Progressive Regional Action and Cooperation on Trade (PROACT)

Positive Trade Agenda for South Asian LDCs

DISCUSSION PAPER

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SAWTEE

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LIST OF ACRONYMS

AoA	Agreement on Agriculture
ASCM	Agreement on Subsidies and Countervailing Measures
ATC	Agreement on Textiles and Clothing
BoI	Board of Investment
DTIS	Diagnostic Trade Integration Study
EBA	Everything But Arms
ECOSOC	Economic and Social Council of the United Nations
EPRP	Export-led Poverty Reduction Programme
EPZ	Export Processing Zone
EU	European Union
FAO	Food and Agriculture Organisation
FDI	Foreign Direct Investment
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GSP	Generalised System of Preferences
ICT	Information and Communication Technology
IF	Integrated Framework
IMF	International Monetary Fund
IPB	Industrial Promotion Board
IPO	Intellectual Property Office
IPR	Intellectual Property Right
IT	Information Technology
ITC	International Trade Centre
KBE	Knowledge Based Economy
LDC	Least Developed Country
MFA	Multifibre Arrangement
MFN	Most Favoured Nation
NTB	Non Tariff Barrier
OECD	Organisation for Economic Cooperation and Development
PPP	Purchasing Power Parity
PRSP	Poverty Reduction Strategy Paper
QR	Quantitative Restriction
RCA	Revealed Comparative Advantage
RMG	Readymade Garment
ROO	Rules of Origin
S&DT	Special and Differential Treatment
SEZ	Special Economic Zone
SPS	Sanitary and Phytosanitary
TBT	Technical Barriers to Trade
TPC	Trade Promotion Centre
TRIMs	Trade Related Investment Measures
TRIPS	Trade Related Aspects of Intellectual Property Rights
TRTA	Trade Related Technical Assistance
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDAF	United Nations Development Assistance Framework
UNDP	United Nations Development Programme
UR	Uruguay Round
US	United States
WHO	World Health Organisation
WTO	World Trade Organisation

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EXCHANGE RATES (as of 18.09.2004)

1 US $ = Bangladeshi Taka 60.63
1 US $ = Bhutan Ngultrum 45.25
1 US $ = Maldive Rufiyaa 12.85
1 US $ = Nepalese Rupee 74.02

CONTENTS

EXECUTIVE SUMMARY

South Asia is one of the poorest regions of the world and houses 40 percent of the world's poor surviving on less than US$ 1 a day. Of the seven countries in South Asia, four – Nepal, Bangladesh, Bhutan, and the Maldives – are least developed countries (LDCs) while the other three – India, Pakistan and Sri Lanka – are developing countries.

The South Asian region has a long history of inward looking policies regarding international trade. Apart from Sri Lanka that started liberalising in the 1970s, the other South Asian countries remained closed economies until the late 1980s with liberalisation taking pace only in the 1990s.

Evidence has shown that market reforms and open trade policies have helped many developing countries to achieve sustained growth and alleviate poverty. According to Sachs and Warner (1995), in the 1990s open economies grew 2 percent to 2.5 percent faster than closed economies. Though this study has received rough treatment from Rodriguez and Rodrik (2000), they too have not disputed the fact that trade liberalisation in general contributes to economic growth.

With the same aspirations, in the last couple of years, the South Asian LDCs have taken bold initiatives to liberalise their economies, particularly for their successful integration into the international trading system. They consider World Trade Organisation (WTO) membership as one of the ways to integrate themselves into the international trading system. Bangladesh and the Maldives are founding members of the WTO while Nepal became a member on 23 April 2004. Bhutan is in the accession process and is likely to become a member in a few years time.

In their pursuit to integrate themselves into the international trading system Nepal and Bangladesh have gone through rigorous liberalisation efforts, evident from the reduction in tariff rates in these countries. Bhutan and the Maldives have also initiated reform programmes and are gradually opening up to the world economy. Dismantling of trade restrictions has resulted in an overall export growth and integration of these countries into the world market. The South Asian countries have sustained a growth rate of 5.5 percent over the last two decades making South Asia one of the fastest growing regions in the world.

There is though no reason for these countries to be assured of sustained development, as their exports are highly concentrated and thus remain extremely vulnerable to external shocks. The lack of skilled human resources, inadequate infrastructure and highly protective developed country markets restrict the potential of South Asian LDCs to benefit from exports. They are also likely to face problems in implementing the commitments they made at the WTO due to weak institutional and human capacities.

Recognition of the problems of LDCs and the need to integrate them into the world economic system have led their de-

> In the last couple of years, the South Asian LDCs have taken bold initiatives to liberalise their economies but their marginalisation from the global economy continues.

To benefit from the multilateral trading system, the South Asian LDCs need to be proactive and take measures at the domestic as well as the international levels.

velopment partners and the international community to make efforts to assist the LDCs. The efforts fall into three categories: special and differential treatment (S&DT), improved market access, and technical assistance. The effectiveness of these measures is, however, questionable as the gap between prescription and practice has been wide and LDCs are being increasingly marginalised. At the same time, LDCs are also to be blamed for not fulfilling their part of responsibility with all sincerity.

The efforts made by the international community notwithstading, the South Asian LDCs, to fully benefit from their integration into the multilateral trading system, need to be proactive and take measures at two levels – domestic and international.

At the domestic level, the South Asian LDCs need to, among others, mainstream trade into their development programmes, promote accountable governance, improve infrastructure, and develop human resources. At the international level, given their limited resources, they will have to focus on their priority areas and form issue-based alliances with other developing and least developed countries to strengthen their say at international fora such as the WTO.

Chapter 1

BACKGROUND

The South Asia region, comprising India, Pakistan, Bangladesh, Nepal, Sri Lanka, Bhutan and the Maldives, is home to 22 percent of the world's population; but 40 percent of the world's absolute poor surviving on less than US$ 1 a day live here. The gross domestic product (GDP) per capita in terms of purchasing power parity (PPP) of the region, US$ 2,000, is markedly lower than that of East Asia and Pacific region at US$ 3,950 and Latin American and Caribbean region at US$ 6,880 (RIS 2004). This is despite the fact that South Asian countries have sustained a growth rate of 5.5 percent over the last two decades putting South Asia among the fastest growing regions in the world.

Apart from Sri Lanka that started liberalising in the 1970s, the other South Asian countries remained closed economies until late 1980s with liberalisation taking pace only in the 1990s. Out of the seven countries in South Asia, Nepal, Bangladesh, Bhutan and the Maldives are least developed countries (LDCs), while India, Pakistan and Sri Lanka are developing countries.

The categorisation of countries as 'least developed' happened in the 1970s. In 1971, the United Nations (UN) designated the poorest countries of the world as LDCs. Based on the criteria established at that time, 25 countries fell into this category. However, in the last three decades, the number of countries in this category has grown, with only one country, Botswana, graduating to the developing country status. At present, there are 50 LDCs in the world.[1]

In its report, "The Least Developed Countries Report 2004", the Economic and Social Council of the United Nations (ECOSOC) used the three criteria – low income, weak human assets and economic vulnerability[2] – proposed by the Committee for Development Policy in determining the new list of LDCs. In the 2003 review of the list, a country fell into the LDC category if it met the three criteria and did not have a population greater than 75 million.

LDCs have, for decades, been striving to find the right development strategy to enable them to reduce economic disparity between them and the more advanced economies. Over the past two decades, an increasing number of LDCs have placed their hopes on a development strategy based on increased participation in the world economy, through exports and inward foreign investment (UNCTAD 2001). According to the United Nations Confernece on Trade and Developemnt (UNCTAD) LDC Report 2004, trade liberalisation in many LDCs has actually proceeded further than in some developing countries. In 2002, 60 percent of the 42 LDCs for which data is available had average tariff barriers below 25 percent, and non-tariff barriers (NTBs) were absent or minor in 29 LDCs.

Over the past two decades, a number of LDCs have liberalised their economies faster than many developing countries but their success in increasing trade and attracting FDI has remained marginal.

In many cases, LDCs have liberalised faster than Chile did in the 1970s and 1980s. However, their success in both increasing their trade and attracting foreign direct investment (FDI) has remained marginal. It is worrisome to note that the LDCs, despite serious efforts to integrate

TABLE: 1.1

PROPORTION OF TRADE IN GDP (IN PERCENT)

PERIOD	COUNTRY			
	Bangladesh	Bhutan	Maldives	Nepal
1985-87	24.26	61.52	60.26	31.91
1990-92	19.83	75.05	88.51	36.28
1996-98	30.47	76.15	167.08	59.59
2000-01	35.50	89.74	168.94	55.06

Source: RIS 2004

into the multilateral trading system, are being marginalised.

The South Asian LDCs' efforts to be integrated into the international trading system started even before the establishment of the WTO in 1995. Two of the four South Asian LDCs, Nepal and Bangladesh, have undertaken substantial liberalisation measures since the early 1990s. The extent of such liberalisation is evident from the reduction of tariff rates over the years in these countries. Bhutan and the Maldives have also initiated reform programmes and are gradually liberalising their trade regime. In 2001, unweighted average tariff in all the four countries was less than 20 percent (RIS 2004). The dismantling of restrictions on trade has also resulted in greater integration of the South Asian LDCs into the international trading system as shown by the increase in trade-GDP ratios in these countries *(See Table:1.1)*.

Services are occupying an increasingly important role in the economies of the South Asian LDCs and some of them have significant export potential.

Although today the South Asian LDCs are much integrated into the international trading system, it is difficult to say whether they can sustain the export growth seen in the last few decades because it is a well-known fact that preferential market access in the developed country markets alone is not enough to ensure increased exports for these countries. The South Asian LDCs will have to develop cost competitiveness in selected manufacturing sectors to benefit from preferential market access.

In many cases, the advantage of preferential market access is eroded by complicated rules of origin (ROO) and burdensome sanitary and phytosanitary (SPS) requirements in the importing countries. Moreover, heavy protection of domestic agriculture in the developed countries through tariffs and subsidies also reduces the export potential of South Asian LDCs, as agricultural export is a key area of their comparative advantage. Furthermore, tariff escalation in the developed countries discourages processing and value addition in the exporting countries.

Services are occupying an increasingly important role in the economies of South Asian LDCs and some of them have significant export potential. For example, Mode 4 of servcie delivery envisioned in the General Agreement on Trade in Services (GATS), which refers to temporary movement of natural persons, is strategically important for the South Asian LDCs, particularly Bangladesh and Nepal, which have potential to export low skilled labour. The liberalisation of Mode 4 in the developed countries, by relaxing the temporary movement of natural persons, can prove very beneficial for these countries.

Hence, it is parodoxical that the developed countries while talking about S&DT to help the LDCs to benefit from international trade, have created tariff and non tariff barriers to goods and servcies of LDCs. The S&DT provisions have also been ineffective in promoting exports from LDCs due to the gap between what is promised and what gets implemented. It has now become evident that the only way for the South Asian LDCs to benefit from their integration into the international trading system is to have a proactive agenda and not rely solely on promises made by the develoed countries.

In light of the above facts, the objective of this discussion paper is to elements fo the positvie trade agenda the South Asian LDCs need to pursue to benefit from their integration into the international trading system. The paper focuses on the policies that South Asian LDCs need to proactively pursue at the domestic and international levels to gain international competitiveness[3]. The chapters are organised as follows: Chapter 2 outlines the historical background of trade liberalisation in South Asian LDCs. Chapter 3 analyses the weaknesses plaguing these countries. Chapter 4 makes an appraisal of the efforts made so far to integrate LDCs into the multilateral trading system. Chapter 5 looks at the domestic and international measures LDCs need to take to enhance their overall competitiveness. Finally, Chapter 6 concludes the discussion paper.

