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Economic Reform In Nepal And WTO Accession : Implications For Agricultural And Rural Development

Kym Anderson*

Bishwa Nath Tiwari **

INTRODUCTION

Nepal is a small developing country, classified by the United Nations as a least developed country, that is land-locked between its two large neighbours, India and China. The Himalayan mountains, the relatively long distance to Chinese ports, and the sparse economic activities and infrastructure in the vast area of Tibet limit Nepal's trade with China. Hence the Nepalese economy is very dependent on trade with and through India. That, together with the fact that the border between the two countries is very porous, ensures that Nepalese trade policy can not be determined independently of India's, not withstanding the transit trade agreement between Nepal and India. This is because smuggling would occur if there was much divergence between domestic prices in the two countries for any tradeable product, something which India is unwilling to tolerate. In the past Nepal's economy has been even less open and liberal than its geography and India's policies demand. But that is beginning to change, and India has also begun to open up more. Nepal's application for World Trade Organization (WTO) membership is an important part of that change. The World Trade Organization members are looking forward to welcoming Nepal as a member of the WTO *club*. As with all clubs, though, benefits and rights of membership are not free. In the case of the WTO, one member's rights or trading opportunities are other members' obligations or challenges.

This paper is not so much about the rest of the world's interest in Nepal joining the WTO but is about Nepal's benifits and costs, its rights and obeigation, its opportunities and challenges from becoming a WTO member. The study focuses particularly on how those opportunities and challlenges relate to the agricultural sector and to rural development in this

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* *Prof. Anderson is Director, the School of Economics and Centre for International Economic Studies, the University of Adelaide, South Australia 5005.*

** *Dr. Tiwari is Associate Professor, the Central Department of Economics, Tribhuvan University, Kirtipur, Kathmandu, Nepal.*

newly reforming economy. It discusses the reasons for focusing on the impacts of Nepal's WTO accession on agriculture and rural development.

NEED TO PAY SPECIAL ATTENTION TO AGRICULTURE AND RURAL DEVELOPMENT

Focusing on the impact of Nepal's WTO accession on agriculture and rural development hardly needs justifying in a poor agrarian country where all but one-seventh of the country's 22 million people live in rural areas, and where more than 40 percent of measured GDP, not to mention uncounted subsistence production, is generated by farmers. But there are three other reasons as to why a rural focus is important. One is that poverty alleviation requires focusing on where the poor are, and they are overwhelmingly in rural areas in Nepal. This is true in most late developing countries, but especially so in Nepal where rural development has been neglected in the past. Another is that economic growth will be enhanced by reducing distortions to producer incentives, and in Nepal, again as in many late developing countries, the economic policy regime is still biased against the rural sector. And a third reson to focus on rural development is that the less the pro-urban policy bias of the past is corrected, the greater will be the drift of people from the countryside to urban centres. Is is not too late for Nepal to avoid the urban pollution problems that have plagued many of Asia's more advanced developing countries, but it will only do so by making a conscious and concerted government effort to push ahead with the recently adopted Agricultural Perspective Plan. That policy reform has been adopted as a unilateral structural adjustment initiative encouraged by the Asian Development Bank (JMA and APROSC 1997). WTO accession provides an opportune occasion for binding important aspects of its agricultural and trade components so as to reduce the risk of future backsliding on that reform initiative.

NEED FOR NEPAL TO SEEKING WTO MEMBERSHIP

Nepal applied for full membership to GATT in 1989, following a dospute with India during which their bilateral trade and transit treaties lapsed. As it turned out, that dispute was short lived and new treaties were signed in 1990, so the urgency for Nepal to become a WTO member so as to be protected under GATT Article V on transit rights decreased. It, therefore, took on observer status, and did not convert that to an application to join the WTO until 1997. Since then, the Government of Nepal has been working gradually through the accession process, which is seen as part of an overall strategy of major policy reforms that begun in the early 1990s.

Benefits And Obligations Of WTO Membership

To become a WTO member is to join a *club*. Like all clubs, the WTO bestows benefits on members but there are some costs; it offers rights but with them come obligations; it provides new opportunities but also some challenges. Evidently the net benefits are overwhelmingly positive, given that more than 130 countries are members and more than 30 others have applied to join. But like all worthy clubs, there are rules to be followed, entry conditions to be met and formal accession procedures to follow. Occasionally the rules and obligations upset political sensitivities because some groups within a country may lose a privilege, e.g., protection from import competition, but almost invariably those rules boost the overall economy of each WTO member. As summarized by Rodrik (1995), the general benefits that come form the freer trade include the following:

* better allocation of national resources towards industries with the strongest comparative advantage;
* enhanced learning and newer technologies from interacting more with the rest of the world;
* greater flexibility, via trade, for dealing with shock such as natural disasters; and less wasteful rent-seeking lobbying activities by groups seeking government assistance and protection.

Four specific benefits of WTO membership are greater and more secure market access abroad for a country's exports, freedom of transit for land-locked countries, availability of a dispute resolution mechanism, and greater discipline at home in sound economic policy making.

On the first of these, WTO rules, and particularly GATT Articles I and III, ensure that a member's exporters are entitled to non-discriminatory treatment by other WTO members in terms of access to their markets. This involves two aspects. One is most favoured nation (MFN) status, or the same market access as other WTO members, to any particular member's markets for most goods. The key exceptions at present involve farm products and textiles and clothing, which are subject to separate agreements involving some quantitative import restrictions still. The orher non-discriminatory aspect is national treatment, which means that a country must treat foreign suppliers no less favourably than domestic suppliers. Secondly, Article V of the GATT provides for freedom of transit for products traded by any WTO member through the territory of any other WTO member "via the route most convenient for international transit". Thirdly, if a member feels another member is not playing by the rules, the WTO has a dispute settlement mechanism for resolving the issue. And fourthly, because WTO rules also apply to one's own policies, membership brings discipline to economic policy making at home as well. This can be a major advantage for a government keen to provide sound economic governance but subject to interest group pleading for special protectionist favours, as seem to be Nepal's coalition governments.

