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Trade Policies in South Asia: An Overview

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ACRONYMS AND ABBREVIATIONS

AD	Anti-Dumping
ADB	Asian Development Bank
AIC	Agricultural Inputs Corporation
AIT	Advance Income Taxes
AGOA	Africa Growth and Opportunity Act
AMS	Aggregate Measure of Support
AoA	Agreement on Agriculture
APEDA	Agriculture and Processed Foods Export
ASEAN	Association of South East Asian Nations
ATC	Agreement on Textile and Clothing
AV	Assessable Value
BADC	Bangladesh Agricultural Development
BCIC	Bangladesh Chemical Industries Corporation
BIS	Bureau of Indian Standards
BOP	Balance of Payment
CACM	Central American Common Market
CAM	Customs Modernization Program
CBERR	Caribbean Basin Economic Recovery Program
CBTPA	Caribbean Basin Trade Promotion Act
CCIE	Chief Controller of Imports and Exports
CCS	Cash Compensatory Support
CD	Customs Duty
CEC	Council for Economic Cooperation
CIF	Cost, Insurance and Freight
CMAI	Clothing Manufacturers' Association Fund
CMT	Cost of Manufacturing + Cost of Transport –
CPI	Consumer Price Index
CWE	Cooperative Wholesale Establishment
DAP	Diammonium Phosphate
DEPB	Duty Exemption Passbook
DGCI &	Directorate General of Commercial
DGFT	Directorate General of Foreign Trade
DRI	Department of Revenue Intelligence
DTRE	Duty and Tax Remission for Exports
EBA	Everything But-Arms
NAFTA	North American Free Trade Area
NFC	National Fertilizer Corporation
NTB	Non-Tariff Barriers
NTC	National textile Corporation
OPT	Outward-Processing Trade
PASSC	Pakistan Agricultural Storage and Services
POL	Petroleum, Oil and Lubricants
EC	European Commission
ELVIS	Electronic Visa Information System
EOUs	Export Only Units
EPCG	Export Promotion Capital Goods
EPO	Export Policy Order
EPZ	Export Processing Zone
ERP	Effective Rate of Protection
EU	European Union
FCI	Food Corporation of India
FDI	Foreign Direct Investment
FID	Fertilizer Import Department
FOB	Freight on Board
FTZ	Free Trade Zone
GATT	General Agreement on Tariff and Trade
GDP	Gross Domestic Product
GOI	Government of India
GSP	Generalized System of Preferences
HS	Harmonised Systems Code
HYO	Hank-Yarn Obligation
IDSC	Infrastructure Development Surcharge
IGEG	Inter-Governmental Expert Group
IMF	International Monetary Fund
IPO	Import Policy Order
IRRI	International Rice Research Institute
JIT	Just – in - Time
LCA	Letter of Credit Authorization
LDC	Less Developed Country
LLDC	Least Developed Countries
LPG	Liquified Petroleum Gas
MERC	Latin American Customs Union
MFA	Multifibre Arrangement
MFN	Most Favoured Nation
MINF	Ministry of Food, Agriculture and
MMTC	Metals and Minerals Trading
MOP	Muriate of Potass
SAPT	South Asian Preferential Trade
SD	Non-supplementary Duty
SEZ	Special Economic Zone
SPS	Sanitary and Phyto-Sanitary
SRO	Statutory Regulatory Order
SSI	Small Scale Industry
STE	State Trading Enterprises

POY	Polyester Partially Oriented Yarns
PSU	Public Sector Units
PTFY	Polyester Texturized Filament Yarn
QR	Quantitative Restrictions
REER	Real Effective Exchange Rate
RMG	Ready Made Garments
ROO	Rules-of-Origin
ROW	Rest of the World
SAARC	South Asian Association for Regional
Sadd	Special Additional Duty
SAFTA	South Asian Free Trade Area
SAIL	Steel Authority of India
T & C	Textile and Clothing
TBT	Technical Barriers to Trade
TCB	Trading Corporation of Bangladesh
TPR	Trade Policy Review
TRIMs	Trade Related Investment Measures
TRQ	Tariff Rate Quotas
TUFS	Technological Upgradation Fund
TV	Tariff Values
UR	Uruguay Round
VAT	Value Added Tax
WTO	World Trade Organization

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Introduction

Agriculture, livestock, fisheries and related rural activities[1] between them still account for by the far the largest part of the workforces of the South Asian countries and major shares of GDP even though those shares have been declining with economic growth. In 2000, agriculture, livestock and fisheries together accounted for 25 percent of the South Asian countries' combined GDP, and employed over 300 million people, equivalent to about 60 percent of their combined workforce. The share of agriculture in the economies of the South Asian countries is inversely but not perfectly correlated with per capita income. In 2000, it accounted for 40.3 percent of GDP in Nepal and about 75 percent of employment (per capita GDP $US 239) versus 19.5 percent of GDP and 36 percent of employment in Sri Lanka (per capita GDP $US $840), for example, but about the same share of GDP in Bangladesh (24.6%) as in India (24.9%) and Pakistan (26.3%) even though Bangladesh's per capita GDP was about 20% lower than per capita GDP in India and Pakistan.

As with everything else in South Asia, it is important to keep in mind that India has by far the largest agricultural economy. In 2000 India accounted for 77.2 percent of South Asian agricultural, livestock and fisheries GDP. The shares of Pakistan, Bangladesh, Sri Lanka and Nepal, were only 11.0, 7.9, 2.2, and 1.5 percent respectively. Sri Lanka's and Nepal's agricultural economies are smaller than the agricultural economies of most of the Indian states; Maldives' and Bhutan's are smaller than the corresponding economies of relatively small areas within states and provinces of the other countries.

The nature and evolution of the trade and trade-related policies that affect these countries' agricultural sectors have been fairly thoroughly documented and analyzed up to about 1997, but less is known about what has happened since. This chapter deals first with the pre-1997 period and then gives an account of the principal developments since 1997.

Trade Policies and Agriculture up to 1997

The pre-reform period: trade controls with anti-agriculture discrimination. The interventionist and highly protectionist policies followed for many years in the South Asian countries were also applied to their agricultural, livestock and fisheries sectors, but the way these policies were applied discriminated heavily against these sectors for many well documented reasons, including the extent of manufacturing protection, the resulting exchange rate overvaluation, and direct controls and/or taxation of agricultural exports.[2] Despite this discrimination green revolution technologies were introduced and spread rapidly with the support of large scale public and private investment in irrigation. As a result, during the 1970s and 1980s domestic grain prices fell very substantially in real terms, and with the notable exception of Sri Lanka, the subcontinent became a low-cost grain producer by world standards. For example, the real price of wheat in India declined by more than half between 1965 and

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[1] In this chapter the term "agriculture" is sometimes used broadly to refer to all these activities i.e. agriculture, livestock and fisheries. When this broad use is intended rather than the narrower meaning of agriculture as crop farming, should be clear from the context. The chapter also discusses food processing, in part because processed foods are covered by the WTO Agreement on Agriculture. Food processing includes agro-industries such as rice milling, sugar cane milling, and cotton ginning which are closely integrated with farming and needed for the farm products to be internationally tradable, but also processing industries which are parts of the urban manufacturing sectors and which may have little direct connection with domestic farming activities in some cases.

[2] Some of the evidence on anti-agricultural discrimination during this period is summarized in Blarel, Pursell and Valdes (1999), Chapter 3.

1991 (Fig 1.2). There were similar long term declines in the real prices of rice and other food grains in Pakistan, Bangladesh and Nepal during the same period.

Despite differences between countries, these policies had some broad common effects on the agricultural and livestock sectors of the South Asian countries.

- Exchange rate overvaluation hurt both established and potential primary export industries. Export controls, export taxes, and parastatal export monopolies worsened these effects. One very large potential export product was common rice in India, where for more than 30 years the domestic price was suppressed by an export ban.

- Except for some (but not all) exportables and a few importables, markets for most agricultural and livestock products were largely insulated from world markets, and there were few direct linkages between world prices and domestic prices. The extent of this insulation was most marked in India and varied from product to product.

- Depending on the degree of insulation, implicit nominal protection for most primary commodities (i.e. measured differences between actual domestic prices and world prices) had little or no relation to import tariff rates. Domestic prices were determined by internal supply and demand, support price policies, export policies, and input and other subsidies. Measured nominal protection mainly varied with the ups and downs of world commodity prices and the individual countries' exchange rates. In India, Pakistan, Bangladesh, and Nepal, during this period the implicit protection rates of the principal food grains were generally low or negative, except in a few years when world prices were exceptionally low (e.g. during 1985-88).

- There were some heavily protected import-substitution primary industries (e.g. oilseeds and edible oils in India, Pakistan, and Bangladesh, rubber in India, sugar in India and Pakistan, milk and dairy products in India), but because of the overwhelming importance of foodgrain production, empirical studies in these countries all found that the weighted average implicit nominal protection rates of their agricultural and livestock sectors (taken as a whole) were negative.

- In various ways Sri Lanka was different from the other South Asian countries. As discussed in Chapters 1 and 2 in Volume I, general trade liberalization started much earlier, in 1978, than in the other South Asian countries. During its pre-liberalization period, its principal food grain, rice, was heavily protected, but the overall impact of this was outweighed by export controls and taxes applied to its major plantation export crops, coconut/copra, rubber and tea, and the exchange rate overvaluation associated with very high protection of import substitution manufacturing. Consequently, during this period, Sri Lanka's trade regime also discriminated heavily against agriculture as a whole. Following its initial trade liberalization in the late 1970s and early 1980s, indirect disprotection of agriculture through manufacturing protection policies and exchange rate overvaluation continued but was greatly diminished. Export controls and taxes continued to be applied to plantation crop exports, however, in contrast to continuing high protection of import substitution rice production, which was extended to include some other major food crops (potatoes, onions and chillies).

- Farming and rural production in South Asia was generally left to the private sector, but there was extensive government participation in, and regulation of importing, exporting, trading, and storage. This government presence included parastatal organizations such as the FCI in India, PASSCO in Pakistan, TCB in Bangladesh, the CWE in Sri Lanka, and many others, as well as regulatory controls over prices and practices in the private sector, of which the most comprehensive and draconian is

probably the Indian Essential Commodities Act. Government participation and intervention was also pervasive as regards the major agricultural inputs, both internationally tradeable inputs such as fertilizers and seeds and non-tradeable inputs such as irrigation water, electricity, and credit. The intention and effect of these interventions was to replace or at least drastically control and limit the role of the private sector, which advocates of these policies considered to be inherently opportunistic and exploitative. The interventions were used to implement a variety of direct subsidies (e.g. subsidized retail prices of food grains and edible oils) and cross subsidies (e.g. pan-territorial and pan-seasonal farm support and fertilizer prices), which drastically reduced the incentive for the private sector to undertake its normal storage, arbitrage and risk-bearing functions in these markets. In India, this effect was reinforced by direct controls to combat "hoarding" over private inventories of "essential commodities" (which included nearly all agricultural commodities) and therefore over the buying and selling policies of private traders. Controls over international trade of both outputs and key inputs were considered an integral part of this general control system and essential for the viability of the domestic controls. They took a variety of forms, including government department and parastatal export and import monopolies, import and export licensing, and prohibitively high tariffs with periodic partial or complete exemptions when it was decided that imports were required.

General trade liberalization, 1977-97. The general trade reforms of the South Asian countries, the first of which were Sri Lanka's reforms in 1977 and after, had the potential to substantially change the level and structure of incentives for these countries' primary industries, but up to about 1997, the impact, while varying considerably between countries, had been limited overall. Because the agricultural industries are complicated, politically highly sensitive, and involved many regional and bureaucratic interests, the general trade policy reforms focused mainly on manufacturing, and reforms directly affecting agriculture were uneven and limited in scope. This was especially true in India[3], but there was more and earlier action in some respects in the other South Asian countries: Sri Lanka removed its export controls and taxes, Pakistan removed various interventions and subsidies affecting agricultural inputs and Bangladesh began to seriously cut back on the government's role in agricultural commodity markets in the mid-1980s. In India, import substitution food processing industries were also largely left out of the trade policy reforms as a result of the consumer goods import ban. The same omission occurred there and in the other South Asian countries for some major traditional agro-industries which are closely integrated with domestic agriculture, such as oilseed processing, sugar milling and refining, and flour milling. On the other hand, trade liberalization was accompanied by industrial deregulation, more liberal rules on FDI, and increased emphasis on export promotion, all of which led to new private investments, both domestic and foreign, in export-oriented food processing in particular. Except in India, there was also some impact on some food processing industries which began to face actual or potential competition from imports that had previously been strictly limited or excluded altogether.

For the South Asian countries' agricultural, livestock and fisheries sectors, the principal effects of the general trade reforms came not so much directly from the trade reforms themselves as from the manufacturing trade liberalizations and the large real currency devaluations which preceded and accompanied them. For example, the Indian real effective exchange rate declined by about 130 percent between 1985 and 1992. These exchange-rate devaluations principally helped export commodities and also a few low-cost import substitution primary industries (e.g. pulses in India, Pakistan, and Bangladesh) which were not insulated from world markets by prohibitively high protection. However, there was little or no direct pass-through of the devaluations to the domestic prices of products with redundant protection resulting from QRs, state trading monopolies or prohibitive tariffs.[4] Consequently, the overall reduction

[3] Trade policy reforms which would have directly affected Indian agriculture e.g. "decanalization" (i.e. the removal of parastatal import and export monopolies from major commodities) were included in the trade policy reforms that were supported by the World Bank's 1992 structural adjustment loan, but these parts of the agreed reforms were never implemented.

[4] This disconnect between border and domestic prices is apparent from the behavior of domestic wheat prices in relation to wheat reference prices in India during 1988-92 (Fig 1.1). During this period domestic prices continued to decline even though

of anti-agricultural bias that would be expected to show up in the domestic terms-of-trade for agriculture following trade liberalization was generally slow to appear and modest in extent.

The Uruguay Round and the Agreement on Agriculture. Nepal and Bhutan were not WTO members at the time of the Uruguay Round negotiations, but the other South Asian countries participated and as part of their WTO membership signed on to the Agreement on Agriculture (AoA). For a number of reasons, however, signing the AoA also had little or no immediate impact on their agricultural trade policies. First, except for Sri Lanka, which bound its agricultural tariffs at 50 percent, and some Indian tariff lines, India, Pakistan and Bangladesh bound nearly all their agricultural tariffs at very high to prohibitive levels (100, 150, and 300 percent). As intended, this has given these countries practically unlimited discretion to increase applied tariffs up to levels which in many cases amount to *de facto* import bans. Secondly, partly because of AoA concessions to developing countries, but mainly because of their low domestic support prices for major foodgrains mentioned above (in particular rice and wheat) they easily passed the AMS (Aggregate Measure of Support) test and were under no obligation to reduce support prices or agricultural input or other subsidies. Thirdly, the WTO recognition of the legitimacy of state trading enterprises (STEs) -- government operated or mandated import or export monopolies-- meant that these organizations could continue to control trade in agricultural commodities. Fourth, India continued its long established general import licensing of consumer goods which it justified under the GATT balance-of-payments clause (Article XVIII (b)). Consumer goods were defined to include all agricultural and most livestock and fisheries products, and for most of them import licensing was in practice an import ban. Finally, as members of the WTO and signatories of the AoA in 1995, the South Asian countries in principle had signed on to "tariffs only" protection of their agricultural sectors, except for recognized GATT-legal import controls, of which the most important are controls justified under the balance of payments clause, health and safety and technical standards (regulated by the SPS and TBT agreements) and controls based on religious and similar social considerations. However, it is probable that a major motivation for the ways in which some of these controls were implemented was protection of particular primary and food processing industries, in addition to which some *prima facie* GATT-illegal QRs were employed.

In India, Pakistan and Bangladesh agricultural and livestock products were included in the general trade liberalization programs of the late 1980s and early 1990s. Many QRs were removed in Bangladesh and Pakistan, and agricultural applied tariffs were substantially reduced in all three countries, but the exchange rate devaluations which accompanied the reforms partly offset and sometimes more than offset the tariff cuts. In general, the governments of Pakistan and Bangladesh made sure that the tariff cuts were not so large as to lead to substantial increases in import competition for domestic primary industries, and in India agricultural and livestock imports were mostly banned altogether, and if not, they were controlled by the general import licensing system and/or by the parastatal import monopolies.

Although not much changed on the import side, the exchange rate devaluations between the mid-1980's and the mid-1990s in India, Pakistan and Bangladesh did make a big difference on the export side. Traditional agricultural and other primary industry exports became more profitable than they otherwise would have been, and the devaluations supported the development of new export industries such as shrimp farming and the export of processed fruits and vegetables. The real devaluation of the Rupee in India between 1985 and 1992 also supported the expansion of common rice exports once export controls were lifted in 1995/96 and even helped make wheat exports profitable during a period of high world prices in 1996 and 1997.

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there was a huge increase in reference prices propelled by a sharp recovery in world prices combined with the continuing large (real) devaluation of the Rupee.

The situation in 1997 For the reasons given above, around 1997, despite their earlier trade-reform programs and their participation in the Uruguay Round, with some exceptions the domestic agricultural, livestock, fisheries and processed food markets of India, Pakistan and Bangladesh remained about as closed to imports as they had been in the mid-1980s and earlier. The exceptions were products for which imports had been open even during the restrictive import-substitution period (e.g. pulses) and others for which influential industrial lobbies had been able to negotiate for unrestricted, low-tariff imports of important inputs (e.g. cotton and wool). Edible oils remained a major primary import for all these countries despite continuing efforts to replace them with domestic production, but they were subject to erratic protection policies including the use of QRs and specific duties.

The situation in Sri Lanka around 1997 was very different. As already noted, it reflected the fact that its initial trade reforms and the accompanying devaluation came earlier, in the late 1970s and early 1980s. By 1997 most QRs had been abolished and tariffs were generally low to moderate, including tariffs protecting domestic primary and food processing industries. Hence many of these industries were subject to import competition. There were some important exceptions, however, and both formal and realized protection of four major domestically produced agricultural products -- rice, potatoes, onions, and chillies -- was very high. At the same time, during the second half of the 1980s and during the 1990s, Sri Lanka's exchange rate was supported by the rapid growth of its garment export industries and its tourism sector, and provided no stimulus to its primary export industries.

By contrast with India, Pakistan, Bangladesh and Sri Lanka, in 1997 (and for many previous years) the agricultural and livestock sectors of Nepal and Bhutan were quite open to imports, with no QRs and generally low, uniform MFN tariffs plus tariff preferences for India in Nepal and duty-free treatment for imports from India in Bhutan. Both countries also had (and still have) duty free access for their agricultural exports to India. Because of the difficulty and expense of bringing in bulky low-value imports from non-South Asian countries overland through India, more than is the case with manufacturing industries, the extent to which their agricultural and livestock sectors are protected or disprotected with respect to the rest of the world principally depends on the extent to which the equivalent industries in India are protected or disprotected. This connection is reinforced by their fixed nominal exchange rates with India and the large informal border trade in primary products. However in both countries there appear to be pockets of high protection in some import substitution food processing industries, principally industries relying on imports of inputs over zero or low tariffs.

What has happened since 1997?

Up to about 1997 the level and structure of agricultural incentives and the trade and trade-related policies of the South Asian countries are fairly well documented and researched, but there is less information and analysis of what has happened since then. Developments in import policies, traded policies for agricultural inputs, export policies and trade-related domestic policies and institutions are summarized briefly below. Before doing so, three major aspects of the external environment which are important for understanding what has happened to these policies should be noted.

The external environment. First, as discussed in Volume I, Chapter 2, India fought a rearguard action at the WTO to delay having to remove its across-the-board import licensing system which it justified under the GATT balance-of-payments article XVIII(b). Most of the products covered by this system were consumer goods, which were defined to include nearly all agricultural, livestock and fisheries products, and for most of these products "licensing" was a de facto import ban. After losing its effort to extend the phaseout of the system to 2005, India abolished the list of products subject to these restrictions in April 2001. Not surprisingly, there have been strong pressures to reinforce other existing means of protection and to find new ones. The principal methods have been:

- The continued use of parastatal import monopolies, previously known as "canalizing agencies" and now renamed "State Trading Enterprises" (STEs) for compatibility with the GATT
- The use of health and safety rules and technical regulations
- Tariff increases

A second important aspect of the external environment since 1987 is that world prices of some major commodities have declined substantially. During the mid-1990s, world markets for a number of commodities which are important in South Asia were quite strong, including food grains, edible oils and oilseeds, cotton, and rubber. Since then prices have been much lower, however (Tables I.2, I.3, I.4 and Fig I.5) e.g. world wheat and rice prices (in nominal US dollars) went down by about a third and 20 percent respectively, palm oil and coconut oil by more than 50 percent, cotton by about a third, rubber by about 50 percent.

Third, except in Pakistan, real effective exchange rates remained about the same between 1997 and mid 2004 (Fig I.1). As a result, these world price declines were more or less fully reflected in real domestic-currency border prices. This performance contrasts with a similar slump in world commodity prices between 1985 and 1988, when some of the decline was absorbed by substantial real devaluation. In India and Pakistan the real effective exchange rate went down by about 28 percent, in Bangladesh by about 18 percent, in Sri Lanka by about 17 percent, and in Nepal by about 15 percent. Between 1997 and 2001 Pakistan's real exchange rate was devalued by approximately 15 percent, but this decline only partly offset the slump in world prices of food grains, edible oils, and cotton, all of which are very important in Pakistan.

Import policies. Not surprisingly, the declines in the world prices of key commodities have been important elements behind strong pressures emerging in South Asia since 1997 for increased agricultural protection and subsidies. These pressures were accentuated in India as a result of the phaseout of its import licensing system. India, Bangladesh, and Sri Lanka have been very responsive to these pressures, but for the most part Pakistan has resisted them, continuing with a radical (by South Asian standards) liberalization of its trade and trade-related policies in agriculture. There have also been some recent tariff increases in Nepal.

Table 1.1 shows current or recent (MFN, non-preferential) tariffs and non-tariff barriers for the principal agricultural products, livestock products and processed-food products produced and consumed in South Asia. With a few exceptions [5] these products are covered by the Agreement on Agriculture; for the South Asian WTO members, they are therefore subject to basic AoA rules, in particular the requirement to bind all tariffs, the prohibition on the use of QRs, and the rules on domestic support and export subsidies. The tariff rates reported in the table include the estimated total protective effects of Customs duties and the para-tariffs discussed in Volume I, Chapter 3. . The table also notes the use of specific tariffs (denoted by an S) and non-tariff barriers, including STEs (State Trading Enterprises-i.e. government mandated import monopolies), QRs (import licensing or quotas), TRQs (tariff rate quotas), and tariff values (TVs i.e. the use of specified values instead of cif prices to calculate tariffs). Non-tariff import controls based on religious and social considerations (e.g. beef in India and pork in Pakistan and Bangladesh), and controls justified on grounds of health, safety, and the regulation of technical standards have not been noted except in a few cases (denoted NT) where information is available that suggests that the principal motive and effect has been to protect the domestic industry. However, as discussed later, it is possible that a close look at these controls would find similar predominant protective motives and effects in some and perhaps many cases.

[5] Fish and crustaceans, natural rubber, logs and timber and vegetable fibers are not subject to the AoA.

Some features of current protection policies for the livestock, agriculture, fisheries and food processing sectors of the South Asian countries which are apparent from the applied tariffs and non-tariff measures listed in Table I.1, are worth noting:

- In terms of these formal instruments, India's and Bangladesh's policies appear to be the most protective, followed by the policies of Sri Lanka. By contrast, in Pakistan, Nepal, and Bhutan, with a few exceptions (notably edible oils in Pakistan), these sectors appear to be fairly open to import competition.

- Non-tariff measures are being freely used in India which appear to be formally WTO-legal (e.g. STEs, TRQs with out-of-quota tariffs below tariff bindings, and the use of health, safety and technical standards).

- There are many high to prohibitively high "tariff peaks" in India and Bangladesh, and some on major commodities in Sri Lanka, which greatly exceed the general maximum tariff. Because of the generally very high tariff bindings in India and Bangladesh, there is ample scope for these countries to make large tariff increases in applied tariffs for most commodities without breaching WTO obligations, and they have been doing so freely. Many big tariff increases have been made during the past two years, partly in response to the decline in world prices mentioned previously, and in India following the final phaseout of its BOP-justified QRs in April 2001. Pakistan also has very high tariff bindings but except for edible oils has not used the discretion this gives it to increase individual tariffs on livestock, agricultural and processed-food products above its highest general tariff slab.

- There are some striking differences in the restrictiveness of import policies (i.e. the level of tariffs and the existence of non-tariff measures) which apply to some major commodities. In particular:
  - Rice: very restrictive in India and Sri Lanka, moderate or low restrictiveness in the other countries;
  - Wheat and coarse grains (maize, sorghum etc): very restrictive in India, moderate or low restrictiveness elsewhere (except wheat in Sri Lanka)
  - Dairy products (powdered milk imports especially): very restrictive in India and Bangladesh, moderate or low restrictiveness in the other countries;
  - Pulses: moderate to high restrictiveness in India and Sri Lanka, low restrictiveness in the other countries;
  - Edible oils: very restrictive in India, Pakistan and Bangladesh, moderate to high restrictiveness in Sri Lanka and Bhutan, low restrictiveness in Nepal;
  - Sugar: very restrictive in India and Bangladesh, moderate in Pakistan, high restrictiveness in Nepal, very low restrictiveness in Sri Lanka.

Export policies In recent years the South Asian countries have been paying increasing attention to the health and quality standards of agricultural and processed exports in order to meet the SPS standards of importing countries. Generally speaking, however, they are no longer explicitly taxing or using licensing or export bans or quotas as in the past deliberately to restrict their agricultural exports and depress domestic prices. The removal of cotton export QRs in India and Pakistan is especially significant, as for many years both countries had used QRs to push domestic cotton prices below world prices, thereby taxing farmers and subsidizing the domestic textile industry. Compulsory parastatal export monopolies have also been abolished, including in India, where had previously used them to prevent or restrict exports of some major commodities, notably common rice. However, there are some exceptions, in particular in India where export conditions for a number of key commodities including common rice, wheat, coarse grains, wheat and coarse grain flours, sugar, bulk powdered milk, and butter are formally "free", but where export contracts have to be registered with APEDA, and the Ministry of Commerce

(DGFT) can announce quantitative ceilings "from time to time". Explicit export licensing also applies to a number of products, including pulses in bulk, onions, paddy, and groundnut oil. Even if no quantitative ceilings are actually announced, keeping the right to invoke them in place is presumably a deterrent for the private sector to invest in developing export markets, and depending on how the system is operated, may not be much of an improvement in this regard over explicit export licensing, In Bangladesh the export of 18 agricultural products is either banned or subject to licensing (Table I.6). Pakistan bans the export of bulk edible oils and subsidizes the leather processing industry through export taxes on hides and skins and partially processed leather. In Sri Lanka, Nepal, and Bhutan, apart from SPS controls, as far as is known there are no export taxes or restrictions applied to agricultural exports.

Under the GATT, export taxes are permissible, but, like quantitative import controls, export restrictions directly breach GATT Article XI, according to which WTO members agree to eliminate export as well as import restrictions and prohibitions. The only plausible escape from this general prohibition is a clause which states that export restrictions and prohibitions can be "temporarily applied to relieve critical shortages of foodstuffs or other products essential to the exporting contracting party" (Art XI.2(a)). This clause could presumably be used to justify India's keeping the power to restrict exports in reserve and even to justify long-term export licensing, but it is difficult to see how export bans such as those in Bangladesh that are in place for long periods are not violating the basic GATT rule. In practice, however, the governments of countries with competing exporters have no motive to challenge other countries that voluntarily remove themselves from export competition, unless the export restrictions seriously reduce their own industry's access to a key product and/or indirectly hurt their export industries by providing an indirect export subsidy. For this reason only a few of the South Asian export QRs have been challenged at the WTO.[6] The most likely route to removing these restrictions would be careful economic analysis clearly showing the losses in economic welfare that they cause.

The South Asian countries are all applying the general export policies (see Chapter 4, Vol. I) used to promote manufactured exports to agricultural exports. The policies include schemes for rebating or exempting import duties on imported inputs that are used in exported products, such as drawback, duty exemption, bonded warehouses, the Indian duty exemption passbook schemes, and export processing zones. India has established a number of specialized agro-industrial zones for exporters. There are also related or separate mechanisms for rebating VAT charged on inputs used to produce exports. Various specialized facilities and subsidies generally available to exporters are being used -- preferential pre-shipment and post-shipment credit lines, export credit guarantee schemes, income and corporate tax exemptions and reductions, and reduced withholding of income taxes. India and Pakistan are also paying freight subsidies for a number of primary exports.

During the Uruguay Round none of the South Asian countries declared any agricultural export subsidies, and consequently under the AoA they have all since had zero export subsidy commitments, except for freight and export marketing subsidies which were available to developing countries until January 1, 2004, and a few other minor subsidies. A number of the currently implemented subsidies mentioned above probably breach this commitment, but their combined level and effect is probably not very great. However, Indian exports of surplus stocks of rice and wheat since 2001 at prices far below prevailing domestic prices are much more significant. Depending on developments, the practice could have major long-term implications for India's agricultural trade policies and more generally could seriously compromise efforts through the WTO to move towards more open world agricultural trade.

The zero export subsidy commitment of India and the other South Asian countries is the principal WTO discipline on their agricultural policies, because it sets a limit on domestic support or subsidies that

[6] Export restrictions on hides and skins and partially processed ("wet blue") leather in India and Pakistan were successfully challenged by the EU and contributed to their abandonment in India and their replacement in Pakistan by an export tax.

generate exportable surpluses. Despite this, during the past three years India has employed exactly such policies and has been disposing of its very large surplus stocks by selling wheat and rice in export markets for whatever prices can be obtained. These sales undoubtedly breach the spirit of the AoA and almost certainly India's legal commitments. If they continue unchallenged and undiscussed, they will effectively remove this key constraint to agricultural protectionism in India, while establishing a very undesirable precedent that other developing countries could be tempted to follow and reducing the pressures for reform in the high-protection developed countries.

The following sections discuss of some of the main features of the agricultural trade policies of the three large South Asian countries-India, Pakistan and Bangladesh- paying most attention to India, which has much bigger and more diverse primary industry sectors and more complex trade and other policies than its neighbors.

India. Judging from the formal instruments employed -- tariff levels and the use of non-tariff measures -- India's agriculture, livestock, seafood and food processing sectors appear to be getting more protection against imports from these instruments than its manufacturing sectors. However, as in the past, it is likely that implicit protection (i.e. actual differences between domestic prices and border prices) of many livestock and agricultural products are considerably less than the apparently high levels of protection that these formal instruments make available: some limited current evidence on this is discussed below. Nevertheless the widespread use of non-tariff measures and the relatively high tariffs probably support correspondingly high implicit protection of some products and are also significant as indicators of some of the protectionist pressures operating in these sectors. In this regard it is relevant to note the following:

- STEs control imports of rice and wheat and all coarse grains except maize (subject to a TRQ) and barley. These grains account for about 40 percent of total agricultural GDP in India. An STE is also being used to protect copra, a highly political crop in Kerala.

- TRQs are being used to protect the dairy industry against powdered-milk imports. As with maize, the import quotas are very small in relation to total Indian production, and the out-of-quota tariffs (maize 50 percent, powdered milk 60 percent) are probably prohibitive.

- Other non-tariff barriers (denoted NT in Table I.1) are being used to protect some major commodities, specifically sugar, baby foods, and powdered and condensed milk. At least formally, India classifies these techniques as WTO-compatible, but the dominant motive and effect seems to be protection of domestic industries. For sugar, the Essential Commodities Act was used during early 2000 to deter imports by requiring importers to sell 30 percent of their stocks at a loss and to obtain permission to sell the balance.[7] The threat of another, similar intervention would presumably discourage imports. Imported baby foods, powdered and condensed milk are included in the November 2000 list of 133 products the exporters and importers of which are required to meet the extremely demanding and expensive quality certification procedures required by the Bureau of Indian Standards (already discussed in Chapter II, Vol. I) Without detailed research it is impossible to assess the protective intent and impact of India's general health, safety, and technical regulations, which apply to practically all imports of livestock, agricultural, and processed-food products. No attempt to do so has been made in compiling Table I.1. However it is pertinent to note that these regulations were introduced or reactivated and applied to imports at abut the same time that general import licensing of consumer goods was abolished on April 1, 2001.[8] Since the imports of most livestock and

[7] Goyal, *Easy Reference Customs Tariff, 2000-2001,* p 232.