The issue of competitiveness is vital for the successful integration of the South Asian LDCs into the global economy.

ISSUES FOR COMMENTS

- How can the South Asian LDCs sustain the growth seen in the decade of the 1990s?
- What was the contribution of the liberalisation policies adopted by the South Asian LDCs in the growth they were able to achieve?
- What can the South Asian LDCs do to use trade for poverty reduction?
- What do the South Asian LDCs need to do to benefit from services exports?
- In what ways can the South Asian LDCs collaborate to negotiate better terms in international trade negotiations?

Chapter 2

PAST TRADE POLICIES AND PERFORMANCE

The South Asian LDCs, traditionally closed and inward looking, have in general been adopting liberal and export oriented policies since the early 1990s. This chapter looks briefly at country profiles: trade policies adopted by these countries and their performance in the recent past.

2.1 Bangladesh

Bangladesh, which lies in the Bay of Bengal between India and Burma, became an independent state in 1971 when the then East Pakistan separated from West Pakistan. Despite sustained domestic and international efforts to improve economic and demographic prospects, with a per capita income of US$ 351.00 in 2002 (UNDP 2004),Bangladesh remains a poor nation. With a land area of 144,000 square kilometers and a population of 141,340,476, Bangladesh has the highest population density in the world. Most of the country is situated on deltas of large rivers flowing from the Himalayas.

Various economic reform measures pursued by Bangladesh have helped the country to achieve a steady 5 percent growth in the last couple of years.

Although half of the GDP is generated through the service sector, nearly two-third of the Bangladeshi population is employed in the agricultural sector, with rice as the single most important product. In the 1970s and 1980s, trade and investment regimes in Bangladesh were designed to service an inward-looking, import-substitution growth strategy. The liberalisation policies first pursued in the late 1980s by Bangladesh can be segregated into three phases. The first phase of reforms started with the introduction of a new industrial policy in 1982, and the liberalisation measures included, among others, a shift from a positive list of import controls to a negative list, reduction in the number of banned commodity imports and the introduction of duty drawback facilities. The second phase of reforms was initiated in 1986 and covered a period up to 1991. During this phase, the number of quantitative restrictions (QRs) decreased from 478 to 239. This phase also saw the rationalisation of tariffs, reduction in the number of tariff slabs and introduction of systems of concessions and incentives such as zero-tariff access and the establishment of export processing zones (EPZs). The third phase of reforms started in 1991, resulting in a decrease in the average nominal tariff rates from 89 percent in 1991 to 17 percent in 2000 (CPD 2001). As a result, the average nominal protection rate fell from 89 percent in 1990 to 25 percent in 1995 and 17 percent in 2001 (CPD 2001, 10). In addition, Taka, the Bangladeshi currency, was made fully convertible for current account transactions in 1996. At present, the major elements of the country's trade policy include liberalised import with no need of licensing, rationalisation of tariff structures and reduction in QRs.

It is encouraging to note that, as a result of these reforms, growth rate has been a steady 5 percent for the past several years. However, there are still many impediments to growth. These include frequent cyclones and floods, inefficient state-owned enterprises, inadequate port facilities, a rapidly growing labour force that cannot be absorbed by the agricultural sector alone, delays in exploiting energy resources such as natural gas, insufficient power supplies, and slow implementation of economic reforms. The reforms are also frequently stalled by political infighting and corruption at all levels of the government.

2.2 Bhutan[4]

Bhutan is strategically located between India and China. With a population of about 700,000 land area of 47,000 square kilometres and per capita income of US$ 695 in 2002 (UNDP 2004), Bhutan is one of the smallest least developed economies in Asia. Government expenditure accounts for almost half of the GDP while donor-financed capital investments represent almost half of the government expenditure. Agriculture and forestry provide the main livelihood for more than 90 percent of the population. Agriculture consists largely of subsistence farming and animal husbandry. The economy is closely aligned with the Indian economy through strong trade and monetary links and dependence on India's financial assistance.

Bhutan's hydropower, with the potential to generate 30,000 MW of electricity, is the main economic resource, with tourism in second place. In 2001, Bhutan had a total installed capacity of 420 MW, with one project, the Chhukha Hydro Power, alone accounting for 336 MW. The importance of this sector can be gauged by the fact that in 2001 it accounted for 11 percent of the GDP and 45 percent of the total domestic revenue. The dominance of this sector will increase with the commissioning of the 1,020 MW Tala Project in 2006.

Though the industrial sector is technologically backward and dominated by cottage industries, the availability of cheap electricity has given rise to power-intensive industries in the towns bordering India. However, heavy controls and uncertain policies in areas like industrial licensing, trade, labour and finance continue to hamper industrial growth and foreign investment.

Bhutan initiated a series of structural reform measures in the 1990s to enhance growth and increase private sector participation in economic activities. The trade regime has been strengthened by rationalisation of import tariffs and export duties. Bhutan has also decided to join the WTO and hopes to complete the accession process by 2007. The government is gearing up for the necessary legislative and regulatory changes in a phased manner to comply with WTO requirements.

2.3 The Maldives

The Maldives, an archipelago in the Indian Ocean, was for a long time a Sultanate under the Dutch and the British before gaining independence in 1965 (WT0 2002). With a per capita income of US$ 2,182 in 2002 (UNDP 2004), population of around 340,000 and 300 square kilometres of land area, the Maldives is extremely vulnerable to rise in sea level as 80 percent of the land area is less than one meter above sea level.

Tourism, the Maldives' largest industry, accounts for one third of the GDP and 70 percent of exports. Fishing is the second leading sector and accounts for 6 percent of the GDP. Over 90 percent of government tax revenue comes from import duties and tourism-related taxes. Manufacturing continues to play a lesser role in the economy. Most staple foods are imported because of the limited availability of cultivable land and the shortage of domestic labour.

The Maldivian government began an economic reform programme in 1989, initially by lifting import quotas and opening agriculture and some exports to the private sector. Subsequently, it has liberalised regulations to allow more foreign investment.

Most of the tariffs are bound at 30 percent. However, 3 percent of the tariff lines are bound at 300 percent. Changes in duties and customs commodity classifications in May 2000 lowered the average protection rates. The average applied most favoured nation (MFN) tariff

While Bhutan initiated structural reform measures in the 1990s to enhance growth and increase private sector participation, the Maldives began an economic reform programme in 1989 by lifting import quotas and opening agriculture and some exports to the private sector.

(unweighted) is 20.8 percent and few formal non-tariff barriers (NTBs) are in place (WTO 2002). Import quotas were eliminated in 1998, except on rice, sugar and wheat flour.

Permission to foreign banks to operate in the country, opening of state trading floor in 2002 and the rationalisation of interest rates initiated in 2001 are expected to contribute positively towards economic development, including development of the country's financial sector.

Small and many dispersed islands, heavy dependence on fishing and tourism, small size of the domestic market, inadequately skilled human resources, lack of adequate trade representation network abroad, weak support institutions and heavy reliance on imported inputs severely constrain the export potential of the Maldives.

The key measures of Nepal's economic reforms during the 1990s included reduction and restructuring of import duties, elimination of most QRs and import licensing requirements, and introduction of full convertibility for current account transactions.

2.4 Nepal

Nestled between China in the North and India on all other sides, Nepal is a landlocked country with a population of 23 million and 147,181 square kilometres of land area. Nepal's per capita income of US$ 230 in 2002 (UNDP 2004) makes it one of the poorest countries in the world. During the last two decades, the share of agriculture in the economy has decreased from 60 percent to 40 percent while the share of industry has not gone beyond 22 percent. Nepal's economy, thus, is still highly underdeveloped.

With a trade to-GDP ratio of more than 50 percent, an average tariff rate of about 14 percent and virtually no quantitative restrictions, Nepal is one of South Asia's most open and trade dependent economies (MOICS/ HMGN, 2003, i) . However, the country has not been able to fully utilise the potential for export growth, as its exports are concentrated in a few products and a few destination markets. Within manufacturing, Nepal's export basket consists of a few products: ready made garments (RMG), carpets and pashmina. Also, Nepal depends on export to three markets with 90 percent of total exports going to India, Germany and the USA. Similarly, Nepal has also not been able to benefit from its hydropower potential and its tourism sector is suffering from political instability.

The key measures of Nepal's widespread economic reforms during the 1990s included reduction and restructuring of import duties, elimination of most QRs and import licensing requirements, and introduction of full convertibility for current account transactions. Due to the reforms, the average rate of protection declined from 111 percent in 1989 to 22 percent in 1993 and to 14 percent in 2002. Most rates now fall at 5-25 percent compared to more than 70 percent of the rates exceeding 25 percent in 1990 (MOICS/ HMGN 2003, 19).

Nepal's trade reform programme was complemented by the enactment of Industrial Enterprises Act, 1992 and Foreign Investment and Transfer of Technology Act, 1992 in line with the open market oriented policy. In addition, interest rates were deregulated and the operation of joint-venture banks permitted as part of the financial sector reform programme of the government.

Nepal's geophysical constraint of being a landlocked country has limited its export potential. Moreover, high transit costs, political instability, Maoist insurgency, and widespread corruption, in addition to a difficult terrain, have been the main impediments to Nepal's growth.

2.5 Trade Performance

Table 2.1 shows the annual growth of exports and imports of the South Asian LDCs. Both exports and imports have grown for these countries since they initiated reforms. It is remarkable that even during the East Asian crisis of the late 1990s, the South Asian LDCs showed strong growth in exports. The slowdown in the early years of the new millennium could be because of the sluggish world demand.

The RMG sector has played a significant role in the overall growth of exports of Bangladesh *(See Table: 2.2)*. The share of RMG in total exports of Bangladesh grew

TABLE: 2.1

GROWTH RATES OF MERCHANDISE TRADE, 1991-2004

YEAR	COUNTRY							
	Bangladesh		Bhutan		Maldives		Nepal	
	Export	Import	Export	Import	Export	Import	Export	Import
1991/92	12.7	-7.4	7.9	-14.4	1.9	17	12.8	-0.2
1992/93	16.1	0.5	-9.6	14.0	10	18.4	56.1	15.8
1993/94	19.5	15.5	4.9	50.4	-19	5.9	18	14.9
1994/95	6.3	2.9	-4.1	-25.7	43.1	9.7	3.6	21.9
1995/96	37.1	39.2	10.2	4.6	12.7	20.9	-9.7	21.7
1996/97	11.8	19.1	39.6	14.1	-6	12.6	1.9	5.8
1997/98	14.0	-7.5	1.7	18.4	15.8	15.6	10.2	21.6
1998/99	16.8	5.4	12.0	3.7	3.4	1.5	11.9	-12.4
1999/00	2.9	6.6	-5.9	20.5	-4.3	13.6	18.2	-10.3
2000/01	8.2	4.4	6.6	12.8	13.2	-1.0	42.3	20.1
2001/02	11.4	11.3	-12.9	6.1	1.4	1.3	4.6	-0.2
2002/03	-7.6	-8.7	-1.8	-4.0	18.1	-2.4	-18.0	-11.4
2003/04	9.5	3.5	6.7	8.5	6.3	8.5	5.0	5.0

Source: RIS 2004

from 16 percent in 1985-86 to 76 percent in 2001-02.

In the case of Nepal, exports to India increased in the late 1990s *(See Table: 2.3)*. Total exports to India grew from Rs 1,552 million in 1990-91 to Rs 26,430 million in 2002-03. However, this was mainly due to export of goods such as vegetable ghee and copper wire, which would have otherwise been subjected to higher tariff in India if imported from a third country, and exports of Indian subsidiaries based in Nepal. Since Nepal does not have comparative advantage on products like vegetable ghee and cooper wire, their export volume to India will naturally shrink when Indian government reduces tariff on these products.