More specifically, Nepal will be required to tariffy its non-rariff import restrictions, bind them, which reduces the risk of policy reversals, and possibly agree to a phasing down in those bound rates over time to free up trade in services over time, again with specific commitments recorded in its schedules; to strengthen and enforce its intellectual property rights legislation; to reduce state support for or direction of other especially trading enterprises; to limit domestic support for agricultural industries; and to enforce WTO rules uniformaly and predictably. Typically, WTO members are more demanding in all these respects on acceding countries than on existing members, although perhaps less so for least developed countries such as Nepal.

All trade and trade-related policy measures must be notified to the WTO Secretariat. This adds to domestic policy transparency, making it more difficulty for interest groups to be protected without detcection. Numerous WTO agreements require a single enquiry point to be established in Kathmandu where WTO members can seek information on policies covered by those agreements, e.g., TBT, SPS, TRIPs and GATT. Nepal will also be required to inform the WTO Secretariat each year if any significant policy changes occur, to provide statistical information annually in a set format, and to undertake with the Secretariat, probalby every six years, a comprehensive review of the member's trade and trade related policies and practices.

There are other notification requirements as well. For example, all state trading enterprises must be notified to the WTO's Council on Goods, even those enterprises not engaged in international trade. Any trade restrictions imposed or changed for balance of payments reasons, or for sanitary or phytosanitary reasons, must be reported to the WTO. Techinical standards different from accepted international standards, and conformity assessment procedures, any trade related investment measures and import licencing porcedures that are not in conformity with Uruguay Round agreements, as do all subsidy programme and all GATT inconsistent voluntary export restraints, also have to be notified.

Clearly these notifications and review requirements are non-trivial, and require considerable cooperation and coordination among the relevant agencies of the various levels of government. Furthermore, an enquiry point must be created and maintained such that other WTO members can readily find up to date information about trade and trade related policies. New trade practices and porcedures must be codified into laws and regulations and recorded in an official journal to which other WTO members can have ready access.

Special And Differential Treatment For Developing And Least Developed Countries

In addition to receiving the standard WTO membership benefits such as MFN and national treatment, the right to some of the low tariff rate quota access to others' agricultural markets, the possibility of accelerated growth in access to US and European Union (EU) markets for textiles and clothing, and access to the WTO's Dispute Settlement Body, those WTO members that are developing countries, and in particular least developed economies, also receive some special, although typically temporary, treatment in the WTO. This crops up in many places in the WTO agreements (UNCTAD 1997). However, this is not a set of rights automatically given in full to an acceding country. On the contrary, each of those items must be negotiated, and in practice many developing and transition countries are finding it difficult to secure much in the way of special and differential treatment.

As a least developed country, Nepal will find it helpful to avail of the special treatment from such countries who were founding members of WTO. This treatment is included in the Uruguay Round's Agreement on Agriculture, and also in two Ministerial Decisions made at the time of signing the Marrakesh Declaration of 15 April 1994 which concluded the Uruguay Round. Since then there have been several initiatives to implement those decisions. For example, the first WTO Ministerial Conference, held in Singapore in December 1996, approved a comprehensive and integrated Plan of Action for the Least Developed Countries (LDCs), and in the same year a sub-committee on LDCs was set up within the WTO Committee on Trade and Development. That sub-committee subsequently played a significant role in organizing a high level meeting in Geneva on 27-28 October 1997, involving the trade ministers of LDCs and six intergovernmental agencies, WTO, UNCTAD, ITC, IMF, World Bank and UNDP, which endorsed a trade assistance programme designed to help LDCs to increase their ability to trade, and led to announcements of new and improved preferential access to richer-countries' markets (WTO 1997). The new Trade and Development Center website (http:// www. itd. org), created and maintained jointly by the World Bank and WTO, has a strong focus on providing plain-language information, at least in English, concerning the rights and obligations of LDC members of WTO.

NEPAL'S RECENT AND PROSPECTIVE GROWTH AND STRUCTURAL CHANGES

Recent planned developments in the Nepalese economy which include the relatively rapid economic growth of the past decade, the structural changes that have accompanied the growth and the relative decline of agriculture and the dramatically changing policy setting particularly, have affected rural areas. This review of the recent past, together with what we have learnt from standard open economy development theory and the experiences of more advanced economies, provides a basis for saying something about where the economy is heading over the next decade or so if the new policies incorporated in the Ninth Plan are implemented and sustained into the next century. That projection as to the likely path ahead under the reform policies has two purposes: it helps identify which markets will be important for Nepal to concentrate on in its market access negotiations in the future; and it allows a comparison with pre-reform policies and with what may be required in order to accede to WTO.

The ambitious economic liberalization programme introduced as part of the Eighth Five Year Plan in 1992 covered not only trade but also industrial, financial, foreign investment, exchange rate, monetary and fiscal policies (Bajracharya and Sharma 1996; Shand and Bhati 1997). Deregulation in many areas freed up markets for manufactures and financial services, and by 1993 the Nepalese rupee was made fully convertible on current account. An exception with the floating of the currency is the Indian rupee, with which a fixed rate is maintained. The 62 state owned enterprises (SOEs), many of which were loss making, were to be privatised, with the exceptions of utilities and social service agencies. Only ten had been privatised by 1995, and since then privatisation process became slower. Utilities were given flexibility to be more market oriented in their pricing policies in return for cuts in governmnet subsidies.

Realative Decline Of Agriculture

The effect of these reforms on GDP growth rates to date has been positive but small. Agriculture has continued to expand at about half the rate of the rest of the economy, 3 percent compared with 6 percent p.a. over the past decade, and falling its share from one third to one twentieth in all merchandise exports. For the 80 percent of the population living in rural areas, where the population growth rate is around 3 percent, this has meant a continuation of almost no growth in per capital income. This is disappointing in the sense that economists were projecting agriculture to be a major winner from the reforms incorporated in the Eighth Five Year Plan (Bajracharya and Sharma 1996.) The fact that clear gains are not yet to be discernible should not be surprising, however, all the evidence from other reforming countries suggests that, (a) rewards can take a decade or more to show up, and (b) they are smaller and slower in coming, the more hesitant and partial are the reforms (Williamson 1994).

