Chapter - 4

AGREEMENT ON AGRICULTURE: EXPORT COMPETITION

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Economics is rarely positive about export subsidies. Besides causing economic inefficiencies and high cost to both consumers and taxpayers in the subsidizing country itself subsidies can inflict considerable negative effects on trading partners. The vast majority of the developing countries do not subsidize exports simply because they cannot afford it. But they are affected indirectly by subsidies given by their trade partners. This works through several ways.

First, export subsidies increase the share of the exporter in world markets, at the cost of those who do not subsidize. Second, they depress world prices, which not only cut export earnings of other countries but also transmit disincentives to farmers in the third-world countries. Third, export subsidization also makes world market prices unstable thereby increasing difficulties of coping with price risks for an importer. For these reasons, export subsidies are considered to be most distorting of three main policies covered by the Agreement on Agriculture (AoA). The other two being domestic subsidies and border measures.

Nepal, like the other LDCs and a majority of the developing countries, does not subsidize exports. Nor it can afford. During the WTO accession it has also committed not to subsidize exports. Yet, as noted above, the Nepalese agriculture stands to be affected negatively by this practice of trading partners. In fact, some of the negative trade experiences documented in various chapters of this volume, e.g. difficulties encountered in accessing the Sri Lankan market for lentils and import surges of wheat and rice in recent years, are due to export subsidies by other countries. Furthermore, some other trade policy measures implemented in Nepal are disciplined by the WTO Agreements. They are the various export incentive measures and export restrictions and export taxes.

The chapter, organized in three Sections, covers the following areas: (1) an overview of the WTO provisions on export competition including direct and indirect forms of export subsidies covered by the AoA, various export incentive measures and export restrictions; (2) an examination of the relevancy and implications of these provisions for Nepal and (3) a summary of the main conclusions and suggestions for further work

THE WTO PROVISIONS ON EXPORT COMPETITION

There are three aspects of export competition in the WTO Agreements relevant to Nepal. The first and most important for agricultural trade is direct and indirect forms of export subsidies covered by the AoA itself. The second is various export incentive measures addressed in the WTO Agreement on Subsidies and Countervailing Measures (the Subsidies Agreement). The third is the disciplines on export restrictions.

Export Subsidy in the AoA

The main focus of the AoA is on disciplining direct and indirect forms of export subsidies, not so much on export controls and restrictions. In deed, four out of the five AoA Articles on *export competition* (Articles 8 to 12) are on export subsidies, and only one on export restrictions.

Direct forms of export subsidies

Article 8 of the AoA - *export competition commitments-* is overarching. It states "Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule." Its Article 9.1 defines various types of export subsidies that are disciplined (Box 1). Article 9.2(a) simply states that, subject to some flexibility provided for in 9.2 (b), the maximum quantity of the product in respect of which export subsidies may be granted and the maximum level of outlay for such subsidies are specified for each year in the Member's Schedule. These articles also imply that a Member that has no export subsidy commitment in the Schedule is not allowed to introduce them in the future.

Box 1
Types of direct export subsidies subject to reduction commitment

a. The provision by governments or their agencies of direct payment to exporters *contingent on export performance;*
b. The sale or disposal for export by governments or agencies of non-commercial stocks of agricultural products at a price lower than to buyers in the domestic market;
c. Payment financed by virtue of government action from which the exported product is derived;
d. The provision of subsidies to reduce the costs of marketing exports (other than widely available export promotion and advisory services) including handling, upgrading, and other processing costs, and the costs of international transport and freight;
e. Internal transport and freight charges on export shipments, provided or maintained by governments, on terms more favourable than for domestic shipments;
f. Subsidies on agricultural products contingent on their incorporation in exported products.

Direct subsidies that could be quantified were measured for the base period 1986-1990[25]. The reduction rates to apply to the base period subsidy levels were 36% during the implementation period on outlays, with initial cuts of at least 6% in the first year and equal annual reductions over the five subsequent years, and 21% on volumes subsidized with reductions staged in similar proportions.

For developing countries, the reduction rates required were two-thirds of those for the developed countries and the implementation period was 10 years instead of six. In the case of the LDCs, no reduction is required. For the developing countries, including the LDCs the provision of export subsidies to reduce marketing costs and transport and freight costs i.e. subsides classified under (d) and (e) in Box 1 above are also permitted.

[25] Note that the base period for export subsidies (1986-90) differs from the base period for several other provisions of the AoA (1986-88). This had the effect of increasing the base period outlays and so greater room for subsidization during the implementation period.