In general, Nepalese exports to countries other than India still depend largely on carpets and RMG *(See Table: 2.4)*. In the fiscal year 2002-03, RMG accounted for

The significant contribution of the readymade garment sector in exports of Bangladesh is evident from the increased share of garments in total exports from 16 percent in 1985-86 to 76 percent in 2001-02.

TABLE: 2.2

BANGLADESH GROWTH IN RMG SECTOR

Period	Export Volume ('000 doz)	Exports (US $ millions)	Share in total exports (percent)	Employment (millions)	Number of garment factories
1985-86	4,763	131	16.0	0.2	594
1990-91	30,567	867	50.5	0.4	834
1995-96	72,005	2,547	65.6	1.3	2,353
1999-2000	111,906	4,349	75.6	1.6	3,200
2001-2002	140,445	4,583	76.6	1.8	3,618

Source: IMF 2004

TABLE: 2.3

NEPALESE EXPORTS TO INDIA (RS. IN MILLION)

Goods	1990-91	1995-96	1999-2000	2001-02	2002-03*
Pulses	77.0	314.7	969.7	1005.7	880.4
Jute Goods	272.3	453.2	1103.9	1630.1	1899.0
Tooth Paste	-	309.2	2262.9	1606.7	1002.8
Soap	-	0	1083.5	528.9	469.2
Vegetable Ghee	-	0	2743.0	7081.4	3812.3
Copper Wire Rod	-	0	631.5	2620.5	356.0
Total Exports to India	**1552.2**	**3682.6**	**35541.4**	**27956.2**	**26430.0**

Source: MoF 2004

* Provisional

BOX: 2.1

THE PHASING OUT OF THE MULTIFIBRE ARRANGEMENT

From 1974 until the end of the Uruguay Round (UR), trade in textiles was governed by the Multifibre Arrangement (MFA), and since 1995, textiles trade has been regulated under the Agreement on Textiles and Clothing (ATC). Although the WTO aimed for the tariffication of all QRs to trade, the ATC continued to allow QRs, namely quotas, in specific imports. Trade in textiles and clothing was also characterised by exceptions to the MFN principle, which demands that all members in the international trading system treat all other members in the system alike. Under the agreement relegating the trade in textiles, countries were able to treat others in an unequal manner, meaning that they could set different import quotas for textile exports of different countries. But while most countries faced relatively high import barriers on their textile exports, LDCs and countries that are referred to as small suppliers of textile products, benefited from preferential market access.

It is on this basis that some LDCs managed to diversify out of commodity exports and develop manufactures exports. The Asian LDCs, in particular, have taken advantage of these preferences. Textile exports were equivalent to 61 percent of the merchandise exports of the Asian LDCs, but only 2.0 per cent of those of the African LDCs. During the 1999-2001 period, textile exports of 14 Asian LDCs accounted for 94.2 percent of the total textile exports of 49 LDCs.

The ATC entails a 10-year schedule to bring the trade in textiles and clothing under General Agreement on Tariffs and Trade (GATT) stipulations. In accordance with this schedule, there has been a first group of textile products (at least 16 percent of all relevant products) that have been brought under the GATT rule in the period 1995-1997. A second group of textile products (at least 17 percent of all relevant products) has been brought under the GATT rule in the period 1998-2001. Likewise, a third group of textile products (at least 18 percent of all relevant products) has been brought under the GATT rule in the period 2002-2004, while a final group of relevant products (all remaining 49 percent of the relevant products) will need to be brought under the GATT rule by 1 January 2005. These changes have gradually eroded the preference margins enjoyed by LDCs. By 2005, the preferential margins and the import quotas provided to LDCs will be completely eliminated.

The overall outcome, however, will also be determined by whether the provision of unilaterally granted market access preferences for LDCs can balance the negative effects of the phasing out of the MFA. It is probable that most non-Asian LDCs will suffer only marginal losses from the phasing out of the textile regime, whereas the group of Asian LDCs may actually experience significant losses. During the past years, Bangladesh and Nepal, for instance, have significantly increased their production and export of textiles owning to the provision of market access preferences by developed countries, especially the European Union (EU) and the United States (US) (Appelbaum 2003). After the phasing out of the MFA, the Asian LDCs should still benefit from far-reaching market access preferences to the EU as they are eligible for market access preferences granted under the 'Everything but Arms' (EBA) initiative. However, they would no longer have a preferential market access to the US as they are not eligible for market access preferences granted under the African Growth and Opportunity Act (AGOA).

Source: UNCTAD 2004b

TABLE: 2.4

EXPORT TO OTHER COUNTRIES (RS. IN MILLION)

Goods	1990/91	1995/96	1999/2000	2001/02	2002/03*
Hand Knotted Carpets	3733.0	8163.9	9842.1	6212.5	5320.0
RMG	1350.3	5374.8	13942.4	7833.0	11890.1
Pasmina	-	-	-	1245.0	1152.3
Total Exports to other countries	5835.3	16198.5	28602.0	18988.6	23500.6

Source: Economic Survey 2003/04, MOF, HMGN

* Provisional

50 percent of Nepalese export to countries other than India and 24 percent of the total exports.

It is, however, questionable if Nepal and Bangladesh would have ever entered the RMG sector had it not been for the quota system (*See Box 2.1)* since competition from neighbouring countries such as India and China would have been fierce.

In the case of Bhutan, out of the total exports of Nu 5,261.8 million in 2002, electricity export from Chukha hydropower project to India was Nu 2,171 million (41 percent of total export). In the same year, the total exports to India was Nu 4919.1 million (93 percent of total export) consisting of hydro-electricity, chemicals, metal, wood, processed food, mineral products and textiles, followed by stone, cement and asbestos products.

Inspite of the export growth observed in the South Asian LDCs' in the 1990s, their manufacturing sector is still uncompetitive at the global level. According to the Trade Performance Index developed by the International Trade Centre (ITC), the trade performance of the South Asian LDCs at the global level has been dismal *(See Table: 2.5)*.

The South Asian LDCs' share of basic manufacturers in the global market has been insignificant. Although Bangladesh and Nepal have performed badly in terms of product diversification, they seem to have done well compared to Bhutan in terms of market diversification.

TABLE: 2.5

TRADE PERFORMANCE INDEX IN BASIC MANUFACTURES IN SOUTH ASIAN LDCs*

INDICATORS	COUNTRY		
	Bangladesh	Bhutan	Nepal
Relative ranking among 184 countries	122	124	-
Trend of exports	18	123	70
Average annual change in per capita exports	105	121	25
Share in world market	83	119	121
Product diversification	81	123	90
Product Spread (concentration)	71	124	103
Market diversification	53	122	44
Market spread (concentration)	62	122	88

Source: RIS 2004

*Relative ranking among 184 countries

Note: Data year for Bangladesh is 1997-2001, Data year for Bhutan is 1995-1999 and Data year for Nepal is 1995-99.

TABLE: 2.6

SECTORAL COMPOSITION OF PRODUCTION IN SOUTH ASIA (AS PERCENT OF GDP)

Country	Agriculture		Industry		Services	
	1991	2002	1991	2002	1991	2002
Bangladesh	29.5	21.9	21.1	25.5	49.4	52.6
Bhutan	43.1	33.9	25.0	37.4	32.9	31.6
Maldives	20.6	9.5	17.1	15.5	62.3	75.0
Nepal	48.6	40.6	17.9	21.8	35.5	40.8

Source: RIS 2004

BOX: 2.2

TOURISM SERVICES IN LDCs: POOR NATIONS, RICH DESTINATIONS

While LDCs account for only 0.5 percent of world services export, international services are an important aspect of their economies. At the end of the 1990s, services accounted for nearly one fifth of their total export of goods and services. The share of LDCs in world exports of tourism services jumped from 0.6 percent in 1988 to 0.8 percent at the end of the 1990s. Throughout the 1990s, tourist inflows to LDCs increased more rapidly than to the rest of the world. Particularly, a strong growth was observed in seven LDCs: Cambodia, Mali, the People's Democratic Republic of Lao, Myanmar, Samoa, Uganda, and the United Republic of Tanzania. In some LDCs, such as The Maldives, the Gambia, Vanuatu and Tuvalu, tourism remained the main export sector of the economy throughout the 1990s. It has been among the top five sectors in nearly two thirds of the LDCs. In the case of The Maldives and Vanuatu, tourism services helped to generate a surplus in the external balance of goods and services. In Comoros, Samoa and the United Republic of Tanzania, international tourism has been the most important source of foreign exchange earning since 1985. For many LDCs, tourism represents a viable option for sustainable economic and social development, poverty reduction, and beneficial integration into the global economy.

Source: UNCTAD 2004a

TABLE: 2.7

STRUCTURE OF SERVICE EXPORTS

Country	Commercial Services Exports (US$ mn.)		Transport (% of Total Service)		Other (% of Total Service)	
	1990	2001	1990	2001	1990	2001
Bangladesh	29.5	21.9	21.1	25.5	49.4	52.6
Bhutan	43.1	33.9	25.0	37.4	32.9	31.6
Maldives	20.6	9.5	17.1	15.5	62.3	75.0
Nepal	48.6	40.6	17.9	21.8	35.5	40.8

Source: RIS 2004

In the services sector, travel and transport services play an important role in the economies of Nepal and the Maldives.

Theoretically, with the growth of an economy, services occupy a more important role. The share of the services sector in the economies of the South Asian LDCs has also been on the rise *(See Table: 2.6)*.

In this respect, the services sectors have the potential to play an important role in increasing exports from these countries *(See Box 2.2)*.

In the services sector, travel and transport services play an important role in the economies of Nepal and the Maldives *(See Table: 2.7)*. In the case of Bhutan, hydroelectricity accounted for nearly 40 percent of its exports in the year 2002.

The discussions above show that the South Asian LDCs have progressively liberalised their economies since the early 1990s, with remarkable growth in exports. This is, however, no reason for these countries to remain complacent, as their exports are highly concentrated among a few goods and services and thus extremely vulnerable to external shocks. On the other hand, the lack of skilled human resources, inadequate infrastructure and highly protective developed country markets restrict their potential to benefit from services exports.

ISSUES FOR COMMENTS

- What are the main lessons from the trade policies initiated by the South Asian LDCs in 1990s?
- Have the South Asian LDCs given enough attention to domestic measures required to benefit from trade liberalisation?
- What policies do the South Asian LDCs need to pursue to improve their competitiveness in the manufacturing sector?
- What are the areas of competitive advantage of the South Asian LDCs?
- How can the South Asian LDCs make optimum use of their hydropower and tourism potential ?
- How can the South Asian LDCs compete in the RMG sector in the post MFA era?

Chapter 3

WEAKNESSES PLAGUING THE SOUTH ASIAN LDCs

The South Asian LDCs continue to suffer from serious social, economic, political and structural weaknesses, which are the underlying reasons behind their inability to benefit from integration into the global trading system. Some of these are due to specific geophysical constraints, such as landlockedness (e.g. Nepal and Bhutan), some due to the political situation, such as civil strife (e.g. Nepal), some due to social factors, such as poor health and education, while some others are infrastructure-related. However, the factors are inextricably intertwined and it is hard to single out any one factor as the reason behind the condition of the economy. What follows is a discussion of the major weaknesses of the South Asian LDCs hindering their prospects for better integration into the international trading system.