[8] It has been reported that this was an initiative of the "War Room" set up in 2001 within the Ministry of Commerce to combat and monitor imports (see discussion in Chapter 2, volume I)

agricultural products and processed foods were previously banned, it was logical to activate these regulations and apply them to imports at this time. But two questions remain (1) How widely and rigorously were these regulations being applied to domestic production before the abolition of QRs?; and (2) Are they currently being applied to imports and domestic production with equal or at least similar rigor? As described in Goyal, they were not applied rigorously to domestic production before 2001, and the new 2001 regulations as currently written and applied appear to involve a very substantial harassment factor at Customs which would heavily disadvantage imports.[9]

- Many agricultural, livestock, and processed-food tariffs far exceed the current "general maximum" tariff of 30 percent discussed in Chapter 3, Vol. I. These tariff peaks are mostly in a range of between 50 and 100 percent for powdered milk; rice, wheat and some coarse grains; baby foods; some fruits and nuts; coffee, tea, a number of spices, copra, edible oils, sugar, and latex. Relative to the total number of livestock, agricultural and processed-food tariff lines, there are many more of these "tariff peaks" than there are tariff peaks (even allowing for specific duties and anti-dumping duties) among non-agricultural tariff lines. More significantly, the share of agricultural and livestock production that they protect is probably considerably greater than the corresponding share being protected by non-agricultural tariff peaks.

- Aside from the tariff peaks just mentioned, nearly all other livestock agricultural, and processed-food tariffs are in the top 30 percent "slab" of the general range of agricultural tariffs.

- Of the major commodities listed in Table 1.1, relatively few can be imported without non-tariff restrictions over low tariffs. For most of those that can, there are strong domestic lobbies for which the product is a key intermediate input e.g. raw hides and skins, cotton, raw wool, raw jute, unshelled cashews (used by India's large, cashew export industry), barley, and oilcakes and meals. For many years pulses were restriction-free, final consumer agricultural products that were consistently imported in substantial quantities over low tariffs even though the imports compete with domestic production, but in 2003 this tariff was sharply increased and is now 30%. Onions are also restriction-free and subject to a low tariff, but India is a very low-cost onion producer, and prices are generally suppressed below export border prices by export controls, so it is not profitable to import.

The above summary of India's current tariffs and non-tariff barriers to imports suggests that its agricultural, livestock and food processing sectors are heavily protected. This conclusion is certainly accurate if protection is understood as the extent to which barriers are placed in the way of competing imports. But empirical studies have shown that for many years measured nominal protection of major crops was low or negative even though competing imports were banned altogether or subject to QRs. Similar detailed empirical studies comparing domestic and international prices would be needed in order to properly understand the current situation.

Some indication that it probably has not changed in its essentials is suggested by an update from 1997 to April 2002 of earlier nominal protection estimates for wheat. These results are graphed in Fig 1.2, which shows the domestic support price for wheat in relation to an estimated import reference price and an estimated export reference price, with all prices (per quintal[10]) expressed in constant 1980/81 Rupees. The graph illustrates a number of relevant points. First, expressed in Rupees, since 1965 there have been large fluctuations in border reference prices but no obvious trend, up or down. Reference prices in 2002

[9] The new phytosanitary requirements for imports of plants, fruits, seeds etc (introduced in May 2001) and for imports of animals and animal products (introduced in July 2001) are described in Goyal, *Easy Reference Customs Tariff, 2002-2003,* pp P/41 and P/42. On the latter, the discussion concludes that "the immediate implication of the permit condition for entry is that normal inflows of animal foods will be stopped by the customs".

[10] 1 quintal=100 kg

were about the same as they were in 1965 despite a very large decline during this period in world wheat prices expressed in constant US dollars (Fig 1.1). The devaluation of the Rupee effective exchange rate during these 37 years just about exactly offset the decline in the US dollar price of wheat.

Second, with only a few upward blips, the domestic wheat price remained in a strong downward trend -- declining by more than 50 percent in real terms -- for 27 years until 1992. Since 1993, however, real wheat prices have increased by about one third, with an especially sharp jump in 1998.

Third, over the entire period there has always been a very large gap between import and export reference prices. In 2002, this gap was equivalent to about 40 percent of the import reference price; put another way, the export reference price is 40 percent less than the import reference price. The reasons for this gap are that the high costs of international transport relative to world wheat prices create large differences between cif and fob prices at Indian ports.[11] and high domestic transport costs (relative to international prices of wheat) create an even bigger gap between prices farmers would receive if they were to export their wheat and the prices with which they would have to compete if wheat were imported.

Fourth, except in the early period between 1965 and 1973 when wheat was protected with respect to both import and export reference prices, and for about 6 years during the 1990s when domestic support prices were lower than export reference prices, domestic prices have been in between import and export reference prices. This positioning means that the implicit or measured protection of wheat was ambiguous: negative if measured with respect to the import reference price and positive if measured with respect to the export reference price. As the graph illustrates, this remained the situation between 1998 and 2002. In 2002 the domestic support price was about 25 percent below import reference prices, but about 40 percent above export reference prices. From this it is apparent that the current wheat tariff (50 percent) has no apparent relevance to actual protection levels, since there would be no (or very few) wheat imports even with zero tariffs and the abolition of FCI's import monopoly while domestic prices remain so far below import reference prices. Among other things, this reality suggests that the very large, excess, public wheat stocks that India has accumulated over the past few years are not the result of high protection of the industry against imports, but rather the result of a major failure of domestic price policies, where support prices have been increased in real terms instead of allowing prices to adjust and equilibrate domestic supply and demand. The same general policy failure also explains the very large, excess, public stocks of rice.

In addition to wheat, it is highly probable that detailed empirical investigation would reveal that many other products have considerable redundant protection, in particular:

- Animals, meat and eggs
- Common rice (substantial exports)
- Coarse grains (maize, sorghum etc)
- Fish and crustaceans (there are substantial exports)
- Vegetables (substantial exports)
- Processed fruits and vegetables (substantial exports)
- Spices (a major export industry)
- Tea and coffee (substantial exports)
- Raw tobacco (substantial exports)

The existence of high and very high tariffs and also non-tariff measures protecting these industries against competing imports, even though within most of them some products have low

[11] Inadequate bulk handing facilities inland and at Indian ports explain some part of the high domestic and international transport costs. Apart from affecting domestic transport and port costs directly, international freight rates are higher because of uncertainties and delays at Indian ports.

production costs and are being exported, suggests that the protection they are receiving reflects long-ingrained, anti-import impulses to exclude all imports, rather than any likelihood that imports would be very substantial or require much adjustment in domestic markets if imports were allowed restriction-free over low tariffs.

On the other hand, it is probable that for some other primary industries, high tariffs and non-tariff measures are in fact producing high, realized protection in the domestic market. These include:

- Dairy products
- Some frutis and nuts
- Coffee
- Edible oils
- Raw silk
- Sugar
- Latex and natural rubber

It is significant that world prices of most of these product groups are highly cyclical and that coffee, copra, edible oils, and sugar, for instance, have been in a low phase of their cycles for the past several years. How to manage policies for products such as these raises well known but difficult problems which until 2001 India had largely avoided as a result of its unhindered use of QRs.

Pakistan. As discussed in Chapter II, Vol. I, Pakistan has carried out a much more radical liberalization of its general trade policies since 1996/97 than India and Bangladesh, and this reform has included its agricultural sector. As of August 2002 (Table I.1):

- There were no QRs on imports of agricultural, livestock, and processed-food products (except for products not included in the positive list exempted from the general ban on imports from India).

- All parastatal import and export monopolies had been removed.

- With the exception of edible oils, the general maximum tariff of 25 percent is also the *de facto* applied maximum tariff for agricultural, livestock, seafood and processed-food products, subject to the proviso that some extra protection is being given through the advance income tax on imports and possibly through sales tax exemptions for some domestically produced agricultural products (see Vol I, Chapter 3)

- All export QRs and export taxes had been removed, except again for edible oils and a few other products

The steady removal during the 1990s of import licensing, STEs, and other non-tariff barriers to imports of livestock, agricultural and processed-food products from MFN sources was completed in 2001. As for industrial products, the general ban on imports from India of products not on the limited positive list of 677 items is a major qualification to these liberalizing reforms, given the considerable potential of this trade. However, there are about 75 livestock and agricultural products on the list, including live animals, various vegetables, pulses, coffee, tea, some spices, edible oils, soybean meal, and raw silk, wool, cotton, and jute and other vegetable fibers. The list, however, excludes fish, meat, dairy products, food grains and food grain flours, and almost all processed foods. As with industrial products, the composition of the list appears to be heavily influenced by the lobbying power of the local industries that in some cases benefit from being able to import raw materials from India (e.g. abattoirs, textile producers)

and which in other cases probably do not object to the exclusion of various products from the list since it prevents (legal, if not illegal) competitive imports from India.

Between 1996/97 and 2002/03, the "tops down" approach to tariff reduction reduced the general maximum tariff in the agricultural, livestock, and food-processing sectors from 65 percent to 25 percent. In striking contrast to India, tariff peaks in excess of this general ceiling have been allowed for only one group of agricultural products (edible oils). Consequently, the variance of Customs duties and the apparent potential for high effective protection from escalated tariff structures has also been substantially diminished. Between 1996/97 and 2001/02, both the mean and standard deviation of agricultural and livestock tariffs fell by more than half, along with similar reduction in the mean and standard deviation of processed food tariffs (Table I.5). Both the mean and standard deviation probably declined again since the 2002/03 budget, which reduced the general maximum tariff (the top tariff "slab") from 30 percent to 25 percent.

As discussed in Chapters 2 and 3 (Volume I), the extent to which the apparent absence of QRs and moderate to low tariffs corresponds to moderate to low protection for domestic industries is subject to the caveat that actual protection could be considerably higher if Pakistan's VAT-type sales tax is less rigorously collected from domestic producers than from importers, and similar effects would result from asymmetric collection of the income withholding tax. In this regard it is relevant to note that the 15 percent sales and the 6 percent withholding tax apply uniformly to all products in the Customs tariff schedule, including all primary products covered by the Agreement on Agriculture. In an extreme case in which both these taxes are collected on imports by Customs but not collected at all on the equivalent domestically produced products, for the maximum customs tariff of 25 percent which applies to many processed foods, the total protection rate would be 52.4 percent, of which the components (percent of cif prices) would be: 25% (Customs duty)+sales tax(18.8%)+withholding tax(8.6%). On the same extreme assumption, the protection corresponding to a 10 percent Customs duty would be 34.1 percent=10%(Customs duty)+16.5%(sales tax)+7.6%(withholding tax).

Leaving this complication aside, the tariff reforms have also created generally uniform tariffs within major product groups (Table 1.1): 10 percent for coarse grains, oilseeds, and fresh vegetables; 20 percent for spices; 25 percent for most fruits and nuts; and 25 percent for most processed foods, for example. In strong contrast to Bangladesh, and to a lesser extent India and Sri Lanka, this tariff uniformity for livestock, agricultural, marine and food products should be an important plus for customs administration in Pakistan.

Finally, again with the exception of edible oils, "cyclical" commodities such as sugar, natural rubber, and coffee have not been singled out for special protection. For some of these products, a principal reason is that they are either not produced in Pakistan at all, or not in significant quantities. Thus, no effective producer lobbies prevent intermediate and final consumers from benefiting from low world prices. This is not true of other commodities, however, notably sugar, which is Pakistan's fourth largest crop accounting for over 6 percent of agricultural and livestock GDP.[12] Despite this, in contrast to India (60% tariff plus QRs), Bangladesh (93.9% total protection rate) and even Nepal (44.5% tariff), in Pakistan no QRs apply to sugar imports, and tariff increases from 10% in 2001 to 25% currently have not gone above the general maximum rate.

As noted earlier, Pakistan's (real) exchange rate has declined since 1997, but this has only partially offset the decline in sugar and other world commodity prices since. Pakistan has been much more willing than India and Bangladesh to stick with its general trade liberalization program without backtracking and making opportunistic exceptions, accepting and benefiting from the downswing phase

[12] This is the share of sugarcane farming only. Sugar milling is also a very large industry but is not included in agricultural GDP.

in the world prices of these cyclical commodities. The special treatment of edible oils, an exception to this approach, appears to have more to do with the strength of industrial oilseed processing lobbies than with the farming oilseed sector. Oilseed production in Pakistan only accounts for about 0.5 percent of livestock and agricultural GDP and oilseed tariffs are low (10 percent), but the oilseed processing sector includes 11 public-sector firms some of which are being fully or partially privatized.[13] Future import liberalization of edible oils will be made more difficult as long as the present very high protection through specific duties is used to protect employment in and profits of public-sector firms and to provide incentives for the private sector to buy or participate in these firms.

In addition to radically liberalizing its agricultural import regime, since 1997 Pakistan has also removed most of its remaining export controls and restrictions.[14] In particular, exports of cotton (after wheat Pakistan's second largest rural industry) were decontrolled in 1999. Prior to this, export controls were periodically imposed in order to suppress domestic cotton prices and thereby subsidize the textile industry. With a few exceptions, the private sector can now freely export cotton and all other livestock, agricultural and processed products without having to obtain licenses (other than health, safety, and quality assurance clearances) or pay export taxes. Export controls have also been removed from hides, skins, and partially processed leather, as have export quotas from potatoes. The two principal remaining restrictive export measures are a ban on bulk exports of edible oils and a 20-percent export tax which has replaced the previous export controls over hides, skins, and partially processed leather. The role of parastatals in exporting has also been abolished or reduced as part of the general policy of withdrawing from government participation in trading in agricultural and livestock products.

On the other hand, the government is operating a number of export subsidy schemes which include livestock and agricultural products. The most important appears to be a 25-percent freight subsidy for exports of fresh fruit and vegetables, fresh fish, and flowers and confectionery. According to the 2002 WTO TPR report, this freight subsidy is now confined to potato exports only.[15] In addition, food processing firms in EPZs benefit from the general tax and other concessions of the zones; together with all other exporters, firms exporting livestock, agricultural, and processed-food products are subject to much lower (1.25%) income withholding tax on export proceeds than importers. Although a number of these export subsidies are probably incompatible with the AoA and other WTO rules,[16] unlike India, Pakistan does not appear to be operating any major agricultural export subsidies with important effects and implications for the general direction of its trade policies[17].

In Pakistan as in India, the old import substitution regime strongly discriminated against agriculture directly through measures that suppressed domestic agricultural prices and indirectly through manufacturing protection and exchange-rate overvaluation. In the aggregate, these effects on output prices far outweighed substantial subsidies for tradable (e.g. fertilizers, pesticides, farm machinery) and non-tradable (e.g. electricity, irrigation water, credit) inputs. The principal empirical study which documents these effects covers wheat, cotton, rice, and sugarcane growing for the period 1960-86, activities which together accounted for about half or more of agricultural and livestock GDP during this period. It would be of considerable interest to update these earlier studies and to broaden them to include other crops and also livestock and fisheries[18] sectors, which now respectively account for about 36 percent and 4 percent

[13] WTO , Pakistan TPR Report 2002, Table III.4.

[14] More detail on Pakistan's export policies is in the Pakistan 2002 TPR report, pp 59-66.

[15] Ibid, p.64.

[16] Unless changes are made to the rules during the Doha round negotiations, the freight subsidy is allowed under the AoA until the end of the 9-year implementation period for developing countries on January 1, 2004. Subsidized export credit and the reduced income-withholding tax rates are probably WTO-compatible. However according to the TPR report, some of the other subsidies probably breach AoA and/or other WTO rules on export subsidies.

[17] However, it has been reported that Pakistan exported wheat at subsidized prices during 2003

[18] As in India and Bangladesh, a major part of fisheries production is from inland ponds and waterways.

of total agricultural and livestock GDP. It would be particularly important to include the livestock sector which grew very rapidly during the 1990s (at over 6 percent per year during 1991/92 and 2001/01) and within that to include milk products and the poultry industry. For a number of reasons, it is probable that the general anti-rural-industry discrimination that existed up to the mid 1980s still exists but has diminished substantially.

The dramatic drop in manufacturing protection, especially since about 1997, also implies that exchange rate overvaluation that discriminates against tradeables and agricultural exportables in particular (especially cotton and basmati rice) has declined. Direct discrimination (export controls and taxes) against exportables has also been removed. Subject to caveats about smuggling, the new "tariffs only" protection regime *a priori* suggests generally low to moderate positive nominal protection for most import-substitution agricultural and livestock products which may on average not differ very much from average manufacturing protection. A possible exception is the oilseed industry, as a result of the high specific tariffs applied to edible oil imports. But this protection seems to be focused on edible oil manufacturing. The extent to which oilseed farming is protected is not clear, given that oilseeds can in principle be imported restriction free over a uniform 10 percent tariff.

On the other hand, at least up to 2000, some provisional price comparisons for wheat (Fig IV.3) indicate continuing substantial tariff redundancy, since domestic wholesale prices were still substantially below import reference prices, even though wheat was being imported by the government during most of this period. Wheat prices actually received by many farmers (especially small farmers) are reported to have been lower than reported wholesale prices, owing to the monopsony position and buying practices of the grain parastatal (PASSCO). The government's reform program which aims to phase out PASSCO's operations in the wheat market and to remove barriers to private-sector grain trading and storage should, in principle, pull up wheat prices closer to import reference prices. However, that change depends on the supply response to this and other reforms, including reforms affecting input prices, quality and availability. Depending on how these work out in relation to demand and trends in world prices, it is quite possible that Pakistan could achieve self-sufficiency in wheat (and also in common (IRRI) rice production) with domestic prices frequently (but not always) lying somewhere within the very large gap between import and export reference prices. If this were to happen, it would be incorrect to characterize the entire gap between domestic wholesale prices and import reference prices as direct "disprotection" or anti-agricultural discrimination.[19]

All of the preceding discussion assumes that Pakistan's ban on wheat (and other food grain) imports from India will continue. If this were to change, unless India were to become a net importer as a result of the exhaustion of its security food grain stocks, the relevant import reference price would be much lower than reference prices based on wheat imports from non-South Asian sources such as Australia or the US. In that case, the major wheat-growing areas in Pakistan's Punjab would be in direct competition with wheat grown next door in the Indian Punjab and the other northwest Indian states. Wheat growers and traders in these states would presumably be willing to offer prices equivalent to fob prices at Indian ports minus the very substantial transport cost they would save by shipping the wheat to

[19] When international and domestic transport and marketing costs are very high relation to world prices, as they are for wheat and other grains such as corn and sorghum (and to a lesser extent rice) , and domestic prices lie between export and import reference prices, it can be misleading to assume that the entire difference between these references represents "protection" of " disprotection" in some sense. In fact, if there is no significant government intervention that influences domestic prices, the protection system is approximately neutral, in the sense that domestic prices would not be much different under free trade in these products. Ideally, when there is intervention (as there has been for these commodities in Pakistan and India) which clearly affects domestic prices, the relevant reference price with which these with-intervention prices should be compared, are estimated "without intervention" prices i.e. domestic prices which would equate domestic supply and demand in the absence of intervention. Sometimes (perhaps frequently) these estimated non-intervention reference prices may also lie between the import and export reference prices.

the Pakistan land border in the north rather than to the Indian ports in the south. As with the partial integration of the Indian and Bangladesh rice markets (see below), both Pakistan and India would realize major economic welfare gains from open, bilateral trade in food grains. For both countries, but especially for Pakistan, general grain trade liberalization including India-Pakistan trade would have considerably greater economic welfare benefits than general grain trade liberalization that left the present ban on India-Pakistan trade in place.

Bangladesh. During the 1990s Bangladesh included agriculture, livestock, and fisheries in its general liberalization of trade and trade-related policies. As of March 2004, in terms of the formal protective and other instruments and institutions in place, these sectors appeared to be considerably more open to international trade than they are in India, but less than in Pakistan. A few salient points (see Tables I.1 and I.6):

- There are no purely protective import QRs being operated, except for the import bans on fowls and eggs.

- There are no legally enforced state trading monopolies of either exports or imports. These were removed during the early 1990s, much earlier than the recent withdrawal of the government and parastatals from international trade in Pakistan. In particular, the private sector now has the dominant role in rice importing.[20]

- But 18 products are subject to export QRs: for 13 an export ban and for 5 export licensing (Table I.7) Banned exports include oilseeds, edible oils, wheat, pulses, onions, unprocessed and unfrozen prawns and shrimp, raw hides, and wet blue leather. The principal motivation is presumably to decrease domestic prices, which in the case of intermediates such as hides and leather and fresh shrimp subsidizes the user industries.

- As in India, it is likely that a strong protection motivation exists in the application of some health and safety (SPS) regulations to imports. Domestic industries for which this impetus may be important include dairying (i.e. milk and milk-based products), oilseeds and edible oils, and some fish and crustacean products (Table 1.1)

- As part of Bangladesh's general tariff reforms during the 1990s, Customs duties applied to agricultural, livestock, and fisheries products have declined very substantially.

- But as discussed in Chapter 3 (Vol. I), since the mid-1990s a number of other import taxes have been used to give extra protection. At present these include the IDSC tax (an extra 4% on top of Customs duties on practically all imports), supplementary duties, regulatory duties and exemption of selected domestically produced products from the 15% VAT applied to imports. Including the IDRC tax means that the maximum general protective tariff is actually 34%, not 30%, and the selective use of VAT exemption, regulatory duties and supplementary duties can give much higher and also difficult-to-quantify extra protection to the domestic industries which benefit. As shown in Table 1.1, these methods have been used to apply very high-to-prohibitive protective tariffs to such products as bulk powdered milk, cheeses or baby foods, sweet biscuits, fresh apples, oranges grapes, and mangoes fresh orange and apple juices, frozen fruit juices, jams and jellies, various spices and sugar.

The large number of tariff peaks well above the general maximum tariff of 34% suggests that in Bangladesh, as in India, strong domestic rural and food processing industry lobbies are able to obtain

[20] The private role in rice importing and trading is discussed Murshid (1999). See also Shilpi (1998) and Dowlah (2001).

special treatment with little government resistance. Thus the 2002/03 and 2003/04 budget speeches announced a series of new and increased supplementary duties which involved large increases in total protective duties for a number of the products mentioned above, without indicating the resulting levels of protection involved and without any explanation of the justification for the increases. These changes are good examples of the general point emphasized in Chapter **3,** Volume 1 and also in a number of World Bank, WTO, and other reports on Bangladesh's tariff policies, that the complexity and lack of transparency resulting from Bangladesh's multiple import taxes is a major problem in itself. One of the most important is the resulting ability to introduce major changes in protection without indicating their total effects. The remedy for this situation is very simple: merge all the additional protective measures in a single Customs duty so that the protective effects of changes would be clear. The apparent resistance to this obvious reform suggests that the complexity and lack of transparency is deliberate and is retained precisely because the effects of *ad hoc* changes are obscured.[21]

Looking at unweighted average Customs duties alone as indicators of relative incentives, it would appear that incentives for the rural sector (i.e. livestock, agriculture and fisheries) as a whole are about the same as incentives for manufacturing as a whole. For a number of reasons this could be a very misleading conclusion. First, as emphasized above, it is necessary to take account of the protective effects of the other import taxes discussed above. Taking these into account, unweighted average protective import taxes are much higher in agriculture than in manufacturing (see Chapter 3, volume I). On the other hand, , effective protection that takes account of input protection as well as output protection can be very different from output protection alone. Because Bangladesh tariffs are quite escalated according to the degree of processing, and intermediate material inputs are generally a much higher share of the final selling prices of manufactured products than of farm and other rural products, effective protection would tend to be higher in manufacturing. Third, rice is by far the most important rural product, and its implicit protection rate has historically been low or negative. As this still appears to be the case, the weighted average protection of the rural sector remains is still quite low. It is also likely that the implicit protection of other major crops (especially other food grains which compete with rice) is also low or negative.

This suggests that there is probably still substantial overall anti-rural bias in the system, though its extent is probably moderated by a number of factors. As demonstrated by many past empirical protection studies[22] and reaffirmed once again by a new detailed study,[23] effective protection of manufactured exports in Bangladesh is low or negative. Since the garment and other export industries now constitute a very large proportion of total manufacturing production, allowance for their position will substantially reduce the weighted average protection of the manufacturing sector as a whole. Allowance also needs to be made for the very large volume of smuggled imports, especially from India, of both intermediate and final consumption goods. The net effect of this large smuggling trade on implicit protection is difficult to predict, because while smuggled, low-priced, final consumer goods will reduce

[21] In addition, the complexity also has the highly undesirable consequence of increasing the scope for negotiation during Customs clearance

[22] e.g. World Bank, 1996. *Bangladesh: Trade Policy Reform for Improving the Incentive Regime,* and World Bank, 1999. *Bangladesh Trade Liberalization: Its Pace and Impacts.*

[23] Maxwell Stamp PLC, 2002. *Review of Relative Protection,2002.* Report prepared for the Bangladesh Tariff Commission. February, First Draft Report. This study estimates the nominal and effective protection for 204 firms that was available from output and input tariffs during the three years 1999/2000, 2000/01, and 2001/02. Exports are assumed to have zero nominal protection and to benefit from import duty exemptions for the inputs used to produce them. The empirical results demonstrate the very marked anti-export bias resulting from the tariffs and their structure, and also the highly inefficient dispersion of effective incentives that the tariffs make available for production for the domestic market and show in a convincing manner the large efficiency gains that could result from lower and more uniform tariffs. However, the study does not attempt to estimate the actual differences between the border and domestic prices of outputs and inputs sold domestically, which for a variety of reasons, including competition from smuggled goods, may in practice differ considerably from the price differences theoretically available from protective tariffs. For most Bangladesh manufacturing firms, this probably means that actual realized effective protection is lower (perhaps considerably lower) than the effective protection available from tariffs.

the nominal and therefore the effective protection of Bangladesh production of the same goods and smuggled, intermediate goods will likewise reduce the nominal and effective protection of competing Bangladesh producers, smuggled intermediates will have the opposite effect and increase the effective protection of Bangladesh producers that use them as inputs. On balance, it is likely that smuggling has been substantially reducing the average realized protection rate (nominal and effective) of the manufacturing sector's production for the domestic market, below the protection rate theoretically available from tariffs.

As regards the broad structure of incentives within the rural sector, the following hypotheses seem plausible and would be worth checking empirically:

- Low incentives for the major food grain crops -- rice, coarse grains, wheat, and pulses. Together, these account for by far the largest part of agricultural GDP and employment.

- Low or negative incentives for the major exported primary products, principally, frozen shrimp and fish, tea, and raw jute. This is despite high tariffs and assumes that competition between exporters is keeping domestic prices broadly in line with export prices.
- Moderate to low incentives for oilseed crops competing with imports over relatively low tariffs.

- High to very high incentives for some import substitution crops, in particular vegetables, fruits and nuts, and spices, and sugar during down years of international price cycles. Although these crops only account for a small share of agricultural GDP at present, this share will grow as consumption of vegetables and fruit increases with higher real incomes.

- In the livestock sector, high to very high incentives for dairy products and the poultry industry, but probably moderate to low for cattle herding as a result of the export ban on live cattle, skins and partially processed leather.

- Very high and probably redundant protection for the fisheries sector in the domestic market, especially following the introduction of regulatory duties in the 2003 budget.

TABLE I..1
AGRICULTURAL, LIVESTOCK AND PROCESSED FOOD TARIFFS AND NTBS IN SOUTH ASIA

	India 2004/05	Pakistan 2002/03	Bangladesh 2003/04**	Sri Lanka 2002/03	Nepal Aug 2003	Bhutan 2002
1. Animals	30	10/20/25	11.5	30	19.5	0
Poultry	30	10/20	26.5+QR	30	19.5	0
Eggs	30+NT	20	34+QR	30	19.5	10
2. Meat & skins						
Meat: Fresh, chilled, frozen, processed (except poultry meat)	30	10/25	41.5	30	14.5	10
Poultry meat	30/100	25	49	30	14.5	10
Hides & skins raw	0	0	4	12	7.5	10
Processed incl leather	20	0	4	12	14.5	10
3. Fish and crustaceans	30	10	64/79+NT*	12	19.5	10
4. Dairy products						
Fresh milk and cream	30	25	49	30	19.5	30
Yogurt	30	25	49	30	19.5	30
Powdered milk bulk (<1.5%)	15 or 60 (TRQ)+NT	20	63.25+NT	10	24.5	30
Powdered milk (>1.5%)	15 or 60 (TRQ)+NT	20	63.25+NT	10	24.5	
Powdered milk retail pack	15 or 60 (TRQ)+NT	20	63.25+NT	10		30 30
Powdered milk (>1.5%) sweetened	60+NT	20	30.8/34/63.3 +NT	10	24.5	30
Butter	40	25	86.4	30	19.5	10
Butter oil	40	25	66.5	30	19.5	30
Cheeses	30	25	49/86.4	30	19.5	10-30
5. Rice						
Common	87.2+STE	10	7.5	S	24.5	0
Basmati	87.2+STE	10	7.5	S	24.5	0
6. Wheat and wheat flour						
Durum (hard) wheat	80+STE	25	7.5	0+STE	19.5	0
Other wheat	70+STE	25	7.5	0+STE	19.5	0
Wheat flour	30	20	18.5	10	19.5	10
7. Coarse grains & flours						
Maize	15 or 50 (TRQ)	10	0	0	19.5	0
Sorghum	50+STE	10	4	30	19.5	0
Millet	50+STE	10	19	30	19.5	0
Barley	0	10	4	12	19.5	0
Rye	0+STE	10	4	12	19.5	0
Oats	0+STE	10	4	12	19.5	0
Other grains	0+STE	10	19	30	19.5	0
Coarse grain flours	30	10	19	30	19.5	10
8. Processed cereals						

	India 2004/05	Pakistan 2002/03	Bangladesh 2003/04**	Sri Lanka 2002/03	Nepal Aug 2003	Bhutan 2002
Baby foods	30	20	53.5	5	7.5	30
Baker's dough	30	25.	34	12	14.5	30
Pasta	30	20	34	30	44.5	30
Biscuits (sweet)	30	25	131.5	30	44.5	30
Biscuits (other)	30	25	49	30	44.5	30
Breakfast cereals	30	25	34	30	19.5	30
All others	30	25	34	30	19.5	30
10. Pulses	30	5	11	30	7.5/14.5	0
11. Vegetables	**30**	**10**	**26.5/47.9**	**30**	**19.5**	**10**
Potatoes	30	10	34	S	19.5	10
Onions	30	10	26.5	S	19.5	10
Tomatoes	30	10	34	30	19.5	10
Garlic	30	10	26.5	12	19.5	10
Dried mushrooms	30	20	26.5	30	19.5	10
Dried onions	30	20	26.5	30	19.5	10
Dried potatoes	30	20	26.5	30	19.5	10
12. Fruit	**30**	**25**	**26.5/34**	**30**	**14.5/19.5**	**20**
Apples	50	25	86	30	19.5	20
Grapes	40	25	86	30	19.5	20
Plums	25	25	34	30	19.5	20
Dried prunes	25	25	34	30	19.5	20
Dried grapes	105	25	86	30	19.5	20
Cashews: in shell	0	20	26.5	30+QR	14.5	20
Cashews: shelled	30	25	26.5	30	14.5	20
Coconuts	70	20	26.5	30	19.5	20
Almonds	S	20/25	26.5	30	14.5	20
Areca (betel) nuts	100	25	99	30	14.5	20
Dates	30	25	25.5/75.5	6	14.5	20
Figs, pineapples, guavas	30	25	34	30	19.5	20
Mangoes	30	25	86	30	19.5	20
13. Preparations of fruits and vegetables	**30**	**25**	**34/86**	**30**	**29.5/44.5**	**30**
About 13 veg preps	30	25	34	30	29.5	30
Fruit juices	30	25	34/86	30	44.5	30
Fruit juices, frozen	30	25	34/86	30	44.5	30
Jams, jellies etc	30	25	86	30	29.5	30
Orange juice, not frozen	30	25	86	30	44.5	30
Apple juice, not frozen	30	25	86	30	44.5	30
14.Coffee *(unprocessed)*	100	20	34	30	14.5	20
Roasted coffee in bulk	100	20	34	30	29.5	20
15. Tea	100	25	34	30+QR	29.5	20
16. Spices	**30**	**20**	**34/49**	**30**	**7.5/14.5**	**20**
Pepper	70	20	34/49	30	7.5/14.5	20
Chillies	70	20	26.5/49	S	7.5/14.5	20
Cardamons	70	20	49/66.5	30	14.5/29.5	20
Caraway seeds	30	20	34/49	12	7.5	20
Thyme, bay leaves	30	20	34/49	30	14.5	20
Coriander	30	20	34/49	30	7.5	20
Cumin	30	20	66.5	30	9.5	20
Cinnamon	30	20	86.4	30	14.5	20

	India 2004/05	Pakistan 2002/03	Bangladesh 2003/04**	Sri Lanka 2002/03	Nepal Aug 2003	Bhutan 2002
Cloves	70	20	49/66.5	30	14.5	20
Turmeric	30	20	49/66.5	30	14.5	20
Nutmeg	30	20	34/49	30	14,5	20
Ginger	30	20	26.5/41.5	30	19.5	20
Dill, cassia & others	30	20	34/49	30	14.5	20
17. Oilseeds	**30**	10	**0**	30	14.5/19.5	10
Copra	70+STE	10	26.5	30	14.5	10
Sunflower seeds	30	10	0	12	19.5	10
Soya	30	10	0	30	19.5	10
Rape/mustard	30	10	0	30	19.5	10
Rape & colza seeds low acid	30	10	0	12	14.5	10
18. Oil seed cakes & meals	15	10/20	0	12	19.5	0
19. Edible vegetable oils: Crude	75	S	7.5	26	9.5/14.5	30
Refined	85	S	34	30	19.5	30
Crude palm oil	65+TV	S	7.5+NT	26	9.5	30
Processed palm oil	85+TV	S	26.5/34+NT	30	19.5	30
Soya oil, crude	45	S	7.5	30	19.5	30
Coconut oil, crude	75	S	26.5+NT	30	14.5	30
Coconut oil, refined	85	S	66.5+NT	30	14.5	30
Margerine (veg vanaspati)	85	S	34	30	19.5 19.5	30
20. Raw cotton	10	0	0	0	2.5	0
21. Other fibres						
Raw wool	5/15	0/5	11.5	0	2.5	0
Raw jute	5	5	26.5	0	7.5	0
Flax,	15	5	26.5	0	7.5	0
Sisal, coconut etc	25	10	26.5	0	7.5	0
Silk cocoons	30	5	4	0	2.5	0
Raw silk	30	5	26.5	0	7.5	0
Fine wool: cashmere	15	5	19	0	7.5	
22. Sugar						
Raw	60+QR	25	93.9	3.5	44.5	30
Refined	60+QR	25	93.9	3.5	44.5	30
23. Natural rubber						
Latex	70	5	19	12	7.5	20
Smoked sheets	25	5	19	12	7.5	20
24. Raw tobacco	30	25	19	90	12.5	100
25. Wood and wood products	5-20	10-25	4-53.5	0-30	02.5-19.5	10-20

	India 2004/05	Pakistan 2002/03	Bangladesh 2003/04**	Sri Lanka 2002/03	Nepal Aug 2003	Bhutan 2002

Notes: The products included in this table have been chosen because they are derived from rural livestock or agricultural activities which are important in all or at least some of the South Asian countries, and are also important in consumption.

