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WTO, Industrial Policy And Nepal

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INTRODUCTION

The current World Trade Organization (WTO) provisions have limited the industrial policy tools available to WTO members. On the one hand, there is proof to demonstrate that a number of policies that distort trade are still permitted under present rules. On the other hand, the added discipline imposed by the WTO rules has reduced the flexibility of national Governments to undertake development objectives. This article examines the issues emanating from the possible revision of the WTO provisions as they relate to the pursuit of industrial and trade policy objectives by least developed countries (LDCs) in general and Nepal in particular. It also highlights some WTO-related challenges in the area of industry and trade that should be considered by the policymakers of Nepal in the light of the country's accession to the WTO in the future.

SPECIAL AND DIFFERENTIAL TREATMENT

The Uruguay Round Agreements have changed both the form and content of most of the major special and differental treatment (SDT) provisions. Many post-Uruguay Round SDT provisions are denoted with respect to transitional periods, differences in threshold levels and on mandatory offers of technical assistance to fulfill specific obligations rather than in the form of substantive exemptions from specific rules, as in the pre-Uruguay Round era. Moreover, the length of transitional periods and the level at which thresholds have been fixed, seem, for the most part, to have chosen in an ad hoc and haphazard way.

An important component of SDT has been special market access, through trade preferences. While its actual benefits have been short of the potential due to its many limitations, and while further negotiated tariff reductions on a most-favored nation (MFN) basis will continue to erode preferential trade margins, its continued importance should not be underestimated. Especially, it could be a significant boost to the exports of Nepal and other LDCs if current limitations relating to product coverage could be eliminated. The proposal to provide duty and quota-free and bound access for all exports of the LDCs would lead to an elimination of these limitations; it could considerably enhance the export prospects of Nepal after it becomes a member of the WTO.

However, this proposal could proceed a little further, that is, for the developing countries to also provide special market access to the LDCs, not

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necessarily on the same duty-and-quota-free basis as the developed countries but perhaps at up to 50 percent of the applied tariff rates of the developing countries. Still, the 'cost' to the developing countries is unlikely to be particularly burdensome. Yet, the action could be a valuable technique not only for demonstrating 'South Solidarity' but also to dilute the impression that it is only the developed countries that are always asked to shoulder the 'burden' of all special arrangements needed to enable the multilateral trading system accommodate the needs of its different categories of members.

It shold be understood that while agriculture and trade in services are pre-determined elements of the market access negotiations in the next Round, the inclusion of trade in manufactured products does not enjoy this status. However, from the LDCs' point of view, industrial tariff negotiations should also be part of the agenda of the next Round. The proposal relating to bound quota-and-duty free market access for all exports of the LDCs in the developed-country markets needs to be formally negotiated and agreed in both the agricultural and manufactured goods sectors. Moreover, the LDCs have an interest in the reduction of industrial tariff peaks and elimination of tariff escalation in the markets of advanced countries, and these can be tackled properly only if negotiations on industrial tariffs are part of the new round.

The concessions that will be offered to Nepal after it becomes a WTO member will primarily be in the form of longer phase-in periods. The country will not gain much from tariff reduction and there could be some lossess emanating from the phasing out of preferences. More important, the intensification of competition is likely to marginalize the country and increase market concentration. In order to overcome the threat of marginalization in the global economy, Nepal should undertake this task from three perspectives. One, the country should be able to pinpoint which of its existing activities need to be retained and improved, and to identify new export products in order to expand the productive base, diversify exports and to identify new export products in order to expand the productive base, diversify exports and build up a more secure and stable source of income. Two, Nepal should participate more effectively in regional trade groupings such as the South Asian Associatioin of Regional Cooperation (SAARC). And three, as will be discussed later, the country could achieve market penetration through strategic alliances with developing and industrialized country firms.

Nepal should clearly understand that although LDCs are exempt from complying with several WTO obligations but if integration with the new world trade order is a policy objective, it must regard these exemptions as of an inherently temporary nature.

IMPORT PROTECTION AND EXPORT PROMOTION

Under WTO, domestic firms could be protected from import competition through tariffs, non-tariff measures and subsidies. However, the scope for import protection continues to fall. Tariffs are declining and local content protection is on the verge of being prohibited. The scope for continued import protection uner the WTO depends on the ability of LDCs and developing countries to negotiate a provision that allows for greater discretion for protection. Import protection can be attained by challenging the fairness of competition by employing anti-ddumping and safegurard measures.

Nepal should employ selective, performance-related and time-bound protection of infant industries. Such protection should be employed strictly as a transitional provision to address market failures and promote learning and capacity-building for future competitiveness.

