconsistent with the obligations under the SPS Agreement. Only after such a *prima facie* determination is made by the Panel that the onus shifts to the responding member to lead evidence and arguments to disapprove the complainant's claim.

6.3 Nepal's Standard Setting Procedures and WTO Commitments¹⁷

Nepal Council of Standards (NCS), chaired by Minister for Industry, Commerce and Supplies, is the designated authority to determine standards in relation to any goods, processes or services. A Technical Committee under NCS sets standards based on internationally defined parameters, national data and national requirements, among others. The Technical Committee includes representatives from the concerned ministries and governmental agencies, the private sector, consumer forums and universities. The Council can invite specialists to its meetings. Before the adoption of any TRS, Nepal Bureau of Standards and Metrology (NBSM) prepares preliminary drafts of the standards or technical regulations. Such drafts are submitted to the Technical Committee for review and amendment. NBSM elaborates

all standards and technical regulations, except for health and food products (SPS measures), and oversees all mandatory certification activities.

Nepal is a member of International Organisation for Standardisation (ISO) and follows the standards prescribed by the body. Nepal bases the standard of its products and processes on ISO, the British Standard Institute, the International Electrical Committee, the Indian Standards and CODEX. If there are no international standards, then NBSM elaborates the national standard according to the country's requirements. However, Nepal does not currently accept equivalent certificates from third country certification bodies.

In Nepal, a very limited number of technical regulations exist, which are applicable for raw wool, cement, iron bars, mineral water, corrugated galvanised iron sheets, dry cell battery, galvanised iron wire and liquefied petroleum gas (LPG) cylinders. With regards to standards, 596 products and testing methods have been approved till date. Similarly, quality certification marks, i.e, Nepal Certification Mark have been approved for 111 companies, covering 32 products.

The Ministry of Health through the Department of Drug Administration and the Ministry of Agriculture through the Department of Food Technology and Quality Control are responsible for the preparation, adoption and application of SPS measures. The export and import of plant and plant materials such as seeds, saplings and seedlings are subject to phytosanitary measures at the border checkpoints. The government is authorised to intercept any person, animal, animal products, and feeds suspected of carrying infectious diseases or agents at entry points. Minimum standards or specifications have been fixed for certain categories of agricultural products (food products - both processed and unprocessed) and animal feeds, and trade of such products must comply with the fixed standards. The government has the right to regulate the export and import of pesticides and may ban and/or restrict any pesticides that are potentially hazardous to health. Nepal bans all prior informed consent (PIC) listed pesticides and chemicals (22 pesticides and five industrial chemicals) except Methyl Parathion and Monocrotophos. Production, import, export, storage, supply, sales, distribution, quality assessment, regulatory control and rational use of drugs are also regulated.

Nepal adheres to the IPPC as well as Plant Protection Agreement for the Asia and Pacific Region. Nepal is a member of the OIE, Codex Alimentarius Commission (CAC) and Asia Pacific Plant Protection Commission (APPPC). In order to bring the regime of standard setting into full compliance with the agreements on TBT and SPS, Nepal needs to amend Nepal Standards (Certification Mark) Act, 1980 and Regulation, 1982 (Amendment), Plant Protection Act, 1972 (Amendment) and Regulation, 1975 (Amendment), Seed Act, 1998 (First Amendment) and other legal texts as well as strengthen standard setting institutions. Nepal has provided a timetable for the enactment of legislation that implements the TBT and SPS agreements.

Nepal has made legally binding undertaking to implement fully the provisions of the TBT Agreement, including compliance with the Code of Good Practice, as well as the SPS Agreement by 31 December 2006. During the transition period, Nepal would require to provide national and MFN treatment to all imports in the application of technical regulations, standards and conformity assessment procedures. Existing technical regulations would be notified to the relevant Committees and reviewed for conformity to WTO requirements. Any standards, technical regulations and conformity assessment procedures adopted during the transition period would be developed in conformity with the provisions of SPS and TBT agreements.

6.4 SMEs in Nepal

In general, countries define categories of enterprises on the basis of employment or investment measures or both. The World Bank categorises enterprises on the basis of value of assets, particularly the working capital, whereas United Nations Conference on Trade and Development (UNCTAD) uses the employment measure. In Nepal, Industrial Policy, 1997 (amended) has classified industries with fixed capital investment up to Rs 30 million as small industries, between Rs 30 to 100 million as medium industries, and the ones with more than Rs 100 million as large industries. However, the policy documents deal basically with industry, and not the whole gamut of business enterprises including services business. Besides, they are also silent about what constitute SMEs.

Hard facts about SMEs' status, investment and contribution to the economy are not available. Nonetheless, it comprises most of the country's economic activities. About 90 percent of the agricultural enterprises are marginal or small, more than 90 percent of the industrial establishments are small and medium, and many service activities are also small business. These sectors together provide livelihood for more than 90 percent of the country's employed not only through their production but also through their backward and forward linkages.¹⁸ The contribution of SMEs in meeting domestic markets of gold and silver ornaments, paper and paper products, handicraft goods, bakery, dairy products, candy, pickles, dalmoth/chips, ketchup/squash/jam, noodles, bamboo products, herbal medicinal plant extraction, honey processing, floriculture nurseries, Nepali paper, fresh fruits and vegetables is considered to be significant.

No authentic information exists regarding the production, export and capacity utilisation of SMEs. Information collected in bits and pieces indicates that the growth in the number of cottage and small enterprises has gradually eroded despite deregulation and liberal economic policy. It has been reported that nearly half the traditional small and cottage industries are on the verge of closure¹⁹ and more than 60 percent of those in operation are characterised by under utilisation of capacity, sickness and closure.²⁰ A recent study jointly carried out by the Department of Cottage and Small Industries and the Cottage and Small Industries Development Board in four districts states that only about 25 percent of the registered industries are in operation²¹.

Similarly, there is no information on the exportable products of SMEs. The list of major exportable products could be used as a basis for an indicative picture of the exportable product of SMEs since 90 percent of industrial enterprises, as alluded above, are SMEs.²² Table 6.1 presents exportable products at HS 6-digit level with more than 50 million rupees in value in 2001. It shows that the major exportable products are garments, carpets, primary and processed agricultural products, metal products including iron and steels, electric parts, office equipment and artistic products, in which SMEs are found engaged in many ways.

6.5 Potential Impact of Standards on Export

The use of regulatory measures in the form of TRS helps achieve public objectives unaddressed by the forces of markets, such as protection of the environment or public health. Technical standards such as emission standards, sanitary requirements such as level of pesticide residuals and phytosanitary requirements such as foot-and-mouth disease (FMD) free products, are, in fact, public goods themselves, as they are available to multiple users or competitors.