In Bangladesh Sri Lanka and Nepal the tariff rate is the total estimated protection rate of other import taxes as well as the Customs duty. See discussion in Vol I, Chapter 3. All the tariffs are the MFN rates i.e. they are not preferential rates. Bhutan has a free trade agreement with India and so there is no tariff on imports from India.

A slash between two or more tariffs means that the rates indicated apply to different products or specifications in the heading.

A dash between two tariffs means that there are a number of rates between the two indicated.

+S means that the tariff is the higher of the *ad valorem* rate or a specific duty.

S means that there is a specific tariff only.

TV means that the tariff is based on a specified "tariff value" rather than cif prices, or the higher of cif prices and the tariff value.

TRQ means there is a tariff rate quota, under which the lower tariff applies to an import quota, and the upper rate to any imports in excess of the quota.

STE means that a state trading enterprise (usually a public sector enterprise such as the Food Corporation of India) controls imports.

QR means that that there is some form of quantitative restriction (e.g. an import ban, import licensing, or an import quota) the principal or major purpose of which is to protect domestic production. The import of some products is banned or restricted for religious reasons: these cases have not been noted as QRs.

In all the countries the products in the table require some form of health, safety, sanitary or phyto-sanitary clearance to be imported. This has not been noted except in a few cases where NT indicates that there is information which suggests protection is probably a major purpose and effect of the controls (see text discussion).

NT* means that this applies to some but not all products within the general heading.

In Bhutan there is import licensing of all imports except imports from India, including livestock, agricultural and processed-food products. Information on the actual restrictiveness of this system has not been obtained.

In some cases tariffs for a general product heading are given when these rates apply to most products under the heading. Important products in that product group and products within the group that have different tariffs or other import conditions (e.g. QRs) than the general rate are indicated below the heading.

(**) Tariff rates for Bangladesh are as of April 2004 and do not reflect the adjustments made in the FY05 Budget announcements of 10 June 2004.

Table I.2
World Prices of Some Major Foodgrains 1995-2002 $US/MT

	Wheat	Maize	Sorghum	Rice
1995	177	124	119	309
1996	207	165	150	319
1997	160	117	110	283
1998	126	94	98	288
1999	112	90	84	234
2000	116	89	88	190
2001	129	89	95	163
2002	128			183

Wheat: No 2 hard red winter, Fob US gulf; 1992 avg first five months; Maize No 2 yellow, fob US gulf; Sorghum: No 2 Milo yellow, fob US gulf; Rice: Thai milled 15% broken, fob Bangkok. Calendar year average prices: 2001 first 11 months for maize & sorghum. Sources: data supplied by IFPRI, and Ministry of Agriculture (New Delhi) website <http://fcamin.nic.in>

Table I.3
World Prices of Some Edible Oils and Copra, 1996-2001 $US/MT

	Crude Palm Oil	Groundnut Oil	Sunflower Seed Oil	Copra	Coconut Oil	Rape/ Mustard Oil
1996	531	897	294	489	752	301
1997	546	1010	274	434	657	281
1998	671	909	309	411	658	294
1999	436	788	239	462	737	204
2000	310	714	207	305	450	190
2001*	250	693	215	191	297	196

Source: *Oil World*

Table 1.4
Sri Lanka: Export Prices for Three Major Agricultural Exports 1992-2001

	Tea	Rubber	Coconut products
	$US/kg	$US/kg	$US/nut
	fob	Fob	fob
1992	1.87	0.86	0.15
1993	1.89	0.92	0.13
1994	1.85	1.05	0.11
1995	2.00	1.63	0.12
1996	2.53	1.44	0.17
1997	2.69	1.28	0.16
1998	2.86	1.05	0.13
1999	2.31	0.77	0.14
2000	2.44	0.88	0.10
2001	2.34	0.74	0.08

Source: Calculated from Tables in: Central Bank of Sri Lanka, Annual Report 2001

TABLE I. 5
Bangladesh. Average and Maximum Customs Duties Since 1992/93

ISIC code		Unwtd average Customs duty %		Maximum Customs duty %		
		1992/93	1999/2000	1992/93	1999/2000	2002/03
1	Agriculture, hunting, forestry & fishing	53.6	21.4	200	37.5	32.5
11	Agriculture and livestock	49.1	22.0	100	37.5	32.5
31	Manufacturing of food beverages and tobacco	68.3	27.0	300	37.5	32.5
311	Manufacturing of food products	64.2	26.1	100	37.5	32.5
3	Manufacturing	59.0	22.5	300	37.5	32.5

Sources: WTO, *Bangladesh Trade Policy Review,* 2000, Table AIV.1, and 2002-03 Customs Tariff Schedule (computer file). Average customs duties for 2002-03 have not been calculated. Because of other protective import taxes, customs duties are lower than the total protection rate.

TABLE I. 6 Bangladesh: Agricultural, Livestock and Fisheries Products Subject to Export QRs	
Oil seeds	Ban
Edible oils	Restricted
Jute and sunlamp seeds	Ban
Wheat	Ban
Molasses and khandsari sugar	Ban
Live animals & animal skins	Ban
Pulses	Ban
Unfrozen and unprocessed prawns and shrimps	Ban
Specified saline water shrimp	Ban
Onions	Ban
Rice bran (except deoiled)	Ban
Bamboo, cane, logs	Ban
Frogs and frog legs	Ban
Raw hides and wet blue leather	Ban
Molasses	Restricted
Wheat bran	Restricted
Cow and buffalo horns and hooves	Restricted
Date-gur	Restricted
Source: Export Policy 1997-2002 as reported in WTO, *Bangladesh Trade Policy Review* , 2000.	

FIG I.1
US WHEAT EXPORT PRICES 1965-2002

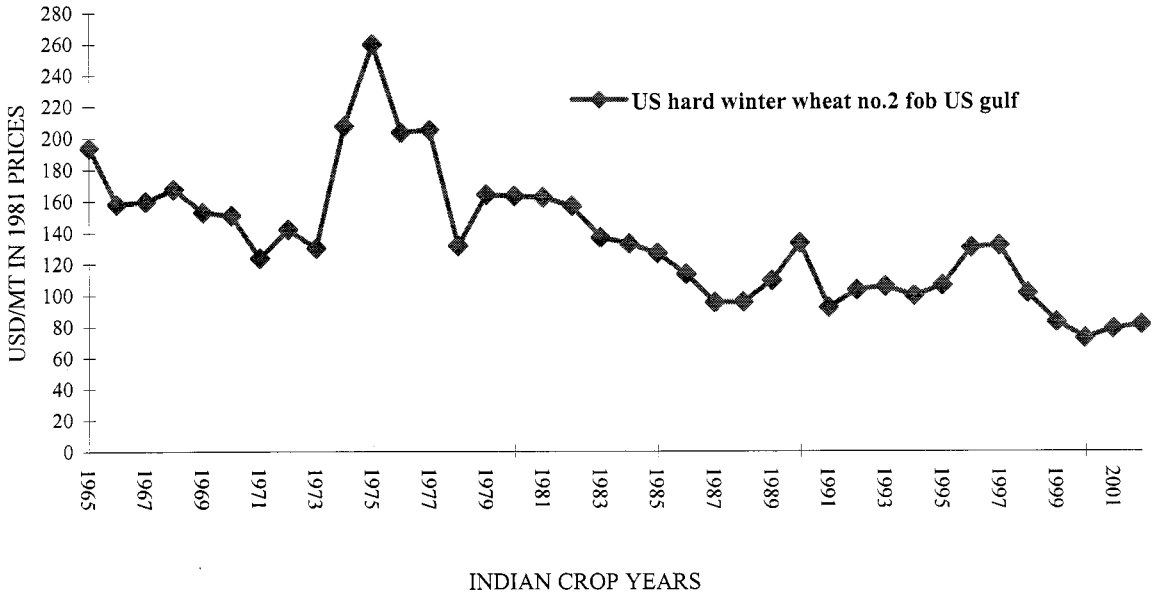

FIG I.2
INDIA DOMESTIC PRICES AND WORLD REFERENCE PRICES FOR WHEAT, 1965-2002

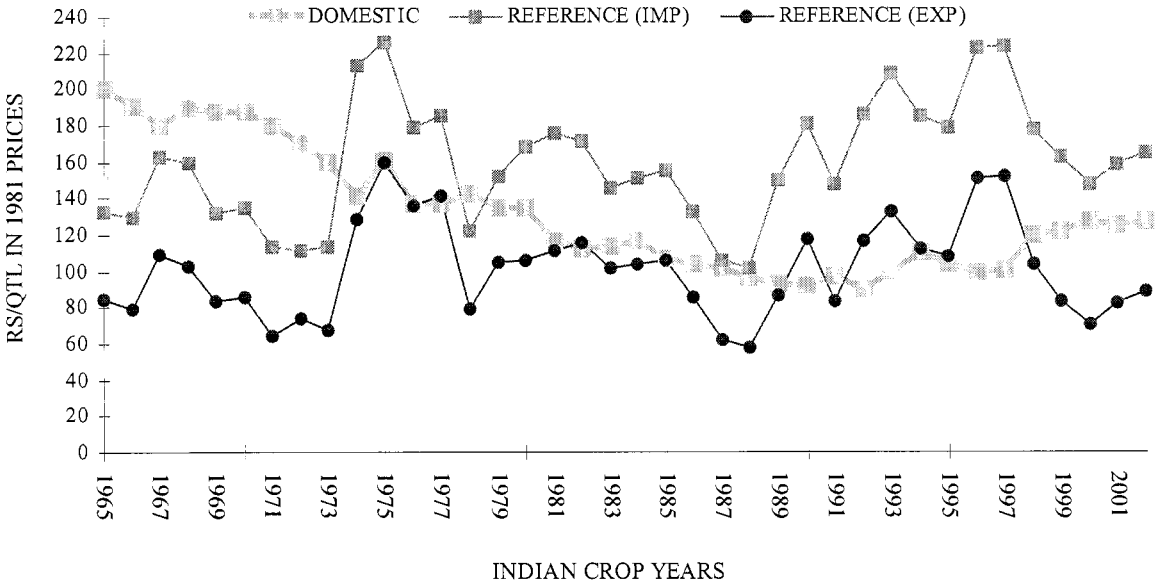

Fig I.3
Pakistan Wheat Prices in constant 1995 Rs/MT

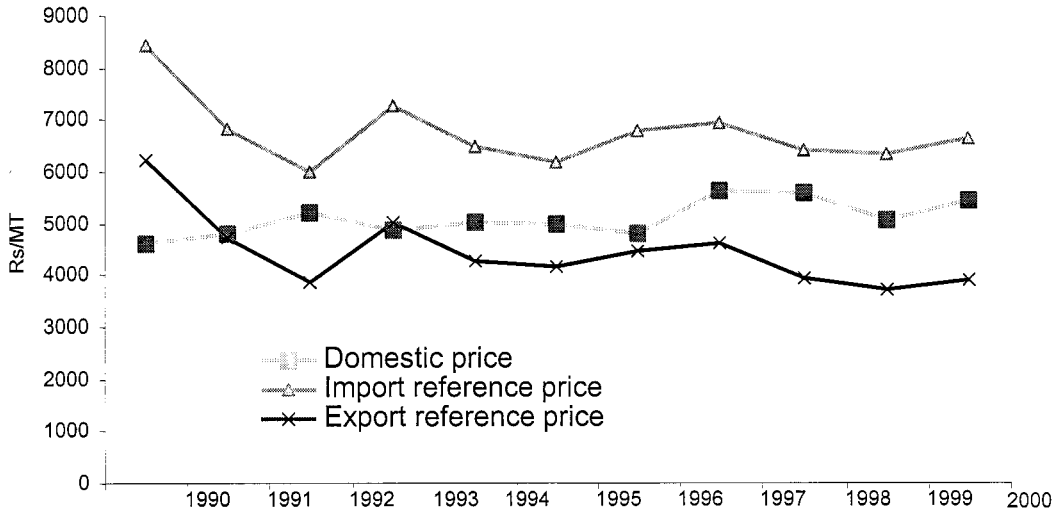

Fig I.4
World Cotton Prices 1980/81-2000/01 (Cotlook A Index, Current $US)

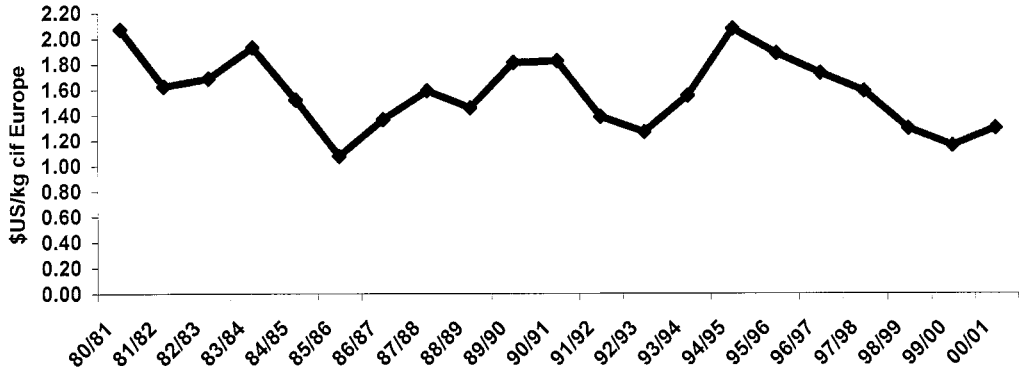

Fig I.5
Some Edible Oil Tariffs in South Asia July 2002

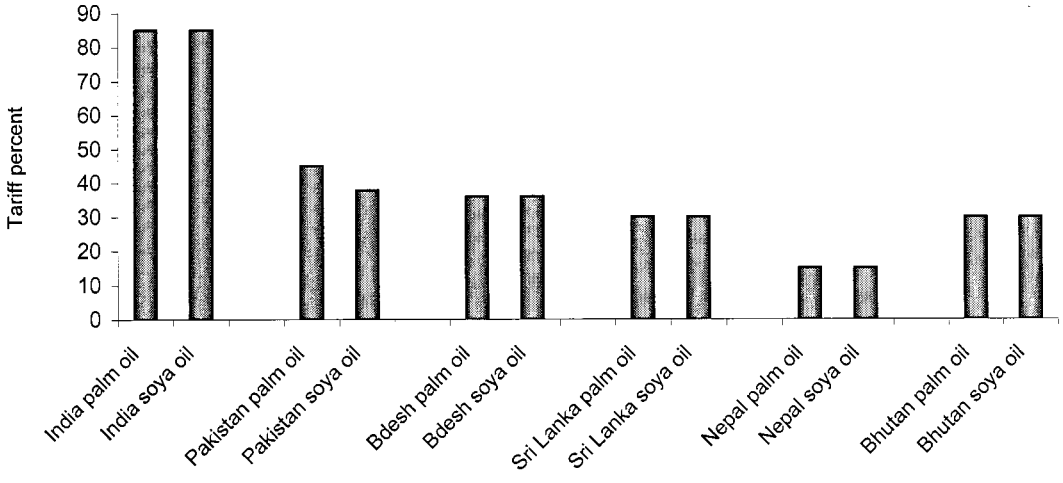

TABLE I.7
TARIFFS AND QRs ON SOME PRINCIPLE TRADABLE INPUTS FOR AGRICULTURAL AND LIVESTOCK ACTIVITIES IN SOUTH ASIA, AUGUST 2002

	India	Pakistan	Bangladesh	Sri Lanka	Nepal	
Urea Other fertilizers	35.2+STE 9.2	5 5	18.5+QR 0/11/18.5+QR	0 0	25 25	
Pesticides Weedicides, fungicides	36 36	5 5	11+QR 8.5/11+QR	0 0	5 5	
Tractors	36	30	3.5+QR	0	10	
Farm machinery & implements	30	10/20	11	12	5	
Dairy equipment	36	5	11	0	5	
Poultry equipment	30	10	11	0	5	
Maize for poultry	19.6 or 56 (TRQ)	10	3.5	0	10	
Oilcakes and meals	19.6/35.2	10/20	0	12	10	

Notes: Tariff rates are percentages; QR=quantitative restriction; STE means there is a state trading import monopoly; TRQ=tariff rate quota. Sources: Customs tariff schedules of each country for 2002-03, except for Nepal which used the 2001-02 tariff schedule. The Pakistan and Sri Lanka tariff schedules are available on line at www.cbr.gov.pak and <www.customs.gov.lk>

Chapter 2: Fertilizer Policies in South Asia

Overview

During their early periods of planned development, there was broad agreement in the South Asian countries that fertilizers should be made easily available to farmers at low prices, and that domestic production should be promoted to reduce reliance on fertilizer imports. Low and stable fertilizer prices were considered essential to persuade farmers to adopt "green revolution" technologies in food grain production, which in turn was considered necessary for food self sufficiency with low food prices. Domestic production substituting for imports was thought to be essential for ensuring that farmers would not be cut off from fertilizer supplies by disruptions of international trade. The principal need was for nitrogen supplements for food grain farming which is supplied by urea: urea still accounts for 70-80% of total fertilizer consumption in the South Asian countries, and the push to establish domestic production focused on this. However, in practice the production costs of import substitution firms-most at first in the public sector-turned out to be high in most years in relation to world fertilizer prices, and higher still than the low prices policy makers considered were needed to persuade farmers to adopt the new technologies. In India, Pakistan, Bangladesh and Sri Lanka, where local fertilizer producing industries were established, these differences were compensated by central government subsidies which covered the excess of the domestic production costs over controlled prices charged to farmers, and also the difference between the prices of imported fertilizers and the controlled farm prices. In addition substantial but hidden subsidies were transferred to the fertilizer producers by charging them prices for feedstocks (mainly natural gas, naphtha or LPG) which were well below their opportunity costs. In India, where at present there are about 34 major urea plants, the feedstocks include naphtha, LPG, natural gas and coal, all of which are supplied by parastatal firms. In Pakistan and Bangladesh the sole feedstock is natural gas, and in Sri Lanka naphtha and LPG. In Nepal there was no local production during this early period, and so its fertilizer subsidies just covered the excess of import prices over the controlled farm prices. Two urea plants commenced production in 1999 but by then Nepal had abolished its fertilizer subsidies.

Judged according to their objectives i.e. low fertilizer prices for farmers and the substitution of local production for imports, the South Asian countries' fertilizer policies have been very successful. For example, farm urea prices in India declined by about 50 percent in real terms between the early 1980s and the mid 1990s and have been well below both average production costs and import parity prices (Fig II.2) while domestic fertilizer production expanded to supply almost 90% of demand compared with about half in the early 1980s. Fertilizer prices for farmers were also kept very low in Pakistan, Bangladesh, Sri Lanka and Nepal, and in the first three domestic production rapidly substituted for imports.

There were some differences between these countries in the ways these objectives were achieved, but they all involved very large budgetary and non-budgetary subsidies, as well as government participation in and comprehensive regulation of production, importing and distribution. In particular, imports were managed by public sector import monopolies under government direction, wholesale and retail prices were set by the government at levels which were well below domestic production costs and in most years below import parity prices, public sector firms controlled domestic wholesale distribution, prices were uniform geographically and seasonally, domestic fertilizer production was subsidized with low priced feedstocks, and the fertilizer manufacturers were subject to detailed government regulation.

While these policies were very successful in achieving what they set out to do, there are strong reasons for thinking that the "green revolution" in grain farming in South Asia could have occurred at much lower economic cost without the subsidized farm fertilizer prices, and that the forced import substitution in fertilizer production also involved high economic costs which were unnecessary because reliable supplies were available from imports. This is an issue in counterfactual history which will never

be definitively resolved, but starting from the present situation i.e. where fertilizers are a normal and well known part of the farming environment, and where very substantial fertilizer manufacturing capacities have been established, there is general agreement that the traditional system of controls and subsidies is economically inefficient in many ways. Recognizing this, there have been reform initiatives of varying comprehensiveness in all five countries.

The two most complete reforms have been in Pakistan and Nepal, where fertilizer subsidies for farmers and state controls over imports, distribution and farm prices have been abolished. Pakistan still transfers natural gas to domestic urea producers at discounted prices, but this has little or no impact on prices charged to farmers since the local producers must compete with imports that are free of QRs and subject only to a 5% tariff. Bangladesh has also liberalized its fertilizer market and abolished explicit fertilizer subsidies for farmers, but subsidized transfer prices of natural gas to local urea producers have allowed urea selling prices which in the past, up to 1996/7 (the last year for which comparisons have been made), were well below import parity prices. Bangladesh has also retained QRs on urea imports and various controls over urea distribution. Sri Lanka has comprehensively privatized importing, distribution and production of fertilizers, and allows imports of all fertilizers including urea without QRs over a zero tariff. However, it has retained a large subsidy and controlled, low farm prices for urea. Some limited reforms of its traditional control system started in India in 1992, but were reversed in 1996. Apart from liberalizing influences from other more general reforms[1], India still operates its traditional comprehensive control system for fertilizers, in which large budgetary subsidies have an essential role. Fertilizers are also still included in the list of commodities subject to the Essential Commodities Act, which allows the government to intervene at all distribution stages, including importing. Government committees in 1998 and again in 2000 recommended phasing out the subsidies and the general control system, but so far there has been no action.

The inefficiencies of the traditional system of fertilizer controls and subsidies which have been widely recognized in South Asia and motivated the reforms and reform initiatives summarized above, can be grouped into effects in the rural economy, effects on domestic producers, and effects on the government's budget. The following summary is fully relevant for India's present system, but only partially for the policies followed in the other South Asian countries which have liberalized their policies to varying extents.

For the rural economy, subsidized low prices for fertilizers lead to their overuse since the cost to farmers is lower than the opportunity costs of the fertilizers, where the opportunity cost is either the (marginal) cost of importing or producing them, plus distribution and marketing costs. Subsidies for non-urea fertilizers have now been abolished in all the South Asian countries except India. Urea subsidies were removed in Pakistan in 1996 and in Nepal in 1999, but there are still large direct subsidies of urea farm prices in India and Sri Lanka. In Bangladesh, there is no explicit subsidization of urea farm prices, but there are probably implicit subsidies in the sense that the controlled urea prices of domestic producers are frequently below import parity prices, as a result of low prices for natural gas supplied to the fertilizer plants.

Secondly, episodes of partial liberalization during which farm-price subsidies were removed for non-urea fertilizers but not for urea, have caused farmers to cut back on the application of non-nitrogenous fertilizers (mainly phosphatic and potassic) but to further expand their use of urea. The overuse of urea in turn has been reported to have had damaging soil quality and environmental effects in some regions. As noted above, all the South Asian countries except India have removed farm subsidies for non-nitrogenous fertilizers: India removed them for a while but then reintroduced them. At present subsidies do not affect farmer choices between nitrogenous and non-nitrogenous fertilizers in Pakistan

[1] E.g. the removal of industrial licensing and the relaxation restrictions on foreign direct investment.

and Nepal, where both subsidies have been abolished. In India both are still subsidized. In Sri Lanka and Bangladesh choices are distorted by subsidies for urea but not for non-nitrogenous fertilizers.

	Non-N subsidies removed	
India	1992	1996: non-N subsidies reintroduced. N subsidies continue
Pakistan	n.a.	1996: N subsidies removed
Bangladesh	1992	Indirect (see explanation above) N subsidies continue to the present
Sri Lanka	1997	N subsidies continue to the present
Nepal	1997	1999: N subsidies removed

*N= nitrogenous

A third major inefficiency for the rural economy is that the traditional system of controls and subsidies involves uniform pan-seasonal and pan-territorial pricing, so that neither transport and other distance-related marketing costs nor inventory holding costs are reflected in farm fertilizer prices, leading to obviously suboptimal use of fertilizers by region and season, as well as making it difficult or impossible for the private sector to operate in the areas in which these pricing rules apply. This is no longer the case in Pakistan and Nepal, where the rural fertilizer market has been fully liberalized. In Sri Lanka, there are no controls over non-nitrogenous fertilizer prices nor over wholesale and retail margins in urea distribution. In Bangladesh there are no price controls over non-nitrogenous fertilizers, and the private sector markets urea after it is sold at a single controlled price at the fertilizer factories. However, in 1998 Shilpi reports that urea traders had to be licensed, were subject to various purchase and sale requirements and were allocated market areas in which they had sole marketing rights. How this distribution regulatory system in Bangladesh has worked out in practice is unclear. In India, in contrast to the other four South Asian countries, the old system is still fully operative i.e there are detailed controls over the wholesale and retail prices of urea and non-nitrogenous fertilizers, which involve uniform prices nation-wide and during selling seasons.

Fourth, as with any price-based subsidy, most of the South Asian fertilizer subsidies go to medium and large farmers who buy most of the subsidized fertilizers. A frequently heard argument for retaining the fertilizer subsidies is that they help small, marginal family farmers who consume most of their own production and hence are short of cash and have difficulty in obtaining credit to purchase fertilizers. But there are many less expensive and better targeted ways of dealing with rural poverty than paying very large subsidies of which only a very small proportion reaches poor rural families. One that has been recommended by an Indian official committee, is the issue of coupons to small and marginal farmers that would enable them to purchase fertilizers at unsubsidized market prices.

As regards domestic fertilizer production, the traditional fertilizer policies in South Asia have also involved high economic costs as a result of the ways by which import substitution in fertilizer (mainly urea) production has been pursued. The sources of these economic costs include:

- Direct government controls over imports which have removed or at least substantially diminished import competition disciplines for the local producers
- Large input subsidies from low preferential feedstock prices which have been discretionary, plant-specific, and non-transparent
- Absence of price competition between domestic producers which must sell at government mandated prices
- The normal motivation and management problems of public sector enterprises[2]

[2] The poor performance of public sector fertilizer producing firms in Pakistan is discussed in Faruquee et al (1995)

- Cost-plus pricing, especially under the "retention price" system in India (see later discussion in the section on India) in which subsidies paid to individual plants are higher the higher their production costs, and in which low cost efficient plants effectively cross subsidize high cost inefficient plants
- Low motivation and bureaucratic obstacles to innovation in all dimensions, including products, processes and marketing.
- In return for protection and subsidies, detailed and intrusive government regulation of firms and plants involving negotiation and discretionary decisions with major financial consequences

Finally, the traditional fertilizer policies in South Asia have involved high costs to national budgets. In India, where the full traditional structure is still in place, the fertilizer subsidy recognized in the 2000/01 central government budget was 4.2% of total central government revenue and 0.66% of GDP. This is without accounting for the substantial non-quantified subsidy from low feedstock prices to the domestic fertilizer industry. Following liberalizing reforms in the other South Asian countries, only Sri Lanka now pays an explicit budgetary subsidy (for urea), in 2000/01 equivalent to 0.21% of GDP. However, there are large subsidies in the form of low natural gas prices to urea producers in Pakistan and Bangladesh. In Pakistan, these subsidies are entirely absorbed by the fertilizer manufacturers, as farm prices of urea are directly linked to world prices through decontrol of imports. In Bangladesh, an unknown share is passed on to farmers in the form of urea prices which are lower than import parity prices. There have been no budgetary fertilizer subsidies in Nepal after the fertilizer market was liberalized and farm fertilizer subsidies finally abolished in 1999.

Pakistan. During the 1970s and 1980s Pakistan subsidized farm fertilizer prices and the government dominated production, importing and distribution. The farm subsidy for fertilizers other than urea (of which the most important is DAP[3]) were removed in the late 1980s, but urea continued to be subsidized, with the result that, as in the other South Asian countries, it was overused relative to other fertilizers. The urea farm subsidy was finally removed in 1996. These reforms also allowed unrestricted imports by the private sector over low tariffs (currently 5%). Consequently domestic fertilizer prices have been tracking border prices, DAP since the early 1990s, and urea since 1996.[4] In order to consolidate the reforms and to guard against "crowding out " effects for the private sector, the Fertilizer Import Department (FID) of the Ministry of Food, Agriculture and Livestock (MINFAL) ceased importing in 1999, and is to be closed as part of the general agricultural policy reform program. Three provincial government enterprises which used to distribute fertilizers imported by FID (as well as other agricultural inputs) are also to be closed. A public sector firm (National Fertilizer Corporation) owns 5 plants which are responsible for about 40% of domestic fertilizer production: these are being privatized. This will also involve closing a public sector distribution company which is a subsidiary of NFC. As in India and Bangladesh, natural gas is being supplied to these plants and to the private sector producers at subsidized prices which are far below the opportunity cost of the gas: the reform program envisages that these subsidies will be withdrawn. This is one of the major remaining issues in the sector, although as long as imports remain open and tariffs are low, it does not directly affect farmers since any production cut-backs could be compensated by increased imports. It will therefore be very important to resist pressures to increase tariffs or reintroduce other means of protection against fertilizer imports which are likely to result from the withdrawal of the natural gas subsidies[5]. Other key issues are:

- Ensuring that entry into private sector importing, wholesale distribution and retailing is not unreasonably restricted and that the distribution network is competitive. According to Shilpi[6], during early 2001 small traders were being excluded by excessive security deposits

[3] Diammonium phospate
[4] Shilpi (June 2001) p.20
[5] The temptation to do so will be especially strong when selling the public sector plants to private buyers,
[6] Shilpi (June 2001) p.20.

- Ensuring that importers and the domestic producers observe quality standards, and minimizing the extent to which farmers (especially small farmers) are cheated by adulteration and similar practices. The reform program envisages that a fertilizer unit will be established within MINFAL to deal with quality standards, but doing something about the latter is obviously much more difficult.
- Resisting pressures to increase tariffs to protect local producers when world prices are low, and resisting pressures to reintroduce farm subsidies when world prices are high. This will mean that farmers and the private manufacturing and trading sectors will have to learn to live with and manage the large swings in world fertilizer prices that have characterized world markets in the past and which will probably continue in the future. One of the normal functions of traders is to deal with uncertainty and changing prices, and if they function efficiently and competitively they will absorb the fluctuations to some extent and partly insulate the farmers.