One of the most striking features of economic development is the relative decline of the agricultural sector in virtually all growing economies. Also typical, particularly of densely populated countries like Nepal, is a decline in their agricultural comparative advantage as industrialization proceeds. This can be explained by modern trade and development theory that is shown to be strongly supported by comparative evidence across countries and over time, particularly for Asia with some exceptions.

In terms of employment, agriculture's overwhelmingly importance does not seem to have diminished in Nepal. Four in every five workers still depend on agriculture as their main source of income. The 100 percent difference between sectoral GDP and employment share suggests agriculture provides a relatively low return to labour.

The decline in the share of agriculture in recorded merchandise exports of Nepal has been accompanied by a steady rise in agricultural imports which have accounted for more than one eighth of merchandise imports over the past two decades and in the 1990s have often exceeded the recorded value of agricultural exports (Thapa and Rosegrant 1995). Given that Nepal is such as agrarian economy still, this often puzzles observers (Koirala, Thapa and Joshi 1995). However, country,s export strength largely reflects the continuing strong comparative advantage that Nepal has in tourist services and its recently emerged strength in exporting rugs and clothing, as is evident from their shares of exports. It is exacerbated, though, by what most observers believe is an over valuation of the Nepalese rupee relative to the Indian rupee (Sharma 1994), for it is from India that the overwhelming proportion of agricultural imports come.

Developments Within The Agricultural Sector

As of the early 1990s in Nepal field crops contributed nearly half of all agricultural output, horticultural crops one eighth, livestock nearly one third, and forestry and fishing one tenth. Production is split equally between terai and hills, with mountainous regions contributing only one twelfth.

Within agriculture there appears, from official data relatively little change in the composition of output in the past 15 years. In terms of crop area, rice uses about the same area of cultivated land as other grains, while oilseed is the largest land using cash crop. All these shares relate to a rising aggregate number of hectares under crop: in the past decade the total area of grains has risen 11 percent while the area of cash crops has risen 26 percent. Outputs of other crops, pulses, fruit and vegetables, have been growing slower than cash crops, and livestock output levels have been growing no faster than grains. This Nepalese experience contrasts markedly with rapidly expanding economies, where typically the growth of horticulture and livestock production far outpaces rates of growth in grain production.

Production And Trade Prospects Through The Ninth Plan

Speculating about the likely path ahead under current and proposed policies has two purposes: it helps identify which commodity markets and countries will be important for Nepal to concentrate on during its WTO accession negotiations and beyond; and it provides a basis for comparing with what is likely to eventuate should the government choose or be required to alter its policies further in order to accede to WTO.

Nepal's Ninth Plan (1998-2003) is as radical as the Eighth, but in a different way. The previous plan began to liberalize the economy generally, which should over time help agriculture indirectly given the past anti-agricultural bias in the government's distortions to production incentives (Sharma 1994, Bajracharya and Sharma 1996). The new plan gives an especially strong emphasis on direct initiatives to boost agriculture. Based on a comprehensive study commissioned over several years by the Asian Development Bank which provides a long term plan for the next 20 years (APROSC and JMA 1995), the medium term beginning of that for the next five years (JMA and APROSC 1997) projects a 50 percent increase in the rate of farm output growth. The basis for the expected growth is not just a continuation of deregulation/liberalization of the economy generally but also better provision of several missing or under supplied ingredients that are required for sustainable rural development: new technologies, essential modern inputs, irrigation, rural credit, and investments in public infrastructure, roads, electricity and human capital in rural areas. Nepal has a long way to go to catch up with Indian and Pakistani grain yields, but if it does so just as India follows China and other East Asian economies into export oriented industrialization, then Nepal may be well placed to help fill the latter economies' rising demand for food imports (Anderson et al. 1997). Whether it is able to do so depends also on intersectoral competition for resources within Nepal itself.

If all aspects of the Ninth Plan are implemented, and if the deregulation and opening up of the economy continues, it is likely that output growth for agriculture would go much closer to matching that of other sectors during the period of adjustment to the reforms. It is true that Nepal has a strong comparative advantage in exporting tourist services and possibly hydro-electricity to India. It is equally true that because Nepal is very densely populated it will continue for some decades to have a strong comparative advantage in light manufactures such as carpets and clothing. For both reasons, Nepal's agricultural comparative advantage is going to continue to be under pressure to decline into the next century.

However, that does not mean that the country is incapable of generating much more farm output. On the contrary, reducing under inverstments in agricultural roads and irrigation tubewells, improving rural credit and fertilizer markets, and boosting investments in agricultural research and basic rural health and education could have high pay offs in terms of greater agricultural production. That prospect would be even greater if deregulation of agricultural marketing allows an improvement in the quality of marketing services (Thapa et al. 1995). Furthermore, should the neighbouring Northern states of India continue to industrialize, Nepal may be able to exploit a local comparative advantage in supplying food and other agricultural products to those states. If the over valuation of the Nepalese rupee in terms of Indian rupee was removed, that would further strengthen that possibility. Moreover, the political resolve and support from multilateral agencies to go down the pro-agricultural liberal policy path is much there more possible now than probabley ever before. It remains to be seen whether that political resolve to implement the Ninth Plan is strong enough to overcome traditional domestic political forces from the relatively small but influential urban groups who might lose from such reform.