Standards perform a number of vital functions if they are used fairly. They facilitate market transactions, reduce costs of uncertainty, increase the elasticity of substitution, promote economies of scale, provide guidelines or focal points around which enterprises can organise their production process, and serve as benchmarks of technological capabilities and guarantee compatibility with other components or with networks.²³ Standards facilitate market transactions by improving information flow between suppliers and consumers about the characteristics and quality of products. In fact, it promotes a system whereby products are 'once tested, once certified, accepted everywhere'.

Standards, however, can be used as trade barriers when they vary among countries. The cost of complying with standards to ensure compliance with importing countries' health or safety regulations may be higher for foreign firms. If we look into the inventory of TRS adopted by WTO members, the list of measures include bovine spongiform encephalopathy (BSE) related measures, pest risk assessment requirements, FMD trade restrictions, pet food import requirements, food safety regulations affecting agricultural products produced from modern biotechnology, zero tolerance for e-coli and pesticide, antibiotic limits in honey, and import restrictions on dairy products.²⁴ If TRS measures adopted by WTO members is viewed in conjunction with the export basket of Nepal, given the level of technical capability of the country to comply with SPS measures, there is every possibility that the market access provided by other WTO agreements could be denied to many industrial products as well as most primary and processed agricultural products. They can prohibit market access by imposing an import ban or by increasing production and marketing costs.

Apart from problems related to complexity, stringency or technical characteristics of certain regulations and standards, Nepal faces a number of constraints as a result of structural problems. These include lack of awareness and management of information, poor infrastructure, dominance of small producers, lack of finance, and insufficient access to technology and institutional capacity. Typically, essential facilities like laboratories are not adequately staffed, scientific equipment is antiquated for the required tests, and there is no systematic collection and recording of information. The high cost of conformity assessment including testing for thresholds of residues is also a serious problem. Besides, Nepal is a 'standard taker', and not a 'standard setter'.

Higher compliance cost: Where TRS are becoming an integral part of product quality, producers irrespective of their level of production need to be able to meet such requirements to realise customary market share. Such requirement of compliance requires new investment in costly equipment and may overturn the comparative advantages of SMEs, which are maintaining low capital costs and high labour inputs. It has been reported that the cost of compliance with SPS measures in some agricultural products, such as spices, peanuts and mango pulp in India, raised the production costs by up to 40 percent. Moreover, small farmers cannot maintain records at the field level as required by HACCP regulation and that may adversely affect the quality of final products. For example, Indian papad has been put by Federal Food and Drug Agency of the US under 'automatic detention list' because of presence of pesticides residue. SMEs will remain in disadvantageous position even if international standards are developed taking into account the need of developing countries and LDCs because the specifications are more likely to be suited to large capital rich multinational companies (MNCs) rather than the labour intensive SMEs.

Loose definition of standard: Although WTO agreements have established certain standards for the application of measures, disagreements between countries about the measures often involve complex issues not specifically addressed by the text of the agreements. Agreements require measures to be based on scientific principles, but scientific research on certain topics may not exist or existing research may be inconclusive. As a result, developed countries have been exploiting such a flexibility to impose stringent

norms and standards in order to restrict imports. A case in point is unmanufactured tobacco, on which Japan insists on a DDT residue level of 0.4 particles per million (ppm), while the international standard is six ppm. Similarly, the Codex Standard for aflatoxins in peanuts is 15 parts per billion (ppb), but the European Commission (EC) has stricter aflatoxin standard of four ppb.²⁵

Unclear risk assessment: The SPS Agreement requires measures to be based on an assessment of risks, but governments may have different risk tolerances or may disagree about how to ensure certain minimal level of risks. Moreover, there has been a move towards shifting emphasis from risk management to risk minimisation or avoidance. The EU standard for milk and milk products requires that checks originate from the level of primary production, and it lays down the conditions of maintaining animals, types of feed to be given, and the monitoring of these regulations.²⁶ In Nepal, where commercial dairy farming barely exists and dairy farms pool milk from many farmers before processing, it is impossible to monitor each animal. Even if the final product is safe, as it is, the sanitary measure simply does not provide market access in the EU.

Non-mandatory equivalence: WTO agreements only recognise the concept of equivalence. It does not oblige members to enter into equivalence agreement. Members often avoid equivalence agreement even after the receipt of formal requests. The reason being either the administrative burden of entering into such agreement is not justified or they do not want to lose their control over imports as well as revenue generation from such imports. Even if formal requests are responded, important components, which they feel are not in their interest, are not addressed in many situations²⁷. In several instances, importing countries look for 'sameness' instead of 'equivalence' of the measures.²⁸

6.6 Conclusion and the Way Forward

This paper makes a case that, if used fairly, TRS promote a system whereby products are 'once tested, once certified, accepted everywhere'. However, standards and technical regulations present barriers to trade in all levels of the TRS regime - from rule making to conformity assessment to accreditation. This is so because of poor

access to compliance resources, including scientific and technical expertise, information and financial resources on the one hand and adoption of discretionary standards by developed countries on the other. In order to overcome the barriers posed by TRS and help SMEs participate effectively in the world trading system, action must be taken at three levels: national, regional and international.

6.6.1 National

The most important issue is that the existing standards regime of Nepal does not ensure quality assurance in international market.²⁹ Thus, without investment in the quality assurance institutions, TRS of all kinds will continue to impose barriers to trade. For this, the government should pursue aggressively the request of technical assistance for the implementation of SPS and TBT agreements referred in the relevant agreements as well as in the Report of the Working Party on the Accession of Nepal.

A mechanism for disseminating information to the exporters on new emerging standards should be created. Particularly, SMEs need to focus on surviving under the international standards regime. This could help in reducing the rate of rejection of export consignments and avoid the costly process of bringing them back or destroying them.

The government should support enterprises by way of incentives or subsidies in WTO compatible manner as well as establish its own test laboratories with international accreditation standards. The government may assist small enterprises in compliance with the new standards through provision of technology and necessary raw materials. The government should also initiate extension programmes, which includes training of entrepreneurs, managers and different level of workers.

Accreditation to international bodies such as multilateral recognition arrangement (MRA) framework developed by the International Accreditation Forum (IAF) needs to be initiated. Similarly, efforts should be made to have bilateral agreements for accreditation and equivalence of standards with major trading partners. Such arrangement obliges signatories to accept conformity assessment of Nepal.

6.6.2 Regional

The export basket of Nepal resembles the export basket of the countries in the South Asian region, and thus, the interest of South Asian countries converges in standard setting mechanism. Experience suggests that international standards such as those in CAC evolved with very little participation of developing countries. Therefore, what developed countries propose gets approved by way of default. We need to participate in these events effectively with our own homework and preparation. A region-wide coordination in international standard setting events and in WTO Committees and other negotiations would serve South Asian interest tremendously. Similarly, the region can work to evolve regional standards especially for products of regional interest and have them accepted globally. South Asian Association for Regional Cooperation (SAARC) can play a vital role in this regard.