Nepal.[7] Until November 1997 the import and distribution of fertilizers in Nepal (until 1999 there was no domestic production) was controlled by a parastatal, the Agricultural Inputs Corporation (AIC). For many years AIC distributed the imported fertilizers at controlled, heavily subsidized prices, plus an additional transport subsidy in remote hill and mountain regions. In November 1997, competing private imports were allowed, the subsidies on non-urea fertilizers were abolished, and a four stage phase-out of the urea subsidy over two years commenced. The urea subsidy was finally eliminated in November 1999. During these two years both total fertilizer imports and the private sector share of imports, increased substantially with apparently favorable effects on agricultural productivity and production. For a while, in late 2000, it appeared that there might be a repeat of the 1995 "urea crisis" in Bangladesh, in this case caused by an AIC decision to not fully pass on the effects of increased world prices and the final withdrawal of the urea subsidy to farmers, but to largely absorb these cost increases and to sell at low prices which would have made it unprofitable for private firms to compete. The crisis was averted in part because of working capital shortages at AIC which kept the amounts it could import low and allowed other importers to return to the market, and by increased penetration of subsidized illegally imported Indian fertilizers.

For a number of reasons the Nepalese fertilizer reforms appear to have been strongly welfare improving. First, the substantial budgetary cost of the subsidy has been eliminated. Secondly, the Nepalese government subsidy was replaced to some extent by Indian government subsidies on illegally imported fertilizer from India[8]. This trade had always existed, especially in the border Terrai areas, where prices on the Indian side reflect both the general system of controlled, subsidized prices and a variety of additional subsidies (both central and state government) for particular groups e.g. the central government's small farmer input subsidies, marginal farmer input subsidies, scheduled castes and tribes input subsidies. Not surprisingly, when the Nepalese urea subsidies were withdrawn and prices in Nepal went up, the volume of subsidized Indian urea smuggled into Nepal increased. Based on farm-level surveys, one estimate is that in 2001 about 60% of fertilizer consumption in Nepal was of illegally imported Indian fertilizers[9]. Thirdly, under the controlled system managed by AIC reliability of delivery was a major problem and is reported to have improved with the entry of legal private importers. Fourth, rent seeking and corruption associated with excess demand for subsidized fertilizer allocated by AIC has

[7] The following account of Nepal's liberalization of its fertilizer market mainly relies on Shrestha (December 2000), a report on the government agriculture reform program: Nepal, Ministry of Agriculture and Cooperatives and Asian Development Bank (2001), and personal communications from Sugandha Shrestha.

[8] Fertilizer exports from India require and export license, precisely to prevent the benefits of the Indian subsidies being passed on to farmers in neighboring countries. But in areas such as those along the India-Nepal border this restriction is impossible to enforce.

[9] Ministry of Agriculture and Asian Development Bank (2002).

been eliminated. [10] Fifth, as regards urea, the quality and reliability of the brands that are legally imported from third countries are reported to be markedly better than most of the Indian brands, and some are smuggled into India where they are preferred by some farmers even though they sell for considerably higher prices than Indian brands. This trade is presumably welfare –improving for both the Nepalese traders and the Indian farmers, although it would be more efficient if the Indian import controls were lifted so that Indian farmers could be supplied directly rather than by the roundabout route through Nepal.

After some delays, the reforms in Nepal privatized AIC, which has a large distribution network throughout the country, and the subsidizing of transport costs to remote areas was transferred to general district agricultural development programs. Fertilizers imported under a Japanese grant program which were previously distributed by AIC and used to cross subsidize its other imported fertilizers, are now being auctioned by the government to the private sector. Some remaining issues are:

- The impact of the subsidy removal and privatization of the import trade on small and marginal farmers. One viewpoint on this is that small farmers are benefiting owing to improvements in availability when the fertilizers are needed. It is also pointed out that small marginal farmers were hurt most in the past when scarce supplies were rationed by AIC. Smuggled low cost Indian fertilizers also continue to be available.
- The viability of Nepal's two new fertilizer plant, established in 1999
- How to ensure reasonable quality and to minimize adulteration and cheating

Sri Lanka[11]. There were thoroughgoing government controls over all aspects of the fertilizer industry during Sri Lanka's import-substitution planned development period. As in the other South Asian countries, this included protected and subsidized production by public sector firms, a government import monopoly, and heavily subsidized farm prices. Most of the subsidized fertilizers (principally urea) [12] went to rice growers and was considered to be a key component in the drive for self sufficiency in rice. No changes were made to these policies during the first phase of Sri Lanka's general liberalizing reforms which started in 1977. Fertilizer reform started in 1990 and proceeded thereafter slowly and somewhat erratically, presumably reflecting its political sensitivity. The main developments have been:

1990-94: removal of the fertilizer farm price subsidies (all fertilizers, including urea) in 1990, but reintroduction in 1994.

1994 and 1996: privatization of the public sector fertilizer producing firms.

1997: farm price subsidy removed for non-nitrogenous fertilizers

1998: State Trading Corporation import monopoly removed and private sector imports allowed

Since 1998: all fertilizer imports allowed over a zero tariff.

2002: In the 2002-03 budget, it was announced that direct subsidies to importers and domestic urea manufacturers enabling them to sell urea at controlled prices, will be replaced by a system of coupons with cash values that are issued to farmers, which they will be able to use to purchase fertilizers and other farm inputs at market prices. As of October 2002, this new policy had not been implemented.

At present fertilizers are imported duty free without QRs and compete with domestic production by four now private ex-PSUs. Domestic producers and importers receive subsidies which enable them to sell at controlled prices which are lower than production costs and usually lower than cif prices paid by the importers. Whether there is some protection for the local producers would mainly depend on the terms on which they receive their raw materials (e.g. naphtha) and on whether the urea subsidy is paid in such a

[10] According to the Nepal Ministry of Agriculture & ADB report (2001, Ch 13. p.8) AIC was only able to import as much fertilizer as was consistent with its annual subsidy allocation from the central government budget. It seems that this allocation was frequently inadequate to meet demand at the subsidized prices, in which case the subsidized supplies were allocated by AIC.

[11] This section mainly relies on World Bank, 2002. *Sri Lanka. Promoting Agricultural and Rural Non-farm Sector Growth; Shilpi* (1995) and Central Bank of Sri Lanka, *Annual Report 2001.*

[12] At present about 75% of the urea used in Sri Lanka goes to rice farmers (World Bank, 2002, p. 23)

way as to be neutral between them and importers. As in India, Bangladesh and Nepal, keeping the farm subsidy for urea while removing it for other fertilizers has created unbalanced use and soil quality problems, but in principle this distortion would disappear if the coupon system is implemented, since in deciding how to spend the cash value of the coupon farmers would take account of the market price of urea as well as the market prices of the other farm inputs for which the coupons can be used (e.g. seeds, pesticides etc). However, the subsidy is very large: in 2001, the retail price of urea was reported to be approximately $US 78/MT which was probably at least 50 percent or more below import parity prices at the farm, and the total budgetary subsidy was equivalent to approximately 0.21% of GDP[13]. As is also the case in India and Bangladesh, medium and large farms use most of the urea and therefore get the most benefit from the subsidy. Another potential advantage of a coupon system, is that it might be possible to target the subsidy to small, poor farmers while reducing or eliminating the coupon values received by large farmers[14]. In this way it could also be used to reduce the total budgetary cost of the subsidy while at the same time not distorting fertilizer and other input prices.

Bangladesh[15]. Until 1988, production, imports, distribution and pricing of fertilizers were controlled by the government. The government role included subsidized prices for farmers, large natural gas input subsidies for public sector producers under the control of the Bangladesh Chemical Industries Corporation (BCIC), and control of both wholesale and retail distribution by the Bangladesh Agricultural Development Corporation (BADC). Starting in 1988, a series of liberalizing reforms allowed the private sector into retail distribution and into importing and wholesaling of fertilizers other than urea. Subseqently, subsidies on two major non-nitrogenous fertilizers were removed in 1992, and the private sector was allowed to participate in urea wholesaling, although urea prices were still set well below import parity levels. Then in 1994/95 a series of uncoordinated and seemingly opportunistic, short sighted decisions by BCIC and BADC led to serious shortages of urea, farmer protests, and a major reversal of the liberalization program[16]. This included the reintroduction of controls over urea distribution. At present, the situation seems to be as follows:

- Urea production by six public sector subsidiaries of BCIC, plus one government joint venture with a Japanese firm. These plants use natural gas at heavily subsidized prices (in 1996/97 about 60% below the price charged to other users). Urea accounts for about 80% of total fertilizer consumption. Production capacity is sufficient to fully meet domestic demand and there are usually no imports.
- No direct budgetary subsidization of the farm urea price, but indirect subsidization through low controlled ex-factory prices made possible by the natural gas subsidies to the urea producers. According to estimates by Shilpi (1998) between 1987/88 and 1996/97 these prices were well below estimated import parity prices, in 1996/97 by about 40%. The extent of this subsidy at farm level since 1996/97 has not been quantified[17].
- Controls to prevent exports of urea which benefit from the natural gas subsidies when world urea prices would make them profitable
- Farm prices for non-nitrogenous fertilizers (potassic and phosphatic) which are imported and distributed by the private sector, approximately tracking import parity prices plus distribution margins

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[13] Ibid

[14] Coupons for small and marginal farmers were suggested by an Indian government committee as a way of helping small farmers cope with the its recommended phase-out of India's fertilizer subsidies. Government of India, *Economic Survey 2001-2002* p.198.

[15] This section mainly relies on Shilpi (1998) pp 24-32, Dowlah (2000) and World Bank (2002).

[16] The "urea crisis" is described in more detail in Shilpi (1998) and Dowlah (2000). Reading between the lines of these two accounts, strongly suggests that it was an outcome of very poorly managed and conceived partial privatization and liberalization of the urea market. The resulting farmer protests and political backlash have made it difficult to reintroduce the reforms.

[17] According to the Bangladesh Ministry of Agriculture website (http://bangladeshgov.org/moa)"The Government is providing no subsidy on fertilizers at the farm level and is selling all fertilizers at full cost pricing". It is not clear what this means: it most likely just means that there is no further subsidy after the urea is purchased from the urea manufacturers. But the Bangladesh public sector producers are subsidized, by the low price they pay for their natural gas. This is compatible with a substantial farmer subsidy if as a result farm prices are lower than import reference prices.

- Private sector wholesaling and retailing of urea, but subject to regulatory controls which specify exclusive distribution zones for wholesale distributors.
- Smuggled imports from India of low priced subsidized fertilizers, especially in border areas
- Government buffer stock operations

Unless there have been major changes since the Shilpi's and Dowlah's papers were written, Bangladesh could still be following economically wasteful fertilizer policies, the effects of which could include overuse of nitrogenous fertilizers, subsidized non-transparent PSU production hiding major inefficiencies including lagging production technologies and failure to introduce new products, and the stifling of competition in distribution. To better understand the present situation, it would be helpful to update Shilpi's comparisons of farm level fertilizer prices with import parity prices (hers go up to 1996/97 only), to undertake an economic cost-benefit analysis of the public sector fertilizer production, and to analyze the present situation in fertilizer wholesaling and retailing.

India. Fertilizer policies in India have had two principal objectives: (1) reduced reliance on imports by promoting and protecting domestic production (2) low, subsidized uniform selling prices to farmers The principal means for achieving the first objective have been direct controls over fertilizer imports by parastatal import monopolies, the establishment of public sector fertilizer producing firms[18], and supply of major fertilizer inputs (especially naphtha and natural gas) to Indian producers at subsidized prices. In order to achieve the second objective there is a large annual central government budgetary subsidy, one component of which is paid to domestic fertilizer producers to make up the difference between their controlled selling prices (called "retention prices") and the fixed, generally much lower farm prices, and another component which is paid to importer/traders to cover the difference between the cost of imported fertilizers and the fixed farm price. This subsidy is one of the largest single components of the central government budget, in 2001/02 estimated at Rs 14,170 Crore or approximately $US 2.95 billion. In 2000/01 it was 4.2% of total central government tax revenue, and 0.66% of GDP. This is without allowing for the subsidized selling prices of the petrochemical inputs (mainly naphtha and natural gas) used by the fertilizer producers. If these input prices were not subsidized, fertilizer production costs and retention prices would be higher and the explicit budgetary fertilizer subsidy would need to be correspondingly greater in order to keep the farm fertilizer prices at the same level.

These fertilizer policies were initially not affected by India's 1991/92 economic reforms: the only change was indirect, through the lifting of industrial licensing which made life somewhat easier for the private fertilizer producers, even though they were still regulated by the Department of Fertilisers in the Ministry of Chemicals and Fertilizers. However, there was a major change in August 1992, when subsidies for phosphatic and potassic fertilizers were discontinued and imports decontrolled. The decontrolling of imports meant that the parastatal import monopoly was removed and private sector imports permitted over a zero tariff, and that domestic fertilizer producers would have to adjust their selling prices to compete with these imports. The removal of the subsidy was followed by a sharp increase in the farm prices of these fertilizers, particularly the price of DAP (Diammonium Phosphate) when there was a jump in world prices during 1994/95. Apart from the resulting farmer unhappiness, this partial liberalization of the fertilizer market with high subsidy rates remaining on urea, led to inefficient fertilizer choices with substitution of urea for non-nitrogenous fertilizers. The rational economic solution would have been to similarly decontrol urea and also remove the urea subsidy, but instead, in 1996 subsidies (but not import controls) were reintroduced for the non-nitrogenous fertilizers. Since 1996/97, the non-nitrogenous fertilizer subsidies have increased in every year except one: in 2001/02 they have been estimated to account for about 40% of the total budgetary fertilizer subsidy, which was made up approximately as follows:

[18] At present PSUs account for about 30% of total fertilizer production (about 15 million tons annually). The rest is produced by cooperatives (20%) and private firms (about 50%).

Subsidy for	Rs Crore	$US million
"Controlled imports" i.e. mostly urea imported by MMTC[19] to make up the difference between production and domestic demand	500	104
"Controlled domestic production" i.e. mainly domestically produced urea	7956	1658
"Decontrolled fertilizers" i.e. mainly imported and domestically produced DAP and MOP	5714	1190
TOTAL	14170	2952

Source: Government of India, Economic Survey 2001-2002, Table 8.17

In 2001/02, the per ton subsidies were equivalent to the following percentages of the controlled maximum retail prices to farmers: urea 89%; locally produced DAP 42%; imported DAP 17%; MOP 75%.[20] That is, without the subsidies, if the full accounting costs of Indian produced fertilizers had been covered, farm retail prices would have been about 30 to 50 percent higher. However, this does not mean that farmers were subsidized to this extent with respect to the international prices of these fertilizers, because, depending on the level of international prices, some part of the subsidy covers the excess of domestic production costs over import prices. In 2001/02 for example, the weighted average urea retention price was about $US 181compared to cif import prices of about $US 120. Hence, if world prices at the Indian border plus port, domestic transport and marketing costs, are taken as the basis for estimating the allocation of subsidies, in years when world prices are low a higher proportion of the subsidy will go to domestic producers and a lower proportion to farmers, and conversely when world prices are high.

These relationships are illustrated for urea in Figs II.1 and II.2, which are based on data from empirical studies of this topic by Ashok Gulati and Sudha Narayanan covering the period from 1981/82 to 1998/99[21]. Expressed in constant Rupees, there was no clear trend in urea reference prices during this period, but strong cyclical patterns and some large year-to-year changes. During the 1980s and up to 1992, the impact of changes in US dollar prices on Rupee reference prices was affected by the large and continuing Rupee devaluation which started in about 1985: in particular Rupee reference prices rose considerably between 1985/86 and 1989/90, by almost 40% while US dollar border prices remained about the same. After 1991/92 the real Rupee exchange rate has not changed much so that changes in Rupee reference prices have been closely aligned with changes in US dollar border prices. The pattern of large cyclical and year to year changes in world urea prices urea has continued since 1998/99, but again there is no apparent longer run trend[22].

Fig II.2 shows the relation between Rupee import reference prices of urea during this period, farm prices, average retention prices, plus for the last four years maximum retention prices. All prices are adjusted for inflation by the Indian wholesale price index. The diagram illustrates a few key points about the urea subsidy system:

- In real terms, urea prices paid by farmers declined very substantially during the 12 years 1981/82 to 1993/94, by more than 50 percent. After that, up to 1998/99 they remained about the same

[19] Metals and Minerals Trading Corporation Ltd

[20] Calculated from subsidy and price data in Government of India, *Economic Survey 2001-01*, pp 196-197.

[21] Gulati, Ashok and Sudha Narayanan (2000). "Demystifying Fertiliser and Power Subsidies in India", *Economic and Political Weekly*, March 4, pp 784-794.

[22] *Urea Futures*, Editorial 16 May 2002. <www.fertecon.com>

- Weighted average retention prices[23] of urea producers declined from the mid 1980s up to about 1995/96. Between 1987/88 and 1995/96 the reduction was about one quarter. This probably reflected increased operating efficiencies of new larger fertilizer plants, but cost and retention price changes were also affected by changing input prices which were in turn affected by input subsidy policies.
- Between 1987/88 and 1998/99 the absolute gap between retention prices and farm prices remained about the same in terms of real Rupees, but increased as a proportion of retention prices. In 1998/99 the farm price was about 45% lower than the average retention price, just slightly lower than the discount farmers received in 2001/02 noted previously.
- During the 1980s average retention prices exceeded import reference prices by a wide margin, indicating that on average the local fertilizer producers were protected by the import control system. By contrast, during a three year period of high world prices during the 1990s (1994/95 to 1996/97) average retention prices were well below reference prices. The data graphed in Fig II.2 on its own suggests that on average the Indian urea producers were competitive with imports during the 1990s, but as noted previously, this is subject to a major caveat regarding input subsidies. Gulati and Narayanan have adjusted for this, and found that in 1996/97 20 of 31 urea plants, accounting for about 68% of Indian production, would have been competitive with imports[24]. The number of competitive plants and the proportion of competitive production would be lower with lower world prices than the 1996/97 prices, however: perhaps about half the plants and half the production at the average level of world prices during the 1990s.
- The Indian retention price system for the fertilizer manufacturing industry is plant-specific and cost-plus. That is, subject to certain guidelines on capacity utilization and some other parameters, a "normative cost of production" is estimated and a price fixed to give a 12 percent post tax return on net worth. Since the fertilizer plants differ in many respects, notably as regards feedstocks, technology, scale, location and vintage, there are very large differences in the resulting guaranteed retention prices. Before adjusting for input subsidies, in Gulati and Narayanan's sample of 34 urea plants, the highest retention price was three times the lowest. After adjusting for the input subsidies and reranking the plants by the adjusted cost, this difference increased to a factor of 3.4. To give some idea of the wide range of production costs among urea plants, the highest retention price in each year during 1995/96-1998/99 is graphed in Fig II.2. It is apparent from this, as emphasized by Gulati and Narayanan, that the Indian system has created and is supporting a substantial group of high cost inefficient urea plants that would either have to restructure or close down if the industry were opened to competition and the two key subsidies removed i.e. the explicit central government fertilizer subsidy, and the implicit subsidy that results from the under-pricing of inputs.

India's fertilizer policies have been highly successful in their own terms. Indian producers have replaced most imports and presently supply about 87% of demand, compared to 77% in 1990/91 and 52% in 1980/81, while as intended farmers are benefiting from low subsidized fertilizer prices which have made it worthwhile for them to increase yields through intensive fertilizer use. The low fertilizer prices also benefit small, marginal farmers who consume most of their own crop and who have limited cash resources to buy it. But these successes have come with very considerable economic costs, which in recent years have been more widely understood and accepted than was the case in the past. Reflecting this new understanding, in February 2000 a government Expenditure Reforms Commission set up to review all non-developmental government expenditure, recommended a four stage decontrol program to take place over five years, starting in February 2001 and concluding in 2006.[25] The recommended reform program included phased increases in retail prices and corresponding reductions in subsidies, initially using average retention prices for groups of urea plants before moving to full decontrol of urea prices

[23] The average retention prices estimated by Gulati and Narayanan are weighted by production. In 1998/99 there were 34 urea plants in their sample.

[24] Ibid Table 3(b)

[25] The recommended decontrol program is summarized in Government of India, *Economic Survey 2001-2002*, Box 8.2 p. 198.

with import competition, a separate freight subsidy for distant areas (e.g. the north east states and J&K), and the issue of tradeable coupons for fertilizer purchases by small and marginal farmers. However it retained the objective of self sufficiency and for that purpose recommended some tariff protection and continuing input subsidies on naphtha and natural gas. These recommendations ran into strong opposition from the fertilizer industry and farmers, as well as bureaucratic constituencies, especially within the Department of Fertilizers and the Ministry of Agriculture. As of October 2002 none of the principal recommendations had been implemented.

Fig 2. 1
India, Urea: Average US Dollar Import Price and Average Rupee Import Reference Price, 1982-1999 (in constant 1981 prices)

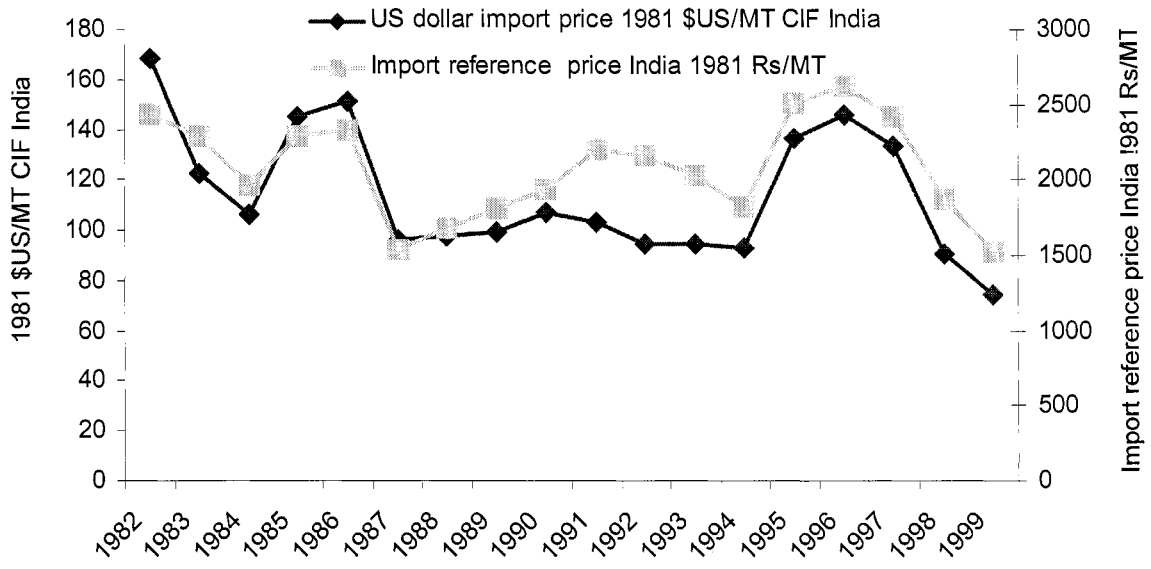
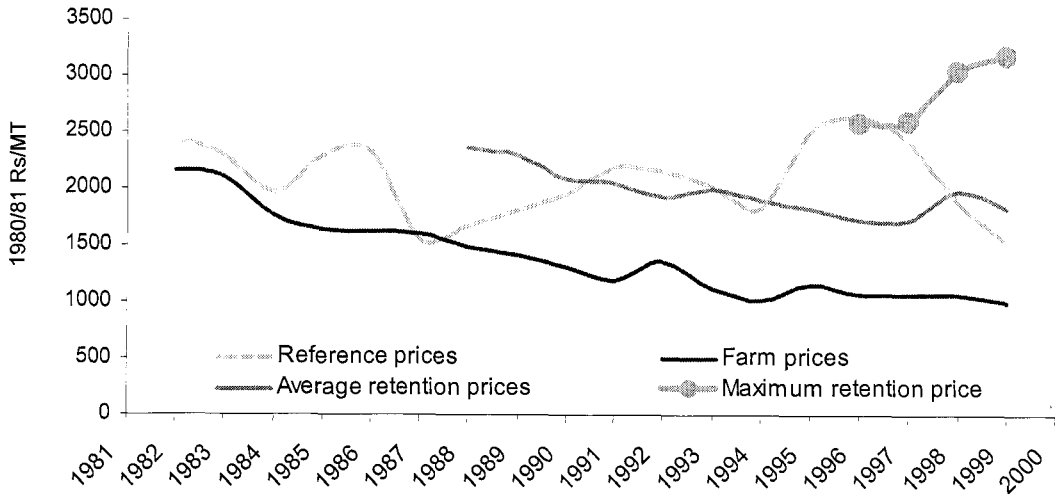


Fig 2.2
Indian urea prices 1982-1999 (constant 1980/81 Rs/MT)



Chapter 3: Textiles, Garments and the MFA Phaseout

The Setting

Exports of Textile and Clothing (T&C) emerged as a significant foreign exchange earner in South Asia countries, in large part, due to the quota system under the auspices of the Multi-Fiber Arrangement (MFA) governing world trade in T&C. The MFA was designed to help a phased and less disruptive decline of the T&C industry in the USA and EU while giving space to the low-cost economies of the developing world. The quota system is being phased out by 2005 as part of the Agreement in Textiles and Clothing (ATC) of the Uruguay Round (UR) trade negotiations. The dismantling of the quota system is expected to increase the market access opportunities for T&C products from South Asia countries as well as pose serious challenges from unbridled competition in a quota-free regime. However, South Asian countries are not evenly poised to reap the benefits from the larger T&C market or to cope with the new challenges. Sri Lanka, Bangladesh, and Nepal were the clear beneficiaries of the quota system, growing into major exporting countries of readymade garments (RMG) in 1990s, after literally starting from scratch. Post-MFA challenges will be far greater for these countries than to India or Pakistan, which were endowed with large competitive primary textile sectors, and which appeared to have been constrained by the quota system, in gaining greater market access in the expanding market for T&C products. Thus, it is pertinent to note, that the post-MFA world presents non-uniform challenges and opportunities to the countries of South Asia.

Global trends in trade and production

World trade in T&C has been undergoing major structural changes in the last decade in terms of composition.[1] Table III.1 shows that world trade in T&C was around $356 billion in 2000. Of this, over half (55%) was accounted for by trade in clothing and apparels (or garments), and the balance by trade in textiles. While trade in textiles accounted for about around 2.5% of world merchandise trade (3.4 % of world exports of manufactured goods), trade in clothing exceeded 3% of world merchandise trade (4% of world exports of manufactured goods). These figures indicate the share of clothing and apparels to be the growing segment of world merchandise T&C trade. Global apparel exports are expected to rise to some $350 billion by 2005-6.

World imports of T&C remained fairly steady from 1998-2000 (Table III.2). Within T&C imports however there is a distinct trend. Textile fibers barely accounted for about 6% of world imports, whereas textile yarn and fabrics accounted for over a third (39%), and apparels and clothing accounted for over half (55%). These disaggregated figures of T&C imports, besides reinforcing the global importance of world trade in apparels and clothing, indicates that within textiles, textile fabrics and made-ups are the next important segment of the world T&C industry.

The share of developing countries in world T&C was approximately around a third (30%) of world exports, with China emerging as a major T&C exporting nation. A look at the world's leading apparel exporters in the 1980s and 1990s reveals both a broadening and deepening of global sourcing networks, if we take $1 billion of apparel exports as a threshold for major players in the global industry.[2] In 1980, only People's Republic of China (PRC), Hong Kong, South Korea, Taiwan, and US were major global apparel exporters. By 1990, Indonesia, Malaysia, and Thailand in Southeast Asia, and India and

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[1] Asian Textile Business, various issues. International Trade Center 2000.
[2] Gereffi, Gary (February 2002).

Pakistan in South Asia were added to the list. By 1998, the new members included the Philippines, and Vietnam in Southeast Asia, Bangladesh and Sri Lanka in South Asia.

Within the South Asia region, India and Pakistan export significant amount of textiles –with Pakistan being particularly successful in exporting textile made-ups in recent times, while India and Bangladesh are significant exporters of clothing and apparels. Bangladesh has emerged as the largest single "Least developing country" exporter of apparels and clothing (both woven and knitwear- although particularly stronger in knit-wear goods) in the last few years.[3] Exports of apparels have been growing significantly in Sri Lanka and Nepal as well.

A notable trend in the world T&C industry- as in other industries- is the globalization of production activities increasing the opportunities for developing countries to participate and gain from trade.[4] Globalization - defined as slicing up of the production chain- provides greater room for developing countries to specialize in the labor-intensive stages of the manufacturing process of a commodity, which as a whole might be capital-intensive.[5] The main factors which have contributed to the globalization of world apparel industry are the labor-intensive nature of apparel production technology, the loss of comparative cost advantage of developed countries, search for production sites with lower labor costs, and the shift in apparel exports from more restricted to less restricted among the developing countries due to the discriminatory nature of the restrictions imposed by Multifibre Arrangement (MFA).[6] It is reported that roughly half of the total production capacity in the apparel industry has shifted from the developed to the developing countries over the past three decades.[7]

Because of their lower wages relative to developed countries and emerging economies in East Asia, developing countries have a greater production cost advantage in the more labor intensive apparel components of the T&C industry than in fibers or textiles. For this reason, the apparel exports of developing countries have been growing much faster than their fiber, textile yarn, and fabric exports.

Shifting Geographical Location Pattern of the T&C Industry. Alongside these T&C industry composition changes, are the changes in the world geographical or spatial location pattern of T&C industries, in response to shifting comparative advantage and the effects of world T&C quota restrictions. These changes will have implications for the T&C industries in South Asia. Despite the binding quota constraints and the adjustment problems associated with the T&C industry in developed countries, the labor intensive sectors of the T&C industry, especially garments, have been moving away from high wage developed countries to low-wage developing countries. There is also a trend for relocation of apparel industries from the high wage emerging economies of East Asia- particularly South Korea and Taiwan- to regions with relatively lower wages, but which have (or at some point in the past had) less binding quota restrictions. The South Asian countries- especially Bangladesh, Sri Lanka, and Nepal- have benefited from this worldwide relocation of T&C activities.

At the same time, the more developed T&C exporters (such as Malaysia) are concentrating on the quota-restricted higher quality, higher priced T&C products in the production of which their relatively high wage levels puts them at less of a disadvantage in relation to the lower wage developing countries. But after the phase out, this segment of the industry –higher priced and quality apparel and textile

[3] Asian Textile Business.
[4] Gereffi and Korzeniewicz (1994)
[5] In the apparel industry, globalization of production activities has meant that a garment can be designed in New York, produced by using the fabric made in India or China, cut in Hong Kong, and assembled in Bangladesh or Nepal, for eventual distribution in the United Kingdom or the US.
[6] Ramaswamy and Gereffi (2000).
[7] Hartmann (1993).

products- will no longer be protected by quotas for any country. The quota phase out will hence provide a major market opportunity for the low-wage producers in higher value-added T&C products as well.[8]

China is expected to be a major competitor for T&C products from South Asia. China / Hong Kong is currently the world's largest exporter of garments, with an 18% share in total world exports.[9] China's T&C exports are largely in the low and medium end segment of the market as are the exports of the South Asian economies – although China has been relatively more successful in diversifying into high-valued added T&C products- particularly from the China-origin T&C products from Hong Kong. China's accession to WTO, the guarantee of minimum T&C quotas for China's T&C products under the Agreement on Textiles and Clothing (ATC), and its commitments to very low bound tariffs which China agreed to as part of its accession requirements, is expected to strengthen China's competitiveness in all segments of the T&C industry. Another low wage East Asian country which is likely to emerge as a formidable competitor for T&C products from South Asia is Vietnam which, although not a member of WTO, is increasingly being integrated into the global economy through the US-Vietnam bilateral trade agreement in 2001.

China's accession to WTO can however be an opportunity for the trade prospects of T&C products from South Asia.[10] One, as part of its accession requirements, China is committed to greater integration with the world economy, and this integration extends to T&C products as well. China's commitment to reduce imports tariffs on yarn, clothing, and textile products by 2004 represents a huge market access potential for exports from South Asia. Two, China's commitment to remove the yarn export quota as a precondition for its accession is bound to benefit countries which import yarn.

Also, South Asia's T&C industries can get some respite for making significant adjustment in their respective T&C industries, due to the stringent accession conditions that China has agreed to for its membership to WTO[11]. Under China's accession conditions, importing countries can impose safeguards against surge of imports from China for a specified period of time from the time of China's entry to WTO. The specified time limit varies across countries as it was determined on the basis of bilateral accords between China and the respective WTO member countries. For T&C products, these safeguards by member countries against Chinese imports can be imposed under two categories: Under the "Textile Safeguards" category, countries can impose safeguards on T&C imports from China , if these imports are deemed to cause "market disruption", for anywhere from four to eight years from the date of China's accession.[12]

While the "Textile Safeguards" pertain specifically to T&C products, under China's accession conditions, member countries can also impose safeguards on products from China under the "product-specific safeguard" category. These safeguards which can be imposed for up to 12 years from the date of China's accession into WTO, differ from "Textile Safeguard" in that they can be imposed on any product- including T&C products. The presence of these safeguards which China has acceded may well undermine the potential Chinese competition in the coming years.