Table 1 shows export subsidization ceilings for WTO Members with most export subsidies. The message is simple – only a few developed countries account for over 90% of the right to subsidize exports, while all developing countries together account for less than 10% of the total. Table 2 shows that export subsidies are concentrated on temperate-zone agricultural products produced in developed countries, e.g. cereals, dairy and meat products and sugar. The last column of Table 2 shows that subsidization potentials exist for over 10% of the 1992 world trade for all products with the exception of rice, sheep meat, vegetable oils and oilseeds. Ten percent or more of the world trade is a large number, large enough to distort global markets.

Table 1: **Export subsidization limits in the Uruguay Round** (Million US$)

Countries	Base (1986-90) Outlays	Bound (2000 or 2004) Outlays	%
EU-15	16 146	10 333	75.3
United States	929	594	4.3
Canada	567	363	2.6
Switzerland	487	312	2.3
Others	1 780	1 068	7.8
Developed total	*19 909*	*12 670*	*92.4*
Mexico	748	553	4.0
Colombia	371	287	2.1
Others	302	208	1.5
Developing total	*1 421*	*1 048*	*7.6*
Total for all	*21 330*	*13 718*	*100*

Source: Authors, based on statistics published by WTO Secretariat (WTO 2000)

Indirect forms of export subsidies

While direct forms of export subsidies were quantified and reduced, this was not done for various indirect forms of export subsidies. These included export credits and food aid in particular. For these, only general rules were prescribed. Thus, it was said that export credits and food aid couldn't be used to circumvent export subsidy commitments. These are addressed in Article 10 of the AoA - *prevention of circumvention of export subsidy commitments* - and reflect a concern that Members will find ways of concealing export subsidies in other guises. Export credits provide one such possibility, the concern here being that they may conceal an element of price or interest rate subsidy (i.e. charging less than the market rate of interest). Article 10.2 calls upon Members to work towards "internationally agreed disciplines" with respect to export credits and insurance programmes, and to conform to these disciplines once they are agreed. Members were asked to work on this matter at the Organization of Economic Cooperation and Development secretariat. But no agreement has been reached so far. Article 10.4 makes a reference to food aid and seeks to avoid possible circumvention of export subsidy commitments. It stipulates that food aid: (a) must not be tied in anyway; (b) must be conducted according to the conventions of the FAO Sub-committee on Surplus Disposal; and (c) must conform to Article IV of the Food Aid Convention (FAC).

Another potential form of export subsidization is the operation of exporting State Trading Enterprises (STEs). The role of the STEs has attracted some attention as regards the compatibility of their "operations" with the guidelines set in

GATT Article XVII and the new Understanding reached in the Uruguay Round. For exporting STEs, the concern revolves around the competitive advantage the STEs may enjoy due to their relationship with the government. This could come in various forms, such as:

- the possibility of subsiding export sales from the proceeds of monopsonistic rents;
- greater opportunity for discretionary pricing facilitated by domestic price pooling; and
- increased scope for offering favourable long-term agreements with importing countries.

The problem arises because: (i) STEs are usually created in order to undertake trading activities in a way which private companies would not, i.e. their objectives are likely to differ by design from those of commercial criteria; and (ii) it is, in any case, very difficult to test for "commercial" behaviour.

Table 2: **Base and final export subsidy commitments vis-à-vis the 1992 world trade**

Commodities	Base level (000 tonnes)	Final level (000 tonnes)	Final as % of 1992 World trade (%)
Wheat and flour	49 612	61 452	34
Coarse grains	20 581	21 236	15
Rice	604	874	3
Butter and butter oil	618	644	38
Skim milk powder	578	609	42
Other milk products	3 326	3 396	-.
Cheese	543	602	49
Beef	1 583	1 753	28
Pig meat	612	617	30
Poultry meat	726	828	24
Sheep meat	30	30	4
Vegetable oils	1 585	2 138	5
Oilseeds	2 508	2 508	5
Oilcakes	30	30	…
Sugar	6 304	6 304	16
Fruit and vegetables	9 268	9 435	n.a.

Note; A dash (-) means not computed due to lack of data on world trade

Source: Pearce and Sharma (2000).

As far as developing countries are concerned, there are very few examples of exporting STEs whose operations are significant relative to the world trade. Also, there is a widespread feeling that the developing countries may need STEs as they play important food security role. Moreover, being small trading nations, STEs can also provide them the economies of scale to compete effectively in international markets.

Special and Differential Treatment for the developing countries

As a Special and Differential Treatment (SDT), the AoA exempts developing countries from disciplines (d) and (e) of Box 1. These countries are allowed to provide subsidies to reduce the marketing costs of exports, including the costs of international transport and freight, and internal transport and freight charges on export shipments.