6.6.3 International

According to Article 12.7 of the SPS Agreement, 'the committee shall review the operation and implementation of this agreement three years after the date of entry into force of the WTO Agreement...' Though the Committee agreed in July 1998 on a procedure to review the operation and implementation of the Agreement, it did not recommend any modification of the text of the Agreement. Moreover, the Doha Declaration of the fourth Ministerial Conference under the rubric of implementation issues has attempted to address some of the problems of developing countries and LDCs. In this regard, Nepal needs to form alliances with like-minded countries in ongoing WTO negotiations. The probable issues may include, among others, defining the maximum level of standard for food products in conformity with Codex guidelines, a concrete time bound technical assistance commitment, recognition of regional and sub-regional laboratories, certification bodies and accreditation institutions, and a sufficient time-frame (minimum of one year) between application and publication of new measures.

Endnotes

- ¹ Annex 1 of the Agreement defines technical regulation as 'document which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method.' In EC - Asbestos, the Appellate Body clarified the term "technical regulation" and held, *inter alia*, that a 'technical regulation' has the effect of prescribing or imposing one or more 'characteristics' - 'features', 'qualities', 'attributes', or other 'distinguishing mark'.
- ² Annex 1 of the Agreement defines standards as 'document approved by a recognised body, that provides, for common and repeated use, rules, guidelines or characteristics for products or related processes and production methods, with which compliance is not mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method.'
- ³ Annex 1 of the Agreement defines conformity assessment as 'any procedure used, directly or indirectly, to determine that relevant requirements in technical regulations or standards are fulfilled.' It includes, *inter alia*, procedures for sampling, testing and inspection; evaluation, verification and assurance of conformity; registration, accreditation and approval as well as their combinations.
- ⁴ The Second Triennial Review of the TBT Agreement contains 'Indicative List of Approaches to Facilitate Acceptance of the Results of Conformity Assessment' (WTO/G/TBT/9 13 November 2000).
- ⁵ This part heavily draws from Pandey, 2003.
- ⁶ The Codex is an intergovernmental body based in Rome, Italy, whose main mandate the implementation of Codex Alimentarius - Code, which formulates and harmonises food standards and ensures their implementation and utilisation by all consumers, food producers and processors, and national food control agencies at the international level. It was established in 1962 and started operating in 1963. Current membership is 168.
- ⁷ The mandate of OIE includes the harmonisation of the health requirements for international trade in animal and animal products and the adoption of international standards in the field of animal health.
- ⁸ The IPPC is responsible for phytosanitary standard setting and the harmonisation of phytosanitary measures affecting trade. The IPPC is an

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- international treaty for plant protection to which 107 countries currently adhere.
- ⁹ WTO, Dispute Settlement Body. nd. Panel Report on Japan - Agricultural Products II.
- ¹⁰ WTO, Dispute Settlement Body. nd. Appellate Body Report on EC - Hormones.
- ¹¹ WTO, Dispute Settlement Body. nd. Above note 10.
- ¹² WTO, Dispute Settlement Body. nd. Above note 10.
- ¹³ Oyejide, T. Ademola et.al. 2000. "Quantifying the Trade Impact of Sanitary and Phytosanitary Standards: What is Known and Issues of Importance for Sub-Sahara Africa". Paper presented in a workshop on Quantifying the Trade Effect of Standards and Regulatory barriers: Is It Possible?. 27 April, World Bank.
- ¹⁴ Henson, Spencer and Rupert Loader. 2000. Barriers to Agricultural Export from Developing Countries: The Role of Sanitary and Phytosanitary Requirements. World Development. Vol. 29. No.1.
- ¹⁵ WTO, Dispute Settlement Body. nd. Above note 10.
- ¹⁶ Goh, Gavin and Ziegler, Andreas R. 1998. A Real world Where People Live Work and Die. Journal of World Trade. Vol. 32, No.5.
- ¹⁷ Based on Report of the Working Party on the Accession of the Kingdom of Nepal to the World Trade Organisation, WT/ACC/NPL/16 (28 August 2003)
- ¹⁸ Khatiwada, Yuba Raj. 2001. "Small and medium Enterprises Development in Nepal: issues and Opportunities" in Bishwa Keshar Maskey (ed) *Small and Medium Enterprises Development in Nepal: Emerging Issues and Opportunities*. Centre for Development and Governance. Kathmandu.
- ¹⁹ Khatiwada, Yuba Raj. 2001. Above note 18.
- ²⁰ Pandey, Govinda Dev. 2001. "Entrepreneurship Development for SMEs Promotion: Desired Action" in Bishwa Keshar Maskey (ed) *Small and Medium Enterprises Development in Nepal: Emerging Issues and Opportunities*. Centre for Development and Governance. Kathmandu.
- ²¹ Shrestha, Nabina. 2002. Micro and Small Enterprise Policy in Nepal (draft). Internal Report prepared for UNDP/Nepal, Kathmandu.
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- ²⁴ Detailed list of SPS measures is provided in World Trade Organisation, Committee on Sanitary and Phytosanitary Measures. Specific Trade Concern. G/SPS/GEN/204/Rev.3. Geneva.
- ²⁵ Jaiswal, Ananda Kumar. 2003. WTO Agreement on SPS: Strategic Implications. Economic and Political Weekly. 8 November 2003.
- ²⁶ Saquib, Mohammed. 2003. Above note 23.
- ²⁷ Sareen, Shashi. 2002. Standards and Quality Issues in International Trade: India's Response. Paper presented during Regional Conference on Globalisation and Agriculture: Challenges for South Asia, 45 December 2002, New Delhi.
- ²⁸ South Centre. 1999. WTO Sanitary and Phytosanitary Agreement: Issues for Developing Countries. Geneva.
- ²⁹ Glaring examples include butter export to autonomous region of Tibet and honey export to Norway.

