# Overview

In 1998, Mahbub ul Haq had eloquently argued that globalization was no longer an option. Developing countries only had two choices: learn to manage the process, or drown in the global cross currents. The 2009 Report on *Human Development in South Asia* comes a little over a decade after this insight—a decade which has seen South Asia choose to undertake extensive steps to swim, rather than sink, in the global cross currents.

The region has undergone tremendous liberalization in most sectors of its economy and the impact of this integration with global markets is now both widespread and deeply felt. However, the link between trade, growth and human development has been neither direct, nor consistent across South Asian economies and sectors.

The central thesis of this report is that the post-2001 Doha Round of trade negotiations has largely been a story of unfulfilled promises for the countries of South Asia. There is no denying the fact that international trade can bring many benefits to developing countries and the Doha Round was supposed to help realize these benefits by explicitly factoring in the developmental needs of developing countries.

However, for the developing countries the potential benefits from trade are still largely unrealized. The key points of contention between developed and developing countries remain unresolved from the pre-Doha Round period. Developing countries still suffer from the unfair agricultural subsidies of developed countries; the removal of industrial tariffs, imposition of intellectual and property rights, and environmental and health-related standards hurt the domestic manufacturing sector. Also the gains from services liberalization are limited by restrictions on the movement of people.

This Report on *Trade and Human Development* follows the 2001 Report on *Globalization and Human Development* by looking critically at the nature of the trade liberalization process, the impact of this on the economy and the people of South Asia and the potential for gains by better policies, institutions and regional cooperation. Several issues related to trade liberalization are discussed with a particular focus on the link between trade, growth and human development; the contentious issues of agricultural trade; the reasons for limited gains from manufacturing trade; and the unfulfilled promise of the services trade. The benefits and constraints of intra-regional trade within South Asia are explored. All these are discussed within the broader objective of deriving positive impact on people in terms of employment, poverty reduction and women's empowerment.

**Although trade theories suggest that international trade could be useful for developing countries, the reality on the ground does not bear this out.**

Classical trade theories generally state that international trade is beneficial for all countries and leads to faster growth by taking advantage of different factor endowments to increase allocative efficiency, improve capacity utilization, achieve economies of scale in production, and make a wider variety of products available for consumption.

However, classical trade theories fail to explain the post-World War II period of trade, which was characterized by high intra-industry trade between countries with similar endowments. They also fail to address the issues of the large costs of adjustment that follow trade liberalization and the distribution of the gains from trade. As such, opinions on whether trade always benefits a country remain divided. The opinions on the impact of trade liberalization on poverty are even more divided. In general, the multilateral trading system has failed to reduce the vulnerability of the poor in developing countries.

The most direct impact of trade liberalization on the poor takes place through two channels: prices and employment. The post-liberalization era in South Asia has been characterized by higher prices, loss of employment opportunities in sectors that absorb unskilled and low-skilled labour, and an increase in the volatility of both prices and employment. As such, the welfare gains promised under the Uruguay Round to some key sectors that were of primary importance to the poor remain unrealized.

The implementation of the World Trade Organization's (WTO) Agreement on Agriculture (AOA) was supposed to benefit developing countries by reducing distortions in and opening up the global agriculture market. However, developed countries still continue to heavily subsidize their agriculture sector, thus hurting farmers in poor countries by leading to lower world prices for agricultural commodities and threatening the security of their livelihoods. The WTO rules for Non-Agricultural Market Access (NAMA) make it almost impossible for governments to give protection to small and medium enterprises (SMEs), a sector that tends to employ more workers per unit of output than large firms. Finally, negotiations in services trade liberalization continue to push for the free movement of capital, while restricting the free movement of people. South Asian countries have a large surplus of unskilled and semi-skilled labour and stand to reap tremendous benefits if barriers to migration are relaxed.

**From gender perspective, trade liberalization has opened up employment opportunities for women. But the terms and conditions of women's participation have not been an unmixed blessing.**

Trade liberation and associated domestic reforms are exacerbating problems for women farmers. Many women farmers, as well as small farmers, are finding it difficult to cope with the dual problems of increasing production costs and low domestic prices resulting from increased competition from developed-country subsidized imports. Commercialization of agriculture is adding to the problem of female employment in rural economies. Although contract farming has opened up new employment opportunity for female casual employment, the employment conditions, including low wages, in these farms are in general exploitative.