3.1 Lack of Competitive Ability

In the era of global competition, it is not sufficient for the South Asian LDC companies to be competitive only at the national level. It is crucial for them to possess competitive advantages such as economies of scale, cutting-edge technology, marketing strengths, efficient production and distribution systems, and / or cheap labour to be competitive in the international trading system (Adhikari and Ghimire 2001). The South Asian LDCs do not have a comparative advantage in any one of these areas except for the availability of cheap labour. Studies have shown that the highest revealed comparative advantage (RCA) for the South Asian LDCs is in low technology manufactures and primary products. However, because of the low productivity of labour, resulting mainly from the lack of education, skills and poor health, even this comparative advantage has not been fully exploited. Moreover, a country's ability to gain from trade and global integration depends on how efficiently it is able to produce goods and services.

What makes matters more complicated is the fact that there are stark differences even among the South Asian LDCs in terms of competitive ability and the resulting trade performance. Bangladesh and Nepal have been able to increase their exports of manufactures from US$ 1,671 million in 1990 to US$ 6,530 million in 2001 and US$ 204 million in 1990 to US$ 737 million in 2001 respectively. However, there has been no significant increase in the exports of manufactures of Bhutan and the Maldives during the same period.

There are stark differences among the South Asian LDCs in terms of competitive ability and the resulting trade performance.

According to the Global Competitiveness Report (GCR) 2003-04[5], which analyses the potential of economies to attain sustained growth, Bangladesh's ranking has deteriorated between 2002 and 2003. The 2003, growth competitiveness rank (GCI) of Bangladesh was 98 out of 102 countries and business competitiveness rank (BCI) was 86 out of 95 countries (CPD 2003). Bangladesh is the only South Asian LDC included in the study. This may be an indication that the other South Asian LDCs are not considered significant players in international trade. This clearly shows that these economies have a lot of homework to do in order to catch up with the more competitive economies.

3.2 Supply Side Constraints

Lack of linkages between production and services and infrastructure facilities in the South Asian LDCs have limited their potential to specialise in crucial productive sectors and reap the benefit of productivity gains. Poorly developed human capital has led to paucity of managerial, entrepreneurial and technical skills, and the ability to conduct adaptive research is severely constrained by the lack of incentives and entrepreneurial zeal. Moreover, poorly developed infrastructure (e.g. transportation, power and storage facilities) and support services (e.g. telecommunications, financial services and other technical support service institutions) have further hampered the competitiveness of the South Asian LDC economies in the international market (Adhikari 2004).

Trade support services such as access to business information and information technology, advice on standards, packaging, quality control, marketing and distributional channels and new product development are virtually non-existent in the South Asian LDCs.

Trade support services such as access to business information (particularly on rules and procedures of export markets); use of information technology; and advice on standards, packaging, quality control, marketing and distributional channels, and development of new products are virtually non-existent in the South Asian LDCs. There is also a lack of capacity and resources to modernise and reform customs and other government agencies involved in trade transactions and simplifying export and import procedures (Bhattacharya and Rahman 1999).

Access to finance is a major problem facing exporters in the South Asian LDCs. This can, in part, be ascribed to the virtual absence of capital market in most of the South Asian LDCs and lack of investor confidence where stock markets do exist. Moreover, due to high spreads[6], and discriminatory lending rates based on risk perception, access to credit is severely limited for small borrowers. Low labour productivity is another major problem. Besides lack of skills and poor health, industrial enterprises in the South Asian LDCs continue to lose to their competitors from more advanced countries because of a high degree of politicisation of labour (Adhikari and Ghimire). Box: 3.1 presents some supply side constraints of the Maldives as an example.

The gradual reduction of tariff and non-tariff barriers in international trade has now brought the focus to the reduction in cost of doing business. This in turn is affected by delays in customs, inefficient transport and port facilities and corrupt and inefficient public sector. The cost of transport for Nepal and Bhutan is extremely high as both countries are landlocked.

3.3 High Export Concentration

All the South Asian LDCs depend on a few products for their exports. As shown in Table 3.1, Nepal and Bangladesh depend heavily on RMG. Bhutan depends on the export of electricity to India and the Maldives depends on the export of

BOX: 3.1

THE MALDIVES: SUPPLY SIDE CONSTRAINTS

Supply side constraints are major obstacles to the Maldives' trade expansion. These include its small and many dispersed islands, which greatly compound the problem of regional development; heavy dependence on fishing and tourism; limited natural resources; smallness of the domestic market; limited technology; limited trade, industry, and export financing; inadequate skilled human resources; lack of adequate trade representation network abroad; limited knowledge of export opportunities; weak infrastructure, including transportation facilities; weak human and resource capacity of support institutions; inadequate investment regime; inefficient legal system; and heavy reliance on imported inputs. These problems are often inter-linked and compounded, impairing the overall trading environment. For instance, weak infrastructure, particularly inadequate shipping facilities, has compounded the problems of the Maldives' island dispersion,

Other infrastructural bottlenecks, including comprehensive but expensive telecommunications and utility services, such as electricity, water, and sewerage facilities, may be linked to inappropriate technology, uncompetitive market structure, and inadequate investment. In addition, lack of knowledge of export opportunities and export financing facilities has constrained the country's ability to diversify its narrow export base.

Source: WTO 2003

RMG and seafood. Both Nepal and the Maldives rely heavily on tourism as well for foreign exchange earnings. Because the South Asian LDCs have not been able to diversify their domestic production structures, they remain extremely vulnerable to international market volatility.

TABLE: 3.1

CHARACTERISTICS OF SOUTH ASIAN LDCS' EXPORTS

Country	Concentration Index at HS-4 level (1)	Concentration Index at HS-6 level (2)	Market Diversification (3)	Principal Products
Bangladesh	32.6	24.1	**2**	RMG, leather
Bhutan	55.3	55.3	3	Hydroelectricity
Maldives	57.0	51.3	4	RMG, seafood, fish
Nepal	54.6	46.6	3	Carpets, RMG

Source: WTO 2002a

1. *Share of top 3 exports in terms of value in total exports based on HS–4 digit classification*
2. *Share of top 3 exports in terms of value in total exports based on HS–6 digit classification*
3. *Defined as the number of different countries to which an LDC exports 90 percent of its products*

What makes the situation worse is that, while exports of a particular product may constitute a large share in the export basket of the South Asian LDCs, they count for relatively little in terms of the international supply and hence are unable to influence world prices. Nepal has been able to export new products to India in the late 1990s. However, as noted above, most of these goods are those that attract high tariffs in India if imported from a third country and have low value added in Nepal. Hence, these exports will significantly decline once India lowers the tariff rates for imports from other countries. Carpets and RMG dominate Nepal's exports to countries other than India as Nepal still lacks a strong manufacturing base and has limited exportable items.

As already stated above, Bhutan's main exportable item is electricity. But the excessive dependence on hydroelectricity and concentration in the Indian market make the Bhutanese economy vulnerable to political and geo-structural disturbances. Likewise, though the Maldives has benefited from the growth of its tourism industry, the precarious nature of this industry makes the Maldivian economy vulnerable to external shocks.

3.4 Implementation Problems

WTO membership requires countries to fulfill two types of commitments, one related to reducing trade barriers and other related to regulations and processes in the domestic economy such as technical standards, SPS standards, customs procedures and regulations and intellectual property law. At the time of signing the Uruguay Round (UR) accord, LDCs were given certain transitional periods for the implementation of most of these agreements, such as the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) and SPS. However, in spite of the longer period available, implementation will be an onerous task for the South Asian LDCs as there is a severe lack of capacity to carry out these measures.

Many LDCs have not been able to fully implement several WTO agreements. However, arguing for the need to extend the transitional periods for LDCs, a report by UNCTAD states that such 'time-bound transitional periods' given to LDCs have serious shortcomings. The report says: "Because of their limited duration, the transitional periods have limited impact on capacity creation for trade and production…. Such time-bound derogation from obligations also assumes the existence of both institutional and resource capacities in LDCs to take maximum advantage of the relevant provisions. For most South Asian LDCs these capacities do not exist (cf SUNS, n.d).

It has been estimated that the cost of implementing three of the UR agreements, namely TRIPS, SPS and customs valuation, for an advanced developing

Many LDCs have not been able to implement several WTO commitments related to reducing trade barriers and regulations and processes in the domestic economy.

country like Mexico amounts to around US$ 130 million (Finger and Schuler 1999). This cost is more than the entire annual budget of many LDCs. The cost would probably be much higher in LDCs as one has to begin further from the required standards. In Box: 3.2 a summary of the cost of implementing select WTO agreements in Jamaica is given as an example.

The Nepalese government has estimated that for Nepal it will cost US$ 12.5 million to introduce an improved SPS regime and US$ 12 million over a five-year period to comply with the TBT Agreement.

At the time of accession to the WTO, Nepal submitted a detailed action plan for implementing the SPS measures. The action plan estimates that it will cost US$ 12.5 million to introduce an improved SPS regime. Similarly, the Nepalese government estimates that it will need US$ 12 million over a five-year period to comply with the Agreement on Technical Barriers to Trade (TBT). This would cover procuring equipment (including US$ 10 million for calibration equipment), training staff, and purchasing consulting services. Similarly, it is estimated that it will cost between US$ 4 to US$ 32 million to fully implement intellectual property rights (IPR) laws in Nepal (MOICS/HMGN 2003). During the Trade Policy Review 2003, the Maldives raised concerns regarding the implementation of anti-dumping, safeguards, SPS and TRIPS agreements. The Maldives will have difficulty in implementing the TRIPS Agreement by the end of 2005, as no IPR legislation exists in the country. Similarly, it is estimated that the drafting and implementation of new IPR laws in Bangladesh will require a one-time cost of US$ 250,000 and annual cost of US$ 1.1 million (Finger and Schuler 1999).

Non-compliance of notification obliga-

BOX: 3.2

COST OF IMPLEMENTING SELECT WTO AGREEMENTS IN JAMAICA

The TRIPS Agreement

Implementation of the TRIPS Agreement in Jamaica will require an initial public sector investment of at least US$ 1 million. This is associated with upgrading and modernising the domestic IPR system. Modernisation involves the revision of existing laws (on, for example, trademarks and patents), enactment of new laws on layout design, geographical indications, plant varieties, etc and the development of proper administrative structures to implement intellectual property (IP) procedures and policies as required by the legislation and the government.

A new Intellectual Property Office (IPO) will administer the laws required by the TRIPS Agreement. Approximately US$ 437,500 was already allocated to the existing IPR structures; another US$ 875,000 - US$ 1.25 million will be required to develop the Jamaica Intellectual Property Office (JIPO) so that it covers all TRIPS areas. The estimated cost required for establishing the JIPO comes to about US$ 775,000 a year over five years, after which the office is expected to be nearly self-sufficient. An additional estimated US$ 250,000 is needed to jump-start the implementation of major enforcement programmes, including border controls.

Agreement on SPS Measures

Implementation of the SPS Agreement will require a total of US$ 7.6 million. This includes the costs of revising current laws and regulations to make them WTO-compliant (US$ 200,000); establishing an Agriculture Health and Food Safety Authority to administer and coordinate SPS activities (US$ 6 million); upgrading and equipping existing laboratories in areas such as pest identification, pesticide residue analysis, and microbiology, and providing training in lab methodology, quality management, and use of equipment (US$ 500,000); conducting pest surveys, surveillance, and monitoring (US$ 150,000); creating and strengthening inspection facilities at ports of entry and exit to serve all agencies involved in the certification of food imports and exports with provision for additional staff, training, and equipment to detect high-risk materials in shipments (US$ 500,000); and funding for participation in international standard-setting meetings, working groups, and the Committee on SPS Measures (US$ 30,000). Many of these costs will be recurring in nature.