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Table 6. 1: List of products with export value more than Rs 50 million in 2001

HS Code	Product Description	HS Code	Product Description
6302.91	Toilet linen and cotton linen	1211.90	Other plants or parts of plants
7601.20	Aluminium alloys	6103.49	Men/boys trousers or shorts of other textile materials
6110.20	Cotton jerseys and pullover	1001.90	Other wheat and meslin
6210.20	Garments made of fabrics	6404.19	Sports footwear
3305.10	Shampoo	7407.29	Other metal products
6205.10	Shirts of wool or animal hair	6208.29	Nightdress and pyjama
1902.19	Uncooked pasta	7314.20	Grill
1517.90	Edible preparation of animal or vegetable fats	5402.39	Textured yarn
1103.11	Groat, meal and pellets of wheat	3401.19	Other soaps
4820.10	Register, account books etc	3003.90	Other vaccine
4410.19	Other metal products unworked than sand	6203.22	Men/boys ensembles of cotton
6207.91	Cotton Singlets and dressing gown	2203.00	Beer made from malt
4106.19	Other leather products	9403.70	Furniture of plastic
4802.20	Paper and paperboard	0910.99	Other spices
1701.11	Sugar	9701.10	Painting, drawing and pastels
5303.10	Jute	6109.90	T-shirt. Singlets and other vests
7408.19	Raw jute	2302.30	Bran of wheat
6203.49	Men/boys trousers and shorts of other textile materials	6204.22	Women/girls ensembles of cotton
6105.90	Men/boys shirts of other textile materials	1515.90	Other oils of vegetables
0902.40	Black tea and other fermented tea	2302.50	Bran of leguminous plants
6204.59	Women/girls dress	5402.32	Textured yarn of nylon
6202.11	Women/girls overcoat	8504.90	Parts of electric equipment
6210.40	Men/boys garments	6209.10	Babies garments of wool or fine animal hair

WTO Membership: Opportunities and Challenges for SMEs in Nepal

Standard Dalatar WTO Arrangements: Opportunities and Challenges for SMEs

HS Code	Product Description	HS Code	Product Description
6203.42	Jacket and blazers of cotton	6204.69	Women/girls trouser and shorts of other textile materials
6203.21	Men/boys ensembles of wool or animal hair	6505.90	Hats and other head gears
6203.33	Jackets and blazers of synthetic fibres	7210.41	Flat-rolled iron/steel
0404.90	Other whey and modified whey	6205.30	Men/boys shirts of man made fibre
4104.90	Tanned leather	6106.10	Women/girls blouse of cotton
9701.90	Other painting and drawing	3926.10	Office or school supplies
0910.10	Ginger	6203.39	Men/boys jacket and blazers of other textile materials

Source: Ministry of Finance 2002

Chapter - VII

Trade Remedy Measures as Means to Protect and Promote SMEs

Ratnakar Adhikari

7.1 Introduction

Nepal's accession to the World Trade Organisation (WTO) is the manifestation of its desire to lock in trade liberalisation thereby ensuring a transparent and predictable business environment. One of the main reasons for embracing 'openness' - which is what the WTO aims at - as the mantra for economic growth and prosperity is to infuse competition in the hitherto protected sectors of the economy. A right dose of competition from foreign enterprises (whether through import or commercial presence) is good for the local consumers, but not for the local producers, who have either been sheltered by tariff wall or have thrived on the anti-competitive business conducts such as cartels or territorial allocations. However, an overdose of competition is good for none of the domestic actors, including consumers, at least certainly not in the long run.

Such overdose and unruly nature of competition coming from the foreign supplier/producer, called 'unfair competition' in trade jargon, could have deleterious impact on the domestic small and medium enterprises (SMEs). Unfair competition could be in the form of 'dumping' of goods below cost price in the home country by a foreign exporter, selling subsidised goods in the domestic market or simply exporting large consignments of particular goods and creating import surge in the home country. Such measures, which are usually temporary in nature, could create upheaval in the domestic economy, with SMEs facing a disproportionate burden of adjustment.

Though WTO membership ties the hands of the government in terms of protecting or favouring domestic enterprises, it, nevertheless, provides some leeway to protect and promote vulnerable and sensitive segments of the economy. SMEs are vital nerves of the

Nepalese economy because of their sheer contribution to poverty alleviation¹ and economic development through the generation of employment. It is clear that the prime beneficiary of the government's plan to make use of WTO agreements to protect and promote the interests of the vulnerable segment of the economy should be SMEs and poor and marginal farmers. However, since the focus of this paper is SMEs, it will only deal with those WTO provisions that have a bearing on SMEs.

7.2 Promoting SMEs in the Face of WTO Accession

In the multilateral trading architecture, agreements and subsequent decisions of the WTO affect business enterprises, both operating locally and internationally. Indeed, no firm is insulated from foreign competition in the WTO era. SMEs with limited capital, assets base, expertise, knowledge, marketing calibre and market base are likely to be affected more by competition from foreign enterprises than their bigger counterparts. While there is a general lack of capacity to deal with WTO issues among the Nepalese business sector², SMEs are far behind in terms of understanding the implications of WTO agreements and decisions. Given the level of contribution made by SMEs in economic development, it is imperative for a country like Nepal to render the necessary support in the post accession era.

A powerful component of the new SME orthodoxy is the normative judgement that small and medium firms, often seen as traditional in nature, are somehow more valuable to a developing economy than are large firms. The special value of small firms justifies special treatment². Irrespective of the varying degree of industrialisation and varying social and economic structures, SMEs represent the backbone of many economies. They have a major share in the export potential in a number of countries and offer high potential and opportunities for specialisation and special skills³. Therefore, SMEs will continue to remain vital for the economic development of such countries. This is more so for a country like Nepal where large-scale industrialisation has remained a pipedream due to the small size of the market.

Talking about protecting and promoting the interests of SMEs, it is something member countries should have done even if they were not

the members of the WTO. Membership of the WTO would mean added responsibilities to them and the member countries should have a proactive agenda rather than the reactive ones as earlier. It is imperative for the trade negotiators of a country like Nepal to develop their negotiating positions that are in sink with ground realities at home. Therefore, consulting with the local stakeholders and appreciating and internalising their concerns are a must. Clearly, SMEs cannot be brushed aside at the time of preparing such positions.

Nepal's trade negotiators have already secured in-built flexibility at the time of conducting accession negotiations to protect the interest of SMEs. The major means through which SMEs are going to be protected is tariff. Compared to as low as 14 percent applied tariffs on an average, Nepal's trade negotiators could bind tariffs on industrial products at 24 percent and agricultural products at 42 percent⁴. Now there are two questions that emerge. First, will Nepal be able to make use of these flexibilities in order to protect and promote the interests of SMEs, or will it be using them to satisfy the whims and fancy of the big business enterprises only, falling prey to their lobbying and clamour for protections? This question is related to domestic governance issues, hence the answer should be searched in the light of the mutually beneficial rent sharing relationship our politicians are having with big business enterprises. Second, given the fact that extensive negotiations on non-agricultural market access (NAMA) are likely to take place at the WTO, and each country would be asked to reduce their tariffs on industrial products, will Nepal be able to take shelter under the least developed country (LDC) umbrella and refuse to reduce tariffs, or will it give in? This question is related to the ability of the stakeholders to influence the negotiating position of the country and the ability of the trade negotiators to obtain concessions at the WTO platform without conceding much.