With regard to export promotion, direct intervention by Governments to boost exports is being increasingly restricted by the WTO rules. This leaves LDCs little room for manoeuvre in the area of export subsidies for industrial products. However, there is a wide range of alternatives that are still undertaken by Governments. These include export credit and insurance schemes below market rates, concessional tax and duty provisions and export processing zones. While some of them remain WTO-consistent, LDCs need to reassess the degree to which other policies, which discriminate in favour of particular producers, are in their national interest. This will determine the degree to which LDC members should negotiate further restrictions on export subsidies in the next Round. The focus should be on reducing fiscal and procedural constraints on exprts, trade facilitation, and generic policies to make the country more competitive such as infrastructure development and an appropriate exchange rate policy. Human capital formation, innovation policies, joint venture agreements and infrastructure are important for determining export competitiveness, and are allowed within the framework of the WTO.

TRADE RELATED INVESTMENT MEASURES

The Uruguay Round Agreements also incorporate provisions with respect to Trade-related Investment Measures (TRIMs). They commit signatory LDCs to phase out over a period of seven years (a) local content requirements (b) import restrictions related to foreign exchange earnings and (c) export obligations that they may have imposed on foreign firms. Temporary deviations from TRIMs obligations for balance of payments are permitted.

The final text of the Agreement on TRIMs merely clarifies some policies against the GATT 1947 context. It is argued by many countries that the list of illustrative TRIMs should not be extended. Moreover, the transition period should be extended, as the policies included in the illustrative list are important in fulfilling their development objectives. The seven-year transition period (to expire on January 1, 2002) is not adequate for LDC members to benefit from those policies.

As the TRIMs text now stands, there is no scope for implementing a performance requirement (based on the prevailing illustrative list) in a discriminatory fashion. If developing and LDCs believe that TRIMs on the illustrative list are needed to satisfy their other objectives and must be implemented with regard to foreign firms, this will have to be negotiated.

Extending the illustrative list will demand intense negotiations. As it currently stands, the list is very much a compromise with regard to the initial negotiating positions. Some developed countries wil try to extend the list, while developing and LDCs are likely to oppose such an initiative. It will be hard to predict the result of the negotiations since the negotiations, by definition, will focus around those performance requirements that are directly related to trade.

TRADE-RELATED ASPECTS OF INTELLECTUAL PROPERTY RIGHTS

The impact of Trade-related aspects of Intellectual Property Rights (TRIPs) on LDCs seems to be continuously debated. It involves various changes in national legislation. Some adverse effects have been estimated. These were, among others, higher prices for protected technologies and products, and restricted possibilities for diffusion through reverse engineering.

The TRIPs Agreement envisages restrictions on replication or violation of registered trademarks, patents, industrial and textile design and layout design of integrated circuits. The production of counterfeited products is prohibited. Intellectual property is overwhelmingly concentrated in developed countries. The present owners of patents, design and trademarks will be the major beneficiaries of the implementation of the TRIPs. Royalty payments for the acquisition of technology and information by LDC firms will increase. Patent holding firms may refuse to sell the technology preferring to serve the LDC market by exports.

The implementation of the TRIPs could make the transfer of technology to Nepal more expensive. Reverse engineering opportunities may be seriously reduced, while innovation and technological adaptation will become more difficult. The liberalization of the investment and technology transfer regime will increase the financial marginalization of Nepal. Hence, as mentioned elsewhere, it is very important to construct strategic alliances between firms in Nepal and firms based in developing and industrialized countries to overcome these systemic biases.

As Nepal does not possess comparative advantage in innovation, attempts to develop certain sectors within the WTO imply that they will have to depend largely on the transfer and diffusion of technology from foreign countries.

Certain changes are required in the Agreement on TRIPs as disclosed by the fact that about 70 members have not been able to fulfil the conditions of TRIPs within the prescribed deadline. Moreover, Nepal lacks the required financial, legal, institutional and human resources to carry out the provisions of the Agreement before the deadline.

The foregoing issues should be seriously considered by the policymakers and the transition period provided by the Agreement should be exploited to the maximum. It should be noted that the time to comply with this Agreement has been extended to 2016.

COMPETITION POLICY

Competition policy is a set of policies, which enhances competition among producers in markets. As markets become globalized, competition is international.

WTO plays an instrumental role in promoting competition. One of the most significant determinants of competition in markets is the free movement of goods across borders and, particularly in the service industries, the free movement of foreign direct investment (FDI). These are subject to WTO rules and discipline. One plus point of the WTO rules in this regard is that they are neutral between foreign and domestic producers. This helps to ensure that domestic and foreign producers are able to compete on equal terms.

Nepal, especially after being a WTO member, could be concerned about the restrictive business practices of the MNCs, which set up affiliates in its economy-for instance, price fixing and market allocation. Foreign investors are subject to the laws of the host economy. Hence, when the anti-competitive practices takes place in the host economy, the suitable response is the development and application of national competition laws. Thus, the policymakers in Nepal should consider developing some type of competition laws as these address the source of the problem directly.