Agreement on Customs Valuation

The estimated initial cost of implementing the Agreement on Customs Valuation is US$ 840,000, most of which is needed for training (US$ 120,000), computing equipment and databases (US$ 50,000) and increased staffing (US$ 600,000). Staffing costs will be recurring. (The estimates do not take into account the need for and cost of ancillary investments and reforms that may be required to support implementation.)

Source: The World Bank 2002b

tions has been yet another obvious weakness. The WTO system puts great emphasis on transparency, which requires members to notify the WTO about their trade policy measures. Altogether there are 215 notification obligations. LDCs have lagged far behind other countries in meeting these obligations, with a compliance rate of less than 16 percent (Ghimire 2001). The South Asian LDCs will also have problems in fulfilling such obligations.

3.5 Lack of Capacity

An analysis of the lack of capacity reveals that three issues figure prominently. The first relates to the capacity to implement the WTO Agreements discussed above. The second relates to the capacity to understand the texts of the different WTO agreements and their implications for the country. The third issue relates to the capacity to negotiate effectively in the increasingly loaded agenda items of the WTO. The latter two issues will be discussed in this section (Adhikari 2004).

Most WTO agreements reflect the tough negotiations that went on during the drafting process. Most of these negotiations took place between the developed countries, although some developing countries too played a role. The final agreements are highly legalistic[7] and would require a well-trained trade lawyer to understand these agreements and interpret them. However, most South Asian LDCs have a shortage of such lawyers. Officials at the commerce ministries, who in most cases receive no other exposure than attending training courses on trade policy offered by the WTO Secretariat, are not likely to be able to understand all the provisions relating to such complicated agreements of the WTO such as those on agriculture, SPS, TBT, TRIPS or anti-dumping (Adhikari 2004).

The capacity of the South Asian LDC representatives to participate in the regular negotiation process that takes place at various Committees of the WTO on a regular basis and to negotiate the built-in-agenda items and new issues is severely restricted for a number of reasons. The first one again relates to the lack of understanding of the issues at stake. The second reason is the lack of institutional capacity of these countries. For example, the Maldives and Bhutan do not have a permanent mission in Geneva, while the Nepali and Bangladeshi missions are too small and are unable to follow the numerous WTO proceedings. Hence, it is quite certain that the South Asian LDCs will face serious difficulties when negotiating at the level of WTO.

3.6 Exclusion from the Knowledge Based Economy

One of the major factors of production in the 'new economy' is knowledge. It can greatly enhance the effectiveness of the other factors of production – land, labour and capital. Knowledge Based Economy (KBE) is a general phenomenon, encompassing the exploitation and use of knowledge in every production and service activities, and not just those classified as high-tech or knowledge intensive (Kelegama 2001).

Knowledge Based Economy (KBE) is a general phenomenon, encompassing the exploitation and use of knowledge in every production and service activities, and not just those classified as high-tech or knowledge intensive.

Strong telecommunications and information infrastructure is a prerequisite for a KBE. An innovation system, effective human resources development activities and a business environment supportive to enterprise are some other requisites for converting an economy into a KBE. These factors are generally missing in the South Asian LDCs.

The South Asian LDCs are in fact net importers of technology and new products, and it is evident that the issue of technology transfer has not moved beyond rhetoric[8] . This puts them in an extremely disadvantageous position in the global economy, especially since knowledge has proven to be a critical element in the development of any economy today.

3.7 Other Weaknesses

Out of the four South Asian LDCs, Nepal and Bangladesh have serious political and governance problems. Nepal has been facing a violent Maoist insurgency for about a decade, and Bangladesh is plagued by political instability. Similarly, BOX: 3.3

HOW TO IMPROVE NEPAL'S INVESTMENT SCORE?

The Index of Economic Freedom, published by The Heritage Foundation, uses a relatively objective and transparent scoring system to rate countries on a 1-to-5 (good-to-poor) scale, under a series of headings. While Nepal rates relatively well to critical macro indicators, such as monetary policy, where it scores two for low inflation environment it rates poorly on investment-related indicators. The score for capital flows and foreign investment is four (high barriers), property rights is four (low level protection) and regulation is four (bureaucratic delays, inefficiency, and pervasive corruption), thus contributing to an overall score of 3.5.

How can Nepal move this score closer to one or to even 2.5, as in such key competitor countries as Cambodia, Uganda, or Madagascar, which are able to attract much FDI and are increasing their world share? Nepal can take the following steps:

Facilitate Business Approval

- Review functions of Board of Investment (BoI), Industrial Promotion Board (IPB), Trade Promotion Centre (TPC), etc to rationalise to a maximum of three bodies addressing investment approval, concessions/facilitation, and trade and investment promotion.
- Implement policy of automatic business approval where license requirements are met.
- Amend the Labour Act of 1992 and other measures that make labour markets rigid.
- Implement bankruptcy and foreclosure laws to reduce investor risk.

Attract FDI

- Remove accounting, consulting, marketing, and all business support services from the negative list for FDI.
- Review other items on the list.
- Improve infrastructure.
- Clarify regulations.
- Publish amended versions of the Industrial Enterprises Act 1992 and the Foreign Investment and Technology Act 1992 to fully reflect changes brought about by the Income Tax Act 2002 and any other policy changes on incentives.
- Improve government–business relations.
- Improve tax and customs administration.
- Establish a consultative government-business body to gather business opinion on government policy implementation, beginning with required changes to implementation of the tax code.

Source: MOICS/HMGN 2003

the lack of democratic culture and pluralism is likely to affect economic growth in all the South Asian LDCs. Openness to trade and investment and leaving everything at the mercy of market mechanism do not guarantee economic growth. Institutions guaranteeing, *inter alia*, adequate protection of property rights, regulation to prevent fraud and deceptions, macroeconomic stabilisation, social insurance and conflict management are necessary to fully reap the benefit of openness. As an example, Box 3.3 illustrates the case of Nepal. As Rodrik (2002) argues, "All well-functioning market economies are 'embedded' in a set of non-market institutions without which markets cannot perform adequately". However, such institutions are either non-existent or non-functional in invariably all the South Asian LDCs.

In addition, bribery and corruption in high offices, which is a recurrent phenomenon in the South Asian LDCs, has contributed significantly towards holding back the development prospects of these economies (Adhikari 2004). According to the Corruption Perception Index produced by Transparency International[9], in 2003, Bangladesh – a long time leader of the LDC camp in the WTO – figured at the top of the list. This problem is exacerbated by the fact that these countries lack credible institutions to tackle corruption issues.

Openness to trade and investment and leaving everything at the mercy of market mechanism do not guarantee economic growth.

ISSUES FOR COMMENTS

- Should the South Asian LDCs focus on few areas to increase their competitiveness? If yes, which are the areas where they need to focus?
- How can the South Asian LDCs effectively utilise international technical assistance to address their supply side constraints?
- Is it too late for the South Asian LDCs to become KBEs?
- What do the South Asian LDCs need to do to work in a coordinated manner involving all the relevant stakeholders to benefit from international trade?

Chapter 4

EFFORTS MADE BY THE INTERNATIONAL COMMUNITY

The international community has given due recognition to the problems inherent to LDCs. As such, it has been assisting LDCs to prepare for better integration into the international trading system. This chapter concentrates on some of the major efforts undertaken in this process. The efforts fall into three categories: S&DT, improved market access and technical assistance.

4.1 Special and Differential Treatment

Unless well-designed, effective, enforceable and time-bound S&DTs are provided to the South Asian LDCs, they will continue to fail to integrate their economies into the international trading system.

Analysts are divided on whether or not S&DT is the right policy to facilitate the integration of developing countries and LDCs into the international trading system. According to Srinivasan (2000), the continued insistence of developing countries on S&DT and their reluctance to take part in the GATT negotiations as equal partners were the main reasons for their marginalisation from the global economy. However, developing countries, as a group, insisted on S&DT, asserting that applying the same rules to unequal trading countries could be disastrous (Adhikari 2004).

It is true that countries that have achieved long-term economic growth have usually combined the opportunities offered by world markets with a growth strategy that mobilises the capabilities of domestic institutions and investors (Rodrik 2002). Therefore, well-designed, effective, enforceable and time-bound S&DT is necessary for the successful integration of the South Asian LDCs into the international trading system. Some developing economies, which are now well integrated into the global economy, were major users of the preferential market access opportunities in the past and some of them (such as Thailand, South Korea and Brazil) are reluctant to 'graduate' to a higher status.

The Preamble to the WTO Agreements recognises the special provisions that developing countries need in order to ensure a share in the growth in international trade commensurate with their economic development needs. The preambles to many of the UR agreements contain similar language. The references to LDCs are more generous. It is stipulated that LDCs will only be required to undertake commitments and concessions to the extent consistent with their individual development, financial and trade needs or their administrative and institutional capabilities. However, sincere initiatives to translate these broad objectives into concrete action are wanting.

The Enabling Clause of 1979 provided the basis for "special treatment of LDCs in the context of any general or specific measures in favour of developing countries".[10] The UR Agreements contain 17 provisions that apply specifically to LDC members, in addition to those that are applicable to all developing members (WTO 1999). These include provisions for more extended transitional periods than those applicable to developing countries for the implementation of agreements on TRIPS, SPS and Trade Related Investment Measures (TRIMs). The Agreement on Agriculture (AoA) exempts LDCs from all reduction commitments, while the Agreement on Subsidies and Countervailing Measures (ASCM) places no restriction on the ability of LDCs to grant export subsidies (though it does require them to phase out import substitution subsidies, they are given a longer time frame than other developing countries). The GATS Annex on Telecommunications contains a provision seeking to encourage private suppliers to transfer technology and training to LDCs with the aim to develop the telecommunications sector (Michalopoulos 2000).

Inspite of the S&DT provisions contained in various WTO agreements, LDCs are being increasingly marginalised. The 'measures' in favour of LDCs have not been of much help to them due to the gap between prescription and practice. There are three main reasons for this. First, developed countries have not shown willingness to meet their obligations because these provisions are not legally binding and are merely 'best endeavour' clauses. This fact was well recognised in the UNCTAD report "The Least Developed Countries Report 2004"*(See Box 4.1)*. Secondly, LDCs are too weak to implement their side of the programme. And finally, developed countries and multilateral agencies have, by and large, failed to come together to provide effective technical assistance to LDCs.

Kessie (1999) analyses five sets of S&DT provided to LDCs in the UR and comes to the conclusion that the provisions permitting longer implementation periods and the assumption of lesser obligations are the only enforceable provisions that are being applied in practice.[11] The other provisions are nothing more than loosely drafted 'best endeavour' clauses.

BOX: 4.1

STRENGTHENING SPECIAL AND DIFFERENTIAL TREATMENT

At present, the effectiveness of S&DT appears to be undermined by the fact that a good number of S&DT provisions are of non-binding nature, and also by the fact that the right to such provisions is undermined by the process of accession to the WTO, which requires LDCs to negotiate all trade rules, including all S&DT provisions, on an individual basis. In order to increase the utility and effectiveness of the different S&DT provisions, it therefore appears important that the provisions be turned into rights for LDCs and obligations for other countries. And they must be granted in an automatic manner to all LDCs that decide to become members of the multilateral trading system. It is also vital that they be actually statements of intent. Otherwise, they will not be effective and will not achieve their objectives.

Source: UNCTAD 2004a

4.2 Market Access

Improved market access for goods and services originating in LDCs is much needed for any effective integration of LDCs into the world trading system. Realising this need, many developed countries have offered zero tariff for most LDC exports.