Thankfully, tariff is not the only means through which domestic industries in general and the SMEs in particular can be protected. As mentioned in the introductory section, temporary protection of domestic industries is possible through various WTO-compatible measures. We will look at those measures in the next section.

7.3 Trade Remedy Measures

One of the major objectives of the multilateral trading system has been to promote free and unfettered trade without any distortion and discrimination. This is naturally one of the objectives of the WTO, but due to political ticklish concessions involved during trade negotiations, it is unlikely that the WTO will be able to achieve this objective in the near future. One such issue on which there has been much division among WTO members is providing remedy against 'unfair' competition. This is mainly due to the mindset of the trade officials. This is also a manifestation of double standards in trade policy making process in all the countries alike. Every country's trade officials feel that they need to provide remedy against 'unfair' foreign competition, but remain adamantly opposed to reform their own trade regime, where the elements leading to the creation of 'unfair' conditions for competition in the foreign market are also present.

Be that as it may, there are three direct and two indirect trade remedy measures that are available for SMEs. While direct measures include a) Anti-dumping, b) Countervailing measures, and c) Safeguards, indirect measures include a) Balance of payment (BoP) cover⁵, and e) Special safeguards in the case of agriculture⁶. However, due to non-applicability of the last measure in the context of Nepal, we shall only discuss about the first four measures.

7.3.1 Anti-Dumping Measures

If a foreign supplier sells goods at a price below his/her cost of supplying the same goods in the domestic market, it is considered an act of 'dumping'⁷. Due to dumping of such products in the domestic market, the prices of those goods are reduced, thereby providing benefits to the domestic consumers. However, this act hurts the domestic industries, particularly SMEs, which are engaged in producing competing products. In order to protect the domestic industry from such practice, the government can levy an amount equivalent to the 'margin of dumping' at the border thereby creating level playing field for the domestic players. This duty is known as 'anti-dumping duty'. Alternatively, the supplier itself could be forced to resort to 'price undertaking' whereby he/she would

undertake not to sell his/her products below certain prices so as to create fair condition of competition for the domestic players in the complaining country.

The WTO rule governing anti-dumping measures are dealt with by the Anti-Dumping Agreement (ADA, but officially known as Agreement on Implementation of Article VI of General Agreement on Tariffs and Trade (GATT), 1994). As per the rule book, it is extremely difficult to take anti-dumping measures against foreign enterprises. The reason these rules have been made extremely cumbersome and complicated is that the drafters of the GATT text wanted to make it possible only for the genuine cases of dumping to be penalised. Moreover, they wanted to avert the temptation on the part of the host countries to take these measures with protectionist intent. However, there is still a lot to be desired in terms of improving the rule book because rules contained therein have not been terribly helpful in averting such a tendency. We shall now turn to discuss those rules.

First, no country can take recourse under the ADA unless and until it has enacted a legislation, which is fully compliant with the ADA. This rule also applies to the acceding countries. For example, in the Working Party Report of Nepal's Accession (See Annex 1), Nepal has mentioned that it would enact such a legislation.

Second, no country can take recourse under the ADA unless and until it has put in place an institutional mechanism, which is equipped with powers to undertake investigations (such as International Trade Commission, or ITC for short of the US). This institution can only start investigation on the basis of a complaint from the domestic industry⁸.

Third, the remedial process requires the determination of three elements, namely i) existence of dumping, ii) margin of dumping, and iii) existence of injury. This implies that mere dumping is not sufficient to trigger action. It has also to be proven that dumping has caused injury⁹ to the domestic industry. The demonstration of causal relationship between the dumped imports and the injury to the domestic industry should be based on an examination of all relevant information before the institution.

Fourth, the examination of the impact of the dumped imports on the domestic industry concerned should include an evaluation of all relevant economic factors and indices having a bearing on the state of the industry, including actual and potential decline in sales, profits, outputs, market share, productivity, return on investments, or utilisation of capacity; factors affecting domestic prices; the magnitude of margin of dumping; and actual and potential negative effects on cash flow, inventories, employment, wages, growth and ability to raise capital or investments. Moreover, this list is not exhaustive, nor can one or several of these factors necessarily give decisive guidance.¹⁰

Fifth, the imposition of anti-dumping duty or price undertaking can only be for temporary period. It may be discontinued provided the interested party (which could be an importer of the product in question, or a group of consumers) provides positive information substantiating the need for a review of such duty. During the review, if the authority feels that there is no need to continue such a duty or price undertaking, it could be lifted. Even if no review takes place in the interim, such measures cannot be continued for more than five years under normal circumstances.¹¹

7.3.2 Countervailing Measures

While anti-dumping measures are taken to create a level playing field for the domestic enterprises to protect them against unfair competition by the foreign enterprises, which are caused due to the action of the private sector (dumping) of a foreign country, countervailing measures are taken for the same purpose, except that these measures are taken to counteract the action taken by the foreign governments (providing subsidies). Agreement on Subsidies and Countervailing Measures (ASCM) governs countervailing measures. When a foreign government provides trade distorting¹² subsidies to its domestic enterprises, the home country has a right to impose additional duty over and above the normal duty in order to 'countervail' the impact of such subsidy in the home market. Like dumping, subsidies provided by a foreign government are a boon for the home consumers because they could purchase foreign goods at cheaper prices, but the import of subsidised goods hurts the

domestic industry. The impact on SMEs could be even more severe because of their inability to compete.

However, there are certain rules to be respected before imposing countervailing duty at the border or forcing the exporter to resort to 'price undertaking', like in the case of imposition of anti-dumping duty. Some of them are discussed below:

First, no country can take recourse under the ASCM unless and until it has enacted a legislation, which is fully compliant with the ASCM. This rule also applies to the acceding countries. For example, in the Working Party Report of Nepal's Accession (See Annex 1), Nepal has mentioned that it would enact such a legislation by May 2004. This also needs to be notified to the WTO Committee on Subsidies.

Second, no country can take recourse under the ASCM unless and until it has designated an institution, which is equipped with powers for conducting necessary investigations. Once the institution is designated, it needs to be notified to the WTO Committee on Subsidies. This institution can only start investigations on the basis of a complaint from the domestic industry.¹³

Third, the remedial process requires the determination of four elements, namely i) existence of subsidy, which is prohibited and actionable; ii) the amount of subsidy; iii) the existence of injury to the domestic industry; and iv) the existence of causal relationship between subsidy and injury.¹⁴

Fourth, the examination of the impact of the subsidised imports on the domestic industry concerned should include an evaluation of all relevant economic factors and indices having a bearing on the state of the industry, just like in the case of ADA. The only addition in countervailing measures is that in the case of agriculture, where an evaluation¹⁵ should be made to see if the burden on the government support programme has increased.