Whether those pro-agricultural reforms will be enough to reverse the trend since the early 1980s of agricultural imports increasingly exceeding agricultural exports is a moot point. In their assessment prior to the development of the Agricultural Perspective Plan, Thapa and Rosegrant (1995) examined Nepal's long run food trade prospects. Their base scenario projected net grain imports doubling over the ten years from 1995 to about 280 kt. per year. In another scenario they assume income growth is higher than in the base case. Even if faster agricultural productivity growth is one of the causes of that higher income, the boost of this income growth gives to domestic demand for food in this still poor country and outweighs the food supply expansion, and net grain imports by 2005 are projected in that scenario to be 370 kt. by 2005. In that case any expansion in net exports of agricultural products most likely would have to come from cash crops whose domestic demand rises much less as income rise. Gill (1997) suggests regions in the hills and mountains are most likely to be successful with high value to volume products such as saffron and *jaributi*, non-timber forest products that provide the raw materials for essential oils, resionoils, spices and herbal medicines. Gill (1997) also suggests that there is potential for horticultural products to be exported to the higher income economies of East Asia. However, many of the poorer countries of

Southeast Asia including Vietnam are hoping to succeed in the same way, so competition will be strong.

The directions of Nepal's trade are straightforward, particularly on the export side given the strong concentration of exports in woollen carpets and clothing. In 1996/97, one quarter of recorded merchandise exports went to India, another quarter to the United States, and one third to Germany, leaving just one sixth for all other countries. On the import side, more than one quarter came from India, almost another one quarter from Hong Kong, plus an extra 3 percent from China, and one eighth from Singapore, leaving only one third from all other countries. India's share may continue to fall gradually over time as Nepal diversifies the commodity composition of its trade and secures better transit rights through India via GATT Article V. With trade already being close to free between the two countries as a result of their bilateral trade treaty of April 1990, there is little scope for the share of India to expand as Nepal lowers its trade barriers on a MFN basis. That trade treaty, incidentally, will have to either conform with Article XXIV of the GATT and/or be subsumed under the South Asian Preferential Trade Area (SAPTA) and eventually the South Asian Free Trade Area (SAFTA), which themselves will have to comply with Article XXIV on preferential trading.

India's on going reforms will change its trade with Nepal, assuming the reforms continue under the new government in Delhi, over the long term, to a greater openness and deregulation in India should cause that densely populated Indian economy to grow faster and to industrialize more. That should switch its comparative advantage away from farm products, thereby providing more scope for Nepal to fill niche markets there. However, actual trade patterns will be affected by the SAFTA agreements. If SAFTA follows the example of many other regional trade agreements, trade in some agricultural products may remain restricted, thereby reducing the opportunity to fully exploit comparative advantages within the region and in particular between Nepal and northern India.

REQUIRED POLICY CHANGES FOR WTO ACCESSION

Joining the WTO invariably involves some policy changes to conform with WTO rules, as well as some commitments to provide greater access for WTO members to Nepal's markets for goods, services and financial capital in return for the benefits of WTO membership and the greater access that members may provide for the acceding country's exporters, if not immediately then in subsequent rounds of negotiations. The greater the preparedness of Nepal to poen up its markets to imports, the faster will be its accession and the greater the chances of Nepal being able to negotiate better access to markets abroad for its exports in the years ahead. In this respect first is the agricultural policy changes per se, before turning to other policy changes that will impact indirectly on agriculture.

Agricultural Policy Changes

The main areas where Nepal's agricultural policies will need to conform with WTO rules and obligations have to do with the three key items in the Agreement on Agriculture, distortions to imports, to exports and to domestic production, with the Sanitary and Phytosanitary (SPS) Agreement, and with respect to Import Licensing and State Trading.

Distortions To Imports

Nepal will be required to tariffy all its non-tariff restrictions on agricultural imports and to bind them. In principle Nepal also may be requested to lower some of those bound rates over the transition period following accession, even though least developed country founding members of WTO are not so required. Where non-tariff barriers are currently in place, it is difficult to know how high those levels are. In general, the governments of acceding countries are under pressure not to follow the example of GATT contracting parties who, in the Uruguay Round, indulged in *dirty* tariffication. In practice, however, Nepal may not have to bind its agricultural tariffs much below those of India's applied tariffs or even its bound tariff levels.

As to the main food staple, there is the possiblility that Nepal would not have to tariffy rice. GATT contracting parties who were classified as least developed by the United Nations were provided that exemption as part of the Uruguay Round Agreement on Agriculture. Whether an acceding least developed country will be granted that opportunity is something Nepal may have to negotiate as is the case with all such *concessions* provided to current WTO developing and least developed country members.

There are provisions in GATT Article XX and in the WTO's SPS Agreement allowing import restrictions where they are necessary to protect human, animal or plant life or health. However, a case would need to be made for each item so claimed. Members will scrutinise those cases carefully. Normally acceding members have to accept stricter standards than those currently applying to present WTO members, but that may not be so in the case of a least developed country such as Nepal except perhaps for products in which India has a vested interest.

Distortions to Exports

Nepal does not subsidise its agricultral exports, so the most that could be demanded by WTO members is that none be introduced in the future. Export subsidies are likely to be disallowed not least because the Cairns Group and others will be seeking in the next round of negotiations, to begin by late 1999, a ban on their use.

There are, however, few export restrictions still in place in Nepal. Exports of raw wool, hides and skins are restricted to promote domestic processing of those primary products, while exports of grains and some other foodcrops, pulses, lentils, mustard, linseed, are restricted for food *security* reasons (Ministry of Commerce1997). While such restrictions are not outlawed by WTO, lowering them would of course be in the spirit of the WTO and would increase the incentive for farmers to become more export oriented and would thereby raise rural incomes.

Some of those barriers are quantitative restrictions rather than export taxes, as with cereals pulses and oilseeds which cannot be exported without a licence from the Ministry of Agriculture. Converting them to duties would make them more GATT consistent and at the same time would raise government revenue. An exception can be made, however, in times of critical food shortages. Article XI.2 (a) allows the use of *temporary export* restrictions in such cases. The espoused purpose of the policy, to keep down the domestic price of food staples, would not be affected by changing from a quantity based instrument to a tax measure. Converting the quota to an export tax would add to policy transparency as well as to the government's tax revenue. Lowering that tax over time would of course stimulate export growth and raise rice farmers' incomes. As has been argued at length by Goletti, Minot and Berry (1997) for Vietnam and Warr (1997) for Thailand, the food security needs of the poor who have to purchase food staples could be met much less expensively by targeting them directly rather than keeping rice prices low for everyone.