Interestingly, trade liberalization has seen the feminization of the workforce in several export-oriented industries. The tourism, healthcare and textiles and garments sectors employ a large number of women. Many women from South Asia are also employed as migrant workers in the domestic services sector. However, the net impact on women remains uncertain for a number of reasons. First, women are increasingly hired as casual or temporary workers in peripheral, insecure jobs and paid smaller wages than men. Second, most women engaged in agricultural activities in rural areas do not own their land and so do not have access to institutional credit and support. Consequently, they are largely unable to take advantage of export opportunities and instead, are hit hard by drop in domestic prices because of cheap, subsidized imports and disappearance of common property resources that follows the commercialization and mechanization of agriculture in villages.

The IT and IT-enabled services sector are generating employment for women. The proportion of women working in data processing and call centres in India varies between 40 and 70 per cent. But employment opportunity in this sector is crucially dependent on higher levels of education and skill that only a very small percentage of women in South Asia possess.

**Liberalization of South Asia's agriculture sector has been particularly harmful for most of the poor in South Asia, not because trade *per se* has anything to do with it, but because the policies and practices of some governments and multilateral trading institutions have not been sensitive to the needs and concerns of the developing countries' poor.**

While the trade policies of South Asian countries have largely focused on protecting and strengthening manufacturing at the expense of agriculture, the latter is unarguably the most important sector in the region. Although agriculture's contribution to the gross domestic product (GDP) has declined from 41 per cent in 1965 to 19 per cent in 2005, 55 per cent of the labour force continues to depend on it.

In South Asia, the state of agricultural trade has deteriorated after the 1995 trade reform. During this period, both the growth rate and the share of agricultural exports have been lower than the pre-reform period. This poor outcome of the trade reform on people's lives has not been properly appreciated by national or global policymakers. The incidence of rural poverty and hunger increased after 1995. The absolute number of rural poor in the region increased from 385 million to 407 million between 1993 and 2002.

The trade reforms in agriculture have affected poverty through several channels in South Asia. First, labour-intensive crop production has been replaced by capital-intensive techniques. Second, cheap imports have been introduced into the market. Third, the shift of production from food crops to cash crops and the use of food crops for bio-fuels has increased the exposure of developing countries to volatility in international market prices and led to a deterioration of the food security of millions of poor people. As a consequence, the structural transformation that followed liberalization in agriculture has led to poor and unpredictable outcomes for millions of South Asians. These outcomes are unlikely to improve much in the absence of factors that can help make farmers more competitive, such as institutional reforms at the national and international level, investment in research and development (R&D), land reforms and the provision of extension services and adequate credit.

From the very beginning, agriculture has been an extremely contentious issue in global trade talks. Although agricultural trade accounts for less than one-tenth of the world's merchandize trade, it has been responsible for the failure of the Doha negotiations. The main concerns are over the continued support provided by developed countries to their agricultural sector. Overall, the Organization for Economic Cooperation and Development (OECD) countries provide almost US$1 billion a day in support to their farmers. This enables the farmers to produce more than their domestic food requirement and thus the developed countries dump the excess products in international markets at prices that hurt farmers in developing countries. Furthermore, developed countries have fought hard to limit the use of provisions such as the Special Safeguard Mechanism (SSM) and Special Products (SPs) that help address the food security and other concerns of developing countries. These concerns will have to be addressed to improve the positive impact of agricultural trade liberalization on the poor.

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**Despite the numerous benefits of manufacturing sector in terms of growth, employment and poverty reduction, South Asia as a whole has not been able to develop this sector as well as East Asia and the Pacific.**

Industrialization is often considered to be the key to rapid economic growth. This is because trade in manufactured goods does not expose economies to as many shocks as trade in agriculture, primarily because the prices of manufactured goods are not as volatile as those of commodities. A unique feature of South Asia's structural transformation is that the declining share of agriculture in total output has not been met by a rise in the share of manufacturing output. From 1980 to 2007, the share of the manufacturing sector has remained stagnant between 16 to 17 per cent.