A distinct "regionalisation" trend is also evident in the consolidation of regional sourcing structures to take advantage of geographical proximity in the two largest T&C markets- US and EU, with implications for countries in South Asia. Countries in Asia are in general becoming much less important

[8] International Trade Center (2000). WTO Annual Report (2002)
[9] Based on 1998 Comtrade Database.
[10] Eglin, WTO Secretariat 2000.
[11] Lardy, Nicholas , 2001.
[12] The time limit for countries varies, since they are based on bilateral accords (Eglin, WTO 2000).

in US apparel sourcing.[13] Mexico is now the leading export supplier for the US market in the wake of the North American Free Trade Agreement (NAFTA). The fastest growing T&C suppliers in US are the Latin American and Caribbean countries including Honduras, El Salvador, Dominican Republic and Jamaica. The US market is clearly showing a trend favoring suppliers located in the Western hemisphere at the cost of Asian suppliers, as indicated by the relatively lenient Rules-Of-Origin requirements for the special trading arrangements that US has entered into with countries in the Western Hemisphere in the last few years.[14] This trend is expected to intensify with the additional preferential benefits provided to these countries with the passage of the United States Trade Development Act of 2000 discussed below.[15]

In the case of the EU, the sourcing of clothing is being gradually diverted to Eastern countries and the countries of the Mediterranean rim. Two factors have contributed to this: One, the low labor costs and Two: the prospects of reduction in transport costs and reduced delivery time associated with geographical proximity of these countries. Moreover, the EU nations have established what are known as Outward-Processing Trade (OPT) to shift apparel production from high costing Western Europe to low costing Eastern European nations. OPT, regulated in EU since 1982, is the practice by which companies export fabrics, or parts of garments, to be further processed in a third country and then re-imported as finished garments in an EU country.[16] These rules create incentives to use inputs (yarn or cloth) that originate within the region, since trade policy in EU discourages the shift of textile production. If non EU fabrics are used in OPT, they are penalized by a tariff of 14 percent levied on their re imports. The level of tariff duties offsets the advantage of lower production costs. This facility is believed to have an impact on the sourcing operations of EU, and thereby the shifting of trade in the 90s away from Asian suppliers.[17]

The presence of African (excepting for Mauritius) and Middle East countries in the US and EU market have not been very significant as yet, despite the presence of the Lome Convention providing preferential access to products from Africa in the EU market. This however is likely to change under the combined influence of duty-free access and rules-of-origin relaxation conditions under the Africa Growth and Opportunity Act (AGOA) in US, and duty free access for less-developed countries under the "Everything-But-Arms" initiative of EU.[18] Likewise, the presence of Middle East countries-particularly Jordan- is likely to change with the passage of the US- Jordan bilateral Free Trade Agreement.

In the new global market environment of the post-MFA, the following distinct trends are most likely: (a) T&C industries in medium- and high-cost countries (US and EU) will shrink and these countries will no longer be importing textiles or exporting garments, which they still do. (b) established textile exporting countries in South Asia (India and Pakistan) will be exporting more garments (in addition to China, Hong Kong) in a quota-free environment, and (c) new exporters (Bangladesh, Sri Lanka, Nepal) have opportunities to further augment RMG exports, but Sri Lanka is poised to outperform Bangladesh or Nepal, because it has the best image among South Asian suppliers of product quality and consistency, there has been substantial transfer of technology and marketing expertise due to the large FDI presence in the sector, and it has a fairly open trade regime for inputs of yarn and fabrics.

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[13] Gereffi (2002). The four countries PRC: Hong Kong, China: Korea and Mexico were core US suppliers during the last decade. Now only Mexico and PRC hold that distinction.

[14] Rules-of-origin requirements in US and EU are discussed below.

[15] United States- Caribbean Trade Partnership Act (2000)

[16] Gereffi (2002)

[17] Spinanger (2000).

[18] Both AGOA and 'Everything-But-Arms" initiatives are discussed below.

Preferential Trade in Textiles and Clothing

GSP. GSP is the scheme by which developed countries –especially US and EU- provide preferential market access to goods from eligible developing countries. Preferential access can either mean quota-free status, and/or market access at preferential tariffs – as compared to the MFN rate- or duty-free status for goods from eligible countries. Preferential tariff rates and duty free status for the beneficiary countries allow the importers from the preference granting countries to claim duty drawback on imports from beneficiary countries, thereby providing incentives for importers to source imports from beneficiary countries. The GSP preferences granted by both US and EU are country and product-specific, that is, they accrue to imports from selected countries, and selected products from eligible countries. There are however, significant differences in the eligibility criteria used by the two preference granting countries in terms of product coverage, the types of preferences granted, and Rules-of-origin (Roo) requirements for eligibility.

US and EU GSP.[19]The GSP status in both the US and EU are based on income criteria (specified in terms of per capita income). Countries whose per capita income are below a level specified by the World Bank for three years in a row are eligible for GSP benefits. All the five countries of the region qualify for GSP status based on the income criteria.

However, US GSP system (as does EU) has a product criterion as well, specifying which products are eligible for GSP status. T&C products are specifically prohibited in US. This means that even if countries qualify for GSP preferences based on income criteria. as is the case of South Asia countries, T&C products from these countries would still be subject to quotas and the specified MFN tariff rate for that product category in US.[20] The US GSP expired in 2001, and has not been renewed, although legislation to renew the program with retroactive effect is under consideration in congress.

The EU GSP system has been in effect since 1971, and in view of the importance of EU GSP system to the regional countries, the EU GSP (2002) is discussed in detail.[21] EU has an income category for GSP eligibility as does US, and all five countries of South Asia qualify for EU GSP based on income criteria. EU system has a product criteria as well, and the extent of GSP benefits varies across products. The EU system has no quantitative restrictions on products from eligible countries. That is, products from beneficiary countries face no quotas in EU. The EU system provides product-specific tariff preferences as well, and these preferences are calculated as a percentage of the MFN rate.

Products are classified as sensitive and non-sensitive for the sake of GSP preferences. On non-sensitive products (numbering 3300), beneficiaries get duty-free access in addition to quota-free status. For sensitive goods (numbering 3700) - and this includes T&C products as well, beneficiary countries get preferential tariffs as compared to the MFN rate, and quota-free access. In general, for most sensitive products, preferential tariffs- linked to the MFN rates- are reduced by a flat percent of 3.5 percentage points.[22] An exception is the preferential tariffs for T&C products, whose duty is reduced by 20% of the MFN rate for beneficiary countries.

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[19] US Generalized System of Preferences Guidebook. Office of the USTR Executive Office of the President, Washington DC. (March 1999).

[20] Six categories of textile products- handicraft textiles- were eligible for GSP treatment under a special scheme. Handicraft textiles from Nepal and Pakistan were beneficiaries under this scheme. This scheme was suspended in June 30, 1996.

[21] EU GSP (2002).

[22] A reduction of an MFN rate of 14% on a product by a flat rate of 3.5 percentage points would result in a preferential rate of 11.5% for beneficiary countries. If however, the MFN rate is 7%, the reduction of 3.5 percentage points would result in a preferential rate of 3.5%. (EU GSP 2002).

GSP benefits can be denied in EU on two conditions: (1) *Under the exclusion principle*, countries deemed to be sufficiently developed based on income criteria can be excluded from GSP status (that is, countries whose per capita income exceeds the level specified in the World Bank for three years in a row). (2) *Under the Graduation principle.* Under this principle, GSP benefits can be denied for specific products, although the country is still a GSP beneficiary based on the income criteria. Such preferences can be withdrawn for two reasons. One, if the sector in question from a country is presumed to have reached a level of competition which would ensure their growth without preferential access to EU. Such preferences may also be withdrawn if imports of a product from a country to EU exceeds 25% of the imports of the same product from other beneficiary countries. T&C products from India and Pakistan forfeited their GSP status in EU in 1999 under the graduation principle. (The GSP for T&C products from Pakistan was however reinstated in 2001 under a different scheme discussed below).

While the general preference accrues to all beneficiary countries (no quotas, duty free access for non-sensitive goods, and preferential tariffs as compared to the MFN rate for sensitive products), there are certain other schemes by which beneficiary countries can get additional benefits under the EU GSP scheme. (1) *Under special Incentive arrangements*, beneficiary countries get additional benefits - over and above what is given for general beneficiaries- for complying with certain environmental requirements and labor standards (the social clause). Benefits are doubled (as compared to general beneficiaries) for countries complying with these standards. These benefits are granted upon request and require compliance with environmental or labor standards. (2) *Under the EBA (Everything But-Arms)* scheme: Under EBA, countries formally recognized by the UN as least developed countries (48 countries including Bangladesh and Nepal), get duty-free access on all sensitive goods (including T&C , but excluding arms). Intended beneficiaries of this scheme are however, subject to stringent Roo requirements discussed below. (3) *Benefits in the form of duty-free access* for sensitive products are also given to countries for undertaking efforts deemed at combating drug and narcotics production. The reinstatement of GSP benefits for Pakistan in 2001 was under this scheme.

In sum, all the five regional countries were recipients of US GSP system (now expired). The US system however excludes T&C products. Although all countries are GSP beneficiaries in EU based on income criteria, India's T&C products face quotas due to the graduation principle. T&Cs from Sri Lanka benefit from GSP under general arrangements- no quotas and tariff preferences as compared to the MFN rate. T&C from Pakistan, Bangladesh and Nepal face no quotas and duty-free access in EU. The duty-free access for Bangladesh and Nepal are contingent upon strict Roo requirements .

Roo Requirements in EU[23]These requirements exist to ensure that the benefits provided to preferential trading arrangements are confined to products originating in the beneficiary country, and that such goods are not merely trans-shipped or given minimal processing in the country receiving the benefits. Goods shipped to the US and EU must comply with these requirements for preferential market access eligibility.

Since T&C products are specifically excluded from the US GSP schemes, T&C exports from South Asia face the MFN rate in the US market. Further, although US does grant Roo relaxations for T&C products made with imported US fabrics for countries from certain regional groups with which it has special arrangements discussed below, it does not do so for countries in the SAARC region. Given the importance of the EU GSP status for apparel exports from Bangladesh and Nepal, the ensuing discussion focuses on the EU Roo requirements.

In the EU Roo guidelines for T&C products, wholly obtained products (defined as products with no import content) are eligible for GSP preferences. Products manufactured with inputs from other

[23] EU GSP (2000)

countries are considered as originating in the exporting country and hence eligible for GSP benefits, if they undergone sufficient working or processing in the exporting country.[24]

The criteria for determining whether there has been sufficient working or processing of the product is based on two factors: (I) "*Change of Tariff Heading Rule*". The product in question must have undergone processing sufficient to fall under a different tariff heading at the Harmonized System 4 digit level. (2) *Percentage Criterion.* The value of the imported inputs must not exceed a certain specified percentage - 40% of the value of the finished product.

For most articles of apparel and clothing accessories that are not knitted, the EU requires manufacture from yarn. The use of imported fabrics would not confer origin, a significant disadvantage for countries like Bangladesh and Nepal whose apparel exports have a high import fabric content.

Regional Cumulation. The EU GSP utilization for Bangladesh and Nepal for knitwear particularly, registered a considerable improvement since 1999, due to EU's change of Roo which allowed garments made from imported yarn to qualify for GSP.[25] EU Roo 1999 provides for regional partial cumulation of origin for T&C products in certain cases. A product manufactured in the originating country with inputs from two or more countries belonging to a regional group can satisfy the Roo conditions, and hence be eligible for EU GSP benefits. This may include inputs from countries of a regional group that are beneficiaries of less favorable arrangements or which are not beneficiaries of the GSP at all. However, the main criteria is that imported inputs have to be specifically from countries which are part of the regional group.

Countries of the SAARC region qualify for this EU GSP facility and regional cumulation for SAARC entered into force in 2000.[26] In terms of this, inputs originating in any SAARC member States which are further worked or processed in an other SAARC country can be treated as if they originated in the country of further manufacture, provided the value added in the beneficiary country claiming the GSP benefit is greater than the highest customs value of the inputs originating in SAARC.

That is, Bangladesh and Nepal which use imported fabrics from India- would be eligible for duty-free status in EU, if the value added in Bangladesh or Nepal is greater than the value added in India. EU importers can in these cases claim a 100% duty rebate on imports of T&Cs from Bangladesh or Nepal with imported fabrics.[27] However, if the value added in Bangladesh or Nepal is less than the value added in India, Bangladesh and Nepal can still claim GSP benefits, although the duty drawback that EU importers can claim on imports from these countries would not be 100%, but the rate applicable to India.[28] The verification associated with EU Roo however is however quite complex.

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[24] The issue of Roo for Bangladesh came into prominence following allegations by EC to the effect that Bangladeshi exporters were claiming GSP on the basis of false declarations of origin between 1994-1996. As a result, thousands of GSP certificates issued by the Export Promotion Bureau were cancelled and Bangladesh was also asked to return about $60 million in which EC customs authorities had paid on duty drawback to EU importers of apparels from Bangladesh. (Bhattacharya and Rahman 2000).

[25] Bhattacharya and Rahman (2000).

[26] The other regions are: The Association of South-East Asian Nations (ASEAN): The Central American Common Market (CACM): and the Andean Community.

[27] According to current GSP provisions under EC preferential regime, LDCs are eligible to receive 100% duty rebate (EU GSP 2000).

[28] According to current GSP provisions, while the duty rebate for LDCs is 100%, the duty rebate is only 15% for developing countries like India (EU GSP 2000).

The T&C Industry in South Asia

The textile sector is one of the oldest manufacturing sectors in both India and Pakistan. Both countries are significant producers of cotton and export and synthetic yarn and fabrics. The textile component of the T&C industry's exports is smaller in Bangladesh, Sri Lanka and Nepal.

Under the MFA regime, while apparel exports of established producers, India and Pakistan, were constrained, exports from Sri Lanka, Bangladesh and Nepal, grew rapidly as these countries offered abundant competitively priced labor, were able to meet quality standards of existing customers, and had supporting government policy framework in place. But Bangladesh, and perhaps Nepal, suffer from major weaknesses that might stifle future growth of RMG exports. These are: total dependence on buyer's agents with buying houses providing orders for manufacturers' garmenting capacities, unreliable delivery dates and inconsistent quality, low labor productivity and machine utilization levels, limited market knowledge, problems with ports and inland transport, and so on.

T&C Regional Exports. Tables III.3 provides the importance of T&C in terms of their contribution to foreign exchange earnings. In 1998, T&C exports accounted for over three quarters of the gross foreign exchange earnings from merchandise exports in Bangladesh and Pakistan (80% and 75% respectively), over a half in Sri Lanka and Nepal (53% and 48% respectively), and slightly less than a third in India (27%). The contribution of the sector in net terms (after deducting for T&C imports), is reduced in Bangladesh, Sri Lanka, and Nepal, with net foreign exchange earnings as a percentage of total export earnings being 60% in Bangladesh, 28% in Sri Lanka, and 35% in Nepal. The rather low contribution in net terms is due to the high import content of T&C in these countries in terms of imported fabrics.

Table III.4 gives the composition of T&C exports. Exports of textile fibers is limited in most of the countries, except Pakistan. The share of textile yarn and fabrics in total T&C exports is high in India (about 51%), followed by Nepal (56%) and Pakistan (15%). Apparels account for over 90% of total T&C exports of Bangladesh and Sri Lanka.

Table III.5 gives the composition of T&C imports. Imports of T&C products consist mainly of textile yarn and fabrics, as the share of apparel imports in all the countries is very small. The share of textile yarn and fabrics in total T&C imports is particularly high in Sri Lanka (92%), followed by Bangladesh (79%) and Nepal (68%). While reliance on imports does not necessarily mean a disadvantage since imports can be sourced competitively from cotton producing neighboring countries (India and Pakistan) and elsewhere, import reliance does influence lead times and transportation costs. Transport and logistics efficiency are hence especially crucial for these countries in a post MFA phase.

The growth of the T&C industry in the regional countries was mainly due to the relatively large quotas access in US, and both quota free and preferential tariffs by EU under the Generalized System of Preferences (GSP) including duty-free access for T&C from Bangladesh, Nepal and Pakistan. In view of the importance of preferential access for T&C products from the countries, the GSP preference schemes are discussed at length.

Export Destination of T&C. Table III.6 gives the comparative US quota utilization in selected quota T&C categories for India, Bangladesh, Pakistan, Sri Lanka, and China in 1999. Quota utilization has been particularly high in Bangladesh, Sri Lanka, India and Pakistan in that order. On average it was around 85% for Bangladesh, 80% for India and Sri Lanka and around 60% for Pakistan. The quota utilization realized in these countries compare favorably with that of China. These figures suggest that the T&C sector of these countries have been reasonably capable in utilizing the opportunities provided by T&C quotas.

The T&C exports from the region remains highly concentrated in terms of export destination (Table III.7). US and EU accounted for bulk of the apparel exports from the regional countries (over 90% in the case of Bangladesh, Sri Lanka and Nepal, and over 80% in the case of India and Pakistan). Although there has been apparel market penetration of countries like Japan, Australia, New Zealand, and emerging countries in East Asia by India and Bangladesh especially, export diversification of apparels is limited in the region, with hardly any intra-regional trade in apparels.

Although India and Pakistan export textile fabrics and EU provides Roo relaxations for garments made with imported fabrics from regional countries, intra- regional trade in textiles is limited. This is particularly true for intra-regional trade between Pakistan and other regional countries, despite Pakistan being a significant cotton producer, and Bangladesh, Nepal and Sri Lanka dependence on imported fabrics.

T&C Product Concentration. The region's T&C export composition are highly concentrated in cotton-based products. The bulk of the exports of the region are in categories pertaining to Chapters 61-63, these being articles of apparel and clothing accessories knitted or crocheted, articles of apparel not knitted or crocheted, and other made-up textile articles.

At a more disaggregated level, exports of apparel from the region consist of standardized low-value added items such as T shirts, singlets, headgears and fittings, men's or boy's suits and women's or girls suits, trousers and shorts, anoraks and parkas, and textile made-ups such as towels, and bed sheets. Though there is some diversification in the case of India and Bangladesh with the countries diversifying into slightly high-value added items like quality suiting, the extent of product diversification is much less than that of China. The product composition of T&C products from the regional countries shows concentration in the items which are likely to be more competitive from the other low-wage countries in the post quota phase.

In sum, T&C products from the region are highly concentrated in terms of export destinations and product composition. While such concentration is understandable given the sheltered quota access, such concentration in terms of market destination renders the countries of the region vulnerable to country-specific external shocks.

MFA Phase out

The bulk of world trade in T&C is regulated by the Multi fiber Arrangement (MFA) which came into force in 1974. Under the MFA the developed countries negotiate bilateral agreements with individual trading partners in order to restrict the quantity of exports of specific product categories by their trading partners. The intention of MFA was to protect domestic producers in the developed countries from market disruption.

An important outcome of the Uruguay Round (UR) in 1995 was the Agreement on Textiles and Clothing (ATC), by which the textile quota imposing industrial countries agreed to phase out the clothing and textile quotas (the Multi-Fiber Agreement), which had governed world T&C trade for three decades or so.[29] The ATC provides the legal framework for the ten-year, three stage phasing of the MFA and the integration of T&C into the GATT/WTO framework by 2005. From 1995, no new restrictions can be introduced except as provided for under the agreement or under provisions such as the balance-of-payment rules. The main features of the ATC are:[30]

[29] Agreement on Textiles and Clothing (ATC). WTO Website.
[30] Report on Workshop: Textiles and Clothing: Implications for the Less- Advantaged Countries. (June 1999).

One, the ATC stipulated that quotas were to be phased out in four stages- with complete dismantlement of T&C by the end of 2004. At the start of each phase of integration, importing countries must integrate (or bring into the nondiscriminatory MFN framework of WTO) a certain specified minimum portion of their textile and garment exports based on total trade volume in 1990. In the first stage, 16% of T&C categories in the Harmonized System were to be "integrated" (or brought into the nondiscriminatory MFN framework of WTO) by 1995, a further 17% in the second stage by 1998, followed by a 18% in the third stage by 2002, and a further 49% by the end of 2004. For products which remains on the list, the MFA bilateral framework (example US and EU bilateral agreements) are to continue. Two, with integration there was to be an increase in the existing quota growth rates, with annual quotas increasing by 16% , 25%, and 27% in 1995, 1998 and 2002 respectively. Three, it was mandatory that products selected at each stage for integration had to include at least one product from each of the following sub sectors: Yarns, fabrics, clothing and other textile products.

The third stage of integration was completed in Jan, 2002. Both US and EU integrated further 18% of product categories as per the agreement. Very few T&C categories (particularly in the largely labor-intensive apparel category) of interest to countries in South Asia were integrated in the now completed three stages - with US and EU choosing to integrate product categories- where imports of products are already unrestricted, or relatively capital intensive.

The limited integration of product categories in which the regional countries have comparative advantage suggests that virtually all of the liberalization of the politically sensitive high-value added textile and clothing items would be in the final stage. Before we come to what the regional countries have done to prepare themselves for meeting the challenges, and what the countries can do enhance their competitive advantage in the post MFN phase, we briefly describe what are likely to be the problems for the T&C industry for the regional countries.

Tariffs in the Post MFA Phase. Although quota restrictions will be removed in 2005, MFN tariffs on T&C will remain. These are not likely to be reduced in the future, given the political sensitivity of these industries and the restructuring and adjustment problems associated with these industries in developed countries. Although average tariffs in developed countries have come down from 6.3% during the Pre Uruguay Round to about 3.8% on average for manufactured goods, MFN tariffs for T&C, and particularly on the apparels continue to remain high.[31] An indication of MFN tariff rate that T&C products can be expected to face in future is provided by the current MFN rates for US and EU in 2002.(Table III.8).

Average tariffs on T&C products in both US and EU have tended to go up in line with the stage of processing to protect the high value added items in both countries. The average tariffs on T&C products is much higher in US than in EU. The US MFN rates on selected apparels range are as high on average as 19%, on Cotton Yarn 7 % and woven cotton fabrics is 10%. The comparable figures for EU are around 12% for apparels, 4% on Cotton yarn and 8% on woven cotton fabrics.[32] EU however does accord duty-free access to T&C from Bangladesh, Nepal (subject to Roos) and Pakistan, and a rate lower than the MFN rate for apparels from Sri Lanka.

Trade Diversion and preferential trading arrangements. Also no less important are the potential trade diversion implications due to the rules-of origin relaxations for beneficiary countries under the Africa Growth and Opportunity Act[33] and the US Caribbean Trade Partnership Act, with the passage

[31] In spite of across the board reduction by the EU countries, reduction commitments by EU during the UR were the lowest for textiles and apparels. (Bhattacharya and Rahman 2000), and Hoekman et al (2002)

[32] The US MFN rate even within selected product categories varies depending on specification of the product. The EU tariff rate on the other hand, within product categories does not vary that much.

[33] AGOA ACT (2000)

of the US Trade Development Act in 2000. Under AGOA, US is committed to providing unlimited duty free and quota free access to apparel made in Africa from US made materials.[34] Further, under a special rule, apparels from lesser developing countries in Sub-Saharan Africa with a per capita income of less than less than US 1500 dollars, apparels from beneficiary countries could be accorded both duty and quota free access to the US market from fabrics made anywhere in the world.

Likewise, the current US Caribbean Basin Trade Promotion Act (CBTPA) signed in 2000 to boost the economies of Caribbean and Central American countries differs from the existing US Caribbean Economic Recovery Program (CBERP) in providing additional preferential access to goods from beneficiary countries.[35] Important features of this act include: (a).Extending NAFTA like preferential tariff treatment to several products excluded from the past CBERP. (b). Duty free and quota-free treatment for certain textile and apparel products previously excluded from CBERP. (C) Roo relaxations for goods made with US fabrics for beneficiary countries. This means that even if countries like Bangladesh, Nepal and Pakistan get US GSP (which excludes T&C) if and when it is renewed, the T&C products from these countries would be at a disadvantage (since their T&C products would still be subject to the existing MFN rate), when compared to T&C products from African and Caribbean countries whose T&C products are entitled to preferential and/or duty free treatment with Roo relaxations for goods made with US fabrics.

Transitional Safeguards and Anti-Dumping (AD). The phase out of MFA will result in the demise of the special transitional safeguards on T&C,- the measures which countries can resort to in the event of a surge of imports from particular destinations . Although safeguard measures are still allowed after the T&C phase out, safeguards in the post MFA phase will have to be non-discriminatory, and conform to other normal requirements of WTO such as strict proof of domestic injury criteria, and compensation of affected exporters.[36] However during the transitional period, transitional safeguards are possible. Action under transitional safeguards could be taken if it can be demonstrated by the importing country that the imports from an exporting country were a threat to domestic industries. Action under the transitional safeguard mechanisms which could be taken either by mutual agreement following consultations or unilaterally, could remain in place for up to three years without extension or until the product has been integrated into the nondiscriminatory MFN framework of WTO.

This implies that T&C products of regional countries may be vulnerable to transitional safeguards during the implementation period of ATC. An example of such transitional safeguard measure was the attempt by the US government to defend its quota restrictions on imports of combed cotton from Pakistan in 1999 which was removed by US in 2001 after having been turned down by three appellate bodies of the WTO.[37]

AD cases can be expected to continue after the MFA phase out. The use of AD extends beyond high income nation, with many middle-income nations such as Argentina, Mexico and Turkey increasingly relying on AD against T&C imports from developing countries.

Some recent instances of AD cases against T&C imports from regional countries include the imposition of AD on bed linen from India by EU, AD duty on Polyester Texturized Filament Yarn (PTFY) by Turkey against India, re imposition of AD on towels by US on Bangladesh, and AD on cotton combed yarn from India by South Korea.[38] While these traditional methods of precluding market access

[34] Even though T&C imports were explicitly forbidden under the US GSP scheme prior to its expiry in 2001.
[35] The US Caribbean Trade Partnership Act (2000).
[36] Hoekman et al (2002)
[37] WTO Annual Report (2002)
[38] Anti Dumping (AD). WTO Website.

are likely to increase in intensity, regional countries have to be prepared for some new methods (environmental and social standards) which can be used as non-tariff trade barriers.

Supply-side policy issues and policy changes in South Asia

India

The T&C industry in India is one of the most important manufacturing sectors in India as in neighboring Pakistan. It accounted for about 20% of the total output of manufactured goods and about and 27% of the foreign exchange earnings during 2000-2001.[39] Fabrics, garment exports, and made-ups account for the bulk of this sector's exports. India's T&C exports are largely cotton-fiber based.

The industry's comparative advantage and success in penetrating foreign markets is due to a combination of factors. These include: One, labor cost advantage as compared to the wage rates in countries of East Asia. Two, indigenous availability of cotton fabrics, since India is a major cotton producing country. Three, T&C quotas in the major industrial markets. Four, the largely decentralized mode of production, which has proven successful in production of low-volume apparels in a wide variety of fabric design specifications. Indian suppliers are perceived by importers to be especially "accommodating" in making small sample runs, compared to minimum order pieces from East Asia countries.[40]

India's exports of textile-based products and garments are destined mainly to the quota-imposing countries of EU and the US. The combined share of these two markets is over 70% and non-quota countries account for the balance. Other export destinations include the entrepot centers, where intermediate textile products from India are processed for re exports (eg, Singapore, Taiwan and Bangladesh and Sri Lanka in the region).

Apparels exports from India fall mainly into the middle-price segment of casual wear for which the principal competition is from China, Taiwan, Bangladesh and Sri Lanka.
India's garment exports are also concentrated in only a few items, with women's outerwear and men's shirts contributing more than 50 percent of India's garment exports. India's T&C products face quotas in US, and EU as well (since T&C products are not entitled to EU GSP since 1999).

The main challenge for India's T&C industry in the post T&C quota phase stem from the following: One, despite textiles being a relatively old industry, India's T&C products remain in the low to medium price range, where price is the main determinant for success (and India's low-labor costs has definitely been an advantage in these products). World competition from relatively low-wage countries, which are increasingly being integrated with the global economy and which are entering into regional preferential arrangements with major world importers is however likely to be more intense in these products. Two, perceptions about the low quality of India's T&C products - and more importantly – quality inconsistency of largely cotton-based Indian textile and & clothing products. Closely related are also perceptions regarding the quality consistency of indigenous cotton.[41] Three, the domestic fabric base is believed to be not fully compatible with the demands of large-scale factory production, with large lengths of uniform lots of fabric, which are needed for factories.[42] The lack of uniform quality is largely a consequence of the pro-small sector bias and discrimination against large-scale enterprises in the T&C

[39] Ministry of Textiles, Annual Report, India 2001-2002.
[40] World Bank (2000)
[41] In a study of 149 apparel manufacturers in five countries of South East Asia, manufacturers in Hong Kong and Thailand observed that Indian garments lacked consistency and uniformity in quality (Khanna 1993).
[42] Kathuria et al (2001).

sector. Recent textile policies have removed some aspects of the pro- small sector bias. Prior to discussing the policy changes, we give a brief summary of the structure of the T&C industry in India.

Structure of India's T&C Industry:[43]Unlike the T&C industries in most other countries, the T&C industry in India reveal a dualistic manufacturing feature characterized by highly 'decentralized' and small-scale industries (SSI) in the knitting and garment component of the T&C industry, and a vertically integrated "composite' component of the industry.[44] T&C enterprises in India, comprising of spinning, weaving, fabric processing and garment-making units, are classified as "organized" or "unorganized", and this classification is based on criteria such as permissible investment, employment and so on.

The organized sector in the textile sector consists of composite mills (vertically-integrated mills covering the full array of all textile processing operations- spinning, weaving, dyeing and printing) and independent spinning mills. While there is extensive public involvement in the composite mills, the independent spinning mills are largely in the private sector.

The "unorganized sector"- called as such due to the decentralized nature of their operations- consist of power loom, handloom, knitting and fabric processing units. Coordination of production is by a master weaver or loom owner. In the master weaver system, the fabric supplier, upon accepting an order from a garment manufacturer, purchases yarn and arranges for their weaving. The resulting "gray cloth" is sub contracted to a processing house for dyeing and printing. In the loom-owner system , the loom owner coordinates all the processing activities. The unorganized sector currently produces the bulk of fabrics in India.

India's textile policy have until recently favored small-scale enterprises in the T&C sector. The SSI bias was manifest in discriminatory policies against the "composite" mill segment relative to the handloom sector, reservation policies for small scale enterprises in the knitting and apparel component of the T&C sector, and reservation of production categories of textile articles (such as cotton sarees, dhotis, towels and lungis, exclusively for the handloom sector). The discrimination was through regulations relating to firm size, product composition, investment ceilings, exclusive rights to produce certain fabric varieties, low-interest working capital, and tax exemptions of products produced by small scale enterprises.

Government policy for promoting small-scale industries uses the value of capital investment to define small scale factories. Small scale units are eligible for a variety of promotional measures like preferential credit, investment subsidies, etc. Some products such as hosiery are reserved for exclusive production by small scale enterprises. The small scale nature of Indian production has resulted in flexibility advantage. Small-scale producer demand for specific fabrics is largely met by the power loom sector- which have the advantage of shorter lead time in the delivery of fabrics, which is critical for apparel manufacturers supplying largely to fashion-oriented niche markets.

However, there are problems of quality fabrics for standardized garments based on standardized cloth, and difficulty of procuring certain types of heavy cotton fabrics and fabrics in required counts and widths.[45] Another constraint often cited is the unavailability of good quality trimmings, and embellishments such as laces, buttons, zip fasteners, thread interlinings, and packaging materials. The reservation of clothing products and accessories for the small scale sector has precluded entry of both

[43] India Cotton and Textile Industries Reforming to Compete. World Bank, 2000. and Kathuria et al (2001).
[44] A "sick" enterprise in the Indian context is defined as a company that has been registered for five years and has negative net worth (accumulated losses exceeding equity plus reserves). World Bank (2000).
[45] Uchikawa (1998)

large domestic firms and foreign direct investment into the apparel sector, besides restricting the flow of new investment and technology upgrading.[46]

India's textile policies have been guided by two objectives: One, the policy of ensuring an adequate supply of reasonably-priced cotton to the largely protected domestic textile industry. Two, protecting employment in the T&C industry, both through exit barriers of the large textile mills and through explicitly encouraging employment in the handloom sector and small-scale enterprises in knitting, hosiery and the garment component of the T&C sector.