Distortions To Domestic Production

Many forms of domestic support to agriculture are allowable under the so called *green box* of the WTO's Agreement on Agriculture. In Nepal's case these include such generally available public investment programmes as agricultural research and extension, rural education and health, rural infrastructure such as roads, electricity, telecommunications, irrigation, mitigation of such natural disasters as flood and typhoon, and the greening of barren land and mountains. Domestic support in the form of fertilizer subsidies which are generally available to low income and resource poor producers have also been exempted. In Nepal's case, the price of fertilizer cannot vary from the price in India by more than the transaction and transport costs anyway, for otherwiese there would be sumuggling from the lower priced country. Also allowable, in the sense that it does not get included in the Aggregate Measeure of Supoort, are domestic food aids such as subsidies to grain consumers in the hills and mountains.

SPS/Quarantine Policies

Nepal's SPS import bans will have to be able to be justified scientifically to conform to the SPS Agreement. In the case of SPS barriers faced abroad by Nepal's exporters, the SPS Agreement encourages WTO members to provide techinical assistance to least developed country members to help them meet those high SPS standards.

Import Licensing And State Trading

Those farm products subject to import licences, including seeds, breeding livestock, feedstuffs, fertilizers, farm chemicals and veterinary medicines, will ned to be administered in a more transparent and rules driven manner, as stipulated in the WTO's Agreement on Import Licensing Procedures.

As well, Nepal will be under pressure to increase policy transparency generally, including via the reform of state trading enterprises (STEs). WTO rules on state trading have not been well developed yet, but are coming under scrutiny now as numerous transition and developing countries, with their many STEs, seek WTO membership (Cottier and Mavroides 1998). Reform could take the form of privatization or at least corporatization and de monopolization of STEs to make them compete with the private sector, plus the reduction and eventual removal of all forms of discriminatory government assistance to those enterprises, including preferential access to scarce credit. Thus, WTO accession offers an opportunity for the Government to reduce the inefficiencies of STEs.

Non-Agricultural Policy Changes That Will Affect Rural Development

Non-agricultural policies are more likely to be affected by WTO accession than agricultural ones, since the GATT/WTO rules concerning them are long standing. It is true that Nepal has been steadily reforming its non-agricultural sectors and simplifying the import regime since 1992. Nonetheless, complex interventions remain, and the level of protection to the industrial sector is still much higher than for agriculture and still favours import competing activities over export ortiented ones (Sharma 1994, Shand and Bhati 1997).

In Nepal the highest tariff rates were 250 percent prior to the reforms, but that peak has since been lowered to 110 percent and most items are in the 10-20 percent range. That may not sound high in mominal terms, but they are much higher when expressed as effective rates of protection (Sharma 1994). Furthermore, together with the restrictions still in place on export products, those import barriers lower the relative price exportables to importables by probably more than one third compared with prices at the country's border.

The lingering bias in incentives towards encouraging import substitution and discouraging exports is compounded by the prevalence of state owned enterprises (SOEs) in many of the import competing industries. Those SOEs in the production sphere, together with the dominance of STEs in the provision of many marketing and distribution sphere, together with the dominance of STEs in the provision of many marketing and distribution services affecting tradable products, add substantially to the average cost, and its uncertainty, of exporting and importing.

Agriculture and rural development stand to benefit indirectly from the lowering of barriers to industrial product imports and reforms to SOEs and STEs in three important ways. One is that fewer resources will be employed in manufacturing, which could make more labour and capital available for agriculture. Another is that there would be a redistribution of resources within manufacturing, away from highly protected heavy industry to lightly protected manufacturing such as export oriented handicrafts, rugs and clothing. And thirdly, in so far as SOEs and STEs are required to compete on the same basis as private firms, their preferential access to low interest credit would disappear. That would leave a greater volume of finance available for others, including farmers. Financial market reform and greater opening up to foreign direct investment, in the spirit of the WTO agreements in financial services and trade related investment measures (TRIMs), would further increase the volume of available credit.

Nepal will be encouraged by, but is not going to be under very great pressure from, WTO members to liberalize its non-agricultural markets, given the smallness of its economy, its least developed country status, and the restraints on its trade because of being land locked by much larger and highly protectionist India and China. Whether it, nonetheless, takes this opportunity of accession to further its unilateral reforms is a choice it can make, the effects of which are discussed below hereafter.

Of particular importance to agriculture and rural development are the prospective trade arrangements concerning rugs and clothing. At present Nepal is able to export a selection of those products to the European Union and the United States provided it enforces a *voluntary export quota restraint* (VER). Thus technically this represents a barrier to Nepal's industrial exports even though it is dictated by foreigners as a substitute for them imposing a quota or tariff on their imports from Nepal. Such VERs among WTO mambers are scheduled to disappear by 2005 as part of the phase out of the Multi-Fibre Arrangement (MFA), and will be replaced by bound tariffs in the importing countries. Hence Nepal's bilateral quotas may be phased out by then too after it joins WTO. The larger the size and promised rate of growth of those quotas that Nepal can negotiate bilaterally during the WTO accession process for the phase out period to 2005, the faster will be the potential growth in those labour intensive industries in Nepal. That in turn will boost farm household incomes, either through repatriated earning from those household members who migrate to urban areas to take up clothing jobs, or through part-time work if some of those new firms establish within commuting distance in rural areas.