Liberalization of trade in manufacturing has largely followed the same trajectory as trade in agriculture. In the 1970s, most South Asian countries followed import substitution industrialization policies. The 1980s saw efforts at manufacturing trade liberalization followed by currency devaluations. The structural adjustment programmes of the late 1980s and the establishment of the WTO in the mid-1990s further strengthened these efforts. Trade in manufactured goods deteriorated in the 1995-2000 period, largely because of the East Asian financial crisis and related problems but picked up again during 2000-07. However, the post-WTO era has seen the deterioration of net manufacturing exports of all South Asian countries, except Bangladesh, with growth rates of manufactured imports exceeding that of exports.

A number of reasons explain this phenomenon. The bulk of South Asia's manufactured exports lack both sophistication and diversification. Around 85 per cent of South Asian merchandise exports consist of resource-based or labour-intensive goods. Food products and textiles dominate the sector. The textile and clothing sector is the second largest employer in the region after agriculture but this sector is still protected by developed countries by tariffs and non-tariff barriers. The SMEs, which provide 80 per cent of total industrial employment in almost all South Asian countries, face problems such as lack of access to credit, complicated labour laws, and bad law and order situation. There is a need for public sector programmes to address the problems that SMEs face but WTO NAMA negotiations restrict the space that policymakers have to design such programmes. The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) both constrains the growth of important industries such as pharmaceuticals, and has a negative impact on public healthcare by increasing the prices of life-saving drugs. Apart from the problems that arise from WTO agreements, there are several domestic constraints to growth in manufacturing trade. Overall productivity is limited by the lack of an adequately skilled workforce, repeated energy crises, infrastructural bottlenecks and unfavourable investment and business climates.

**Developed countries have continued to push developing countries to open up sectors such as finance and even to liberalize public services such as water provision but have failed to reciprocate with a relaxation of the rules that govern the migration of people.**

In many ways, the services sector is the most dynamic component of the South Asian economy today and in 2008 it contributed to 53.2 per cent of the GDP of the region. However, trade in services is a relatively recent phenomenon. It was first included in the multilateral trading system when the General Agreement on Trade in Services (GATS) was initiated at the conclusion of the Uruguay Round in 1995 and the first round of services negotiations began in 2000.

South Asia has opened up its services sector to foreign participation quite rapidly in the past decade but the process has been impeded by a number of challenges. First, trade and commerce ministries in the region are often ill equipped to perform a thorough analysis of sectoral competitiveness and requirements. Second, the growth of services depends on factors such as infrastructure, a highly skilled workforce, and strong legal and regulatory frameworks. Except India, all of these are lacking in other countries of South Asia.

Certain segments within the sector are particularly important for South Asian countries. ICT and ICT-enabled services are allowing the reorganization of production globally so as to take advantage of differential costs and attractive conditions in various locations. They span the value chain and help bridge the social divide by creating employment for people with various levels of skills. Tourism is one of the biggest generators of foreign exchange for countries such as the Maldives and Nepal. Unlike many other service industries such as banking and telecom, it helps to absorb large numbers of unskilled and semi-skilled workers. Within this industry, South Asian countries have attempted to develop niche markets such as medical tourism and ecotourism. Finally, and perhaps most importantly, the movement of people, i.e., migration, plays a significant role in the economies of many South Asian countries. On the household level, remittances increase the incomes of families, allowing them to spend more on education, health, nutrition and housing. On the national level, remittances provide much-needed foreign reserves and contribute to exchange rate and macroeconomic stability. They also help reduce dependence on foreign direct investment, official development assistance and loans. Moreover, migration has helped empower women both directly, by providing them with employment opportunities abroad and indirectly, by leaving them behind as the head of household after the migration of men, thus increasing their authority in household decision making.

However, growth in service industries has come with its own set of concerns. The growth of ICT and ICT-enabled services is largely concentrated in urban areas, further exacerbating the rural-urban digital divide. Unfettered mass tourism puts a strain on the environment and often leads to an increase in prices, hurting the poor. For example, as patients from developed countries can usually afford to pay more than locals, medical tourism often pushes the price of quality healthcare services higher. Finally, the GATS has been largely unsuccessful at liberalizing the movement of people, particularly the movement of unskilled and semi-skilled labour.