Tables 4 and 5 in the following section show the actual use of these provisions by the Asian countries, notably by India. Also briefly discussed is India's use of these provisions given its relevance to Nepal. Most of the products receiving such assistance have been niche, non-traditional commodities, like fruits, fresh vegetables and cut flowers. On the whole, the amounts of assistance given have been small. For Nepal, the closest example of this type of subsidies would be the assistance for export of oranges to Bangladesh. The subsidy given to transport apples from Jumla would also be an example if the apples were destined for export. Thus, this provision would be useful for countries like Nepal to give export subsidies occasionally when it is worth doing so on the basis of other considerations.

The July 2004 framework agreement of the on-going Doha Round negotiations states that until such time as the phasing out of all forms of export subsidies is completed, developing countries shall continue to benefit from this provision of the SDT. This means that the special treatment provision may be phased out in future, although there is no reason why developing countries should not make it a negotiating issue in subsequent negotiating rounds.

Export Incentive Schemes of the WTO Subsidies Agreement

Many developing countries routinely provide various export incentives such as tax breaks, currency retention schemes and duty drawbacks. It is the Subsidies Agreement that covers these schemes, not the AoA. All these measures are listed in Annex 1 of that Agreement as *Illustrative list of export subsidies*. There is some confusion regarding the WTO-compatibility of these incentive measures for agricultural products as the AoA clearly says that all forms of subsidies on agricultural products not compatible with the AoA provisions are prohibited, whereas the Subsidies Agreement allows these incentive measures under certain conditions. Article 3.1(a) of the Subsidies Agreement prohibits these subsidies yet the developing countries may have access to them under the SDT provisions of its Article 27.

For developing countries, this clarification is important because while most of them have zero subsidy commitments in the AoA, they continue to have policy measures that promote exports through incentive measures covered by the Subsidies Agreement. In the on-going Doha Round negotiations on agriculture, this issue was addressed in the proposal submitted by India (WTO 2001). The proposal states that the AoA deprives the developing country members of their right to provide export subsidies, which are otherwise permitted under Article 27, read together with Annex VII of the Subsidies Agreement. There is thus "every need to restore the rights negotiated by the developing countries under the Subsidies Agreement". The proposal made was that the special dispensation for developing countries provided under Article 27 read together with Annex VII of the Subsidies

Agreement should prevail over Article 8 of AoA.[26] For the final outcome, one would have to wait until the ongoing negotiations are completed.

Export Prohibitions, Restrictions and Taxes

The focus of the AoA is on export subsidies and only one Article is devoted to *disciplines on export prohibitions and restrictions* (Article 12). This Article refers to GATT Article XI, which is the main GATT/WTO provision on export restrictions. The AoA Article 12 covers only foodstuffs, and not other agricultural commodities like cotton and hides, and calls upon WTO Members to give “due consideration” to food security concerns of importing countries while instituting *new* prohibitions or restriction on the export of foodstuffs. Its paragraph 1(b) requires adequate notice and consultation prior to the implementation of this measure. The developing countries are exempted from these provisions unless they are regular food exporters (e.g. Pakistan and Thailand for rice).

Article XI of GATT 1994 – *general elimination of quantitative restrictions* - is of general application, i.e. for all products including agricultural products. Its first paragraph states that no prohibitions or restrictions other than duties, taxes or other charges shall be instituted or maintained on the exportation or sale for export. Only export taxes are permissible and not non-tax restrictions. Paragraph 2(a) of this Article makes an important exception to this general rule by allowing, “export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party”. The “other products” in this sentence could include non-food agricultural products, but the measure has to be temporary and to prevent or relieve critical shortages.

The developing countries in general have a record of regulating the export of agricultural products through quantitative restrictions and/or taxes. Two main objectives have been promotion of agro-industries by making available raw materials and tax revenue. Both these objectives are not recognized in the above exception clause and so these policies have not been fully consistent with the GATT rules. Although export regimes of most developing countries have been substantially liberalized in the 1990s, many of these countries would favour some room for regulating exports of primary products for the sake of industrialization and revenue.

EXPORT SUBSIDIES, INCENTIVES AND RESTRICTIONS IN NEPAL

Direct and Indirect Forms of Export Subsidies

Nepal neither did nor does provide subsidies “contingent upon export”, as defined in the AoA. While acceding the WTO also she committed not to provide such subsidies in future as well. With regard to the other forms of subsidies listed in Box 1 also the situation is basically the same. That is no subsidies in those forms either.

It is very unlikely that the commitment not to provide any export subsidy in the future has any negative implication for the Nepalese agriculture and export.

[26] Article 8 of the AoA, Export Competition Commitments, reads as follows: “Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member’s Schedule”.