The idea of providing zero tariff access for LDCs was conceived at UNCTAD VIII, held in Cartagena in 1992. The idea was reborn in the Singapore Ministerial of the WTO, when the then WTO Director-General made a plea to members of the WTO to consider the proposal seriously. But the response to his proposal was only lukewarm. During the preparation for the Third Ministerial in Seattle, the EU formally launched a proposal directed at "entering into a commitment to ensure duty-free market access not later than at the end of the new round of negotiations for essentially all products exported by LDCs". Following the failure of the Seattle Ministerial, the proposal for granting duty-free and/or quota-free access for 'essentially all' products was discussed in the context of various international forums and included in the UNCTAD X Bangkok Plan of Action (Inama 2002).

Finally, just two months before the Third UN Conference on LDCs(LDC-III) in May 2001, the EU made its "Everything But Arms" (EBA) proposal, which proposed duty-free treatment for all imports from LDCs except arms, and, for the time being, rice, sugar and bananas. LDCs were jubilant, in hope of better market access opportunities, but little did they know that stringent ROO requirements and NTBs could still hamper their trading prospects (Adhikari 2004).

The LDCs were jubilant with the EBA initiative, in hope of better market access opportunities, but little did they know that stringent ROO requirements and NTBs could still hamper their trading prospects.

BOX: 4.3

DISTORTIONS IN MARKET ACCESS FACILITIES

Trade restrictions imposed by rich countries are costing the world's poorest a staggering US$ 2.5 billion a year in lost foreign exchange earnings. At the same time, aid to the developing world has fallen to its lowest level since the early 1970s.

On trade, the industrialised countries have operated a policy of highway robbery masquerading as market access preferences. The US and Canada are the worst offenders. For example, Bangladesh loses US$ 8 from trade restrictions for every US$ 1 it receives in US aid.

Canada's record on market access for LDCs is downright embarrassing. Tariff peaks in excess of 15 percent affect nearly one third of LDC exports to Canada, compared to less than four percent of average LDC exports to Europe, the US, Canada and Japan. Average duties in Canada on LDC products covered by tariff peaks are 28 percent – almost six times the average Organisation for Economic Cooperation and Development (OECD) tariff.

Though the EU's EBA proposal for providing duty-free and quota-free access to LDC products represented a bold step in the right direction, intensive agribusiness lobbying resulted in key agricultural items - rice, sugar and banana - being dropped. EBA has now been mutated into "Everything But Farms".

Source: www.oxfam.org

Among the tariff barriers, the most pernicious one is tariff escalation, which discourages LDCs from advancing along the processing chain where much of the value addition takes place.

The existing preference schemes have not been effective because they are complex, temporary in nature, and contain numerous exclusions in areas of key interest to LDCs. Some have even questioned the intention of developed countries *(See Box 4.2)*. In addition, LDCs find it difficult to compete with the more advanced countries, which are also eligible for preferential treatment. In the US, for example, only around one percent of imports entering under the Generalised System of Preferences (GSP) come from LDCs (Sugisaki 1999).

Among the tariff barriers, the most pernicious one is tariff escalation, which discourages LDCs from advancing along the processing chain where much of the value addition takes place. Food and Agriculture Organisation (FAO) studies have shown that tariff escalation even in the post UR era has averaged 17 percent in the EU, the US and Japan. In many products of interest to LDCs, tariffs have been much higher (eg. 85 percent on second-stage fruit products entering the EU, 82 percent on first-stage sugar products entering Japan and 28 percent on second-stage sugar products entering the US (Cuddy 2001)). Tariff peaks are also a major problem for LDCs. The bound tariffs on certain agricultural products in the Quad countries are as follows:

Canada	:	Butter (360 percent), cheese (289 percent), eggs (236.3 percent)
EU	:	Beef (213 percent), wheat (167 percent), sheep meat (144 percent)
Japan	:	Wheat products (388.1 percent), wheat (352.7 percent), barley products (361 percent)
US	:	Sugar (244.4 percent), peanuts (173.8 percent), milk (82.6 percent) (Das 1999)

Looking at the utilisation rates of the existing preferences granted by various developed countries, one finds that LDCs still face a host of tariff barriers on exports that are supposed to be covered by the 'preferential' arrangement. According to Inama – If one considers that a major part of current LDC exports still face MFN duties inspite of the available preferences, action should be taken to eliminate the remaining obstacles to full access by expanding product coverage and increasing utilisation rates of available trade preferences (Inama 2002).

Inama further maintains that the four major factors that affect the utilisation of unilateral trade preferences are:

- Lack of security of access, due to unilateral and optional nature of preferences, which can be eliminated at the discretion of the providers.
- Insufficient product coverage, due to exclusion of certain 'sensitive' sectors from the preference scheme by the providers.[12]
- ROO that is excessively stringent in light of the industrial capacity of LDCs.

TABLE: 4.1

PRODUCTS AND MEASURES IDENTIFIED BY DEVELOPING COUNTRIES THAT AFFECT MARKET ACCESS

Product	Problems
Bananas	Health safety: Pesticide residue levels. Difficulties in complying with EU standards, lack of technical knowledge.
Strawberries, apples and pears	
Beef	High cost of meeting SPS standards.
Pork	
Sausages	
Chicken processed	
Fish	High cost of meeting and administering health regulations, and difficulties and cost of testing procedures.
Fresh flowers	Difficulties in meeting environmental and social standards.
Tomatoes, chilled	Health and safety regulations - maximum pesticide residue levels, lack of technical assistance to administer standards.
Tomato paste	
Potatoes	
Courgettes	
Cucumbers	
Organic products	High cost of complying with the EU standards and definitions.

Source: WTO 2002a

- Lack of understanding or awareness of the preferences available and the conditions attached thereto, leading to the application of MFN rates rather than preferential ones.

Market access opportunities for LDCs are not only impeded by tariff barriers, such as tariff escalations, but also by NTBs, such as the requirements to meet health standards. While standards requirements to protect human, animal and plant health are justifiable, the use of the same to protect domestic markets is against the interest of the South Asian LDCs *(See Table: 4.1)*.

4.3 Technical Assistance

It is beyond the capacity of the South Asian LDCs to implement many of the WTO agreements, particularly, Agreement on Customs Valuations, TRIPS, TBT and SPS. They also lack the capacity to develop and implement trade policies. Moreover, their capacity to participate in various WTO negotiations is also severely limited.

In response to the complexity of LDCs' trade-related problems, the Integrated Framework (IF) was inaugurated in October 1997 at the WTO High Level Meeting on 'Integrated Initiatives for Least Developed Countries' Trade Development'. The IF was launched by six multilateral institutions – International Monetary Fund (IMF), United Nations Development Programme (UNDP), the World Bank, ITC, UNCTAD and the WTO, which, with their distinct competence, could complement each other to deliver greater development dividends to LDCs in the multilateral trading system.

The IF has two objectives: (i) to 'mainstream' (integrate) trade into the national development plans such as the Poverty Reduction Strategy Papers (PRSPs) of LDCs; and (ii) to assist in the coordinated delivery of trade-related technical assistance in response to needs identified by LDCs.

The IF was revamped after a review in 2000. The revamped IF was initially implemented on a pilot basis in Cambo-

In response to the trade-related problems of the LDCs, the IF was launched in October 1997 at the WTO High Level Meeting but its implementation has been far short of expectation.

BOX: 4.3

BANGLADESH'S EXPERIENCE WITH IF

A lot of enthusiasm was generated among LDCs when the IF came about. As a direct result of that, almost 40 countries prepared their need assessment papers. Bangladesh was no exception. It prepared its need assessment paper with the active involvement of private sector, civil society and government line ministries. The financial commitment needed, as prescribed in the paper, was to the tune of US$ 300 million. After several reviews of the need assessment paper, Bangladesh requested for a round table meeting. When the round table was finally scheduled (with representatives of country's donors, core agencies, etc), the experience was bitter to say the least. The representatives of the core agencies were either non-committal in terms of outlay of funds or, even worse. Some of the delegates of the donor agencies did not even know what IF was! Ones they knew of it, they then did not know whether IF was to be a part of their existing commitments to the country or new funding was needed!

Source: www.cpd.org

In paragraph 43 of the Doha Ministerial Declaration, WTO Ministers have endorsed the IF as a viable model for the trade development of LDCs.

dia, Madagascar and Mauritania. In light of the lessons learned from the three initial pilots, the pilot scheme was extended to the second wave of 11 LDCs. In addition, implementation of follow-up activities to the IF Round Table Meetings held under the 'old IF' is on-going (in Bangladesh, Gambia, Haiti, Tanzania, and Uganda).

The criteria for assessing the pilot candidates are as follows: (i) demonstration of strong commitment by the government to integrate trade into its national development strategy such as its PRSP; (ii) the preparatory stage of a development plan such as PRSP; (iii) the preparatory stage of upcoming meetings of the World Bank Consultative Group or UNDP Round Table; and (iv) conducive operational country environment (eg. level of infrastructure, resource base of the World Bank/IMF and UNDP country offices, donor response, and the pace of domestic reform).

The implementation of the IF comprises three broad stages. First, preparatory activities, which would typically include an official request from the country to participate in the IF process, a technical review of the request, the establishment of a national IF steering committee, and, to the extent possible, the identification of a lead donor. Second, once the request has been approved, the process moves on to its diagnostic phase, resulting in the elaboration of Diagnostic Trade Integration Study (DTIS). Finally, follow-up activities start with the translation of the findings of the diagnostic phase into the elaboration and validation of an action plan, which serves as basis for trade-related technical assistance delivery.

The IF has received support from both trade and development communities, including the LDC-III and the G-8 Summit in 2001. At the Doha Ministerial held in November 2001, WTO Ministers endorsed the IF as a viable model for LDCs' trade development (paragraph 43 of the Doha Ministerial Declaration). On 15 July 2003, the Heads of the six IF agencies and their representatives issued a joint communiqué underscoring the commitment of agencies to the IF model. The support for the IF is also reflected in the form of increased contributions to the IF Trust Fund, which amounted to US$ 19.3 million as of 3 July 2003.[13] The effectiveness of the IF to address the real problems of LDCs, however, is questionable. *Box 4.3* aptly illustrates this.

ISSUES FOR COMMENTS

- Has the international community done enough to improve LDCs integration into the world economy?
- How can S&DT provisions be made more effective?
- What can the South Asian LDCs do to force developed countries to remove tariff barriers as well as NTBs on exports of their interest?
- What can be done to improve the effectiveness of the IF?

Chapter 5

A PROACTIVE AGENDA FOR SOUTH ASIAN LDCs

The measures that the South Asian LDCs need to take to benefit from the international trading system falls into two categories: domestic and international.

5.1 Measures at the Domestic Level

It is quite evident that if the South Asian LDCs want to benefit from the international trading system, the major initiatives have to come from the LDCs themselves, since international assistance only fills in around the edges. The following represents a non-exhaustive list of the domestic measures that South Asian LDCs need to undertake in this respect. Without these, no amount of market access or well-meaning technical assistance programmes can make a significant long-term difference to the performance of structurally weak South Asian LDCs.

5.1.1 Mainstream Trade with Development Strategies and Processes

Despite the fact that there is no clear linkage between trade and growth, more open economies have grown faster than closed economies over the period of last four decades or so. It has, however, been observed that inspite of the fact that many LDCs have done their utmost to open their economies, some of them could not produce beneficial results because of the lack of coherence between trade and other development policies. It is in this context that mainstreaming trade with development strategies has been advocated where mainstreaming has been defined as involving the process and methods for identifying priority areas for trade and integrating them into the overall country development plan (OECD 2001).