**To overcome the obstacles faced by developing countries in international trade rules, trade within a regional group has become important. But in South Asia intra-regional trade has remained very low.**

While South Asian countries have clearly articulated an outward-looking, export-driven trade policy, intra-regional trade has continued to take a back seat in trade policymaking. Extra-regional trade accounts for 93.7 per cent of the region's total exports and 96.1 per cent of total imports. During 2006-2008 period, intra-regional trade grew but extra-regional trade grew at a faster rate.

Studies indicate that more than 55 per cent of South Asia's intra-regional trade potential remains untapped. The region also lacks integrated production networks based on individual country comparative advantages. The expansion of intra-regional trade could help South Asia meet important needs, such as its unmet demand for energy (by exporting hydropower from Nepal and Bhutan to India and possibly onwards to Bangladesh and Pakistan as well) and promote trade in services such as tourism.

In an effort to enhance intra-regional trade, South Asian countries signed the South Asian Free Trade Agreement (SAFTA) in 2004. It started operations in 2006 and will be fully operational in 2016, after several rounds of tariff reductions. Thus far, regional trade in South Asia has been more influenced by bilateral agreements such as the India-Sri Lanka Free Trade Agreement (FTA) and the India-Nepal Bilateral Trade Agreement. South Asian and South-East Asian countries are also part of a regional cooperation initiative known as the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC).

However, intra-regional trade continues to be limited by a number of factors: political mistrust and hostilities make it difficult to adopt trade-related agreements; similar export baskets encourage South Asian countries to adopt similar tariff structures to protect domestic industries, limiting trade complementarity between them; port-specific restrictions, limited vehicle access and inefficient rail links limit transit connectivity, increase transaction costs and block imports; and agreements such as SAFTA cover limited products and include extensive negative lists, thus restricting meaningful trade liberalization.

**Integration with the world economy will only benefit South Asia if its policymakers design strategic, forward-looking policies, undertake liberalization based on an analysis of sectoral competencies and invest in institutions, infrastructure and human resource development.**

To help policymakers boost extra and intra-regional trade in the agricultural, manufacturing and services sectors in a manner that enhances economic growth and human development, the Report comes up with the following key messages:

- The WTO implicitly works on the principle of static comparative advantage and assumes that countries should specialize in their respective areas of comparative advantage, as dictated by their factor and technology endowments. However, a high percentage of the region's exports consist of low-value agricultural and merchandise items that are price-sensitive and susceptible to exchange rate fluctuations. As such, premature trade liberalization can seriously affect the industrialization process of South Asia. Policymakers need to develop dynamic comparative advantage by encouraging the movement up the value chain, to higher value addition products.

- The global financial crisis has led to a major contraction of world demand, tightening up of credit lines and the fear of adoption of protectionist policies by developed countries. As South Asian countries have moved to export-led trade models, their dependence on developed country markets has increased. While the level of dependence is quite low for India and Pakistan and moderate for Nepal, it is quite high for Bangladesh and Sri Lanka. The greater depth of the crisis in developed countries necessitates the need to check the dependence of South Asian countries on countries such as the EU, US and Japan, and to foster other trade links, both intra-regionally and with areas such as the Middle East and South-East Asia.
- South Asia needs to be wary of signing North-South Regional Trade Agreements (RTAs) in an effort to expand trade further as these agreements tend to include WTO-plus requirements such as stricter labour, environmental and health standards. South-South agreements may be more viable options, particularly with the growing income levels of some developing countries.
- The development of production networks within South Asia is largely limited by high logistic and transaction costs. Apart from reducing intra-regional tariff rates, South Asian countries must improve trade-related infrastructure such as land customs stations, roads, railway links, warehouses and banking and telecommunication related facilities.
- Public investment in South Asia in social sectors such as health, education and nutrition remain amongst the lowest in the world and this limits the productive capacity of its people. To encourage the exports of more skill-intensive, high-value products and services, governments must increase public spending on the social sector.

To conclude, inequities continue to persist in the global trading system to the detriment of developing countries' interests.