Policies have discriminated against the expansion and modernization of vertically-integrated composite spinning mills. Some examples of these policies are, the yarn export quota, the Hank-Yarn Obligation (HYO) , and the discriminatory treatment of man-made fibers relative to cotton fibers.

The vertically integrated mills had an yarn export quota. This policy, instituted to ensure an adequate supply of yarn to the weaving industry, by holding down the domestic prices of yarn relative to international prices, was an implicit tax on textile products produced by mills (The yarn export quota was dismantled following the New Textile Policy of 2001). The Hank Yarn Obligation (HYO), a requirement on spinning mills to supply not less than a quarter of their deliveries in hank form to the "unorganized" handloom sector. Three, discrimination against man made and synthetic fibers, and this discrimination continuing into the yarn and fabric stage. Man-made and synthetic fibers are subject to higher rates of excise taxation than similar cotton-based products, and this made the use of these fibers expensive either as a supplement to cotton in blended yarns or as a substitute.

Apparels in India are primarily produced in small-scale units, a consequence of the past policy of reserving apparels production for the small-scale sector. The apparel sector can be classified into three types: domestic manufacturers (few in number), manufacturer exporters, and subcontractors (or fabricators). The merchant exporter who accepts an export order subcontracts the labor intensive operations to fabricators. These goods are ultimately shipped by the merchant exporter. The amount of subcontracting to fabricators is much higher in India than in countries with a broad base of apparel exports.[47]

The most important policy change pertaining to the T&C industry was the de reservation of garment sector from SSI following the recommendations of the Abid Hussain Committee that the reservation policy had hurt India's ability to compete and expand exports in many areas, including T&C.[48] This is a significant policy change, because there were attempts in the past to promote expansion and modernization of garment industries through increasing the investment ceiling permitted for this sector, there were preconditions attached to the investment expansion in this sector. Such ceilings were permitted only for enterprises which had to fulfilling export obligations (75% later reduced to 50%), and specifications regarding exports to non-quota countries.[49] Given the cyclical nature of demand in export markets and the uncertain domestic demand for ready-made garments, large firms have been reluctant to invest in the garment industry. The de reservation of the woven segment of the garment sector from the small scale sector should provide a more conducive for expansion and modernization through attracting investment- both domestic and foreign.

The knitting and the hosiery sector however continues to be reserved for the small scale sector- although the investment ceiling has been raised for both sectors. The discriminatory treatment of the

[46] Ramaswamy and Gereffi (2000).
[47] Khanna (1993)
[48] Hussain Committee (1997).
[49] Ramaswamy and Gereffi (2000)

handloom sector however, still remains, with reservation of certain textile articles exclusively for the handloom sector.[50] Both the composite mills and the independent spinning mills are still obligated by the Hank Yarn Obligation.

The other significant Textile policy change pertains to the Technology Up gradation Fund Scheme for Textile and Jute Industries.[51] Despite having significant cost advantage and a strong fiber and production base, the textile industry in India suffers from severe technological obsolescence and lack of economies of scale. In order to capitalize on the opportunity arising out of phasing out of MFA and to move up the value chain, the Government of India has initiated a technology up gradation fund (TUFS) in 1999, aimed at making the Indian textile exports more competitive in the international markets. Some of the main features of the scheme are: One, easing the working capital requirements by the identified financial institutions through a 5% reimbursement on the interest for investment in technology modernization in the textile industry. Two, another feature is the benchmarking of technology levels in terms of specific machinery for each sector of the textile industry for reimbursement of interest. For investment in machinery with technology levels lower the specified would not be permitted for reimbursement under this scheme.

Pakistan

The Textile sector is the largest industrial manufacturing sector in Pakistan. In 2000, this sector accounted for 40% of direct employment, 30% value-added production by the manufacturing sector and about 60% of the total merchandise exports.[52] Pakistan's T&C exports in 2001 consisted of cotton yarn, fabrics (and these include in order of importance, cotton fabrics, knit ware (hosiery), art silk and synthetic fiber and tents and canvas), ready made garments, and textile made-ups (including bed ware, linen and towels). Exports of made-ups and ready made garments roughly accounted for slightly more than a half of the export earnings, with the balance accounted for by exports of fabrics and cotton yarn.[53] Pakistan like India, exports mainly cotton-based products.

Structure of the Industry. Enterprises in this sector, as in India, consist of spinning, weaving, processing and finishing, knitted fabrics and clothing, woven garments, and woolen spinning, weaving and garments. Textile enterprises include both vertically integrated units (engaged in an array of activities including spinning, weaving, and unlike in India these enterprises are involved in garment making as well), large enterprises dealing in exclusively knitting and woven garments, and small factories involved in finishing, dyeing and knitwear operations.

Pakistan's T&C exports are highly concentrated in terms of market destination, with the US and the EU accounting for more than 70% of exports. There however is some market penetration of T&C products in markets of South Africa, Turkey and Mexico in recent times.[54] The industry's comparative advantage is due to a combination of factors. These include: One, the labor cost advantage. Two, indigenous availability of cotton fabrics- although there are questions about the quality and quality

[50] The implementation of this policy gor a boost in 1994 when the Supreme Court dismissed the petitions challenging the Handlooms (Reservation of Articles for Production) Act of 1985 (Kathuria et al, 2001).
[51] EXIM Bank Of India (2002).
[52] Textile Vision (2000).
[53] Export Promotion Bureau Pakistan (2002)
[54] Pakistan's T&C exports was particularly hit in 2001 due to a combination of general external shocks (recession in US and EU), and more specific events following September 11 which led to cancellation of orders, difficult buyer-contact (because of travel advisories on the one hand and visa restrictions for Pakistani exporters on the other), imposition of war risk insurance, disruption of airline services, and an overall situation where goods from Pakistan could only be sold at low prices as the buyers perceived Pakistan to be an unreliable source of supply. (Pakistan Trade Policy 2002-2003).

consistency of Pakistani cotton, as in the case of India.[55] Three, T&C quotas in US and no quotas plus duty free access to EU since 2001..

The main problems faced by the T&C industry are: One, although Pakistan's T&C exports have been generally growing, the growth in T&C exports is more in volume than in value terms. The unit prices of T&C exports has been falling over time [56]. Two, due to the perception regarding the quality consistency of cotton fabrics. This is mainly due to concerns about the quality of cotton.

Although T&C exports are a major export earner for the country, there have been few recent policy changes pertaining specifically to T&C sector, except for the cotton policy (discussed below), and the installation of ELVIS (Electronic Visa Information System) with US for eliminating the chances of fake export licenses (visas).[57] This facility is expected to transmit information on textile quota transactions electronically from the computer network in Pakistan to the US Customs Computer Network.

More general policies aimed at enhancing the competitiveness of exports in recent times include, the conversion of the managed floating exchange rate to a market-determined inter-bank floating rate system with currency convertibility for trade transactions, removal of prior permission required for setting up enterprises, facilitating regional trade through developing road transport [58], the setting up of the Pakistan Export Finance guarantee agency, and a favorable climate for FDI.[59]

Pertaining specifically to the T&C sector given the importance of cotton-based products in Pakistan's exports and the concerns regarding the quality and quality consistency of Pakistani Cotton, are the recent policies relating to the cotton sector. These changes include, free import of superior grades of cotton, preparing a draft law for standardization of cotton for improving both the image of Pakistani cotton in world markets and bringing a more sound basis for cotton trading, and removing the seasonal price fluctuations of cotton through resumption of forward trading in cotton.

Bangladesh

The garment sector is the most important export earner (having supplanted jute) in Bangladesh since the last decade or so.[60] Since 1997/98 Bangladesh has been the seventh largest apparel exporter to US and the fifth largest to EU, and these two countries account for more than 90% of the country's garment exports.[61] The industry is estimated to provide employment to 1.5 million directly (mainly women), and official sources estimate that another 10 to 15 million benefit indirectly through this industry. The current export policy (1997-2002) has identified this sector as one of the 'thrust' sectors.[62]

Apparel exports from Bangladesh fall into three categories: goods made from woven fabrics, goods made from circular knitted fabrics, and increasingly- a growing production of sweaters. Although both woven and knitwear goods exported by Bangladesh have shown considerable growth, the growth of knit-wear goods has been particularly significant, ever since the EU granted the Roo relaxations for Knit

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[55] Pakistan, Textile Vision (2000).
[56] Martin (2002) and Pakistan, Textile Vision (2000).
[57] This was done at US insistence, following allegations of misuse of T&C quotas by Pakistan, resulting in a virtual cut in US quotas for Pakistan in 1999 . (Textile Vision, 2000).
[58] At present Pakistan's exports by roads is negligible. This is a constraint for exporters, particularly interested in exporting to the regional markets (Pakistan, Trade Policy 2002-2003).
[59] In the ADB's index of openness to FDI, Pakistan scores 2.0 as compared to 3.0 for other countries in South Asia. Lower score denotes more openness (ADB 2000).
[60] Bangladesh. The Textile Sector Study. (2000)
[61] World Bank (1999).
[62] The Textile and Clothing Industry of Bangladesh in a Changing World Economy" CPD (1999)

wear products with imported regional fabrics. The bulk of the apparel items exported by Bangladesh are destined for the low to medium end of the market.

Structure of the Industry. The industry is largely in domestic hands, with more than 95% of the garment factories entirely owned by Bangladeshi companies or families. Although not policy-induced as in India, most garment firms are small enterprises in Bangladesh. The majority of foreign-owned companies, located in the Export Processing Zones, are South Korean and Hong Kong Chinese.

The competitive strength of the Bangladesh garment industry is due to the following factors: One, apparel from Bangladesh is highly price competitive in apparels. This being particularly so for garments at the low and medium ends of the market. Two, the low labor cost advantage. The wages of garment workers in Bangladesh are low even by South Asian regional standards.[63] Projections of wages further indicate that Bangladesh will have this low labor cost advantage in the near future.[64] Three, though apparels from Bangladesh face quotas in US, it faces no quotas and has duty-free access to EU, and besides has benefited from the Roo relaxations for its knitted products. Further, there is no legal obligation for origin labeling of Bangladesh garment products in EU, which is a significant advantage for Bangladeshi exporters. Four, unlike in Nepal, the growth in apparel exports has encouraged backward linkages in accessories, with almost 80% of the garment industry's accessory requirements, such as elastic, collar bands, hangers, metal clips are now being domestically produced- although there is a shortage of interlining material.[65]

The main challenges to the prospects for Bangladesh garment exports (and Sri Lanka and Nepal as well) stem from the following: One, lack of backward linkages in domestic fabric production (and this applies to the regional countries of Sri Lanka and Nepal as well).[66] Bangladesh is dependent on imported fabrics, and this dependence has raised questions about the whether the country's apparel exports will continue in the post T&C quota phase. A policy change which needs to be mentioned in this connection is the policy prohibiting imports of fabrics for ostensibly curtailing illegal trade through land routes- usually cheaper for small lot consignments from India.[67]

Two, the lead times for delivering garments are long, and this may hamper the garment exports in a quota-free system, given the present trend towards reduced inventory holdings and quick response systems by overseas wholesalers and retailers. The lead times for garments from Bangladesh was estimated to be around 120-150 days from the date of order to the date of shipment from Chittagong. In comparison, leading garment manufactures in Hong Kong and China are believed to offer lead times from 45 to 60 days.[68]

Three, apparel companies offer mainly manufacturing capacities, that is , cutting and sewing,- besides incurring transport costs (CMT). [69] The agents (overseas or domestic) supply the intermediate inputs (the fabrics and accessories), besides providing marketing and sales efforts. The contribution of

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[63] Wage rates reported in Bhattacharya and Rahman (2000) show that wage rates were US$ 0.23 per day in Bangladesh as compared to US$ 0.56 for India, and US$ 0.49 for Pakistan.

[64] Reza, Rashid and Rahman (1998).

[65] World Bank (1999).

[66] A study by the Ministry of Textiles, Bangladesh, reported in World Bank (1999), argued that after 2005, when quotas are abolished, Bangladesh apparel industry would face a shortage of fabrics because quota-constrained countries like China and India which currently export fabrics will use their fabrics to produce apparels to the North American and EU market. Hence it was argued that it would be in the interests of Bangladesh to develop backward linkages in fabric production.

[67] Asian Textile Business (2001).

[68] World Bank 1999.

[69] In most developing countries, CM is used to denote the cost of manufacturing. Typically this includes the cost of producing the garment but excludes the cost of all materials supplied by agents. CMT includes the cost of manufacturing plus the cost of transport minus the cost of materials. (Textile Policy 1999).

garment exporters in terms of selling, marketing and promotion is limited. It is estimated that less than a quarter of the country's garment exports are sold directly to retail groups and brand suppliers overseas. While such reliance is not necessarily disadvantageous given the nascent state of the industry, it would be in the interests of the country to move upwards in the "buyer-driven commodity chain" discussed below.[70]

The issues dealing with development of backward linkages into domestic fabric production, the lead times associated with delivery of products, and moving up the commodity chain, are especially important for Bangladesh, Nepal and Sri Lanka. Since these problems are similar for the countries, these issues are discussed following a brief description of the T&C industries in Sri Lanka and Nepal.

Sri Lanka

Since 1986, the T&C sector is the most important sector in terms of industrial output, employment, foreign exchange earnings. In 2001, this sector contributed approximately 55% of foreign exchange earnings, 44% of industrial output, and provided employment for roughly 8% of the total labor force. Within T&C, the apparel industry is the leading sector and for over a decade, the apparel sector has replaced tea, the traditional front liner as the leading export earner. The import content of this sector is high– since Sri Lanka like Bangladesh and Nepal is dependent on imported fabrics. [71]

Structure of the Industry [72] The garment sector is mainly export-oriented. The textile firms number over 150, with a large number of small enterprises, less than 10 large firms accounting for bulk of gross output of the industry. In contrast, the garment sector had more than 800 firms, with the top garmenting firms accounting for a third of output, and most of the factories operating in the export processing zones..

The factors responsible for the growth of the apparel sector are: One, availability of relatively inexpensive labor (there are however indications that Sri Lanka is either losing or has already lost the labor-cost advantage as compared to the neighboring regional South Asia countries).[73] Two, relocation of garment producing countries by the quota-exhausted countries in East Asia – particularly South Korea, Taiwan and Indonesia.[74]. Three: the beneficial effects of quotas assuring guaranteed market access in US and preferential tariff rate as compared to the MFN rate in EU for its T&C products (although not duty-free access as Sri Lanka and Nepal in EU).

The main problems for T&C products from Sri Lanka are although to a more limited extent than in of Bangladesh, dependence on imported fabrics since the country's domestic fabric base is limited, high lead times (though not to the extent as faced by Bangladesh or India since Colombo has an efficient port and there are plans for making it a hub port for transhipment), and over dependence on domestically-based buying agencies. Nearly 65% of the total garment exports are estimated to be channeled through the buying offices in Sri Lanka.[75] This limits direct access to leading buyers and the potential links on foreign liaison offices.

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[70] Gereffi (2002)
[71] Central Bank of Sri Lanka, Annual Report (2002).
[72] Perera (1997) and Weerakoon and Vijauasuri (2000)
[73] Even by the mid 1990s, labor costs had risen in Sri Lanka, and the labor costs in Sri Lanka are now higher than in India, Pakistan, Bangladesh , Nepal, Vietnam and China- although lower than labor costs in Hong Kong, Singapore and Malaysia (Weerakoon and Vijayasuri , 2000).
[74] Fonseka (1999).
[75] Majumdar (1996).

Nepal[76]

Although exports of T&C products from Nepal is of more recent origin than in any of the other regional countries, currently the industry is one of the largest economic manufacturing sectors of Nepal. In terms of trade, this sector is providing about half of the export earnings from merchandise and this is mainly accounted for by the apparel component of T&C.

T&C Exports are destined mainly to US (where Nepalese garments face quotas) and EU (where Nepalese garments face neither quotas nor tariffs). Nepal, like Bangladesh has benefited from the Roo relaxation for its garments made with imported fabrics from regional countries- mainly India. The products composition is concentrated as well, with men's and boy's trousers and shirts made out of cotton and boys and girls shirts accounting for bulk of exports to both US and the EU.

Some of the major problems facing the industry are long lead times (which in Nepal's case is compounded by its geographical location dependent on transit through third countries) and lack of trade support logistics services.

Backward linkages, commodity chains and lead times

There are two possibilities for countries which lack a domestic fabric base. One, to continue sourcing fabrics competitively, whether locally or from abroad. Two, to enhance the backward linkages by providing a conducive environment for private sector investment (including FDI) in domestic fabric production.[77]

For relatively small producers there are some advantages in procuring fabrics from indigenous sources. Use of local fabrics as compared to imported fabrics would make some difference in reducing lead time and transport costs. However, there are problems associated with developing domestic fabric production at this stage of development for Bangladesh, Nepal and Sri Lanka, suggesting that competitive sourcing of fabrics (whether domestic or imported) is more important than conscious indigenous development of backward T&C linkages. One, indigenous production of fabrics entails more investment in terms of financial resources since Textile industries are by nature capital intensive as compared to the domestic production of garments which are relatively labor intensive[78].

Two, the concern that there could be scarcity of imported fabrics for these countries in the post quota phase since the now quota-constrained countries would start utilizing their fabrics is not well founded, in view of the worldwide oversupply of yarns and fabrics in the qualities similar to that used in Bangladesh, Nepal and Sri Lanka.[79] Further, China's accession agreement on lifting its export yarn quota within a specified time frame suggest that the worldwide shortage of yarns and fabrics is quite unlikely in the near future.

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[76] Nepalese Garment Industry Under Changing Global Trading Environment, WTO Cell (2000)

[77] The Government of Bangladesh is providing an export subsidy – equivalent to 25% of the value of the exported goods for using domestic fabrics. This however has been subject to abuse. Although this subsidy continues, the subsidy for Jamdani Sarees using domestic fabrics was withdrawn after it was shown that exporters were abusing the system for getting the subsidy (World Bank, 1999).

[78] Estimates show that while a garment making factory employing 200 workers and 200 machines could be set up in Sri Lanka for less than US$ 1 million, setting up a weaving factory capable of producing for the minimum level of efficiency of the firm-would require nearly US$ 20 million (Edwards 1996).

[79] Textile Policy (1999).

Three, while indigenous fabrics would improve lead times somewhat, it is not clear whether there could be very significant improvement in lead time solely due to the availability of domestic fabrics.[80] Further what matters for responsiveness in exports and external market penetration is not merely availability of domestic fabrics in sufficient quantity, but quality of domestic fabrics as well[81].

Four, EU GSP does provide relaxation of Roo for Knitwear products with imported fabrics from regional sources. This means that knitted products from countries like Bangladesh, Nepal or Sri Lanka with imported fabrics from India or Pakistan are not at a disadvantage, and this advantage could be increased further by indigenous production of accessories, and thereby increasing the extent of value addition at home relative to value addition in the regional country from which they are importing fabrics.

Lastly, a further important factor that with today's rapidly changing demands for access to the full range of fabrics and styles there would be a distinct advantage in selecting the fabric which will be in fashion for the season from worldwide sources, rather than being in a position of selecting fibers from a limited range of locally produced cloth.

These considerations suggest that while private investment (domestic and/or foreign) in the textile sector should be encouraged for developing domestic production of fabrics, for the apparel industry's prospects it is more important to ensure that fabrics are sourced competitively. Experience from other countries suggest that although possibilities for attracting FDI exist in knitting, dyeing and finishing in these countries, it might be difficult for these regional countries to attract such heavy investment in the near future in fabric production in an industry that is highly capital intensive.[82]

Although there is a trend to shift production capacity of fabrics out of the industrial countries in view of the shifting comparative advantage out of the top ten textile exporting countries in the world, the beneficiaries of such investment have been mainly other industrial countries in the west, with Hong Kong and China being the main exceptions. This shifting trend of textile industries from industrial countries and the beneficiaries from the shifting trend would seem to suggest that potential investors generally prefer to install large-scale textile plants either in other industrial countries, or possibly in countries with a large home market such as India and China where they can also benefit from the huge domestic market.

Lead Times. Lead times refer to the time taken from when orders are placed by wholesalers or retailers to when delivery is made by exporters. Lead times are estimated to be particularly long for Bangladesh and Nepal.[83] Estimated lead times from these countries range from 120 to 150 days- as against 60 to 90 days for India and under 50 for China.[84]. Reducing lead time is undoubtedly important considering the trend towards minimizing inventory holdings and quick response systems by wholesalers and retailers, and increased buying seasons in the fashion-conscious T&C industry.

One reason for the long lead times from these countries is because garment enterprises do not hold adequate stocks for meeting unexpected increases in demand. Estimates provided by the World Bank (1999) show that for standard piece dyed fabrics - representing a major portion of world import demand for fabrics- lead times could be reduced substantially if adequate stocks of non-dyed grey fabric could be held on stock, and processed for delivery as soon as the order is confirmed, and by converting the imported grey fabric into higher value-added goods by adding value addition at the stages of dyeing and finishing. Such a system, applied by a large number of processing houses in Europe, is more effective and less expensive than establishing backward linkages in an industry that is highly capital

[80] Spinanger (2000).
[81] Spinanger (2000).
[82] World Bank (1999)
[83] Spinanger (2000) and Nepal (2000).
[84] Spinanger (2000).

intensive for minimum level of efficiency. It is also instructive in this context that the largest garment manufacturing foreign-owned groups (mainly from South Korea) in Bangladesh, reduced the lead times to between 90 – 120 days for more sophisticated items and to 60 days for basics even though the entire volume of fabrics (synthetics and blends) were imported from South Korea, merely by holding adequate stocks of grey fabrics.[85]

Lead times also depend crucially on the transport efficiency and availability of trade-related logistics services. Transport efficiency in turn depends not only on the quantity and quality of transport infrastructure alone, but the imputed time cost incurred in chokepoints associated with administrative and customs clearance, both at ports and roads. With the worldwide dismantling of artificial trade barriers and phasing of T&C quotas, transport and logistics efficiency is going to be even more crucial in determining the competitive advantage of nations. In an industry, where the demand for rapid change of style is so great and where there is an increasing range of designs in demand, response times can be improved by the use of computer-aided design systems, both for processing trade documentation and for expedited cargo clearance.

In this connection, Bangladesh has made a beginning, with the endorsement of the Customs Modernization Program (CAM), the first phase of which will be completed by the end of this year. [86] The intended objectives of this program is expedited cargo clearance, both by simplifying procedures and by selectivity profiling to ensure expedited cargo clearance without compromising the revenue collection through customs revenue. Elements of this program include rationalizing the cascading duty structure and otherwise simplifying the schedule to reduce the scope for discretionary import assessment, adoption of the WTO mandated transactions system of customs assessment, inspecting some specified percentage of every consignment, random checking of containerized consignment and thereby facilitating movement of containers from the congested port area, and introduction and upgrading of electronic technology for reducing the scope for corrupt practices. Likewise, the lead times for garments from Nepal is expected to be improved considerably with the functioning of the inland container depots.

Buyer Driven Commodity Chain. It would be in the interests of countries, Nepal and to a more limited extent, to establish "Buyer-driven" global commodity chains.[87] A commodity chain refers to a whole range of activities involved in the design, production and marketing of a product. There are two distinct types of commodity chain- "the producer-driven" and "buyer driven" commodity chains. The producer-driven commodity chain are those in which large, usually transnational manufactures play the central roles in coordinating production networks (including their backward and forward linkages). Such producer-driven commodity chains are usually found in capital and technology-intensive industries such as automobiles, semiconductors and machinery. In contrast, the buyer-driven commodity chain, is common in labor-intensive, consumer goods industries such as garments, footwear and toys. In such a chain, large retailers, marketers and branded manufacturers play the main role in setting up decentralized production networks in developing countries. Tiered networks of contractors that make finished goods for foreign buyers carry out production. Large retailers or marketers that order the goods supply the specifications, act as strategic brokers in linking overseas factories and traders with evolving product niches in the main consumer markets.

The buyer-driven commodity chain is different from mere assembling of imported inputs in T&C products, in that it involves a more domestically integrated and higher value-added form of exporting. Whereas the assembly model is a form of subcontracting in which the manufacturers provide the parts for simple assembly to garment sewing plants, the buyer-driven commodity chain is a form of commercial

[85] World Bank (1999).
[86] Draper (2001)
[87] Gereffi (2002) and Ramaswamy and Gereffi (2000).

subcontracting in which the buyer-seller linkage between foreign merchants allow for greater degree of local learning about the upstream and downstream segments of the apparel chain.

Some Conclusions

Worldwide trends in T&C reveal that clothing and textile made-ups represent the growing segment of world T&C trade. While countries in South Asia have made impressive progress in exporting T&C products of good but not necessarily consistent quality, it has been largely in low to medium range of goods, where price is the main determinant of success. The world competition for these goods is likely to be especially intense after the dismantlement of quotas from the other low-wage countries which are increasingly being integrated in the global economy. It would be in their interests to diversify the product composition in terms of higher value-added textile and apparel products, where their labor cost advantage would be a significant -advantage in the Post quota phase, provided they make the necessary adjustments in terms of reducing lead times through transport and logistics efficiency among others.

A notable trend in the geographical pattern pertains to the regional sourcing of T&C imports by US and EU. Both US and EU seem to be doing a preference for sourcing imports from geographically proximate countries to reduce transportation costs and reduce lead times in line with the trend towards reducing inventories for the Quick response system. Although both US and EU (particularly EU in view of the duty free access for T&C products from Bangladesh, Nepal and Pakistan and EU's Roo relaxations for goods made with imported fabrics from regional countries) will remain important markets, it would be in the interests of countries in South Asia to diversify their T&C exports to other countries in general- and encourage trade within the region in particular, by removing the policy-induced impediments to intra-regional trade.

The EU Roo relaxations for products made with imported fabrics from the region again strongly suggests the need for intra-regional trade. Intra-regional trade in T&C is as yet quite limited. (Current figures for the Intra-regional trade in T&C needs to be checked). South Asia has traditionally been a major cotton-producing region, with two of the important cotton-producing countries of the world- India and Pakistan. The region as a whole also has a very large market for textiles and garments which can be easily be supplied from within the region. There is practically no intra-regional trade in apparels. Trade in textiles is largely confined to trade between India, Bangladesh, Nepal and Sri Lanka, with India exporting fabrics to the respective countries. Trade between Pakistan and other countries of the region is extremely limited, although Pakistan is a significant cotton producing country.

Another trend is the world T&C industry is that of increased buying seasons and minimizing inventory holdings through JIT and Quick Response systems by wholesalers and retailers in major markets. This highlights the need for reducing lead times associated with delivery. Lead times depends on the efficiency associated with transport efficiency and efficiency associated with providing trade-related logistics services. Transport efficiency depends not only on the cost, but also the time taken in delivering products, *door-to-door*. That is, not only the cost and time associated with the oceangoing leg of the travel, but the time and cost from factory gates to the port of embarkation (and transit cost through third countries as in the case of Nepal) , and the logistics (expedited cargo and administrative clearance at chokepoints whether it is ports or roads, port charges, expedited trade documentation and so on).

South Asian Domestic Market Protection Policies

Tables III.9 to III.12 compare tariffs and QRs (as of September 2002) in the South Asian countries for some of the principal textiles fibres, yarns and fabrics (i.e. cotton, polyester and acrylic) and for garments (knitted garments and garments made from woven fabrics). A number of major points emerge from these comparisons.

- Explicit QRs are no longer used to protect domestic markets, with the important exceptions of the textile fabric industry in Bangladesh, and India's ban on the import of second hand clothing.

- In addition to its textile fabric QRs (for most an import ban unless they are used by exporters as inputs) Bangladesh also gives extra protection to its textile yarn and fabric producers by exempting them from the VAT which (in addition to Customs and other import taxes) is paid by importers. Hence, as discussed earlier, for these products the VAT on imports may act as an extra protective import duty, depending on whether the purchaser of the domestically produced yarn or fabric is subject to VAT, and if so at what rate. The total protection rate for fabrics goes from 32.7 percent with normal duties only applying, up to 52.1 percent if the VAT exemption is fully effective.

- India employs an extensive array of specific tariffs to protect its fabric and garment industries (see Tables III.13-18). In its T&C tariff HSC chapters (50-63) 267 out of a total of 848 tariff lines currently have specific duties i.e. the duty is the higher of the general *ad valorem* rate or the specific amount. All except two of these are fabric and clothing products, for which the proportion of tariff lines subject to specific duties is as follows: cotton fabrics, 49%; man-made filament fabrics, 88%; man-made staple fibre fabrics, 69%; special woven fabrics (including tyre cord fabrics), 51%; knitted apparel, 30%; apparel, not knitted, 62%. India has also imposed anti-dumping duties on five major synthetic textiles; acrylic fibres, acrylic yarns, nylon tyre cord fabrics, polyester staple fibres, and polyester partially oriented yarns (POY). As noted in the previous discussion of anti-dumping, the anti-dumping duties are targeted at low priced supplies and are also specific. The intention and likely effect of the specific duties is to exclude low priced imports from the Indian market altogether. Some examples of the ad valorem equivalent of Indian specific duties on cotton fabrics and polyester fabrics are shown in Figs V.1-3. For cotton fabrics the four randomly chosen examples correspond to ad valorem tariffs of between 45 and 60 percent, and one of the polyester fabric examples is equivalent to an ad valorem tariff of more than 100 percent. An example of an anti-dumping duty is illustrated in Fig V.3. The export prices and other details of how these ad valorem equivalent duty rates have been calculated are given in Tables III.13-15. By estimating prices cif India from detailed price data on Chinese garment exports to the US, the ad-valorem equivalent Indian tariff on cotton shirts is estimated at 36.9% for the median Chinese export price, and 49.4% for the first quartile Chinese export price. For mens' cotton trousers, the ad valorem equivalent tariffs are 52.7 % (median Chinese export price) and 120.1% (first quartile Chinese export price). As with most of textile specific duties, these protective rates are so high that there is no way that shirts and trousers priced below or even at the median level prevailing in international markets could be profitably exported to India. For low value textile fabrics and garments, tariffs at these levels are effectively continuing the explicit import ban that was finally phased out on April 1, 2001 following India's loss of its GATT Article XVIII (b) case at the WTO.

- Across the board, protection of the domestic T&C industries is much higher in India and Bangladesh than in the other South Asian countries.

- T& C industry protection in India and Bangladesh is also much higher than present tariff protection in China, and higher still compared to China's final bound WTO tariff bindings e.g. 5% for cotton yarn in 2002, 10% for cotton fabrics in 2003, 5% for polyester yarn in 2004, and 5% for polyester fabrics in 2005. For most garments, China's current tariffs are between 18% and 23% and its final tariff bindings, to be reached in 2004 or 2005, are 14% or 16%.

- Tariffs in India and Bangladesh are also much higher than tariffs in the US and the EU. Assuming the MFA quotas are in fact abolished as agreed in December 2004, these tariffs (which are bound at the WTO) will become the principal means of protecting T&C producers in the US and the EU.

- In striking contrast to India and Bangladesh, in Sri Lanka since 1997 there has been free trade in the textile industry i.e. no QRs and zero protective tariffs on yarns and fabrics. There is also a single low 10% tariff on imported garments.

- T&C protection in Pakistan is markedly lower than in India and Bangladesh, but in some segments it still high by international standards. In particular, cotton yarn tariffs (5%) are low, but combined with 25% tariffs on cotton fabrics, make available very high effective protection to cotton fabric production.

- Except in Sri Lanka, T&C tariffs in the other South Asian countries are mostly steeply escalated according to the degree of processing, starting with generally low or zero tariffs on raw cotton and other textile fibres, with higher tariffs on yarns and higher again on fabrics. This systematically provides higher effective protection to processing margins than the nominal protection of final outputs. However, garment tariffs are not always higher than fabric tariffs (notably in Bangladesh), perhaps reflecting the fact that a large share of fabrics are effectively sold as final consumer goods. In India, tariff escalation is also moderated by protection commitments to upstream domestic synthetic fibre and yarn producers, and further upstream by protection commitments for petrochemical producers (not shown in these tables).These high upstream tariffs which are reinforced by anti-dumping and specific duties (see examples for polyester and acrylic textiles in Tables III.13. and III.15) increase downstream input costs and provide arguments which fabric and garment producers have successfully used to obtain extra protection from specific duties. There also appears to be a similar commitment to an upstream synthetic fibre producer in Pakistan, but the government has not allowed this to undermine its general trade liberalization and tariff reduction program by giving extra protection beyond its general maximum tariff slab, to yarn, fabric and garment producers.