First, as noted earlier, export subsidies are not sound economic policies and have high economic costs. Second, Nepal would not be able to afford export subsidies in the foreseeable future. Third, export subsidies on agricultural products may even be phased out in the Doha Round of negotiations, thus closing this window for other WTO Members also. However, as a developing country, Nepal is allowed to provide subsidies to reduce the cost of internal and external transportation of export consignments. This is discussed below.

Existing Incentive Measures for Export Promotion

Nepal, like most other developing countries, implements a number of incentive measures aimed at export promotion. These measures, introduced in the previous Section also result, to some extent similar effects like export subsidies. Therefore they are often a source of controversy. For example, some Members of the Working Party on the accession of Nepal had questioned about the legality of some of the incentive measures in Nepal. They considered that the exemption from incomes taxes for profits earned through export, sales and excise tax exemptions for use of local raw materials, as well as the rebate of 10% of the income tax for industries using 80% or more local raw materials in their output were prohibited subsidies under Article 3 of the Subsidies Agreement[27]. In their view, this subsidy should be eliminated. In response, the representative of Nepal had said that as a LDC, Nepal should benefit from the special and differential treatment provided in Article 27 of the Subsidies Agreement. The representative also added that Nepal would review the incentive measures to make them compatible with the provisions of the Subsidies Agreement. Some of the incentive measures are channeled through the Trade Promotion Board (Box 2). The rest of this sub-section discusses these measures in brief.

Assistance to exports and export-oriented activities through subsidized credits

The government provides this assistance through the Trade Promotion Board. For example, loans are provided to industries and exporters for the importation of machinery and plants for industries that process export commodities. Similarly, revolving funds are created and encouraged in various implementing agencies. In some cases, highly subsidized loans, e.g. at 1% interest rate, are given for specific purposes, e.g. for establishing greenhouses for floriculture, brooms and seed packaging.

Table 3 shows loans advanced since 1996/97 for various agricultural enterprises. Except some years, the total amount of assistance has been about Rs 2 million per year, a very small amount indeed. No budget was released for 2001/02 but it seems that this was also added to the 2002/03 allocation. The table also shows fluctuating level of assistance to various commodities and sub-sectors. Tea and coffee and leather however, feature consistently. The approach to allocate resources across commodities on the basis of demand as against a pre-set target could also be a factor for such variation. As noted in Box 2, the Board has identified a set of products for assistance, but has not set priority among them. Also, the

[27] In paragraph 87 of the report of the working on the WTO accession if Nepal (WTO 2003)

Box 2
Nepal Trade Promotion Board

The main objective of the Nepal Trade Promotion Board is to promote exports and export-oriented industries through incentives and promotional measures. The Board Chaired by the Secretary of the Ministry of Industry, Commerce and Supplies (MoICS) is represented by various ministries, business associations and communities. It provides interest-free loans to encourage exports through programmes like product development, trade-related infrastructures, trade fairs and upgrading of skills. The Board also provides funds to establish "revolving funds" in implementing agencies. The revolving fund is used for interest-free loans to industrialists and exporters.

The Board's programmes are implemented through various entities such as Trade Promotion Center, FNCCI, Federation of Nepalese Chamber of Cottage and Small Scale Industries, Agro-Enterprise Centre of the FNCCI and various commodity associations. In disbursing the fund, the Board calls for proposals from implementing agencies and entrepreneurs. The proposals are assessed and approved on the basis of some criteria like expected impact on product development and export promotion, forward and backward linkages, competitiveness and viability of commercial production

The Board has identified a number of products for assistance. These include fresh vegetables, fruits, vegetable seeds, silk products, floriculture, green tea and coffee, broom, bamboo products, Pashmina shawls, ceramic products and traditional garments. The funds from the Board are also used for the purpose of stabilizing the export of woolen carpets, readymade garments, leather goods, essential oils, Nepalese paper, niger-seeds, spices etc.

Table 3: **Export commodities and sub-sectors assisted with subsidized credit**

Fiscal year	Total credit Allocated (000 Rs)	Commodities/ Sub-sector assisted	Amount (000 Rs)
1996/97	200	Green house for floriculture	200
1997/98	2300	Leather	1300
		Tea and coffee	150
		Niger seeds	850
1998/99	2200	Leather	2000
		Broom	200
1999/2000	2020	Leather	20
		Tea and coffee	400
		Silk	800
		Broom	300
		Seed packaging	500
2000/01	2024	Leather	24
		Flower	500
		Tea and coffee	1000
		Honey	500
2001/02	0	-	0
2002/03	5300	Leather	5300

Source: Nepal Trade Promotion Board.

extent of dynamism and responsiveness of the process to changing needs and market opportunities is not clear. Some industries and traders interviewed in the course of this study opined that there is a considerable room for flexibility in the way the Board grants assistance. This also leaves room for lobbying. The chances of those who lack capability to formulate proposals as well as to "lobby" for assistance, notably small industries and exporters, being deprived of the assistance cannot be ruled out.