Fifth, the imposition of countervailing duty or price undertaking can only be for temporary period. It may be discontinued if during a review (which can be conducted *suo moto* by the authority unlike in the case of anti-dumping duty), the authority feels that there is no need to continue such a duty or price undertaking. Even if no review

takes place in the interim, such measures cannot be continued for more than five years under normal circumstances¹⁶.

7.3.3 Safeguard Measures

Even when goods are not dumped into a WTO member's market, but there is a sudden surge of import leading to 'serious injury' to the domestic enterprises, the country reserves the right to impose safeguard measures to protect its domestic industry. Safeguard measure in effect means the imposition of additional duty at the border over and above the normal tariffs.

As per the legal text of the Agreement on Safeguards (AS), "A WTO Member may apply safeguard measures to a product only if that Member has determined that such product is being imported into its territory in such increased quantities, absolute or relative to domestic production, and under such conditions as to cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products"¹⁷. This is particularly important for the Nepalese SMEs because there could be occasions when such measures need to be taken. Like in the case of other trade remedy measures, before applying safeguards measures, certain conditions need to be fulfilled. These are obviously designed with the intention of restricting the members' temptation to use these measures as and when they please. The safeguard measures introduced on steel by the US government last year, which was deemed inconsistent with the WTO rules and hence lifted recently, is a case in point¹⁸. Let us now take a closer look at these rules.

First, no country can take recourse under the AS unless and until it has enacted a legislation, which is fully compliant with the AS. This rule also applies to the acceding countries. For example, in the Working Party Report of Nepal's Accession (See Annex 1), Nepal has mentioned that it would enact such a legislation as per the Legislative Action Plan (LAP). However, a closer look at the LAP reveals that there is not even a mention of such legislation. What the government is, most probably, planning to do is to amend its Export Import (Control) Act, 1957 and Export Import (Control) Regulation 1978 and add a chapter on Safeguards there. However, this may not be in conformity with the WTO requirements.

Second, no country can take recourse under the AS unless and until it has designated a competent authority, which is equipped with powers for conducting necessary investigation. This could be an existing government institution or a new institution.

Third, during the investigation to determine whether increased imports have caused or are threatening to cause serious injury to a domestic industry under the terms of this Agreement, the authority should evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry, in particular, the rate and amount of the increase in imports of the product concerned in absolute and relative terms, the share of the domestic market taken by increased imports, changes in the level of sales, production, productivity, capacity utilisation, profits and losses, and employment.¹⁹ Moreover, it is necessary to establish a causal link between increased imports of the product concerned and serious injury or threat thereof.

Fourth, a member can apply safeguard measures only for such period of time as may be necessary to prevent or remedy serious injury and to facilitate adjustment. The period cannot exceed four years²⁰ under normal circumstances.

Fifth, a member should immediately notify the Committee on Safeguards upon i) initiating an investigation relating to serious injury or threat thereof and the reasons for it; ii) making a finding of serious injury or threat thereof caused by increased imports; and iii) taking a decision to apply or extend a safeguard measure.²¹

7.3.4 BoP Measures

This measure can only be taken by developing countries (which obviously includes an LDC like Nepal) in the event the country faces serious BoP crisis arising mainly from efforts to expand its internal market as well as from the instability in its terms of trade.²² In order to safeguard its external financial position and ensure a level of reserves adequate for the implementation of its economic development programmes, a developing country may control the general level of its imports by restricting the quantity or value of merchandise permitted to be imported. However, the import restriction instituted, maintained or intensified should not exceed

those necessary: i) to forestall the threat of, or to stop, a serious decline in its monetary reserves; or ii) to increase its foreign exchange reserves.²³

There is no need to prepare a separate legislation and designate an institution to impose import restriction to address BoP difficulty. This can simply be done by the government at the advice of the Central Bank. Like any other trade remedy measure it can only be applied temporarily. One of the major conditions to be adhered to at the time of imposing import restriction on the ground of BoP difficulty is that the importing country should try to use the 'least trade restrictive' measure. This means that increased tariff is considered a better means to protect its foreign exchange reserve than imposing quantitative restriction (QR) or worse still outright ban. Care should also be taken to prevent unnecessary damage to the commercial and economic interests of other WTO members.

However, relying on BoP measure to remedy import surge is becoming more and more difficult these days. The Indian example of imposing QR on the import of rice can be seen in Box 7.1 below.

Box 7.1: Crisis of Over Confidence: How Not to Use BoP Cover?

India had imposed QR on the import of rice by taking shelter under BoP cover since it was facing genuine BoP problem during the early 90s. Since India was over confident that it would be able to use this cover to protect its rice sector, it has bound duty on rice at zero on its schedule of concessions submitted to the WTO.

However, when the developed countries challenged this measure in 1998 at the WTO, India's BoP situation had become much more favourable. The WTO Dispute Settlement Panel (DSP) asked for the opinion from the International Monetary Fund (IMF) on whether or not India had any BoP difficulty. The IMF analysed the Indian BoP situation and responded to the WTO DSP that India had a very comfortable BoP. Based on this advice, the Panel ruled Indian measure of maintaining QR as WTO-inconsistent.

Furious with the decision of the Panel, India moved to the Appellate Body (AB) of the WTO. But to the utter dismay of the Government of India, the AB upheld the decision of the Panel.

Once Indian authorities realised, albeit the hard way, that BoP cover was risky game, they had to remove QRs on the import of rice. They had to eventually renegotiate their tariff on rice with other member countries of the WTO. Now India's bound tariff on rice stands at close to 80 percent, but they had to provide concessions to their trading partners on other sectors at the time of renegotiating their rice tariff.

Note: India's BoP crossed US\$ 100 billion as at 19 December 2003 (The Economic Times, 21.12.03).

Selectivity is a criterion that distinguishes one trade remedy measures from the other. Whereas anti-dumping measure and countervailing measure are the most selective in the sense that they could be applied to a particular product from a particular origin, BoP is the least selective in the sense that once applied this measure should be applied to almost all the products from all the sources. Safeguard measures can also be selective in terms of products but it cannot be selective in terms of origin - it has to be applied to all sources alike.

7.4 Need for Homework

The foregoing discussion has made it clear that applying trade remedy measures for the protection of SMEs is not an easy task. However, it is necessary to protect this sector of the economy not with a view to sheltering it from foreign competition forever, but with a view to providing it with breathing space as and when required.