BEGETTING NEW OPPORTUNITIES FOR NEPAL BY JOINING WTO

In adition to the prospects for growth in rugs and clothing exports to OECD countries, the other improvements in export and import opportunities might result from acceding to WTO, perhaps, the most important of greater certainty of market access. WTO members that did not previously provide MFN access for Nepal's exports will do so, and those that have been offering MFN on a grace-and-favour basis will guarantee it permanentaly and unconditionally, provided Nepal has successfully completed all bilateral negotiations and each member approves its accession, so that GATT Article XXXV cannot be invoked by them. Secondly, being a WTO member also means Nepal will have recourse to the WTO's dispute settlement mechanism, should there ever be any doubt as to its rights of market access or tranist.

Clearly, the bilateral trade and transit agreement modifications reached with India during Nepal's WTO accession process, together with the extent to which India itself, and to a lesser extent other SAPTA members, continues to open its economy, will have an important bearing on the benefits to Nepal from joining WTO. Despite recent reforms, India's applied ad valorem import tariffs in 1997/98 still averaged 26 percent for farm products and 36 percent for manufactures, even after accounting for exemptions. And that does not include the protective effects of specific tariffs nor of the myriad quantitative restrictions India still has in place against imports from overseas (WTO 1998). So unless Nepal can prevent re-exports to India of goods it imports from overseas much better in the future than in the past, it may still find bilateral tensions arise if it tries to lower its import barriers much more than India.

For about export prospects WTO accession will do nothing specific to enhance tourism exports, except in so far as liberalization devalues the Nepalese rupee and freer investment regulations promote foreign direct investment in hotels. The same is true for prospective hydro electricity exports, which will simply involve negotiating bilateral deals with Indian utility authorities as electricity trade is not yet covered by WTO rules. In the case of rug exports, these were interrupted in the mid 1990s because of concerns in importing countries that child labour was being used in Nepal to produce those exports. Joining the WTO will not necessarily prevent such interruptions occurring again, particularly while these products are subject to VERs which can readily be negotiated downwards if the importer is unhappy with the use of such labour.

In general, there are no reductions made in MFN tariffs by current WTO members to accommodate the wishes of an acceding member at the time of its accession, that typically has to wait until the next Round of multilateral trade negotiations. However in the case of agriculture, as with textiles and clothing, for which import quotas are still being tolerated within the WTO, there is at least the theoretical possibility that an acceding country might be given some share in that preferential trade. It is a very slim possibility, and one that probably depends heavily on what Nepal gives in term of market access that is of interest to that trading partner. A consolation is that the agricultural negotiations at least will begin again by the turn of the century, and textiles and clothing in 2005. Hence as soon as Nepal has joined WTO it will have opportunities to negotiate both for shares of in quota sales and for lower tariffs on out of quota sales of products of interest to Nepalese exporters.

Even so, a general point needs to be made about Nepal's prospects for agricultural export expansion following WTO accession. For horticultural and floricultural products especially, success will depend on raising the quality and uniformity and timely delivery of the exported produt and on meeting myriad technical standards and SPS barriers to imports by overseas countries. This is especially true of products that other low wage countries can export, because many of them, as they open up too, are now seeking markets for the same types of products as Nepal is looking to export (Yamazawa 1997). Hence WTO membership does not reduce the need to search out niche markets for items unique to Nepal or at least items it is able to offer as better value for money than can other suppliers. There is an extra advantage of WTO membership, in addition to getting guaranteed MFN access to other members' markets. It is that any techinical import restrictions are subject to the WTO's Technical Barriers to Trade and SPS Agreements signed as part of the Uruguay Round, and thereby are subject to the WTO's dispute settlement mechanism. Furthermore, developing country members are eligible for expanded technical assistance in these areas, as provided for in Article 11 of the TBT Agreement and Article 9 in the SPS Agreement.

EFFECTS OF POLICY CHANGES ON AGRICULTURE AND RURAL DEVELOPMENT OF NEPAL

HMG/N's overarching economic goals are sustainable economic growth, poverty alleviation and the reduction of imbalances between regions, including between rural and urban areas. Its specific objectives for agriculture are to intensify and diversify agricultural production and create more rural infrastructure, while other more general policy objectives include job creation, development that is sustainable in terms of resources and the environment, and adequate government revenue collection to fund such things as public infrastructure investments. The expected effects of the reform programme are that Nepal is in the process of implementing, and will incidentally enable it to become a WTO member.

Expected Economic Growth, Structural Change And Trade

Each of the economic reforms required for WTO membership to proceed will boost Nepal's economic growth. This is no surprise, for WTO rules and obligations are deliberately designed to raise living standards and accelerate national and thereby global economic developmetn in a way that is sustainable. They do so in at least three ways:

- by encouraging the transfer of resources to their most productive use in each economy to maximize the gains from exploiting comparative advantage;

- by reducing policy uncertainty and instability throuth requiring commitments to reform to be legally binding, which increases savings rates and investor confidence and thereby faster rates of capital acumultion including via direct foreign investment; and

- by encouraging, through greater openness to the rest of the world, the inflow of new technologies and new marketing and other business management ideas.

The more Nepal removes distortions to producer and consumer incentives and the more it provides a transparent, open and stabel macroeconomic and sectoral policy environment, both absolutely and relative to other countries, the faster its economy will grow, being other things equal. Secondly, other non-agricultural activities also would expand with the lowering of import barriers and the asociated devaluation of the currency. The most obvious example is unskilled labour intensive manufacturing including rugs and clothing. The third fact that is often overlooked is perhaps the most important. It is that, since incomes will grow faster with the removal of distortionary policies, so too will spending by households, as well as savings; and the majority of household spending is on goods and services that are non-tradable internationally, hence output of the non-tradable part of the economy, particularly services, grows in response to this demand expansion.