The World Bank/IMF induced Poverty Reduction Strategy Papers (PRSPs) and the United Nations Development Assistance Framework (UNDAF) are being used as vehicles for mainstreaming trade into comprehensive development frameworks and for ensuring more effective implementation of the IF. The South Asian LDCs need to conduct this exercise with utmost sincerity and use calibrated trade liberalisation to allow space for national industries to grow and take the desired role in national development. Box 5.1 provides an illustration of how trade can be mainstreamed with development strategies and processes.

At the domestic level, the South Asian LDCs have to find appropriate ways to mainstream trade into their development strategies and processes.

5.1.2 Promote Accountable Governance

Lack of good governance, particularly corruption in high offices and an utter disregard for transparency norms and the rule of law are major problems in most of the South Asian LDCs. Corruption is a tax on the capacity of a country to trade because it creates distortion and results in cost escalation of otherwise competitive exports, rendering them uncompetitive in the global market. A predictable business environment, for example, is a precondition for attracting FDI and enhancing trade opportunities. However, frequent changes in decisions based on the whim of politicians or pressures from vested interest groups, as well as political instability, are major impediments to the growth of trade and investment.

BOX: 5.1

MICRO-EXPORT PROJECTS: THE EXPORT-LED POVERTY REDUCTION PROGRAMME OF THE ITC

In 2002, the ITC launched the Export-Led Poverty Reduction Programme (EPRP). The goal of this programme is to integrate poor communities into international markets. The programme is innovative, with similar potential in international trade as micro-credit has had in the field of finance.

The EPRP approach rests on two man pillars: (i) the development of entrepreneurial capacity of the poor with regard to exporting; and (ii) linking that capacity to take advantage of export market opportunities. The EPRP focuses on five sectors based on an analysis of demand in regional or international markets and the employment and income-generating potential of these sectors for poor communities. The sectors are:

- Agricultural products (fresh and processed);
- Textiles (fibres and clothing);
- Animal hides, leather and leather goods;
- Light manufacturing; and
- Community-based tourism.

The viability of proposed projects in the above sectors are assessed via feasibility studies by interested national governments, and together with the ITC, which analyses international market trends, a final project blueprint and action plan is put in place. The feasibility studies address 10 key considerations:

1. Identifying winning products and growth markets;
2. Product development, product adaptation, standards and quality;
3. Selecting and organising poor producers;
4. Selecting the right product market for the producer organisation;
5. Linking producers to buyers;
6. Financing and credit;
7. Human resources development;
8. Support services;
9. Women's participation and their contribution; and
10. Environmental considerations.

These criteria are not only the building blocks of this programme, but also simultaneously serve to define and guide project benchmarks during the process. For the project to be viable, all blocks must be in place. In addition, the entire process is benchmarked, and attention is paid so that it fits the country's national development strategy and priority areas, and that it is complementary to the work of other developed partners.

The EPRP is an important initiative due to its potential in enhancing the productive capacities of poor, small-scale producers. The programme also develops networks to share best practices in order to multiply the effects of localised micro-export projects.

Source: UNCTAD 2004b

There is a positive correlation between openness and lack of corruption – more open economies are less corrupt than their closed counterparts .

South Asian LDCs have a long way to go before uprooting corruption. Their ability to counter corruption is hampered, *inter alia*, by: a) lack of credible state commitment to rule of law; b) desire of political parties' to stick to power by whatever possible means and their patronage to corrupt officials[14]; c) lack of effective legal and institutional mechanisms; d) questionable efficacy of anti-corruption agencies; and e) a high value put on wealth and social prestige.

Intuitively, one can argue that there is a positive correlation between openness and lack of corruption – more open economies are less corrupt than their closed counterparts. Not surprisingly, there is some empirical support for this view.[15] According to the Corruption Perception Index produced by Transparency International for the year 2003, some of the open developing economies like Singapore, Hong Kong, and Chile, figured among the top twenty 'least corrupt' countries (even ahead of some OECD countries), whereas relatively closed economies like Bangladesh, Nigeria, Russia and Ukraine are among the top twenty 'most corrupt' countries (Transparency International 2004). Promoting good governance through administrative reforms, reduction in discretionary authority and a sound economic system based on competition and rule of law is, therefore, a vital component of trade and economic growth. If the South Asian LDCs themselves do not have the political will to uproot corruption from their society, no amount of international support is likely to produce positive impact in the areas of trade and investment.

5.1.3 Improve Infrastructure

The removal of tariff and non-tariff barriers on trade has brought the focus now to other costs of doing business. Countries with inadequate and inefficient infrastructure have limited chance of competing at the global level. Hence, all the South Asian LDCs need to devote efforts and resources to improve transport, communication and infrastructure.

To address the poor infrastructural services and administrative inefficiencies resulting from cumbersome bureaucratic procedures, Bangladesh created specially designed export-processing zones (EPZs) and has been providing support services to industries. Improving infrastructure in designated areas can be much faster and less expensive than doing it on a larger geographical area. Thus, EPZs are worth emulating by the other South Asian LDCs.

Given the stringent health standards requirements in most developed countries and the lack of institutions such as laboratories to ensure quality standards of exportable products, the South Asian LDCs will have to allocate resources to improve infrastructure in this area too.

5.1.4 Build Capacity

Integration of the South Asian LDCs into the international trading system has been hampered by a serious lack of capacity, whether in terms of being able to trade, to participate in the trade negotiating process or implementation of the commitments made by them in multilateral forums. Capacity building is also required in the area of trade policy making. At the domestic level, the frequent transfer of staff to other ministries and departments nullifies efforts made to develop expertise of their trade officials and to promote specialisation.

While donors can help to some extent by providing resources and skills, the initiative for such capacity building exercises must come from the South Asian LDCs themselves. A number of international and bilateral donors have come forward to help build the trade capacity of LDCs. However, most of them require such technical assistance to be demand driven, i.e. demand for such technical assistance should come from the country concerned. This effectively means that unless and until the South Asian LDCs request for such assistance, it is unlikely to be provided. The South Asian LDCs that have not even been able to identify their needs and priorities are likely to be in a disadvantageous position. Therefore, the LDCs in the region should at least start these processes and tap into the international resources for building their trade capacity. It is encouraging that during its accession process, Nepal has clearly identified the areas where it needs technical assistance. Other South Asian LDCs also need to do the same.

5.1.5 Develop Human Resources

Developing skilled human resources is crucial for seizing market-opening opportunities. The emphasis placed by East Asian countries on this aspect of social development provides an outstanding example worth emulating by the South Asian LDCs. Human capital is becoming a key to success in international trade. From the perspective of South Asian LDCs, three key areas are important. First, capacities need to be developed in product innovation. Secondly, promotion of marketing skills should be stressed. These qualities are needed basically in private sector enterprises. Finally, the workforce in the public sector, especially institutions dealing with trade and commerce, needs to be reformed. Deficiencies in trade related expertise, including analytical and negotiating skills, are a result of limited staff, lack of expertise in human resource management such as hiring and training, inadequate experience, and high turnover. Except for Bangladesh, all other South Asian LDCs have fewer than five officials assigned to work on trade policy issues on a full-time basis.

There is a striking dearth of trade personnel in the South Asian LDCs, ranging from trade lawyers to trade diplomats. There are two challenges in this area. First,

The South Asian LDCs should focus on three key areas: capacities in product innovation; promotion of marketing skills in private sector enterprises; and the quality of workforce in the public sector, especially institutions dealing with trade and commerce.

there is a need to enhance the competence of personnel. Secondly, there is also a need to develop a genuine interest in trade issues, theories and debates among those who are supposed to handle trade issues (Ghimire 2001).

5.1.6 Export Diversification

High dependence on limited low-value export items, such as RMG and carpets, acts as a major stumbling block in enhancing trading opportunities for the South Asian LDCs. However, till date, very few efforts have been made by these countries to reduce their export concentration ratio or specialise in new products or services, which could be exported to the international market. In the case of Bangladesh and Nepal, the growth of RMG exports was due to the quota system under the MFA, which is likely to decline once the MFA is fully phased out. Therefore, it is necessary for the South Asian LDCs to first and foremost identify areas and products in which they have a comparative advantage.

The South Asian LDCs have made very few efforts to reduce their export concentration ratio or specialise in new products or services, which could be exported to the international market.

There are some service sectors, such as tourism (in Bhutan, Nepal and the Maldives) and hydroelectricity (in Bhutan and Nepal), in which South Asian LDCs have comparative advantage. However, these sectors cannot develop unless and until the South Asian LDCs recognise their comparative advantage and invest resources to harness the growth potential of these sectors targeting both domestic and international markets.

5.1.7 Strive to Become a Part of the Knowledge Based Economy

There is no shortcut to becoming a KBE. The governments in the South Asian LDCs will have to pursue appropriate policies to compete in the highly competitive knowledge based industries such as information technology (IT), biotechnology and pharmaceuticals. The governments in South Asian LDCs will also have to make substantial investments in education and human resource development to inculcate the habit of ‘continuous learning’, and develop a ‘learning society’ to increase the absorptive capacity of the economy.

The South Asian LDCs lag far behind developed and advanced developing countries in terms of the use of technology and knowledge base. To become KBEs, LDCs will have to constantly upgrade their technology and increase their human capital. One way of doing so would be to compel the advanced economies to transfer technology at favourable terms and conditions. However, given the fate of the mandated requirement contained in Article 66:2 of the TRIPS Agreement[16] (due to the notoriously apathetic attitude of the industrialised countries), the South Asian LDCs should promote technologies in their own countries and seek help from their regional trading partners such as India to gain access to modern technologies.

The South Asian LDCs also need to enact legislation and set up institutions to promote innovation and protect IPRs. They should provide incentives to the enterprises willing to invest in knowledge based sectors. For example, Nepal is setting up an IT park to attract private sector investment, an initiative that can be replicated by other South Asian LDCs too. However, besides attracting investment and obtaining technology, favourable foreign exchanges regulations, enhanced industry-academia and government-industry interactions are also major requirements for the South Asian LDCs to develop into KBEs.

5.1.8 Compensate the Losers

Countries are usually reluctant to take trade liberalisation measures out of fear of the huge adjustment costs that the economy will have to bear. Protectionist lobbies in many countries are more vocal and powerful than the lobbies in favour of trade liberalisation. Protectionists often make the case that possible downsides such as increase in unemployment, shutting down of businesses due to increased competition, lack of opportunity for domestic ‘infant industries’ to develop, etc and a resulting increase in poverty are strong reasons to oppose reforms. While it is true that there will be short run adjustment costs to the economy, which might accentuate poverty, the long run impact of trade liberalisation is often found to be income enhancing. What is most important is, however, a transitional compensatory and effective adjustment mechanism to overcome the problem of the adjustment burden. However, the adjustment process is glacially slow in some countries as compared to others. LDCs in particular find it impossible to make necessary adjustment without external assistance. This is however a complex issue *(See Box: 5.2)*.

According to Bhagwati (2002): "We need adjustment assistance programmes to take care of these adverse effects when they arise. In some poor countries, the ability to provide such adjustment assistance, which requires budgetary support, may be strictly circumscribed. In that case, it should be precisely the role of Bretton Woods agencies to provide grant funds to make possible a welfare-enhancing, poverty-reducing transition to free trade." However, one must also admit that adjustment process should begin at home. Unless and until potential losers from trade reforms are assured of due compensation, they are likely to oppose any reform process. Therefore, it is the duty of the state to ensure that they are provided with appropriate compensation (Adhikari 2004).