The effectiveness of this export assistance scheme has not been assessed thoroughly and independently. The Board claims some success citing the increasing trend in using improved processing technologies by the assisted sectors, notably leather and tea, and increased export of tea in particular after 1995/96 as examples. Some success is also claimed on the export of vegetable seeds in recent years. However, it would be naïve to associate these improvements with the scheme only as many other factors play a role in export growth. Although the amount of assistance provided by the Board is small, it would be useful to assess the impact in order to evaluate the effectiveness of this and other approaches to promote exports.

Currency retention

In this scheme, exporters are allowed to open bank accounts in hard currency from incomes earned from exports. There are no limits on the amount that can be retained thus. There is some consensus that this incentive has encouraged domestic investors to take interest in the export business.

Duty drawback scheme

Nepal has a duty drawback scheme for the refund of import duty paid on imported raw materials and intermediate goods required for the production of exported products. The duty on the import of raw materials is fully exempted. Bonded warehousing system has also been introduced. All export oriented agricultural and non-agricultural industries are entitled to receive duty draw back against the importation of raw materials once the manufactured products are exported.

Export Promotion Industry

The concept of an Export Promotion Industry was added in 1997 when certain amendments were made to the Industrial Enterprise Act 1992. It is defined as an industry that is established with the objective of exporting 80% or more of its production. No tax, charges or fees of any kind are levied on the export of products produced by these industries, and all custom duties, sales tax, excise duty and premium levied on imported raw materials and auxiliary materials are to be reimbursed. Similarly, an Export Processing Zone (EPZ) has been defined as a zone prescribed for locating Export Promotion Industries. The MoICS has announced plans to establish EPZ in Bhairahawa, Biratnagar and Birgunj in the Tarai.

Other incentives include the exemption of excise and sales duties for 10 years for fruit-based packaging, cider and wine industries with a fixed asset up to two and half million rupees if established in 14 specified remote districts in the hills and mountains. Alcohol industries based on fruits are entitled excise duty exemption for five years with the possibility of extension for additional three years.

However, several stakeholders interviewed in the course of this study felt that the Industrial Enterprise Act 1992 does not provide enough incentives to export-oriented industries relative to what are given in other SAARC countries. For example, in some of these countries, industries considered to be “infant” and facing difficulties in competing in export markets receive tax holidays for 10 to 15 years. Thus, the argument made is that Nepal should also try to match the level of incentives given in the SAARC area, although no analysis has been made of the effectiveness of the current incentives or those proposed.

Commodity-specific incentives

***Tea*:** There is a general feeling in Nepal that tea is a good example of a commodity for which various incentives have worked to spur exports. The declaration of a “tea zone”, a campaign to increase tea farming in eastern Nepal, along with the package of incentives that came with it, is said to be a major factor in the growth of the sector.[28] One incentive associated with this package is subsidized credit. The tea sector is also exempted from land ownership ceiling by allowing private ownership of land up to 6000 *Ropanis* (305 ha) for tea cultivation. This is a unique exemption in Nepal for tea only. The new tea policy of 2000 also added some incentives. Similarly, customs duties are exempted on packaging materials for tea. Some observers have claimed that tea area and production expanded remarkably in the 1990s due to these incentives. But this is a weak claim because many other factors also play a role. Not all analysts, however, agree that the tea sub-sector should enjoy more incentives because Nepal has a comparative advantage in producing and exporting several other commodities (e.g. citrus fruits, honey, flowers, vegetable seeds, niger-seeds etc.). It is also argued that incentives to tea may even act as disincentives to other commodities. In order to discuss these issues, sound analyses are required on the structure of incentives facing tea and other exportable commodities.

***The case of oranges*:** Nepal’s attempt to export oranges to Bangladesh is a widely reported example of a case where some export assistance was used to promote exports.[29] In 1996/97, the Nepal Trade Promotion Board provided Rs 150 000 as an incentive for improved packaging of oranges being exported to Bangladesh on a trial basis. The fund was channeled through the Agro-Enterprise Centre. A total of 14 tonnes of oranges were exported to Bangladesh that year. According to trade sources, the assistance was considered effective in demonstrating how improved packaging helps accessing export markets. This was followed by more exports of oranges to Bangladesh, e.g. 63 tonnes in 1999 entirely with the effort of the exporters, i.e. without the assistance. At the same time, almost 14 tonnes of apples were also exported to Bangladesh that year. Many aspects of this experience are not clear, e.g. why the assistance was discontinued, in what sense was it considered effective, and why subsequent efforts by traders to export oranges did not work. In common with many other similar experiences, virtually no analyses have been conducted that would have pointed to the way forward.