Changing trade policies and hence the domestic price of exportables relate to imported products is a necessary but not suficien condition to guarantee an output and export boom, however. Equally importan in unleashing the potential of the rual sector is the provision of essential infrastructure, to lower the transactions cost of doing business there, plus investment in the people involved. The crucial imfrastructure includes rural roads, electricity, telecommunications and radio transmission, so that costs of transport, communications and information about market condition, new technologies become more affordable. Investments in these items probably will be more expensive percapita than in urban areas, but that needs to be weighed against the net benefits from expanding output faster from rural areas. Irrigation investments also need to be facilitated, even if they are mostly funded at the local level with the help of loans, which require to secure property rights over land use so land can be used as collateral with lenders. The crucial investments in people include basic schooling, for girls as much as for boys, basic health services, and agricultural research and extension. All the empirical evidences point to the social rates of return from such public investments as being very high in developing countries even when price and trade policies discriminate heavily against the rural sector, hence they are likely to be even higher as and when those policies are reformed in Nepal.

Job Creation, Poverty Alleviation And Income Distribution

With a freer and more open policy regime more jobs will be created, more poverty trodden people will be alleviated, and a more equitable income distribution will emerge over time. This is not to deny the reality of economic and social costs of adjustment to reform. Certainly some urban people who have been employed in the most protected industrial sectors may lose their current jobs as protection barriers are lowered. But there will be fewer such people the earlier the reforms take place and the more they are phased in gradually, according to a clear schedule announced at the outset and implemented on time, as is the case in making commitments under the WTO.

Three further points are worth making. First, many of those displaced by reform programmes will have no difficulty getting another job, perhaps even a better, paying one in one of the expanding industries. That is, urban employment will still grow, but possibly somewhat slower initially than otherwise because of more job opportunities becoming available in rural areas. Secondly, agriculture and unprotected light manufacturing in Nepal is much more labour intensive than protected manufacturing, and so too are many of the industries that would expand to build the necessary rural infrastructure and supply services to a faster growing, more market oriented agricultural sector. Hence the reforms will generate a net increase in the overall demand for labour not only absolutely but also per unit of output or dollar of GDP. Real wages, therefore, will be higher.

Thirdly, many of those new jobs will be in industries that are intensive in the use of unskilled labour in particular. This applies to agriculture and related agribusiness activities as much as to light manufacturing. That bias in the expanding demand for workers will raise especially the income earning prospects for the least skilled and thereby poorest people in the country, most of whom happen to reside in rural areas and so can take immediate advantage of those new opportunities. Faster poverty alleviation and a more equitable distribution of income would be outcomes of the reform that are as inevitable as they are desirable and desired, according to espoused government policy objectives.

Resource Depletion and the Environment

The question of whether free trade is associated with more or less natural resource depletion and environmental degradation is a complex one that cannot be answered unequivocally. There are many reasons to assume reform will lead to an improved outcome though. One is simply that freer trade allows a more efficient allocation of all resources in the economy, including land and other natural resources, so long as property rights over thos resources are well defined and enforceable. Another is that we know from standard economics of markets that so long as optimal environmental policies are in place and adjust to changing circumstances, removing trade distortions will necessarily improve welfare. This is so even if there is an increase in environmental damage, since the welfare loss from that damage will be less than the welfare gain from trade reform (Anderson 1992, Corden 1997).

Government Revenue

There is a natural presumption to asume that trade reform must lower government revenue. After all, about one third of Nepal's tax collections come from trade taxes. However, three considerations are worth noting. First, lowering import and export tariffs expands trade. It is conceivable that the rates of trade taxation are so high that the larger volume of trade to be taxed more than makes up for the lower rate of tax per unit. Second, reducing official trade taxes lowers the incentive for people to use otherwise more costly unofficial channels, that is, smuggling. The more goods are thereby redirected through official channels, the greater will be the collection of tax revenue. And thirdly, few restrictions on Nepal's trade, both exports and imports, have been in the form of quantitative non-tariff barriers and even bans on some products. Converting those quantitative restrictions to trade taxes necessarily raises rather than lowers government revenue. In short, the tariffication of non-tariff trade barriers and the lowering of high rates may well raise government revenue.

Furthermore, a simplifying of the structure of tariffs, in the extreme, having just one tariff rate, would reduce administrative costs and corruption at customs posts as well as reduce domestic price distortions and thereby increase the efficiency of resource use within the import competing and export sectors.

CONCLUSION

The effects of opening up Nepal's economy in line with the spirit as well as the letter of WTO law are very much in line with the government's economic and social development plans. How much and how fast the government moves down that reform road is going to be determined only to a small extent by WTO members' demands on Nepal during the accession process. However, largely it will depend on how much the government is prepared to impose in the way of short to medium term adjustment costs that inevitably accompany policy reform.

Choices Confronting

The required policy changes which are discussed in the previous sections are not necessarily all essential for WTO accession. HMG of Nepal might therefore, be tempted to make just the minimum number of additional policy changes and market access commitments as is necessary to ensure accession, and no more. Those changes include tariffying and binding all agricultural import restrictions, and offering MFN and national treatment to all WTO members, apart from the preferences given to SAFTA members. How much more will be required changes of Nepal by WTO members is still difficult to say. However, the experience of other recent and prospective acceding countries suggests accession mught not occur without also committing to significant commitments on services market access, removing at least some preferential assistance to STEs, and otherwise abiding by WTO rules including getting intellectual property rights legislation in order, publishing details of all trade and trade related policies, and notifying the WTO of any changes to those policies.

That sounds like and is therefore, a rather formidable task to offer to do more, to speed the process of accession in Nepal's direct economic interest though the political pressures and the protected interest groups may exert on governments not to reduce trade barriers and increase competition. But, against that needs it should be weighed the benefits to be derived from going beyond the minimum reforms required for membership, bearing in mind that the accession process offers a unique opportunity to use it for political cover to introduce reforms that otherwise would face formidable obstacles and to legally bind them so as to prevent backsliding in the future, and for this following choices may be considered :

Binding The Tariffs At Well Above Applied Rates

It might be argued that this would provide bargaining chips for future negotiations and leave the government with flexibility to raise protection rates in the future. However, economies much bigger than Nepal's find they are too small to have any real bargaining power with such chips; and the downside of retaining some flexibility to raise protection is that it leaves the government vulnerable to protectionist interests seizing that opportunity whether the government likes it or not.