Given this reality, His Majesty's Government of Nepal (HMGN) should take certain measures without further delay. While most of these measures are already outlined in the Working Party Report and they must be adhered to, some others should also be taken up as a matter of priority. The following actions may be warranted:

First, HMG should prepare necessary legislation as per the LAP and designate and/or create institutions to conduct investigations. However, it must be noted that the WTO does not require any member country to create new institutions to make use of trade

remedy measures. Given the resource crunch faced by the country at this point in time, it may be wiser for HMGN to designate an existing institution such as Department of Industry or Department of Commerce to take charge. These actions should also be notified to the concerned Committees of the WTO as and when taken.

Secondly, conducting investigations is a resource demanding task. It does not only demand physical and financial resources, but quality human resources as well. Therefore, it is necessary to conduct training of the officials who are going to be involved in the investigation process including the art of calculating dumping margin, countervailing duty and safeguard duty, among others, in a WTO compatible manner.

Thirdly, a sound commercial information system is required to enable the investigating authorities to know the quantity of goods arriving from different sources and the level of preparedness of domestic enterprises to withstand competition. India, for example, has established a well resourced and well staffed 'war room' for the purpose of import surveillance. This room provides data and information to the concerned authorities on which product from which source require trade remedy action. No wonder, India was the second largest user of anti-dumping measures in 2003 following closely the USA. India has overtaken the Europeans, Australians and Canadians, which used to be the most frequent users of anti-dumping measures in the past. The US is the largest user of anti-dumping measures.

Finally, it is necessary to train lawyers on trade remedy measures because as Nepal starts taking trade remedy measures, there will be increasing danger of being exposed to the WTO dispute settlement system. If we have to rely on the foreign lawyers to fight our cases at the WTO, the fee charged would be so exorbitant that it could be higher than the benefits derived by our domestic industries in general and the SMEs in particular through temporary protection.

7.5 Conclusion

The comfortable level of tariff binding at the WTO during Nepal's accession has provided a much needed policy space for the

government to protect the domestic enterprises in general and the SMEs in particular. However, this may not be sufficient to protect the majority of SMEs, which still need support to face global competition. Moreover, there is little doubt that they need to be protected against unfair competition from foreign enterprises. Trade remedy measures, used cautiously, could prove an appropriate tool for the protection and promotion of these enterprises.

However, use of trade remedy measures requires a great deal of homework in terms of enacting legislation, equipping institutions, developing human resources and information system and capacity building of the civil servants as well as lawyers. Therefore, these processes should start without further delay. A final note of caution: all these should be done in the most cost effective manner so as to avoid putting excessive burden on the already over-stretched financial resources of the country.

Annex 1

Nepal's commitments to the WTO on the application of trade remedy measures: Anti-dumping, countervailing duties and safeguard regimes

The representative of Nepal said that Nepal did not have an antidumping or countervailing duty regime at this time, but intended to introduce a WTO-consistent legal regime with respect to anti-dumping and countervailing measures. A timetable for the enactment of legislation to introduce an anti-dumping law that implements the WTO Agreement on Anti-Dumping in Nepal's legal regime was provided in the Legislative Action Plan circulated in document WT/ACC/NPL/10/Rev.1. Draft legislation would be prepared in December 2003, the endorsement by the Council of Ministers would take place in March 2004 and the expected approval date was July 2004.

A timetable for the enactment of legislation that implements the WTO Agreement on Subsidies and Countervailing Measures in Nepal's legal regime was also provided in the Legislative Action Plan circulated in document WT/ACC/NPL/10/Rev.1. A draft bill, policies and regulations to establish a countervailing duty regime would be prepared by the Department of Industry, submitted to the Ministry of Industry, Commerce and Supplies and were expected to be adopted by the Council of Ministers in May 2004.

With reference to the safeguards regime and protection of the balance-of-payments, the representative of Nepal said his government was authorised to restrict imports by issuing an order in accordance with Section 3 of the Export Import (Control) Act, 1957. The involved authorities are the Ministry of Industry, Commerce and Supplies, Department of Commerce and the Central Bank who would only use that authority in conformity with WTO provisions. Currently, there were no quantitative restrictions on imports other than those banned for import or domestic production listed in paragraph 45 to 48 above. The representative of Nepal noted that it was the intent of his government to introduce WTO-consistent legislation and amend the Export Import (Control) Act (1957) and Regulations (1978) in accordance with the Legislative Action Plan contained in WT/ACC/NPL/10/Rev.1, authorising trade restrictions for trade remedies and for balance of payment purposes only in the cases

specified in WTO agreements and in accordance with WTO provisions.

The representative of Nepal confirmed that from the date of accession Nepal would only use the authority in Section 3 of Export Import (Control) Act of 1957 in conformity with WTO provisions, including in compliance with GATT 1994 Article XVIII and the Understanding on the Balance of Payments Provisions on the General Agreement on Tariffs and Trade 1994. Nepal planned to introduce WTO-consistent legislation and regulations on safeguard measures and other trade remedies as indicated in the Legislative Action Plan circulated in document WT/ACC/NPL/10/Rev.1. He further confirmed that Nepal would apply safeguard, anti-dumping, or countervailing duty measures only after notifying and implementing laws in conformity with the provisions of the WTO Agreement on Safeguards, the Implementation of Article VI of the GATT, and on Subsidies and Countervailing Measures, and that after accession Nepal would apply any such measures only in conformity with the relevant WTO provisions. The Working Party took note of these commitments.

Endnotes

- ¹ In the Nepalese context, SMEs account for 90 percent of all enterprises, employ 95 percent of the non-agricultural workforce and contribute 50 percent of the industrial GDP. See Khatiwada, Yuba Raj. 2001. "Small and Medium Enterprises Development in Nepal: Issues and Opportunities" in Bishwa Keshar Maskay (ed) *Small and Medium Enterprises Development in Nepal: Emerging Issues and Opportunities*, Centre for Development and Governance, Kathmandu. Contribution of SMEs is not only important from economic development perspective but also for ensuring balanced regional development and maintaining peace, tranquillity and harmony in the Nepalese society.
- ² This does not only include their lack of capacity to take measures to mitigate the negative impacts of WTO Agreements and decisions but also to take advantage of market opening WTO membership will offer.
- ³ Wiebe, Franck S. 2001. Foreword in Bishwa Keshar Maskay (ed.), *Small and Medium Enterprise Development in Nepal: Emerging Issues and Opportunities*, Centre for Development and Governance, Kathmandu
- ⁴ Maskey, Bishwa Keshar. 1999. *Small and Medium Enterprise Promotion Through Local Capacity Building*, Centre for Development and Governance, Kathmandu.