- Nepal has a low-tariff regime for textile yarns and fabrics (zero tariffs on cotton yarns) but as in Pakistan these low input tariffs combine with a 25% tariff on imported garments to make available very high levels of effective protection to its garment industry.

- Bhutan also has a very escalated T&C tariff structure, with zero tariffs on fibres and yarns, 20% on fabrics, and 30 % (increased from 20% in 2001) on garments. This structure also makes available high effective protection levels for local fabric and garment production.

- Tariff bindings with the WTO have constrained Indian applied tariffs to some extent, but only a few of Pakistan's T&C tariffs are bound, and none in Bangladesh or Sri Lanka. India has bound 26 percent of its T&C tariff lines, mostly at 25% or 40%. Nearly all these bindings are fibres and textile yarns: of 642 6-digit fabric and garment tariff lines, 604 are unbound (Table III.16). As discussed in Chapter II, the tariff lines which are bound seem to have had some constraining effects. There has also been some constraint on tariff increases resulting from bilateral agreements on maximum applied textile tariffs between India and the US and India and the EU, which were negotiated during the Uruguay Round and which cover a fairly wide range of textile products including a number of fabrics. Although these maximum applied tariffs were negotiated bilaterally, they are applicable multilaterally under the WTO MFN principle. For the US and the EU, however, the maxima are principally seen as ways of possibly opening opportunities for exports to India of some specialized high quality, high-value textile products. Consequently they have not objected and indeed may have been pleased when India introduced specific duties for many of the fabrics covered by their agreements, since the effect of the specific duties was to penalize and probably exclude low-price suppliers such as China, while generally not exceeding the agreed ad valorem duties and therefore not penalizing US or EU exports (or potential exports) to India.

Conclusions and Recommendations

Perhaps more than in any other part of the world, there are very substantial economic opportunities in the MFA phaseout for the South Asian countries. But for many reasons, with the exception of Sri Lanka, the continuing high protection of all or substantial segments of their domestic markets suggests that they are far from ready to take full advantage of these opportunities.

Firstly, high protection takes the pressure off industries to improve their performance and makes it easier for bureaucrats and politicians to avoid or put off taking policy decisions which are clearly in the longer run national interest, but which are politically difficult and which may not serve their institutional or personal interests. A very clear example is the use of specific duties in India. These were introduced in 2000 to compensate for the abolition of QRs and tariff reductions that were in the offing. How and why this was done in the case of garments has been explained by the president of the Clothing Manufacturers' Association of India (CMAI) in a symposium on the textile and garment industry[88]:

"With...the removal of import controls on several commodities including garments, countries are vying with each other to export garments to India. Initially, cheap low quality garments had started entering the country. Alarmed with this trend that could hurt the domestic garment industry, CMAI took in hand the task of calculating specific import duty for each garment. Since then import duty of 40 percent ad valorem...did not offer the industry a level- playing field with the imported garments. The domestic industry is already saddled with duties and taxes on inputs of garments, which cumulatively add up to 38 percent of the cost of production. It took CMAI four long years to convince the ministries of textiles, commerce and finance the necessity to put in place the specific import duties so calculated."

In the same symposium, similar reasons were given by the textile producers for the extra protection they also obtained through specific duties on imported fabrics. These reasons included high prices for their inputs (i.e. fabrics into garments, yarns into fabrics, and synthetic fibres into yarns), the poor quality of domestic cottons, and a variety of problems affecting their processing costs including low productivity machinery. Hence poor quality and high costs in each stage of the processing chain feeds into higher input costs for the next stage, and on this basis each stage has been demanding and obtaining special protection. But all of the problems afflicting the Indian T&C industry have been well known for many years, and attempts of limited effectiveness to deal with them go back at least 15 years. Most of these have been subsidy schemes of various kinds devised and directed by the Ministry of Textiles, the latest of which is the "Technological Upgradation Fund Scheme"(TUFS) introduced in 1999. The main thrust of this scheme is to provide subsidized funding for equipment investments by textile producers, especially the power loom sector, by an interest rate subsidy of 5 percent for purchases (either local or imports) of specified types of equipment, or alternatively a direct subsidy equivalent to 12 percent of the cost of approved types of machinery. One motivation for the TUFS scheme is to help the industry face up to the coming MFA phaseout, but the immediate motivation is to help adjust to the removal of the Indian textile and garment QRs which occurred in April 2000 and April 2001, and also to prospective reductions in general tariff levels including textile tariffs. But the simultaneous imposition of new forms of protection, through specific and anti-dumping duties strongly supported by the Ministry of Textiles, seems to have removed much of the urgency for adjusting, and two years into the scheme there were few takers for the subsidized loans, and pressures to make new investment more attractive by measures such as lowering or removing textile machinery tariffs, paying firms to scrap old spinning equipment etc i.e.

[88] Textile Office. Com website http://www.textileoffice.com/interview/index.cgi/. The website includes summaries of interviews with the Minister of Textiles and the chairmen of the major Indian T&C industry associations

for more subsidies in addition to the TUFS investment subsidies and the extra tariff protection that had been obtained through specific duties and anti-dumping actions[89].

A second reason for the South Asian countries to avoid policies of high protection to their domestic markets, is that low cost, internationally competitive domestic T&C markets will provide a much better basis for exporting to a more competitive post-MFA world than a situation when all or some domestic segments of the T&C industries are protected. For example, there are many advantages for garment exporters when some or all of their fabric requirements are supplied by domestic textile firms e.g. shorter delivery times, closer contact with suppliers, avoiding the inevitably more complex formalities of international trade, especially at Customs. But exporters cannot afford to buy their inputs locally unless the firms that supply them are fully competitive with international suppliers.

Thirdly, exports from a high cost protected domestic industry are much more vulnerable to anti-dumping in importing countries than exports from open competitive domestic markets where internal prices are in line with prices in export markets. With the disappearance of the MFA and relatively low bound tariffs in developed countries, it is unfortunate but realistic to suppose that anti-dumping will become the new dominant form of protection in the world T&C industry. Except for Sri Lanka, the present protective structures of the South Asian countries make them very vulnerable to these kinds of measures. By country, the most vulnerable T&C sectors are probably:

India: synthetic fibres, cotton yarns and synthetic yarns, fabrics, garments
Pakistan: some synthetic fibres, synthetic yarns, fabrics, garments
Bangladesh: cotton yarns and synthetic yarns, fabrics, garments
Nepal: garments

Fourth, in addition to anti-dumping, after the MFA phaseout, T&C exporters in high protection countries are also likely to be more vulnerable than exporters in low protection countries to countervailing duty actions in importing countries that take aim at direct and indirect subsidies, especially excessive duty drawbacks or subsidies resulting from other schemes (such as the Indian advance licenses and duty exemption passbook (DEPB) scheme) which rebate or offset tariffs on directly or indirectly imported intermediate inputs. It is well known that these schemes in South Asia have periodically provided substantial subsidies for a variety of exported products including textiles and clothing, but there have been relatively few cases initiated against them by developed countries, since the exports have in any case been restricted by the MFA quotas. Similar export subsidies have also resulted from the various bonded warehouse schemes, both from legal domestic sales, and from illegal leakage of both duty exempt materials and finished products into the domestic market. When the tariffs on the inputs are zero, as is the case for yarn, thread and fabric inputs for the Sri Lankan garment industry, by definition there is no scope for this kind of export subsidization, except insofar as diversion avoids domestic indirect taxes. Even then, with the VAT systems that are now in place in all the South Asian countries, there would be little tax advantage in the diversion, since the buyer of the illegally diverted materials loses the VAT credit on the inputs.

Fifth, bilateral and multilateral negotiations on world T&C trade are sure to continue after the MFA phaseout, including especially negotiations on regional preferences and the rules of origin associated with them, anti-dumping and subsidies rules, technical and health standards, and labor and environmental standards. The South Asian countries will have a much more credible role in these discussions and will be able to pursue their own negotiating interests more effectively if segments of their

[89] This comes out very clearly from the symposium interviews, including the interview with the Minister of Textiles, published on the Textile Office.com website. See also an interview with the Chairman of the Indian Cotton Mills Federation during 2001 on the ICMF website www.icmfindia.com.

own domestic markets for textiles and clothing are not hermetically sealed or heavily protected against imports. Their markets are also large enough (especially the markets of India, Pakistan and Bangladesh) to give them considerable negotiating leverage with countries from which they import, because even a very small market share in say India could represent a very large export interest for most exporting countries. Of course it could be argued that by heavily protecting their markets now, India and to a lesser extent Bangladesh and Pakistan are increasing their bargaining power and will be able to obtain more concessions from other countries by having more to give away. There are two major problems with this as a strategy. First, the economic costs of the extra protection come up front and are likely to greatly exceed any discounted economic benefits of improved access to other markets that bargaining away the extra protection might (or might not) generate in the future. Secondly, it is highly likely that the domestic interests created by policies of high protection will resist and may prevent altogether or greatly limit future attempts to bargain away their protection, and hence future bargaining benefits may be zero or negligible while the economic costs of the extra protection continue.

Sixth, low or zero protection and open domestic markets for T&C in South Asia would remove much if not all the motivation for both conventional and "official" (also known as "technical") smuggling between India and its neighbours, and would go much further towards establishing a South Asian common market for textiles and clothing than has happened under SAPTA or is likely to happen under the various bilateral trade agreements. This smuggling and the corruption on both sides of the borders that accompanies it is a persistent irritant in India-Bangladesh and India-Nepal economic relations, in particular.

Seventh, open domestic markets would also greatly improve the benefit to South Asian garment exporters of preferential arrangements such as the EU's GSP, under which the use of fabric and other inputs produced in any of the SAPTA countries qualify the garment for the EU's origin rules.

Finally, and most important, South Asian consumers will benefit if protection is reduced or eliminated, as they have in Sri Lanka where there is free trade in textiles and a low 10 percent tariff on garments. In this regard, it is important to recall that in South Asia, although T&C exports are important, domestic sales are very large. *In India about 90 percent of textile fabrics are sold domestically*, mostly in small retail shops to consumers who either employ local tailors or themselves make them into saris or other traditional garments. Most of this very small scale local tailoring activity is not captured at all in published production or national income statistics even though it is much larger than both the "registered" and the "unregistered" garment industries which principally specialize in western style clothing. Consequently high fabric protection reduces consumer economic welfare in two ways, not only by increasing the input costs and the selling prices of garment factories, but much more importantly by directly increasing the prices of textile fabrics purchased by final consumers. Because of the focus of the protection policies on keeping out imports of low price/lower quality fabrics and garments through specific duties and anti-dumping duties, *the economic welfare cost is greater for low income consumers*. In India, the regressive nature of T&C protection is reinforced by the longstanding ban on imports of second hand used clothes, which can only be imported if they are torn up and mutilated sufficiently to be unwearable, and used as an inputs for the shoddy industry (which reprocess the mutilated garments into yarn, rough blankets etc). In this way India has chosen to isolate (or to attempt to isolate[90]) its consumers from the obvious benefits of the extensive world trade in used garments, many of which are not used at all, but are remainders of seasonal unsold stocks in developed countries. The other South Asian countries

[90] It seems that there are substantial leakages of used clothing through Customs. One method is to declare consignments which contain unmutilated second hand clothing as rags. According to the president of the Indian clothing manufacturers association, if the customs officers open a consignment they are supposed to mutilate the contents, but "this effort is both tedious and time consuming and often results in the release of a consignment after the mutilation of only a few pieces." To deal with this "CMAI has suggested the installation of huge shredders at all leading ports for easy shredding of full consignment. As an alternative, the clearance should be denied to such illegal cargo and such consignments should be sent back to the sender of totally destroyed"

allow used clothing imports, albeit in Bangladesh[91], Nepal and Bhutan over the relatively high tariffs that are applied to imports of new clothing. In Pakistan, however, they are imported over a low 10 percent tariff, and in Sri Lanka over its general garment tariff of 10 percent.

[91] For unknown reasons, in Bangladesh only a limited number of traders are licensed to import used clothing.

Appendix

Bangladesh: a note on the protective effects of VAT exemptions or reductions for domestic producers and distributors

As an example take the case of cotton textile yarns. The Customs duty (CD) is 15%, VAT on imports 15% and the IDSC tax on imports is 3.5%. In this case there is no supplementary duty (SD). As explained in the National Board of Revenue website[1] the base for Customs duties is the "assessable value" (AV) which is the CIF price plus landing charges, which are either actual landing charges or the CIF price plus 1%. This has not been allowed for in the estimated protective effects of import duties, so all the protective rates should be understood to be in relation to the landed value or assessable value rather than CIF prices. This is reasonable since what local producers have to compete with is the imported goods after they have been landed, not while they are still on the ship at the CIF stage.

The base for VAT on imports is (AV+CD+SD). The base for IDSC tax is AV. Consequently the total duty paid cost of cotton yarn to an importer/wholesaler would be AV*1.15*1.15+.0325*AV=AV*1.3575. For imports with a landed value (or AV) of Tk 100, the cost to the importer would break down as follows:

Landed value (AV)	100
Customs duty	15
VAT	17.25
IDSC	3.5
Total cost	135.75

In considering how much he would be willing to pay a domestic producer for the same cotton yarn, the importer/wholesaler will take into account (1) the total cost of the imported yarn of Tk 135.75, and (2) the potential VAT credit to him of Tk 17.25 which he can offset against whatever VAT he himself has to pay when he resells the yarn.

If the importer/wholesaler is himself subject to the general VAT rate of 15%, and domestic yarn producers are also subject to VAT at 15%, then the maximum price he would be willing to pay to a domestic supplier would be (AV+CD+IDSC) =(100+15+3.5)=18.5. In this case the domestic producer charges the importer/wholesaler Tk 118.5 +VAT = Tk 118.5+118.5*0.15=(118.5+17.78)=136.27. The importer/wholesaler pays a slightly higher VAT inclusive price than he does if he imports the yarn, but this is compensated by the fact that he has a higher VAT credit (Tk 17.78 instead of Tk 17.25) which he can offset against his VAT liability when the yarn is resold. So the operative cost of imports that he looks at when deciding whether to import or to buy domestically is the landed price plus the Customs duties that can't be offset against his VAT liability.

Now suppose the current actual situation where the VAT on imports is 15% but that domestic producers are exempt from VAT and instead pay an excise tax of 2.5%. If the importer/wholesaler is subject to the normal 15% VAT, this will not change his buying decision, since if he buys from the local producer he has no VAT credit that he can use to offset his own VAT liability when the yarn is resold. Therefore, as in the previous case, the maximum price he will pay the local producer is 118.5. However, the local producer now has to pay an excise tax of 2.5% of his selling price. Therefore, his net price is

[1] <http://www.nbr-bd.org/ots.htm>

118.5/(1+0.025)= 115.6. Therefore, the protective effect is 15.6% and is lower than the sum of the customs duty and the IDRC tax owing to the excise tax that the local producer must pay.

Next, take a case where the local producer is exempt from VAT and instead pays and excise tax of 2.5%, and the importer/wholesaler is also exempt from VAT. This could be legal exemption, or simply due to lax VAT collection from distributors. Also assume that the VAT system does not allow for refunds, and that the importer/wholesaler is not able to offset VAT on imported or domestically purchased yarn against VAT liabilities on other products which he sells. In this case, for the importer/wholesaler all the VAT charges are a cost, and since the VAT is lower when he buys domestically, he will make his decision by comparing the VAT inclusive price of imports with the VAT inclusive price of domestically produced yarn. The total cost to him of imports is therefore Tk 135.75, and that is the maximum VAT inclusive price he will be willing to pay local suppliers. Since the local suppliers have to add 2.5% excise to their selling price, the VAT free price they receive is Tk 135.75/1.025=Tk 132.4. The total protective effect in this case is therefore 32.4% of the landed price i.e. as a result of the combined effects of the Customs duty, the VAT exemption, the excise tax and the IDSC, they would be able to raise their selling prices by 32.4% above the landed prices of imported cotton yarn.

A major point here is that the VAT exemption for domestic textile producers will not give them any extra protection unless the traders to whom they sell are (1) exempt from VAT (2) unable to claim VAT refunds or to credit VAT payments against VAT liabilities on products other than textile yarns and fabrics. If the traders are only partially exempt from VAT on their own sales and (2) holds, there may be some extra protection for local producers from the VAT exemption, but it will be less than the case with full exemption. Hence the estimate of 32.4% protection from the preferential VAT is an upper bound: the actual protective effects are somewhere in between this upper bound and the lower bound of 18.5% which applies if the importer distributor is subject to the normal VAT on his own sales.

How this works out in practice is an empirical question. For example, if the domestically produced textiles are sold by local producers directly to small retail shops which are either exempt from VAT or pay only low VAT rates, imported textiles that pay the full VAT at Customs will be disadvantaged and the protection rate for the local producers may be at or close to the upper bound. But as soon as the domestic textiles are sold to other firms which come within the VAT net at normal rates (whether producers which use them as intermediate inputs or traders) the extra protection will be lower and may approximate the lower bound owing to the loss of VAT credits

Table A.1: World Trade in Textiles and Clothing
(Billion Dollars and percentage)

	Textiles	Clothing	Total T&C
Value (2001)	157	199	356
Annual Percentage Change			
1980-85	-1	4	
1985-90	15	17	
1990-00	4	6	
1998	-4	1	
1999	-2	0	
2000	7	7	
Share in World Merchandise Trade	2.5	3.2	
Share in World Exports of Manufactures	3.4	4.3	

Note: Figures are based on constant dollars
Source: WTO Annual Report(2002)

Table A.2: World T&C Imports
(in Billions of US Dollars)

	1998	1999	2000
Textile Fibers	25	20	22
Textile Yarn/ Fabrics/Art	144	140	143
Apparel/Clothing/Accessories	191	194	206
Total T&C	360	354	371
Share of Textile Fibers in T&C	7	6	6
Share of Textile Yarn in T&C	40	40	39
Share of Apparels in T&C	53	55	56

Source: UN COMTRADE DATABASE

Table A.3: Importance of T&C Exports in Regional Countries (1998)
(in millions of Dollars)

	India	Bangladesh	Pakistan	Sri Lanka	Nepal
Total Exports	33062	5010	8013	4000	524
Total T&C Exports	9123	4023	6023	2123	312
Total T&C Imports	823	1012	300	1000	127
Net T&C Exports	8300	3011	5723	1123	185
Share of T&C in Total Exports	28	80	75	53	60
Net T&C Exports as % of Total Exports	25	60	71	28	35
Share of T&C Imports in T&C Exports	9	25	5	47	41

Table A.4: Regional T&C Export Composition (1998)
(in million of US Dollars)

Product	India	Bangladesh	Pakistan	Sri Lanka	Nepal
T&C Exports	9431	3927	7200	2525	312.1
Of this:					
Textile fibers	92	83	4257	34	0.1
Textile Yarn/Fabrics/Art	4557	59	1097	205	174
Apparels/ Accessories	4782	3785	1846	2286	138
Share of Textile Fibers	1	2.1	59.1	1.4	0
Share of textile yarn	48.3	1.5	15.2	8.1	55.8
Share of Apparels	50.7	96.4	25.6	90.5	44.2

Table A.5: Regional T&C Import Composition (1998)
(in million of US Dollars)

Product	India	Bangladesh	Pakistan	Sri Lanka	Nepal
Total Imports of all goods	42424	7017	10159	5338	1347
T&C Imports	865	1924	587	1433	175
Share of T&C Imports in Total	2.04	27.42	5.78	26.85	12.99
Of this:					
Textile fibers	407	339	470	28	53
Textile Yarn/Fabrics/Art	445	1521	113	1331	119
Apparels/ Accessories	13	64	4	74	3
Share of Textile Fibers	47.1	17.6	80.1	2	30.3
Share of textile yarn/ fabrics	51.5	79.1	19.3	92.9	68
Share of Apparels	1.5	3.3	0.7	5.2	1.7

Source: COMTRADE DATABASE

Table A.6: Comparative Quota Utilization in Selected T&C Categories

(as on Dec 1999)

MFN Category	Produce	India	Bangladesh	Pakistan	Sri Lanka	China
331			88.3	67.8	61.9	75.4
338/339		96.3	88.8	88.0/83.9	85.9	94.8
340/360		99.5	87.3	83.7	88.7	78.8, 97.8
341		93	87.4	24.6	77.0/ 71.6	93.3
342/642		85.7	80.7	38	88.9	87.2
347/348		87.3	100	92.7	93.6	97.1
352/652			95.6	52	71.5	96.1
363		93.9	80.5	90.4	73.4	62.8
369		60.1	90.3	75.1	99.9	4.9
638/639			89.9	75.3	78.3	93.5
647/648		76.3	95	65.7	77.8	81.1/93.3

Source: Reproduced from: Bhattacharya and Rahman (2000)

Note: Products corresponding to numbers need to be checked

Table A.7: Principal Export Destination for Apparels (1998) Per cent

Countries/Region	India	Bangladesh	Pakistan	Sri Lanka	Nepal
World	100	100	100	100	100
North America	39	49	52	61	76
EU	42	48	37	34	17
Japan	4	1	1	1	3
Australia and New Zealand	3	< 1	< 1	1	3
East Asia	3	< 1	2	1	
Middle East and Central Asia	4	< 1	3	< 1	
South Asia	3	< 1	2	< 1	
Others	2	1	2	2	1

Note: < denotes less than

Source: COMTRADE DATABASE

Table A.8 Some Cotton And Cotton Textile Tariffs In South Asia, September 2002

HSC code	Product	India	Pakistan	Bangladesh	Sri Lanka	Nepal	Bhutan
5201	Cotton not carded or combed	5	5	0	0	0	n.a.
5202	Cotton waste	19.6	20	11	0	0	n.a.
5203	Cotton carded or combed	35.2	5	0	0	0	n.a.
5204	Cotton sewing thread	24.8	25	15.6-32.4	0	0	0
5205	Cotton yarn > 85% cotton	24.8	5	15.6- 32.4	0	0	0
5206	Cotton yarn<85% cotton	24.8	5	8.3-24.0	0	0	0
5207.10	Cotton yarn for retail sale > 85% cotton	30.0	20	8.3-24.0	0	0	0
5207.90	Cotton yarn for retail sale < 85% cotton	35.2	20	8.3-24.0	0	0	0
5208	Cotton fabric >85% cotton <200gm/m2	36.0 +S	25	32.7-52.1+QR	0	5	20
5209	Cotton fabric >85% cotton >200gm/m2	36.0 +S	25	32.7-52.1+QR	0	5	20
5210	Cotton fabric <85% cotton < 200gm/m2 mixed mainly with man-made fibres	36.0 +S	25	32.7-52.1+QR	0	5	20
5211	Cotton fabric >85% cotton > 200gm/m2 mixed mainly with man-made fibres	36.0 +S	25	32.7-52.1+QR	0	5	20
5212	Other woven fabrics of cotton	36.0 +S	25	32.7-52.1+QR	0	5	20

Notes: (1) In India, many but not all cotton fabrics in HSC 5209-5212 are subject either to the higher of ad valorem duties or specific duties. This is indicated by "+S". As explained in the text (see also Annex Table A.12) the applied ad valorem duty shown in this table includes the estimated protective effect of the special additional duty (Sadd). Examples of the ad valorem incidence of specific duties are given in Annex Table A.12. (2) In Bangladesh the ad valorem duty shown here includes the estimated protective effect of the IDSC import tax as well as Customs duties. In the case of cotton yarn and cotton fabrics, the 15% VAT on imports may also be protective since domestic cotton yarn and fabric producers are exempt from VAT and instead pay a 2.5% excise tax . Whether there is a protective effect and the extent of the additional protection however depends on whether the purchaser of the yarn or fabric is subject to VAT, and if so at what rate (see text discussion). In Bangladesh, unless they are used as inputs by exporters, the import of all textile fabrics is either banned or subject to import licensing (indicated as +QR). (3) In Sri Lanka the customs duty on all textiles including cotton textiles is zero. (4) There is just one ad valorem customs duty rate in Pakistan, Nepal and Bhutan and no other protective import taxes. The Bhutan tariff schedule (1996 edition) has only two rates, zero for yarns and 20% for fabrics. Fibres are not mentioned (5) Imports in Pakistan are subject to an income withholding tax at the rate of 6% on the cif price plus the Customs duty plus the sales tax. There is a similar "Advance income tax" in Bangladesh at 3% of the "assessable value" i.e. approximately the duty free landed value. These taxes have not has not been included as a protective import taxes since they can be credited against income tax liabilities. However, they could be protective if competing domestic producers pay no or lower income taxes relative to the price of the product, than the advance income tax on imports.

Table A.9 Some Polyester And Polyester Textile Tariffs In South Asia, September 2002

HSC code	Product	India	Pakistan	Bangladesh	Sri Lanka	Nepal	Bhutan
5503 & 5506	Polyester staple fibre	25.6	20	0	0	5	n.a.
5505	Waste of man-made fibres[1]	36.0	10	0	0	5	n.a.
5509	Polyester yarn from staple fibre >85% polyester	25.6	10	15.6-32.4	0	10	n.a.
5511	Polyester yarn from staple fibre > 85% polyester for retail sale	25.6 +S	10	15.6-32.4	0	10	0
5402	Polyester filament yarn (PFY) <750D (general rate)	26.3	25	15.6-32.4	0	10	0
5402.33	Polyester filament yarn (PFY) <750D cabled/texturised	26.3	25	22.9-40.9	0	10	0
5402.42	Polyester partially oriented yarn (POY)	39.2 +AD	25	8.3-24.0	0	10	0
5512	Fabrics > 85% polyester, unbleached or bleached	36.0+S	25	32.7-52.1+QR	0	10	20
5513	Fabrics < 85% polyester with cotton, <170 g/m2	36.0+S	25	32.7-52.1+QR	0	10	20
5514	Fabrics < 85% polyester with cotton, >170 g/m2	36.0+S	25	32.7-52.1+QR	0	10	20
5515	Other polyester fabrics	36.0+S	25	32.7-52.1+QR	0	10	20

Notes: (1) In India, many but not all polyester fabrics in HSC 5209-5212 are subject either to the higher of ad valorem duties or specific duties. This is indicated by "+S". Polyester partially oriented yarn is subject to anti-dumping duties (+AD). As explained in the text (see also Annex Table A.12) the applied ad valorem duty shown in this table includes the estimated protective effect of the Special additional duty (Sadd). Examples of the ad valorem incidence of specific duties and anti-dumping duties are given in Annex Table A.12. (2) In Bangladesh the ad valorem duty shown here includes the estimated protective effect of a number of other import taxes as well as Customs duties. In the case of polyester yarn and polyester fabrics, the 15% VAT on imports may also be protective since domestic polyester yarn and fabric producers are exempt from VAT and instead pay a 2.5% excise tax . Whether there is a protective effect and the extent of the additional protection however depends on whether the purchaser of the yarn or fabric is subject to VAT, and if so at what rate (see text discussion). In the case of polyester filament yarn (PFY) and textile fabrics, the 15% VAT on imports may also be protective since domestic PFY and textile fabric producers are exempt from VAT and instead pay negligibly small excise taxes . Whether there is a protective effect and the extent of the additional protection however depends on whether the purchaser of the PFY or fabrics is subject to VAT, and if so at what rate (see text discussion). In Bangladesh, unless they are used as inputs by exporters, the import of all textile fabrics is either banned or subject to import licensing (indicated as +QR). (3) The Sri Lanka customs duty on polyester and all polyester textiles is zero. (4) There is just one ad valorem customs duty rate in Pakistan, Nepal and Bhutan and no other explicitly protective import taxes. (5) The Bhutan tariff schedule (1996 edition) has only two rates, zero for yarns and 20% for fabrics. Fibres are not mentioned. (6) Imports in Pakistan are subject to an income withholding tax at the rate of 6% on the cif price plus the Customs duty plus the sales tax. There is a similar "Advance income tax" in Bangladesh at 3% of the "assessable value" i.e. approximately the duty free landed value. These taxes have not has not been included as a protective import taxes since they can be credited against income tax liabilities. However, they could be protective if competing domestic producers pay no or lower income taxes relative to the price of the product, than the advance income tax on imports.

Table A.10 Acrylic And Acrylic Textile Tariffs In South Asia, September 2002

HSC code	Product	India	Pakistan	Bangladesh	Sri Lanka	Nepal	Bhutan
5501.30	Acrylic tow & acrylic	26.6 +AD	20	11	0	5	n.a.
5503.30	fibre	26.6 + AD	20	0			
5506.30		26.6 +AD	20	0			
5509.31	Acrylic yarn>85% acrylic.	26.6+AD	10	15.6-32.4	0	10	0
5509.32	Single	26.6+AD	10	15.6-32.4	0	10	0
	Multiple						
5509.61	Acrylic/wool yarn	26.6	10	15.6-32.4	0	10	0
5512.21	Fabric>85% acrylic. Grey	30 +S	25	32.7- 52.1	0	15	30
5512.29	Dyed or printed	30+S	25	+QR	0	15	30
				32.7- 52.1 +QR			
5515.21	Acrylic/filament fabric	30 +S	25	32.7- 52.1 +QR	0	15	30
5515.22	Acrylic/wool fabric	30 +S	25	32.7- 52.1 +QR	0	15	30

Notes: (1) In India, most acrylic fabrics are subject to the higher of ad valorem duties or specific duties. This is indicated by "+S". As explained in the text (see also Annex Table A.12) the applied ad valorem duty shown in this table includes the estimated protective effect of the Special additional duty (Sadd). Examples of the ad valorem incidence of specific duties are given in Annex Table A.12. (2) In Bangladesh the ad valorem duty shown here includes the estimated protective effect of the Infrastructure Development Surcharge (IDSC as well as Customs duties. Acrylic yarns fabrics, the 15% VAT on imports may also be protective since domestic acrylic fabric producers are exempt from VAT and instead pay a small 2.5% excise tax.. Whether there is a protective effect and the extent of the additional protection however depends on whether the purchaser of the fabric is subject to VAT, and if so at what rate (see text discussion). In Bangladesh, unless they are used as inputs by exporters, the import of all textile fabrics is either banned or subject to import licensing (indicated as +QR). (3) In Sri Lanka the customs duty on all textiles including acrylic textiles is zero. (4) There is just one ad valorem customs duty rate in Pakistan, Nepal and Bhutan and no other protective import taxes. The Bhutan tariff schedule (1996 edition) has only two rates, zero for yarns and 30% for fabrics. The fabric tariff was increased to 30% from 20% during 2001. Imports in Pakistan are subject to an income withholding tax at the rate of 6% on the cif price plus the Customs duty plus the sales tax. There is a similar "Advance income tax" in Bangladesh at 3% of the "assessable value" i.e. approximately the duty free landed value. These taxes have not has not been included as a protective import taxes since they can be credited against income tax liabilities. However, they could be protective if competing domestic producers pay no or lower income taxes relative to the price of the product, than the advance income tax on imports Fibres are not mentioned. See text discussion.

Table A.11 Garment Tariffs In South Asia, August 2002

HSC code	Product	India	Pakistan	Bangladesh	Sri Lanka	Nepal	Bhutan
61	Knitted garments (general rate all tariff lines except for those below in some countries)	36 +S	25	36	10	25	30
6103.12/19 6104.12/13	Knitted non-woollen suits	36	25	18.5/36	10	25	30
6112.11	Knitted track suits (cotton)	36	25	26	10	25	30
6112.12/19	Knitted track suits (non-cotton)	36	25	18.5	10	25	30
6112.31/39 /49/49	Knitted swimwear	36	25	18.5	10	25	30
6116.10.10 6117.80.91	Sports gloves and accessories	36	25	26	10	25	30
6117.80/90	Knitted garments: other accessories and parts	36	25	36	10	15	30
					10		
62	Garments, not knitted (general rate all tariff lines except for those below in some countries)	36+S	25	36	10	25	30
6211.11/12	Swimwear	36	25	18.5	10	25	30
6211.32//3 3/39/43/49	Traditional clothing (Dhoti, Lungi, Gamchha, Sari etc)	36+S	25	18.5	0	5	30
6217	Clothing accessories	36	25	36	0	15	30

Notes: (1) In India, 30% and 62% respectively of the Chapter 61 and 62 garment tariff lines are subject to the higher of ad valorem duties or specific duties. Specific duties are indicated by "+S". Examples of the ad valorem incidence of India's specific duties are given in Annex Table A.12. As explained in the text (see also Annex Table A.12) the applied ad valorem protective duty shown in this table includes the estimated protective effect of the special additional duty (Sadd). (2) In Bangladesh the ad valorem duty shown here includes the estimated protective effect of the Infrastructure Development Surcharge (IDSC) as well as Customs duties. In contrast to yarns and fabrics, there is no extra protection for domestic garment producers resulting from exemptions from the domestic VAT. (3) In Sri Lanka the general customs duty rate on garments is 10%. (4) For each tariff line, there is just one ad valorem customs duty rate in Pakistan, Nepal and Bhutan and no other protective import taxes (5) Imports in Pakistan are subject to an income withholding tax at the rate of 6% on the cif price plus the Customs duty plus the sales tax. There is a similar "Advance income tax" in Bangladesh at 3% of the "assessable value" i.e. approximately the duty-free landed value. These taxes have not has not been included as a protective import taxes since they can be credited against income tax liabilities. However, they could be protective if competing domestic producers pay no or lower income taxes relative to the price of the product, than the withholding tax or advance income tax on imports.. See text discussion. (6) The Bhutan garment tariff was increased from 20% to 30% in 2001. (7) A slash between two tariff rates indicates that one or the other rate applies to different specifications within the product category.