[28] For details, see Chapter 14: the case study on tea by Thapa in this volume.
[29] See Chapter 16: the case study on fruits by Thapa et al. in this volume.

Export Prohibitions, Restrictions and Taxes

Export prohibitions and restrictions

In the wake of economic reforms, especially since the early 1990s, Nepal's export trade policies are liberal. Most export controls have been removed, including licensing requirements. Only some products are placed on an export restriction list, e.g. rawhides, skin and raw wool. The export of some food products is also banned or restricted in order to ensure the domestic availability of essential foodstuffs. The question asked here is how do the WTO rules affect these policies?

As outlined earlier, there are two WTO provisions that apply to export restrictions. First, Article 12 of the AoA concerns itself with foodstuffs only, not with other agricultural commodities, and the discipline is fairly weak. All it requires is that a country instituting new export restrictions should give "due consideration" to food security concerns of importing countries. Moreover, the developing countries are exempted from this provision unless they are regular food exporters. Thus, there are no implications of this provision for Nepal because she is not a regular exporter of foodstuffs as; for example, Thailand and Pakistan are for rice. Nepal has a policy of restricting export of some basic foodstuffs in order to ensure the domestic availability of essential foodstuffs, e.g. sugar. For Article 12 to apply, Nepal has to be a regular exporter of sugar (if sugar is assumed to be a basic foodstuff in the context of food security), which is not the case.

As regards non-food agricultural commodities, it is not the AoA that is relevant but the provision in GATT Article XI. As discussed earlier this provision does not permit export restrictions except when these are applied temporarily to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party. The sugar case above should qualify under the provision of "shortages of foodstuffs", but this has to be on a temporary basis, and not as a policy for several years.

Although in practice export bans and restrictions have attracted little attention in the GATT/WTO, given the overwhelming focus on export subsidies, yet it is clear that export restriction policies are not fully consistent with the WTO rules. In Nepal's context too, this issue was raised during the accession negotiations by some Members of the Working Party when they said that the ban on the export of raw hides and skins, raw wool, and logs and timber could not be justified under Articles XI (a) and XX (g) of the GATT 1994, unless the export restrictions were made effective in conjunction with restrictions on domestic production or consumption, or action was taken to prevent or relieve critical shortages of foodstuffs or other products essential to Nepal.[30] They further said that the ban on the export of imported raw materials, parts and capital goods appeared to be inconsistent with Article III and XI of GATT 1994 and should be eliminated. In response, the representative of Nepal said that the export restrictions on raw hides and skins and raw wool had been temporarily applied and Nepal intended to lift this restriction at an appropriate time, while Nepal had banned the export of imported raw materials, parts and capi-

[30] Paragraph 80 of the Working Party report (WTO 2003).

tal goods due to the possibility of trade deflection. It was agreed that Nepal would review these measures in the light of Article III and XI of GATT 1994.

Export duties, charges and other regulations

While Article XI of GATT 1994 disciplines export restrictions, export duties, taxes or other charges are permitted, as in the case of import measures. An important difference is: export taxes or charges are not bound but import duties are.

In the Working Party report on WTO accession, Nepal reported that the same registration requirements and tariff nomenclature were used for exports as for imports. Thus, the import and export-licensing regime had been introduced for statistical purposes. Annex VI of that report provides detailed listing of export duties currently levied. It shows only 13 agricultural commodities facing export duties, 11 tariff lines being vegetable oils and animal fats and two tariff lines on molasses. The export duties shown are fairly low, 5% for all these products with the exception of 2% for coconut oil and fractions. The Working Party report states that the purposes of levying export duties are to discourage environmental degradation, to ensure food security and to discourage trade diversion to neighbouring countries.

In addition, the Working Party report also states that Nepal also levied an export service fee of 0.5% ad valorem. The export service charge is applied on the basis of f.o.b. price to all exports from Nepal. Nepal has not considered reducing further the service charge. An important reduction has already been implemented from 2% to the current 0.5%. It was further said that the current level of the service charge did not represent a tax on export for fiscal purposes, and that Nepal was examining the cost of the services rendered by the administration with respect to exports and imports and would revise the export charge, along with the import licensing fee, to bring them into conformity with the requirements of Article VIII of GATT 1994. The Working Party took note of these commitments.