- ⁵ WTO. 2003. Report of the Working Party on the Accession of the Kingdom of Nepal to the World Trade Organisation, WT/ACC/NPL/16, 28 August 2003 (03-4488), Working Party on the Accession of Nepal, WTO, Geneva.
- ⁶ This can only be used by the developing countries, not by the developing countries.
- ⁶ This can only be used by the countries which have converted their non-tariff barriers on agricultural products to tariffs through a process known as "tariffication" under the Agreement on Agriculture and have inscribed them on their Schedule of Concessions. There are only 36 countries in the world which have done so. Since Nepal had already abolished all NTBs prior to its entry into the WTO it will not be able to use this measure. See Adhikari, Ratnakar (2003), "Trade Remedy on Agriculture" in *The Kathmandu Post*, 14 November.
- ⁷ As per the legal definition "a product is to be considered as being dumped, i.e., introduced into the commerce of another country at less than its normal value, if the export price of the produce exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country (Article 2.1 of ADA).
- ⁸ As per Article 4.1 of ADA the term "domestic industry" shall be interpreted as referring to the domestic producers as a whole of the like products or to those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products. This means that if one or two industries get together and make a complaint to the investigating authority, the authority may not entertain such a complaint.
- ⁹ Under the ADA, the term "injury" shall, unless otherwise specified, be taken to mean material injury to a domestic industry, threat of material injury to a domestic industry or material retardation of the establishment of such an industry (Article 3.1, footnote: 9).
- ¹⁰ Article 3.4 of ADA
- ¹¹ Article 11 of ADA
- ¹² Not all subsidies are trade distorting. For example, subsidies which are of a general nature, i.e., those subsidies which are not specific to particular enterprises (industrial units) or industries (various industrial sectors); and subsidies, though specific, are meant for: a) research; b) development of disadvantaged regions; or c) environmental purposes are not considered trade distorting and hence are not actionable under the ASCM. They would become subject to action in the event of serious adverse effect resulting from them.

- ¹³ As per Article 11.4 of ASCM, the application shall be considered to have been made “by or on behalf of the domestic industry” if it is supported by those domestic producers whose collective output constitutes more than 50 percent of the total production of the like product produced by that portion of the domestic industry expressing either support for or opposition to the application. However, as per the same Article, no investigation shall be initiated when domestic producers expressly supporting the application account of less than 25 percent of total production of the like product produced by the domestic industry.
- ¹⁴ As per Article 15 of ASCM injury means: a) material injury to a domestic industry; b) threat of material injury to a domestic industry; or c) material retardation of the establishment of a domestic industry. Note that this is similar to the definition of injury as in the case of ADA.
- ¹⁵ Article 15.4 of ASCM.
- ¹⁶ Article 21 of ASCM.
- ¹⁷ Article 1 of Agreement on Safeguards
- ¹⁸ For further details see WTO (2003) United States - Definitive Safeguards on Imports of Certain Steel Products, WT/DS248/20, WT/DS249/14, WT/DS251/15, WT/DS252/13, WT/DS253/13, WT/DS254/13, WT/DS258/17, WT/DS259/16, 16 December 2003, WTO, Geneva.
- ¹⁹ Article 2 (a) of AS
- ²⁰ Article 7.1 of AS
- ²¹ Article 12.1 of AS
- ²² Article XVIII:B (8) of General Agreement on Tariff and Trade (GATT)
- ²³ Article XVIII:B (9) of GATT

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Appendix

Resolution of the Seminar

We, the representatives of the business community, civil society, academia, public interest non-governmental organisations and media, in a seminar held on 21-22 December 2003 in Kathmandu on “WTO Membership: Opportunities and Challenges for SMEs in Nepal”, organised by Small and Medium Enterprise Development Project (SMEDP), a partnership project of Friedrich Naumann Foundation (FNSt), Germany and Federation of Nepalese Chambers of Commerce and Industry (FNCCI), in joint collaboration with South Asia Watch on Trade, Economics & Environment (SAWTEE) and Federation of Nepal Cottage and Small Industries (FNCSI), do hereby agree that:

SMEs, which play a vital role in poverty alleviation through employment generation, would confront significant challenges in the context of Nepal’s WTO membership. There arises need for the government to formulate appropriate policies and extend support to ensure the survival of SMEs in the global trade regime.

Nepal’s WTO membership would result in increased competition to SMEs, both in the domestic and foreign markets. The private sector, with the support of the government, must identify products of comparative and competitive advantage and cater to new markets offered by WTO membership.

Competitiveness can only be enhanced through better entrepreneurial skills, modern technology usage, inter-sectoral business linkages, improved product quality and service delivery, and effective flow of market information.

Appropriate government programmes must be initiated with participation of the private sector and civil society to diversify Nepal’s export portfolio and expand markets.

Bureaucratic government structure and inefficient state machinery, including improperly managed trade-related processes and

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procedures, have come as barriers to effective trade, and the same have to be rectified immediately.

State protection is not always possible and practical in the era of globalisation. The government must create an enabling environment for an accelerated development of SMEs.

Necessary interventions must be made by the government to commercialise the agricultural sector. Commercialisation of the sector can go a long way in the expansion and growth of SMEs since most of them are agro-based.

The government, while seeking bilateral and multilateral grants and loans, must keep in mind the needs of SMEs. Likewise, it should be cognisant of the actual needs of SMEs while launching or formulating any programmes for their welfare.

Adequate private sector and civil society participation is necessary in the formulation of SME-targeted programmes. Such participation would ensure greater ownership over the programmes, subsequently leading to better results.

The government must address the problems confronted by SMEs, especially the large number of sick units, and provide necessary financial assistance, apart from imparting necessary technical and capacity building assistances.

Business in the present era must be conducted keeping in mind the intellectual property rights. The government needs to put in place appropriate laws to promote the culture of intellectual property protection. At the same time, flexibilities in the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) must be effectively used in Nepal’s advantage.

Despite the facilities enjoyed by Nepal in bilateral trade with India, there is a need to promote multilateralism, which is essential to do away the complexities inherent in bilateral trading mechanism.

Necessary laws must be formulated and enacted in order to make use of trade remedy measures provided by WTO agreements.

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Besides, human resources must be developed and information systems strengthened to facilitate the use of such measures.

1. Nepal's agro-trade has time and again been subjected to various non-tariff barriers due to the lack of an effective quality certification system. Necessary laboratories must be established to ensure sanitary and phytosanitary compatibility of Nepal's agro-produce.
2. SMEs must be made aware of WTO issues such as anti-dumping, countervailing, balance of payment, safeguards, sanitary and phytosanitary, TRIPS and technical barriers to trade, among others, to ensure that they are better prepared for the WTO regime.

List of the Participants

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2.	Ms. Anjana Tamrakar	Federation of Nepalese Cottage and Small Industries, Kathmandu
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37.	Dr. Kishore Narayan Shrestha	Media Reporter, Kathmandu
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