BOX: 5.2

FINANCIAL COMPENSATION

In principle, accommodating the concerns of small and poor countries through the provision of financial and technical deals can be struck in the WTO. From the perspective of larger countries, offers of incremental aid may be more feasible than offers of unreciprocated market access. The reason resides in the different political economy of aid and trade. The political pain of increasing aid is likely to be diffused, widely spread over millions of taxpayers, reducing the resistance to it. Offers of additional market access, on the other hand, would involve inflicting losses on a small group of import-competing producers, who are likely to offer stiff resistance, making it politically difficult for the government to sustain any unreciprocated market access concessions.

However, four major challenges present themselves. First, will any offer of financial assistance be truly additional to what small and poor countries would otherwise get? Second, can these offers be credible and binding? The stalemate at Cancun reflected in part developing countries' perception that previous commitments to financial assistance had not been met. Third, is there enough coordination between trade and aid/finance agencies within countries that would allow such offers to be rendered credible. The much-talked about issue of coherence in the international architecture between the WTO, IMF, and the World Bank has to be underpinned by coherence within countries between different agencies of government (see also Hoekman et al. 2003). Can the hydra-headed monster of government act consistently in a way that allows trade and finance decisions to be made coherently? And finally will the additional aid be used productively to enhance long-term development? These questions are relevant in the light of the evidence casting doubts about the effectiveness of development assistance more broadly (Easterly 2003).

Source: IMF 2004

5.1.9 Use of Safeguards

Unfettered free trade without any checks and balances can be an open invitation to disaster, as has been made clear by the East Asian and the South American crisis. It is, therefore, necessary to create space for policy manoeuvres, especially in the economically sensitive sectors. It is in this sense that safeguard arrangements are recommended. The purposes of safeguards include: the promotion of self-reliance, especially in critical areas such as food security, the protection of natural resources, and the arrest of capital flight (Ghimire 2001).

There is a possibility of retaining and utilising domestic measures selectively in a transparent manner, which does not contradict multilateral obligations (such as the WTO rules), in order to foster industries that make a strong contribution to overall export growth and competitiveness in the economy. A liberal trade regime, which provides vital access to competitive imports and is supplemented by selective and relatively moderate domestic safeguard measures is a more effective way to achieve openness and reduce poverty than a complicated system of taxes and subsidies (OECD 2001).

The purposes of safeguards include the promotion of self-reliance, especially in critical areas such as food security, the protection of natural resources, and the arrest of capital flight.

5.1.10 Improving Consultations

Mechanisms for consultation on trade policy among governments, the private sector and civil society are weak or non-existent in most of the South Asian LDCs. Involvement of the private sector and civil society is crucial in three of the following four stages in the policy cycle: a) formulation of trade policy and strategy; b) preparation of negotiating positions and strategy; c) implementation of agreements; and d) monitoring and evaluation of policies and agreements. The participation of these stakeholders is of vital significance in each of these, except in the third stage (OECD 2001).

However, this is more a matter of culture and ethos pertaining specifically to these countries and has little to do with the way global trading system functions. Hence, no amount of market access or S&DT will help the South Asian LDCs improve the process of consultation. Technical assistance provided by some agencies is specifically targeted to improve communication between government, on the one hand, and non-governmental actors, such as the private sector and CSOs on the other. However, the process should begin at home (Adhikari 2004). It is true that the private sector and CSOs are poorly funded and may not clearly understand the issues at stake. Therefore, they require some form of technical assistance and capacity building exercise so that their capacities to contribute in the process of policy dialogue are strengthened. However, the lack of capacity of the key stakeholders should not prevent the South Asian LDC governments from including them in the consultation process.

Though the private sector and CSOs are poorly funded and may not clearly understand the issues at stake, this should not prevent the South Asian LDC governments from initiating the process of consultation with the key stakeholders.

5.1.11 Build Credible Alliances

Fifty LDCs, which collectively account for 0.42 percent of the world trade, cannot produce any noticeable impact at the international forum, including the WTO, unless and until they become a part of a larger alliances (Slignac 2001). South Asian LDCs should develop issue-based alliances with the other LDCs and their counterparts in the South Asian Association for Regional Cooperation (SAARC). Their voices will not be heard, and their interest compromised, if they fail to collaborate and project a unified front.

5.2 Measures at the International Level

Having discussed how some of the well-meaning (and some not so genuine) efforts made so far at the international level to integrate LDCs into the international trading system have failed to produce noticeable impact, this section examines what the South Asian LDCs need to do at this level to make the international trading system work for them.

Given their limited resources, the South Asian LDCs need to focus on the areas of their interest at the WTO. As discussed above, they should also forge alliances with other like-minded members to make their voices heard. Among the issues presently being debated at the WTO, the South Asian LDCs should engage in the following:

5.2.1 Negotiate better Market Access

Most of the LDC products enjoy preferential tariff in developed countries. However, in many cases, value added LDC products face tariff escalations. The South Asian LDCs should lobby for binding zero tariff access in developed countries for products of their export interest.

ROO is one of the most contentious issues regarding market access. Many LDCs find it difficult to comply with the stringent ROO and fail to benefit from non-reciprocal preferences. The South Asian LDCs need to lobby with developed countries for relaxation of ROO. For example, they should lobby with the EU for permanent derogation from current ROO for products of their export interest such as RMG.

The quota system due to which Bangladesh, Nepal and the Maldives have been able to export RMG to the US market will come to an end on 31 December 2004. Exports from these countries are likely to suffer as more competitive countries like India and China increase their market share. The South Asian LDCs need to lobby with the US government to grant the relaxed ROO requirements it presently offers to African LDCs under the AGOA.

Product standards in South Asia are much lower than those in the developed world and the South Asian LDCs will have to work hard to improve the quality and standard of their products to be able to export to these countries. This notwithstanding, the protectionist use of technical regulations and health and other standards requirements by developed countries undermine the export potential of South Asian LDCs. The South Asian LDCs must lobby for full implementation of the provisions for transparency, equivalency of technical regulations and mutual recognition of conformity assessment procedures. They also need to lobby for the harmonisation of SPS measures based on science and need and through a fair international standard setting process.

5.2.2 Push for 'Mode 4' Service Liberalisation

According to Rodrik (2004), granting of temporary work visa amounting to no more than 3.0 percent of the rich countries' labour force will easily yield US$ 200 billion annually for citizens of developing countries. Among the four South Asian LDCs, Nepal and Bangladesh have the potential to export services. One area where these countries have a comparative advantage is in the temporary movement of natural persons to deliver services in the recipient country. The South Asian LDCs thus must make efforts to force the developed countries to make substantial market access commitments in 'Mode 4'. They also need to work with other LDCs and developing countries to ensure effective access of developed country markets through mutual recognition and equivalence of qualifications *(See Box: 5.3 for the most common restrictions on Mode 4)*.

South Asian LDCs should also seek more technical assistance to enhance competency in the sectors in which market access opportunities are provided.

5.2.3 Lobby for Agriculture Liberalisation

As the South Asian LDCs have comparative advantage in value added agricultural products, their participation in international negotiations in this area is important. Binding of zero tariff access to agricultural products from LDCs, deep cuts in tariff peaks and elimination of tariff escalation, removal of trade-distorting domestic support by developed countries and preventing developed countries from using SPS measures to discourage imports are important for the South Asian LDCs.

BOX: 5.3

MOST COMMON RESTRICTIONS ON MODE 4

a) Entry restrictions for certain sectors and categories of personnel;

b) Restrictions on the duration of stay of natural persons;

c) Pre-employment conditions and other related requirements;

d) Economic needs, labour market and management needs tests;

e) Quantitative restrictions by numerical quotas for persons who can enter, specifications on the proportion of total employment that can be met by foreigners, specifications on the proportion of total wages;

f) Requirements for technology and skill transfer (training local staff);

g) Discriminatory tax treatment;

h) Requirement of government approval;

i) Requirement of work permits, residency and citizenship in certain sectors;

j) Recognition of professional qualifications by the importing country; and

k) Restrictions via minimum investment requirements.

Source: South Centre 2004

5.2.4 Bargain for Technical Assistance

As discussed earlier, trade related capacity building is an important element for the successful integration of the South Asian LDCs into the multilateral trading system. The South Asian LDCs need technical assistance for human and institutional capacity building to assist them to implement the WTO rules and regulations and participate in further trade negotiations. As mentions earlier one of the goals of IF is "coordinated delivery of trade-related technical assistance to LDCs", which at present is not being realised. To make IF effective the South Asian LDCs have to identify their needs, and negotiating with relevant bilateral, multilateral and regional agencies for assistance.

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5.2.5 Lobby for Strengthening S&DT Measures

The S&DT measures have not been effective in enhancing the capacities of the

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LDCs. The main reasons for this are the "non-binding nature" of most of the commitments and a wide gap between the promise and practice of the developed countries. In this regard, the South Asian LDCs need to lobby at the WTO to convert the "non-binding" commitments to "binding" and develop in-built mechanism in each commitment to monitor their implementation. Various committees at the WTO dealing with S&DT should also be obligated to prepare reports on implementation status of S&DT commitments (Purohit 2004).

ISSUES FOR COMMENTS

- How can the South Asian LDCs build the political commitment required to implement the domestic measures to benefit from trade liberalisation?
- How can the South Asian LDCs improve public-private partnership to enhance competitiveness?
- What should the South Asian LDCs do to build institutional and human resources capacity to deal with different trade issues?
- What should the South Asian LDCs do to ensure that issues of their interest are dealt with positively at the WTO?

Chapter 6

CONCLUSION

The South Asian LDCs are different: in terms of their size, population, natural endowments, constraints and potentials. But one thing all of them have in common is the lack of sustainable competitiveness in any sector.

Inspite of the preferential market access opportunities provided by developed economies, the South Asian LDCs have to struggle to gain market entry as they have to compete not only with other LDCs but also with advanced developing countries for developed countries' markets. These countries need to identify the areas where they have a comparative advantage and enhance competitiveness in these areas.

The South Asian LDCs have performed remarkably well in international trade and have been able to substantially increase their exports in the last few decades. Some credit for this does go to the liberalisation measures adopted by these countries during the same period. It is, however, discouraging to note that these countries have a very narrow export base. Besides, it is also a fact that the growth in exports was mainly due to the quota system in RMG, preferential market access due to bilateral trade treaties or special relationships with strong neighbouring countries - and not because of increased competitiveness. Bangladesh and Nepal would have probably never entered the RMG sector if there had been no quota system. Nepal's export to India has increased mainly due to its special agreement with India. In the case of Bhutan, the increase in exports has come mainly from the export of hydroelectricity to India. However, in Bhutan too, as elsewhere in the South Asian LDCs, there is a serious lack of backward linkages of hydropower projects, and this is not going to help Bhutan enhance its competitiveness.

The phasing out of the quota system on RMG from 2005 is going to pose a major challenge to Bangladesh and Nepal and to some extent the Maldives. These countries are in no position to compete with advanced developing countries like China and India and are surely going to lose their market share to these countries. The only way out for these countries seems to be to lobby with the US government for preferential market access for a few years and utilisation of this grace period for increasing competitiveness in the RMG sector through measures such as improved backward and forward linkages. Nepal's export to India are also likely to suffer as the tariffs on imports from a third country on items such as vegetable ghee and copper wire in India are reduced due to the continuous trade liberalisation of India.

In the domestic front, Bangladesh struggles with political instability and corruption and Nepal is going through a torturous Maoist insurgency. Bhutan, though presently benefiting from its geographical and political proximity with India, needs to diversify its market. The Maldives too is restrained by a host of supply side problems. It is thus apparent that, notwithstanding the measures taken by the global community for the South Asian LDCs to benefit from international trade, the major task lies at putting their houses in order. At the same time, the South Asian LDCs need to join hands with other LDCs and developing countries to negotiate on issues of their interest at international forums, including the WTO.

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