TRADE POLICY AND STRATEGIC ALLIANCE

The broad contours of a development-oriented trade policy for Nepal could be as follows. One, the adjustment of tariffs to modest levels seems to be within easy reach of attainment. This range of tariffs could enable Nepal, to a large extent, to satisfy its industrial protection objectives while, at the same time, limiting the relative price distortions that trade restrictions can generate and thus the damage they can do to the overall economy. Two, special mention should be made of the export component of trade policy. Good export performance is not simply a desirable aim in its own right; it is also a critical means to other important ends such as deeper import liberaliszation and more robust economic growth. A successful and sustainable import liberalization programme demands successful exports. And for this to take place, Nepal needs to identify both potential exports and potential markets for exports. In parallel with this, the country could enhance its trade potential by coming up with products that bear specific features while retaining the marketing potential. By providing a country-specific dimension to a product that should otherwise be normally competitive by global standards, or by developing a more unique form of product on the basis of a special local feature, Nepal could enhance its competitive capacity.

Three, mechanisms must be developed that would endow the trade policy and strategy of Nepal with greater predictability and credibility, and hence ensure that whatever policy changes are made are perceived as being credible by private sector. Because of the large irreversible nature of investment decisions, it is very important for the trade regime to be predictable and stable if appropriate investment and export supply responses are to be elicited from private sector. In other words, an element of confidence in the government's policy for the exporter is crucial. A major risk for exporters is that government policies will change and export profitability will be adversely affected.

It should be reiterated that Nepal's exports prospects could be diminished if it continues to rely on limited products and limited markets. Export concentration is considered undesirable as: a) it renders an economy vulnerable to external shocks related with the products on which it concentrates; b) it restricts opportunities for earning adequate foreign exchange; and c) it does not foster intersectoral linkages, and thus, militates against the emergence of a nationally integrated economy.

Against these and other perspectives, the importance of developing a trade strategy which links strategically positioned firms in Nepal, its neighboring countries, and other developing countries should be addressed. For instance, a strategic alliance between a Nepalese firm producing medium count cotton yarn, a Chinese firm producing standardized apparel and a retailers conglomerate in Singapore may be necessary for the fullest exploitation of the Nepalese textile export potential. Similarly, electronic products and components seem particularly attractive. An annual growth of 10 percent in electronics imports by developed countries is not unrealistic. Possibilities should be explored of Nepasese firms of constructing appropriate strategic alliances with suitable defeloped and developing country firms for penetrating electronics markets. Limited gains also exist for exploiting gains that may occur as a consequence of reduction in the escalation of tariffs especially in the leather and paper products group.

RURAL INDUSTRIALIZATION AND SMALL AND MEDIUM ENTERPRISES

A strong agriculture-industry nexus is crucial for industrial advancement. Experiences of South-East Asia divulge that continuously improved techniques for manufacture of agricultural tools, and forward and backward linkages between agriculture and industry, were a major boost for industrial growth of these countries.

Structural change in the Nepalese economy demands a strategy of simultaneous development of agriculture and industries. Rural industries form an important part of these activities. The success of rural industrialization projects is based on various factors:

— identifying a potential enterprise and entrepreneurs and undertaking comprehensive feasibility studies;

— probing into, and adapting, technology;

— creating production systems appropriate to local conditions;

— organizing the producers into viable groups, and imparting training to them in managing an enterprise;

— securing sufficient finance from suitable credit channels;

— setting up forward and backward linkages for finished products and raw materials;

— ensuring proper and desired infrastructure support;

— incorporating technological changes to orient production to satisfy market requirements;

— imparting training or upgrading labor skills to develop products acceptable to markets; and also to guide the adoption of appropriate technologies.

The policymakers of Nepal should also recognize that the tools and timing of competitive exposure for small and medium scale enterprises need to be selective. In this respect, there are five strategies involved that shold be borne in mind by the policymakers of the country :

— support of infant industry, but for a limited period;

— promotion of activities that possess long learning benefits but generate considerable external benefits;

— rapid liberalizatioin of activities that would bring in new technologies to permit firm to utilize existing capabilities to reach competitive levels without further need for protection;

— slow liberalization of activities that need longer learning periods in order to permit firms to build up capabilites for new technologies and build up new skills for full competitiveness; and

— enhancement of supply-side measures in order to provide the necessary human capital, finance, information and extension services, while firms develop capabilites.