Keeping MFN Tariffs Well Above The Lower Preferential Ones Required To Fulfil SAPTA Commitments

The argumetn here might be that Nepal can compete with limited regional competition within South Asia but could not compete with the rest of the world. The fallacy in this argument is that every economy has a comparative advantage in some products, and no economy has a comparative advantage in every product, so it is only those currently protected industries in which the country has a strong comparative disadvantage that may find it difficult to compete if SAPTA commitments were multilateralized.

Keeping Industrial Tariffs High So As Not To Slow Or Reverse The Process Of Economic Modernization

Since agricultural output would be larger if the domestic price of protected industrial goods relative to the price of farm products were to fall, the concern is that Nepal would revert to an even more agrarian economy, especially if investments in rural infrastructure were to expand. That view ignores three points: that making agriculture more profitable in those ways would boost the commercialization of agriculture and lead to lots of upstream and downstream agribusiness activities; that unskilled labour intensive manufacturing also would blossom with less competition for resources from currently protected industries; and that the greater income generated from allowing the country's comparative advantages to be exploited more would raise the demand for mayriad goods and services that are not tradable internationally because of prohibitive natural transport costs, which would encourage growth in output of non-tradables agricultural development and paves the road to industrialisation (Mellor 1995).

Keeping The Price Of Food Staples Such As Rice Low To Assist Poor Consumers

Certainly keeping the domestic price of food relative to other tradables low helps some consumers. However, the vast majority of the poor in Nepal are net sellers rather than net buyers of food, and the majority of the net buyers of food enjoy much higher incomes than farm households. The small minority of households that would suffer from a food price rise can be assisted much more cost effectively through more direct means, most obviously by providing an environment that facilitates the growth of unskilled labour intensive activities.

Lowering The Expensive Intrastructure And Human Capital Investments Per Cpita in Rural Areas

This view is based on the obvious fact that there is a greater concentration of people in urban areas. Economies of scale ensure that it is relatively cheap to provide city people with roads, electricity, a phone service, basic education and health services and the like. Greater expense does not always equate with poor value for money though. Myriad studies demonstrate that social rates of return to these investments in rural areas of developing countries are very high even when prices that farmers face are lower than in international markets, they would be even higher when farm prices are allowed to rise.

Keeping SOEs And STEs In The Hands Of The State Because They Are Able To Generate Substantial Income For The Government.

The evidence is more often to the contrary, namely that many of these enterprises, and the proportion has been rising, lose money and have to be assisted by the Ministry of Finance. Even where they are returning a profit, the question arises as to whether they could earn even greater profits in private hands. If the market believes they could, selling them would bring a higher price than the discounted value of future profits under state ownership, and at the same time would raise capital for high pay off public investments in rural infrastructure.

Instutitional Set Up

Types of institutional strengthening needed to make the most out of becoming a WTO member would demand substantial resources. They are needed to establish a WTO desk capable of responding to enquiries and coordinationg all the inputs needed to fulfil notification requirements leading up to an following accession, not to mention manning the mission in Geneva and servicing its needs from Kathmandu. Institutional memory of WTO isues then needs to be built up and maintained.

Some of the additional ingredients and suggestions that might be considered in developing good trade policy practice and effective WTO involvement can be found in Hoekman (1995), Anderson (1996) and Michalopoulos (1998) which in brief run as follow:

- adopting an economy wide, whole of government view of trade and trade related policies, rather than an ad hoc piecemeal or sectoral view of selected issue;

- understanding well the economy's long term trading interests and using that knowledge to develop a clear strategy for seeking out the highest pay off market access opportunities leading up to the next Round of multilateral trade negotiations;

- taking an active interest in, including chairing WTO committeess on, new issues of pertinence to Nepal as they emerge on the WTO's agenda;

- providing a clear career path for officials working in WTO sections of key ministries so that they have suficient incentive to invest long term in getting to understand the workings of the WTO and the global trading system more generally; and

- engaging those domestic interest groups who stand to gain from Nepal's reform and involvement in the WTO, particularly exporters, to help to convince skeptics and those who fear they might lose from more openness of its virtues.

All of these requirements demand an expansion of effort and the expending of more resources on the part of the Ministry of Commerce and relevant sections of other ministries for ample technical assistance funding to be made available. In addition to the multilateral agencies such as WTO, UNCTAD, UNDP and the World Bank, numerous bilateral aid agemcies stand ready to receive assistance request, and project funding might be sought for:

- more in-country seminars and short courses, 1-2 weeks, on specific trade policy and WTO topics where information is inadequate either in the Ministry of Commerce or in the wider community;

- training trainers for such dissemination activities, as well as building up a more comprehensive stock of knowledge and wisdom within the Minstry of Commerece and closely related ministries, which could involve offering Graduate Certificate, one semester, or Graduate Diploma coursework opportunities for the most promising officials with few years of experience; and

- developing the WTO desk within the Ministry of Commerce and the necessary contacts with other Ministries, which require a library of trade policy material from abroad, sufficient computers with Internet lines to have continuous access to the WTO's and related websites, and space and library personnel to catalogue and store reference material, including all the necessary details on Nepal's policies so as to be able to notify the WTO and respond to other members' requests for information.

Finally, analyses of the effects of prospective and potentially negotiable policy changes at home and abroad on the Nepalese economy, particularly in the context of its economic growth and structural changes, are fundamental for improving the government's understanding of its trade interests Even when interest is focused just on the agricultural sector, economywide modelling is desirable because of the many indirect effects that other sector's activities can have on the farm sector. To make effective use of the results that can be generated by such models, analytical capability needs to be developed within the Ministry of Commerce or an affiliated research centre or Tribhuvan University or unit for trade/economic policy analysis. This is an area where specialised training would definitely be required desirably in post graduate research techniques offered in Masters and preferably Ph.D. programmes, with technical assistance in the form of scholarships taking care to ensure that the trainess return to the job on completion of their studies.

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