Table A.12 India: Acrylic Textiles. Calculations Of Ad Valorem Equivalents Of Specific Tariffs

HSC code	Product	Basic ad val %	Basic specific duty or anti-dumping duty	CVD %	Sadd %	Indicative export prices July 2002 fob	Estimated total protective duty after freight adjustment (% of cif)	Specification of export offer	WTO binding %	Max applied tariff under India-US & India-EU agreements
5501.30 & 5503.39	Acylic tow & acrylic fibre	20	AD duties varying by country and exporter	16	4	$1.00-$1.20/kg fob Japan	26.6 to 137 depending on country and exporter[1]	Estimate from avg spot prices fob Japan given in <www.newtextiles.com>	40	20
5909.31 & 5509.32	Acrylic yarn	20	AD duty Nepal	16	4		26.6		40	20
5509.61	Acrylic/wool yarn	20		16	4		26.6		40	20
5512.21	Fabric>85% acrylic unbleached or bleached	30		0	0		30		UB	25-35
5512.29	Fabric>85% acrylic other (dyed, printed etc)	30	Rs 47/m2= $0.96/m2	0	0	$1.50/yd fob Busan, Korea	89.7	100% acrylic twill fabric yarn-dyed 58-60"W for jackets 284 gm/yd fob Busan, Korea $1.50/yd	UB	25-35
5512.29	Fabric>85% acrylic other (dyed, printed etc)	30	Rs 47/m2= $0.96/m2	0	0	$2.90/yd fob Busan, Korea	46.2	100% chenille acrylic plain weave yarn dyed 58-60W gm 397/yd fob Busan, Korea $2.90/yd	UB	25-35
5515.22	Fabric acrylic/wool	30	Rs 140/kg =$2.98/kg	0	0	$3.80/yd fob Busan, Korea	35.1	Acrylic 90% wool 10% both-sided dyed one-side brushed check fabric 4/36X4/36 yarn dyed 448gm/yd fob Busan Korea $3.80	UB	25-35
5515.22	Fabric acrylic/wool	30	Rs 140/kg =$2.98/kg	0	0	$2.10/yd fob Busan Korea	43.4	Acrylic 90% wool 10% twill plain dye for jumpers 58-60"W 311gm/yd fob Busan Korea $2.10/yd	UB	25-35
5515.22	Fabric acrylic/wool	30	Rs 140/kg =$2.98/kg	0	0	$1.67/yd fob China	47.8	Acrylic 95% wool 5% check fabric 56-57"W 150X34, 273 gm/yd fob China $1.67/yd	UB	25-35

Table A.13 India: Representative Cotton And Cotton Textile Tariffs, July 2002

HSC code	Product	Basic ad val %	Basic specific duty	CVD %	Sadd %	Indicative export prices July 2002 fob	Estimated total protective duty after freight adjustment (% of cif)	Specification of export offer	WTO binding	Max applied tariff under India-US & India-EU agreements
5201	Cotton n ot c arded o r combed	5		0	0		5		150	20
5202	Cotton waste	15		0	4		19.6			20
5203	Cotton carded or combed	30		0	4		35.2		UB	20
5204	Cotton sewing thread	20		0	4		24.8		40	20
5205	Cotton yarn > 85% cotton	20		0	4		24.8		25	20
5206	Cotton yarn<85% cotton	20		0	4		24.8		40	20
5207.10	Cotton yarn for retail sale > 85% cotton	25		0	4		30.0		UB	20
5207.90	Cotton yarn for retail sale < 85% cotton	30		0	4		35.2		UB	20
5208	Cotton fabric >85% cotton, < 200 gm/m2. Unbleached, bleached & most dyed fabrics	30		16	4		36.0		UB	25-30
5208	Cotton fabric >85% cotton, < 200 gm/m2. Of dyed yarns of different colours, and printed	30	From Rs 9 –Rs 50/ m2 or Rs 200/kg	16	4	Not estimated	36.0 or higher		UB	25-35
5209	Cotton fabric >85% cotton >200gm/m2, unbleached & bleached	30		16	4		36.0		UB	25-35
5209.31	Cotton fabric >85% cotton >200gm/m2, dyed plain weave	30	Rs 150/kg =$3.06/kg	16	4	$7.54/kg fob+ $0.12/kg= $7.68/kg cif	46.3	Dyed poplin 100% cotton 58-59" W, 40s*40s count, 133X100 $1.32/ yd fob China	UB	25-35
5209.41	Cotton fabric >85% cotton, >200 g m/m2, plain weave, yarns of different colours	30	Rs 32/m2 = $1.33/ m2	16	4	$1.29/m2 fob+$0.04/ m2= $1.33/m2 cif	55.8	100% cotton check 57-58" W, 16s*16s count, 68X54, $1.75/yd fob China	UB	25-35
5209.42	Cotton fabric denim > 85% cotton, > 200 gm/m2	30	Rs 25/m2 = $0.51/ m2	16	4	$0.96- $1.08 / m2 + $0.04/m2 =$1.00-$1.12/ m2	52.2-58.0	100% cotton (denim) 59-60W, 10s*10s, 80X44, Min qty 10,000 yds, $1.36-$1.60/yd fob China (four offers)	UB	25-35

Notes : Tariff information from Arun Goyal, *Easy Reference Customs Tariff,* 2002-03. When there is a specific duty, it is applied only when it is higher than the ad valorem duty. The Special Additional duty (Sadd) is added on top of the cumulative amount of the basic customs duty and the countervailing duty (CVD) as explained in the text. The export prices used for the examples of the ad valorem equivalent of specific duties are from textile website www.i-textile.com, which provides prices and detailed specifications of textiles offered for export sale, mainly from China but also from Taiwan and Korea. These were cross checked for consistency with disaggregated (up to HSC 10 digit) US import unit values calculated from US Census Bureau import data CD rom for 2000. Transport and insurance (consignment) costs of fabrics from China to India of US 4 cents/M2 or US 12 cents/kg were added to give estimated cif prices in India. Consignment costs were guessed to be about 20% less than the average consignment costs of textile fabric exports from China to US ports as given in the US import CD rom database. Exchange rate $US1=Rs 49.

Table A.14 India: Representative Polyester Textile Tariffs, July 2002

HSC code	Product	Basic ad val %	Basic specific duty (S) anti-dumping duty (AD) or QR	CVD %	Sadd %	Indicative world prices July 2002	Estimated total protective duty after freight adjustment (% of cif)	Specification of export offer	WTO binding %	Max applied tariff under India-US & India-EU agreements
5501	Polyester staple fibre	20		16	4		25.6		40	20
5505	Waste of man-made fibres[1]	30	QR	16	4		36.0		40	20
5509	Polyester yarn from staple fibre 85% polyester	20		16	4		25.6		40	20
5511	Polyester yarn from staple fibre > 85% polyester for retail sale	20	Rs 31/kg	16	4		25.6 or higher		40	25-35
5402	Polyester filament yarn (PFY) <750D	20		32	4		26.3		40	20
5402.42	Polyester partially oriented yarn (POY)	20	AD duties $ 0.105 to $0.593 /kg	32	4	$0.90/kg cif	39.2 to 95.7		40	20
5512.11	Fabrics > 85% polyester, unbleached or bleached	30		16	4		36.0		UB	25-35
5512.19	Fabrics > 85% polyester, other (dyed, printed etc)	30	S=Rs 42/m2= $0.86/ m2	16	4	$3.30/m2 fob + $0.04/m2=$3.34/m2 cif	36.0	Plain weave 100% polyester fabric bleached & dyed 100D*100D 243X88 54-56" W, min qty 5000 yds, fob Shanghai $4.29/yd	UB	25-35
5512.19	Fabrics > 85% polyester, other (dyed, printed etc)	30	S=Rs 42/m2= $0.86/ m2	16	4	$0.86/m2 fob+$0.04= $0.90/m2 cif	104.7	Plain weave 100% polyester fabric bleached & dyed 150D*150D 137X67 58-60" W fob Shanghai $1.19/yd	UB	25-35
5513.21	Fabrics < 85% polyester with cotton, <170 g/m	30	S=Rs 150/kg = $3.06/kg	16	4	$6.23/kg fob + $0.12/kg =$6.35 cif	55.1	Plain weave polyester dyed fabric for shirts 65% cotton 35% polyester, 45sX45s, 110X76, 43-44" W min qty 3000 yds $0.66/yd fob Shanghai	UB	25-35
5513.21	Fabrics < 85% polyester with cotton, <170 g/m	30	S=Rs 150/kg= $3.06/kg	16	4	$7.96/kg fob+ $0.12/kg= $8.08/kg cif	44.3	Plain dyed fabric for shirts 65% polyester 35% cotton, 45s*45s 133X72, 58"W, min order qty 2000 yds $1.29/yd Zhongshou	UB	25-35
5515.13	Polyester/wool fabrics	30	S=Rs 75 / m2 = $3.06/kg	16	4	$3.10/m2 fob+$0.04/m2 = $3.14/m2 cif	55.6	Polyester 55% wool 45% 48/2 yarn top dyed, "dog tooth" weave, 58-59" W. For suits, trousers. Min order qty 1000 yds $4.29/yd fob China	UB	25-35

Notes: (1) Subject to import licensing (2) Anti-dumping duties against imports from Taiwan (separate rates for six firms and "all other exporters"; Thailand (separate rates for 3 firms and "all other exporters" ; Indonesia (separate rates for 2 firms and "all other exporters", and Malaysia (one rate for all exporters).

TABLE A.15 INDIA: NUMBER OF TARIFF BINDINGS ON TEXTILES AND GARMENTS

HSC Chapter	Chapter Products	Number of 6-digit tariff lines			Fabric and clothing tariff lines		
		Total	Of which bound	% bound	Total	Of which bound	% specific
50	Silk	10	4	40	3	0	0
51	Wool, animal hair etc	39	25	64	11	0	0
52	Cotton	132	49	37	78	0	0
53	Other veg fibres (incl jute)	29	21	72	7	5	71
54	Man-made filaments	66	30	45	34	0	0
55	Man-made staple fibres	115	43	37	68	0	0
56	Wadding, felt, rope etc	33	24	73	17	8	47
57	Carpets and other floor coverings	23	0	0	23	0	0
58	Special woven fabrics (incl tyre cord)	41	4	10	41	4	10
59	Impregnated, laminated fabrics etc (incl industrial)	25	21	84	25	21	84
60	Knitted or crocheted fabrics	43	0	0	43	0	0
61	Apparel and clothing, knitted	114	0	0	114	0	0
62	Apparel and clothing, not knitted	119	0	0	119	0	0
63	Other textile made-ups, worn clothing & rags	59	0	0	59	0	0
	TOTAL	848	221	26	642	38	6

Source: Arun Goyal, Easy Reference Customs Guide 2002-2003.

TABLE A.16

ESTIMATED AD VALOREM EQUIVALENTS OF INDIAN SPECIFIC TARIFFS ON GARMENTS

	Mens' cotton shirts HSC 620520		Mens cotton trousers HSC 620342	
	Median Price	1st Quartile Price	Median Price	1st Quartile Price
Prices of Chinese exports to USA in 2000, $/unit				
Price fas China	6.95	5.37	9.21	5.70
Average consignment cost	0.44	0.44	0.31	0.31
Price cif USA	7.39	5.81	9.52	6.01
Average US quota premium during 2000	1.77	1.77	3.51	3.51
Estimated quota free price CIF USA	5.62	4.04	6.01	2.50
Tariff equivalent protection in USA				
Quota premium	31.5	43.8	58.4	140.4
US tariff (as % of estimated quota-free cif price)	25.0	26.9	23.9	36.3
Operative total protection rate in USA %	56.5	70.7	82.3	176.7
Tariff protection in India (% of cif price)				
Basic ad valorem duty %	30.0	30.0	30.0	30.0
Additional protection from Sadd	6.0	6.0	6.0	6.0
Total protection with ad valorem basic tariff	36.0	36.0	36.0	36.0
Estimated price cif India, $/unit	5.62	4.04	6.01	2.50
Indian specific duty $US/unit	1.73	1.73	2.76	2.76
Ad valorem equivalent of specific duty %	30.8	42.8	45.9	110.4
Additional protection from Sadd %	6.1	6.6	6.8	9.8
Total protection with specific duty	36.9	49.4	52.7	120.2
Operative total protection rate in India %	36.9	49.4	52.7	120.1

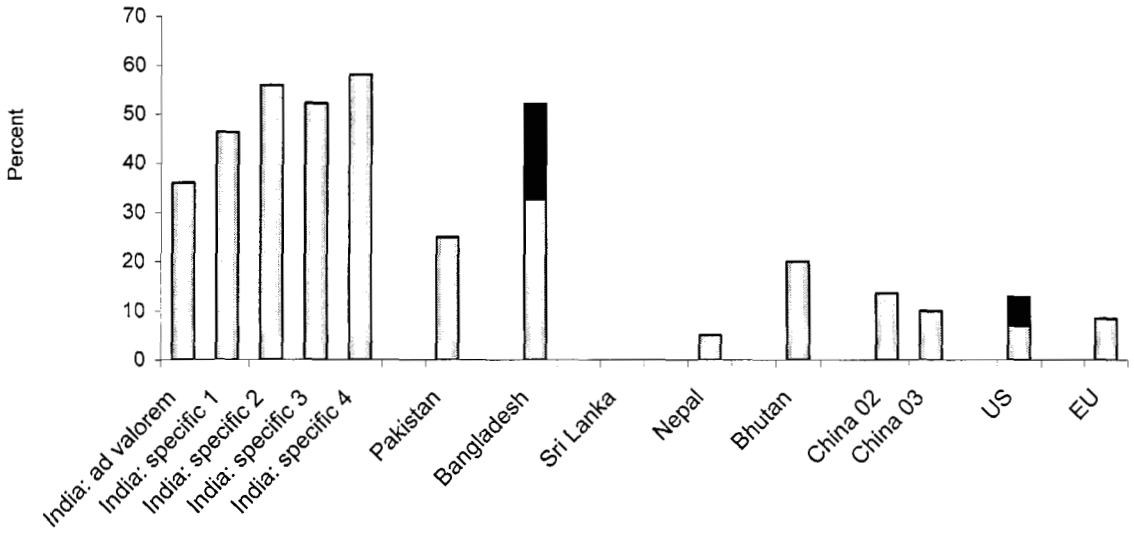
Notes: Indian Tariffs from Arun Goyal (2002). US imports from US Bureau of the Census CD rom of US imports in 2000. This gives a detailed information down to 10-digit HSC levels on individual consignments. The consignment level information includes the exporting country, "dutiable value" (in the US import duties are applied to the fas - free aboard ship-price in the exporting country), import duties paid, consignment costs (i.e. shipping, insurance and other transport costs), number of items (for most garments in dozens), net weight, port of entry, and whether the consignment is by sea or air. The consignments considered in this table are sea shipments from China. The quota prices are averages for Chinese quotas in 2000 as reported in the Chinese quota auction site <www.chinaquota.com>. The cotton shirt and cotton trouser quota prices are for US apparel quota categories nos 340 and 347. Cotton shirt prices ranged from $0.92 a shirt to $25.35 a shirt fas, and cotton trouser prices from $1.59 to $40.81 per pair of trousers. To give an indication of plausible Chinese prices cif India, it is assumed that when exporting to India, Chinese exporters would be willing to charge the US price minus the US quota premium for a given type and quality of shirt or trouser, and that these prices in 2000 would give an approximation of current prices in August 2002. Among other things this assumes that sea consignment costs from China to India are equal to average sea consignment costs from China to USA. The US protection rates have also been expressed with respect to this price i.e. they are the sum of the quota premium as a percentage of the quota-free cif price and the US tariff as a percentage of the US quota-free price. This is indicative only: world prices including Chinese export prices would change if there were no US and other developed country MFA quotas.

TABLE A.17 INDIA: NUMBER OF SPECIFIC TARIFFS ON TEXTILES AND GARMENTS

HSC Chapter	Chapter Products	Number of 6-digit tariff lines			Fabrics and clothing tariff lines		
		Total	Of which specific	% Specific	Total	Of which specific	% specific
50	Silk	10	0	0	3	0	0
51	Wool, animal hair etc	39	11	28	11	11	100
52	Cotton	132	37	28	78	38	49
53	Other veg fibres (incl jute)	29	0	0	7	0	0
54	Man-made filaments	66	30	45	34	30	88
55	Man-made staple fibres	115	50	43	68	47	69
56	Wadding, felt, rope etc	33	0	0	17	0	0
57	Carpets and other floor coverings	23	7	30	23	7	30
58	Special woven fabrics (incl tyre cord)	41	21	51	41	21	51
59	Impregnated, laminated fabrics etc (incl industrial)	25	0	0	25	0	0
60	Knitted or crocheted fabrics	43	0	0	43	0	0
61	Apparel and clothing, knitted	114	34	30	114	34	30
62	Apparel and clothing, not knitted	119	74	62	119	74	62
63	Other textile made-ups, worn clothing & rags	59	3	5	59	3	5
	TOTAL	848	267	31	642	265	41

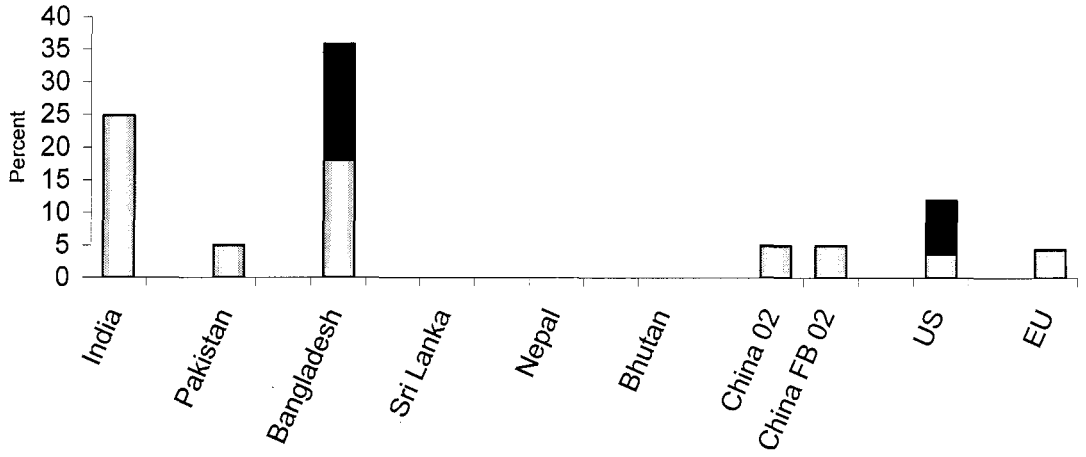
Source: Arun Goyal, Easy Reference Customs Guide 2002-2003.

Fig A.1
Cotton Fabric Tariffs in South Asia, China, US and EU



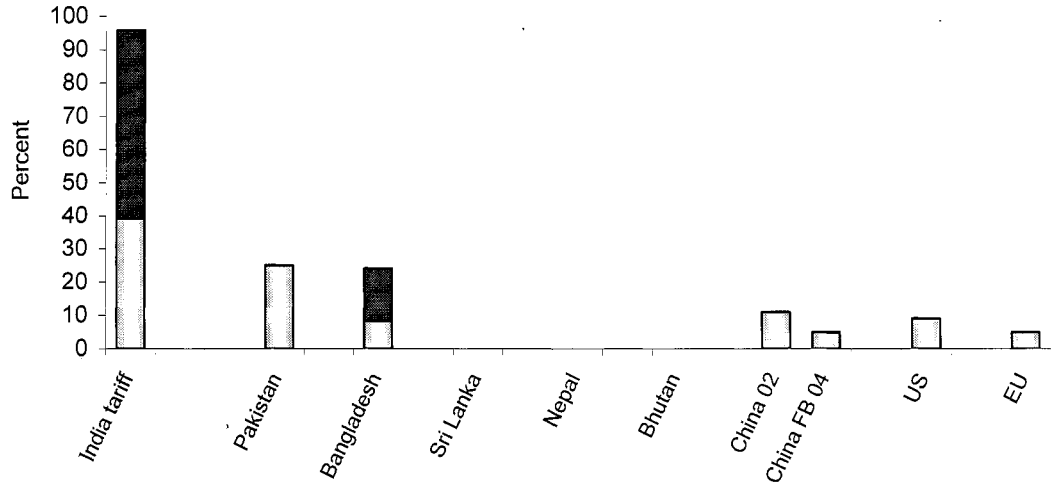
Tariffs are for HSC 5209 (cotton fabrics >85% cotton, >200 gm/m2). The examples of Indian specific tariffs are given in Table A.17. The tariffs of the other South Asian countries are given in Table A.11. In Bangladesh local producers are exempt from VAT which is applied to imports. The diagram shows the estimated upper and lower bound of the resulting protection. In Bangladesh fabric imports are also subject to QRs (in practice an import ban for most fabrics, unless they are inputs for exporters. The Sri Lanka tariff is zero. The second Chinese tariff is the final WTO bound level to be reached in 2003. The US tariff is the present MFN tariff which in principle will be the principal protective instrument when textile import quotas expire at the end of 2004.

Fig A.2
Cotton Yarn Tariffs in South Asia, China, US and EU



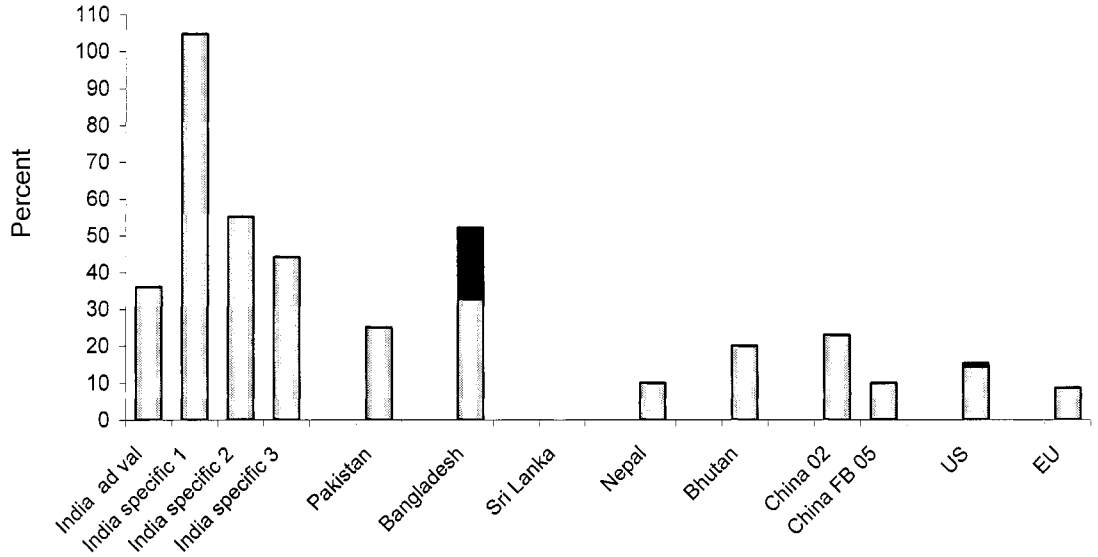
The tariffs are for HSC 5205, cotton yarn >85% cotton. The South Asian tariffs are given in Table A.11.The tariff range for Bangladesh distinguish between possible protective effects resulting from the exemption of local producers from VAT which is applied to imports. Tariffs in Sri Lanka, Nepal and Bhutan are zero. The second Chinese tariff shown is the final bound level under China's WTO accession agreement, for this product reached in 2002. The range of US tariffs and the EU tariffs are the present tariffs which will become the principal protective instrument after the end of the MFA quotas in December 2004.

Fig A.3
Polyester (POY) Yarn Tariffs in South Asia, China, US and EU



Notes: These tariffs are for HSC 5204.42 polyester partially oriented filament yarn (POY). The tariff rates are given in Table A.11 and explained in the table notes and in the text. The first Indian tariff is the general ad valorem rate. The second shows the range of total protection above the ad valorem rate resulting from anti-dumping duties which vary by exporting firm and country. The Bangladesh tariffs are the range of possible protective effects resulting from the exemption of local producers from VAT which is applied to imports. Tariffs are zero in Sri Lanka, Nepal and Bhutan. China FB04 is the final level in 2004 of China's polyester filament yarn tariff bindings. The US and EU tariffs are current MFN tariffs which in principle will be the principal form of protection when the MFA quotas expire at the end of 2004.

Fig. A.4 Polyester Fabric Tariffs in South Asia, China, US and EU



Notes: These tariffs are for HSC 5512.19 and 5513.21, which are respectively polyester fabrics (>86% polyester) and polyester/cotton fabrics. Details are in Table A.8 and Table A.9. The range of tariffs in Bangladesh distinguishes between possible protective effects resulting from the exemption of local producers from VAT which is applied to imports. Fabric imports in Bangladesh are also subject to QRs, for most types in practice an import ban unless they are used as inputs by exporters. The China FB 05 tariff is the final WTO bound rate to be reached in 2005. The US and EU tariff are the current tariffs which will become the principal means of protection when the MFA quotas expire at the end of 2004.

Fig A.5 INDIA: ACRYLIC FIBRE JULY 2002
ESTIMATED AD VALOREM INCIDENCE OF ANTI-DUMPING DUTIES ON IMPORTS FROM VARIOUS EXPORTERS AND EXPORTING COUNTRIES

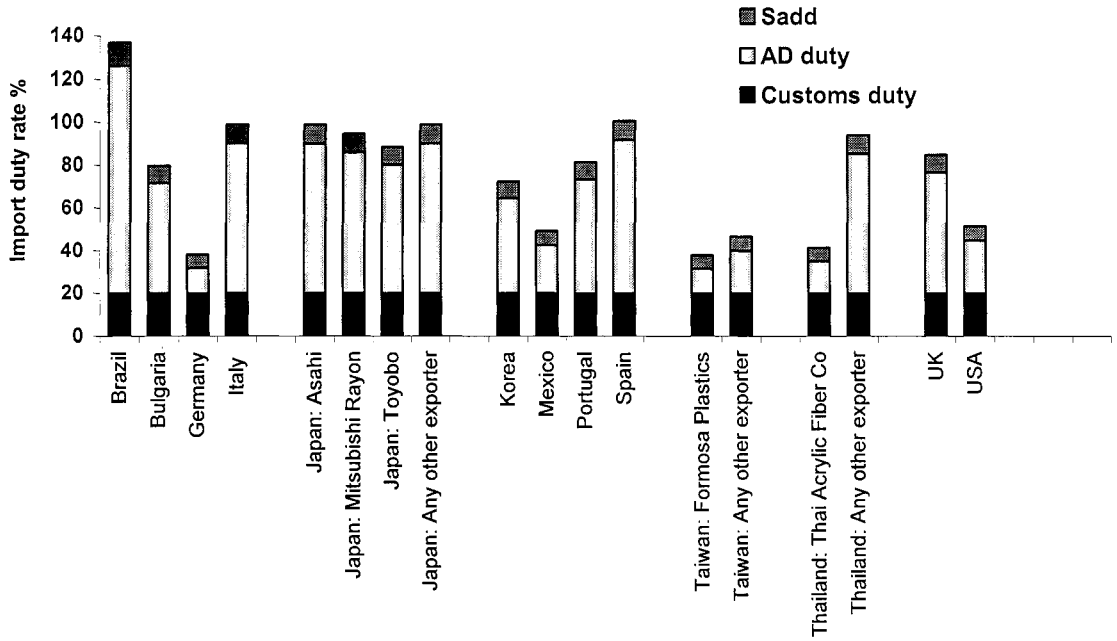


Table A.18 Bangladesh : Tariffs and protective import taxes on textiles

COTTON TEXTILES

HSC		CD	SD	VAT on Imports	VAT on Domestic Production	Excise Tax on Domestic Production	AIT	IDSC	PD1	PD2
5201	Cotton not card/combed	0.0	0	0	0	0	3	0	0.0	n.a.
5202	Cotton waste	7.5	0	15	15	0	3	3.5	11.0	n.a.
5203	Cotton carded/combed	0.0	0	15	15	0	3	0	0.0	n.a.
5204	Cotton sewing thread	15.0	0	15	0	2.5	3	3.5	15.6	32.4
5205	Yarn >85% cotton	15.0	0	15	0	2.5	3	3.5	15.6	32.4
5206	Yarn <85% cotton	7.5	0	15	0	2.5	3	3.5	8.3	24.0
5207	Yarn retail sale	7.5	0	15	0	2.5	3	3.5	8.3	24.0
5208-12	All cotton fabrics	32.5	0	15	0	2.5	3	3.5	32.7	52.1

Notes:

See cell formulas for how the total protection has been estimated
Domestically produced cotton yarns and fabrics are exempt from VAT and subject to a 2.5% excise tax
** Another excise tax on grey cloth (5208,5209,5210, 5211, 5212) is 50 paise/m2 or <1 US cent/m2. which is negligible and not allowed for.
The advance income tax (AIT) is shown here but has not been included in the estimation of the total protective duty rate, since in principle it can be credited against normal income tax liabilities
PD1=Protective Duty rate (total) without allowing for exemption of domestic producers from VAT
PD2=Protective Duty rate (total after allowing for exemption of domestic producers from VAT
In FY 03 License Fee (LF) abolished, IDSC increased to 3.5%
Note: VAT reduction on local sales will only give extra protection if it is on a final product which is sold at the last stage of the VAT chain e.g. to distributors assuming VAT stops at the ex-factory stage. A VAT reduction on an intermediate product doesn't help the user because he will have that much less to claim as a credit against VAT due on his own sales. For yarn this probably means that the effective domestic VAT exemption (1) gives no extra protection against imports when it is sold to domestic producers of knitted garments, since they are subject to the normal 15% VAT (2) gives extra protection when it is sold to fabric producers, since they are also exempt from domestic VAT (3) gives some extra protection when it is sold to wholesalers or retailers which don't pay the full normal VAT or which are exempt from VAT. The same distinctions apply to the exemption for fabrics. If the fabrics are sold to garment firms there is no extra protection for the fabric producers since the garment firms lose this part of their normal VAT input credit. However, if the fabrics are sold directly to distributors including retailers that are not subject to the full normal 15% VAT there could be some extra protection depending on the effective VAT rate applied to the distributors. Most domestic fabrics in Bangladesh are sold in retail stores and sewn either in households or by small artisan tailors who are not subject to VAT. The extent of the extra protection to the fabric producers therefore depends on to what extent fabric wholesalers and retailers are effectively subject to VAT. At present not much VAT is actually collected at this level and so the higher protective rate shown in the column PD2 column is the most relevant.
These estimates do not allow for "tariff values" which are base for import duties for many textiles. In order to quantify this actual cif prices would be needed. The actual cif prices of a few fabrics in August 2002 were considerably lower than the tariff values on the NBR Customs tariff website, but the latter were for the old tariff schedule. It's possible they have been changed and not reported yet on the website.

Table A.19 Bangladesh

Polyester textile tariffs 2002-03

HSC		CD	SD	VAT on Imports	VAT on Domestic Production	Excise Tax on Domestic Production	AIT	IDSC	PD1	PD2
5503 & 5506	Polyester staple fibre	0	0	0	0	0	3	0	0.0	n.a.
5505	Polyester waste	0	0	15	15	0	3	0	0.0	n.a.
5509	Poly yarn from staple fibre >85% polyester	15	0	15	0	2.5	3	3.5	15.6	32.4
5511	Poly yarn from staple fibre >85% polyester retail sale	15	0	15	0	2.5	3	3.5	15.6	32.4
5402	Poly filament yarn (PFY)	15	0	15	0	2.5	3	3.5	15.6	32.4
5402.42	Partially oriented yarn (POY)	7.5	0	15	0	2.5	3	3.5	8.3	24.0
5402.33	Poly Filament Yarn (PFY) cabled	22.5	0	15	0	2.5	3	3.5	22.9	40.9
5512	Polyester fabrics	32.5	0	15	0	2.5	3	3.5	32.7	52.1

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