WTO, POVERTY AND EMPLOYMENT

Trade reforms — reducing tariffs and nontariff barriers—have had profound effects in many developing and LDCs. It has been shown that a lowering of barriers to trade seems to increase the demand for relatively abundant factors of production. In case of Asia, these have been initially unskilled and semiskilled laborers, that is, those most likely to be poor. There also exist a strong negative relationship between growth in the incidence of poverty and the rate of long-run economic growth. This is illustrated by the newly industrialized economies of South-east Asia, where the development of outward-looking, export-oriented countries led to rapid income growth and a reduction in poverty during the 1980s and 1990s.

The economic reforms required for WTO membership to move forward could boost Nepal's economic growth. This seems to be done in three ways: a) by encouraging the transfer of resources to their most productive use in each economy to optimize the gains from exploiting comparative advantage; b) by lowering policy uncertainty and instability through requiring commitments to reform to be legally binding, which raises savings rates and investor confidence and thus faster rates of capital accumulation; and c) by encouraging, through more openness to the rest of the world, the inflow of new technologies and new marketing and other business management ideas.

The more the country abolishes distortions to producer and consumer incentives and the more it provides a transparent, open and stable macroeconomic and sectoral policy environment, the faster its economy should grow, *ceteris paribus*. Moreover, the more the economy moves away from assisting import-competing industries and discriminating against actual and potential export sectors (most notably agriculture), the faster will output grow, Trade, too, will grow faster with such reform.

Also crucial in releasing the potential of the rural sector is the provision of essential infrastructure, to lower the transactions costs of diong business there, plus investment in the people involved. Infrastructure includes rural roads, electricity, telecommunications and radio transmission, so that costs of transport, communications and information become more affordable. Investments in these items probably will be more expensive per capita than in urban areas, but that needs to be measured against the net benefits from expanding output faster from rural areas. Irrigation investments also need to be facilitated. Investments in people include basic education, health services, and agricultural research and extension.

There will be more employment opportunities created, more poverty alleviated, and a more equitable income distribution will emerge over time with than without a freer and more liberal policy regime. Some urban people who have been employed in the most-protected industrial sectors may lose their jobs as protection barriers are lowered; but there will be less such prople the sooner the reform measures are implemented and the more they are phased in gradually. It should be noted that many of those displaced by reform programs will have no difficulty getting another job in one of the expanding industries. That is, urban employment will still grow, but possibly somewhat at a slower rate at the beginning than otherwise owning to more employment opportunities becoming available in rural areas.

The country could build up non-agricultural employment by associating agro-enterprises and available human resources with industrial occupation in order to develop rural-urban linkages. It is also important to develop micro-enterprises and informal sector at the grassroots level, generate intermediate goods as their forwarded linkages, and link them to medium and large-scale industries with comparative advantages. If such a policy is framed, it could be possible to attain the defined objective of poverty alleviation to some extent, and create multiple effects in the economy by developing areas of comparative advantage.

CONCLUSION

Experiences of developing and LDCs who are already members of the WTO have revealed the following:

— The Uruguay Round and its implementation process did little to improve market access for their exports of goods and services.

— These countries were of the view that WTO rules and regulations were unbalanced in many crucial development-related areas such as the protection of IPRs, and the use of industrial subsidies, while the SDT, which the Uruguay Round bestowed upon them, was insufficient.

— Inadequate human and financial services and weak institutional capacities limited the ability of many developing countries and all LDCs to exploit the opportunities open to them under the WTO system, especially with regard to its dispute settlement mechanism, together with its inability to comply fully with their multilateral obligations.

Nepal, thus, has to grapple and understand these issues, and after it becomes a member, it should proactively participate in the various Rounds with the goal of further integrating itself into the global economy.

The tools of industrial policy must be employed very carefully, or else they could generate large costs of their own. A major pressing policy problem in Nepal is less the establishment of new industries than of enhancing the competitiveness of existing inefficient and technologically stagnant industires. It should, therefore, address the removal of an accretion of many irrational and inefficient interventions that many governments have undertaken in the past. Address industrial reform and restructuring need, thus, to address various determinants of capability development: the incentive framework, the supply of human capital, the supporting technology infrastructure, finance for technological activity, and access to foreign technologies.

In today's competitive environment Nepal should attermpt to boost its competitiveness by opting industries and products with the potential for high growth and high value added. There is a need to identify new exportable products and new markets if the country wants to survive in the long run. Immediate steps should be launched by the policymakers in this regard.

The WTO rules are ownership-neutral. Excluding the General Agreement on Trade in services and TRIPS, where a national treatment standard is applicable, policies such a subsidies and local content protection do not distinguish between foreign affiliates and domestic enterprise. The important point is the 'trade effect' of the instrument. This implies that if Nepal wants to apply a particular policy to foreign-owned firms, it must first find a provision in the Agreement that permits the use of the policy. Then, it can apply it to a foreign firm as long as there is no 'trade effect'.

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