As said above, export taxes are compatible with WTO rules. The implications are from the standpoint of the economics of export taxation. By lowering domestic prices below export parity levels, export taxes hurt farmers or producers while benefiting consumers and other users of the product, e.g. agro-industries. Many developing countries apply export taxes also for the purpose of generating revenue. Thus, the main issue is the political economy of export taxes as different groups of economic agents gain and lose in the process. Export taxes in Nepal are generally low. So the level of distortions, gains and losses would not be high. What may be significant are the red tapes associated with any measure to regulate export, even automatic licenses for that matter.

Export Subsidization by Asian Countries, Particularly by India

Export subsidization by the Asian countries

Among the Asian countries only Indonesia has reserved the right to grant export subsidies, that too for rice only. As developing countries, they are allowed to provide subsidies to reduce transport and marketing costs, as per Article 9.1(d) and (e) of the AoA. Table 4 shows that only five Asian countries used this provision during 1995-2000. Most of the products receiving such assistance have been niche, non-traditional commodities, like fruits, fresh vegetables and cut flowers. On the whole, the amount of the assistance is very small with a large year-to-year fluctuation. One exception is the Republic of Korea's marked increase of the assistance in 1999, five times the average level of 1995-97, and a further increase in 2000. These assistances have not attracted much attention of other WTO Members in the WTO Committee on Agriculture meetings where these notifications are discussed. It may be so because the level of assistance was small. However, there is a risk that WTO Members may raise it as an issue if the level of assistance rises markedly in the coming years, and may lead to calls for capping these subsidies.

Table 4: **Export subsidies by Asian countries under AoA Article 9.4** 1/
(Million US$)

Country	1995	1996	1997	1998	1999	2000
India	n.n 2/.	1.99	3.92	2.51	2.33	1.10
Korea, Republic of	1.53	2.98	3.20	2.58	12.51	16.87
Pakistan	1.70	2.29	2.84	2.65	0.38	n.n.
Sri Lanka 3/	-	-	0.15	n.n.	n.n.	n.n.
Thailand	15.24	6.24	4.53	n.n.	n.n.	n.n.

1/ These subsidies are for reducing transport and marketing costs allowed by the AoA Article 9.1(d) and (e) for developing countries under the Special and Differential Treatment.
2/ Refers to no notification for the year in question
3/ This is the only instance when Sri Lanka's WTO notification shows export subsidies; there are no further notifications to confirm if the assistance has been continued.

Source: Ruamraksa (2002), based on WTO Notifications.

With this brief overview of the Asian picture some export assistance schemes implemented by India are discussed in the following paragraphs, in view of their relevance for Nepal. Note that India does not have the right to grant direct export subsidies on agricultural products, but as developing countries can assist exports under AoA Article 9.1(d) and (e).

India's transport subsidy on fruits, vegetables, flowers and poultry products

India assists agricultural exports through a scheme that grants transport assistance for identified horticultural, processed food and poultry products. Agriculture and Processed Foods Export Development Authority (APEDA) of India implements the programme.[31] As per the rule, the assistance would be limited to a maximum of 10% of the f.o.b. value, subject to a ceiling of 25% of the freight cost or fixed per kilo rate for each mode of transport (air and sea), whichever is lower. For 2002-04 the rates fixed on a per kilo basis were as follows. For transport by air, the rates that vary by destination were in the range of Rs 6-22/kg for horticultural products, Rs 9-34/kg for floricultural products (Rs7-30/kg in the peak season) and Rs 6/kg for poultry products (only Middle East markets eligible). For shipments by sea, the subsidy rates for fresh and frozen fruits, vegetables and poultry products ranged from Rs 3/kg (Middle East and South East Asian markets) to Rs 8/kg (North and South American markets). The rates were much lower for other products. Nepal is

[31] See the AEDEPA web-site http://www.apeda.com/ for details.

also listed as a destination eligible for the assistance. Clearly, only the air transport rates apply. Table 5 shows the level of export subsidies and the amount of exports that benefited from these subsidies in the form of international airfreight assistance. India has notified subsidies on the five products shown in the table under the AoA Articles 9.1(d) and 9.4.

Table 5: **Indian exports subsidies in the form of international airfreight assistance**

Product	Heading	1996/97	1997/98	1998/99	1999/00	2000/01
Fresh fruits	*Subsidy (Million $)*	*1.350*	*3.740*	*1.910*	*1.580*	*0.488*
	Quantity (tonnes)	20112	5162	9826	67554	88052
Fresh vegetables	*Subsidy (Million $)*	*0.040*	*0.005*	*0.139*	*0.210*	*0.134*
	Quantity (tonnes)	244	27	32	190	366
Plants and flowers	*Subsidy (Million $)*	*0.550*	*0.175*	*0.302*	*0.374*	*0.266*
	Quantity (tonnes)	2168	748	273	77892	18172
Cardamom (small)	*Subsidy (Million $)*	*0.053*	-	-	-	-
	Quantity (tonnes)	226	-	-	-	-
Poultry products	*Subsidy (Million $)*	-	-	*0.158*	*0.170*	*0.213*
	Quantity (tonnes)	-	-	2633	2725	4059

Note: The "quantity" heading refers to quantity of subsidized exports. These subsidies were provided under AoA Articles 9.1(d) and (e).

Source: India's WTO notifications, Document G/AG/N/IND/3, 1 March 2002.

India's transport subsidies for the export of wheat and rice

The government of India decided in October 2001 to export its wheat stocks at highly subsidized prices (initially about IRs. 4 150 or $86 per tonne ex-FCI warehouse). Similar programme was initiated in April 2001 for rice. At that time, these prices were considered to be less than 50% of the government's economic cost. The subsidies were effective to boost exports. The way the scheme worked was that initially the government made available rice and wheat at ports at subsidized prices, but this was found not to be in conformity with Article 9.1 (b) (sale or disposal for export of government stocks at a price lower than to buyers in the domestic market). In view of this, the scheme was changed whereby the government reimbursed exporters for the cost of transport and marketing, which would be AoA-compatible under Article 9.1 (d) and (e). As government stocks started to decline, in large part also because of the exports, the government began to reduce transport subsidy. The schemes were discontinued in August 2003.

It is not clear to what extent the subsidized rice and wheat leaked to Nepal, to the detriment of farmers and benefits to consumers and agro-industries. There were nevertheless several reports in the local newspapers of "import surges" in Nepal of rice and wheat during the period when India was rapidly de-stocking cereals.[32] In any case, the important point is that the Nepalese agriculture stands to be affected negatively from subsidized exports by India of cereals and other products. The WTO rules are like a double-edged sword – while Nepal may utilize the provisions of the AoA Article 9.1 (d) and (e), there are also negative implications of having such provisions in the WTO Agreements. The worst case is when Nepal does

[32] See the chapter on import surge in this volume.

take advantage of the special provision but is affected negatively when trading partners subsidize exports using the provision. The poultry case study in this volume reports some episodes of "dumping" from India although it is not clear if there is any connection to the subsidy shown in Table 5.

India's inland transport assistance scheme

Under this scheme, valid for the duration of the Ninth Plan (2002-07), India grants subsidies for promoting the export of identified agricultural products and processed foods (mostly horticultural products) originating in the northeast region of the country. The assistance is released through APEDA. Support is provided on a first-come first-served basis and subject to availability of funds.

CONCLUDING REMARKS

In what follows, the first five points summarize the main conclusions of the study, notably the implications of various WTO rules on domestic policies on export subsidies, export promotion and export restrictions. The sixth and the subsequent points make various suggestions for analytical works.

***Nepal's WTO commitment not to subsidize the export of agricultural products has little negative implications on the Nepalese agriculture*:** As with most LDCs and a majority of the developing countries, Nepal did not grant and does not provide subsidies "contingent upon export", as export subsidies are defined in the AoA. At its low level of economic development, Nepal could not afford export subsidies, even if export subsidization was a government policy. Nepal committed not to grant any export subsidies on agricultural products at the time of the WTO accession. Nepal could not have claimed the right to subsidize for the simple reason that Nepal did not grant any subsidies in the past. This commitment has hardly any negative implications for the Nepalese agriculture because even if Nepal had the right to subsidize it could not afford to do so. Moreover, export subsidization is not a first- or second-best economic policy (Sharma 2002). Nepal is not unique in this position. Among the 20 WTO members that acceded after 1995, only two (Bulgaria and Panama, but only until 2003 for Panama) reserved the right to subsidize exports (Brink 2003). None of the SAARC countries have access to this policy instrument. Moreover, export subsidization will most probably be phased out by the ongoing Doha Round negotiations. Therefore, all in all, this is hardly an issue.

Nepal however can grant subsidies to reduce the cost of domestic and international transportation. This Special and Differential Treatment is available for all developing countries. As discussed in the preceding section some Asian countries, and India in particular, have been taking advantage of this provision, providing export subsidies for a few niche products. Thus, for example, the assistance given by Nepal to export oranges to Bangladesh would be WTO-compatible on the basis of this provision. Similarly, the subsidy given to transport apples from Jumla is also an example of this provision (assuming that the apples are destined for exports). Thus, the provision could prove to be useful for Nepal in the future, provided that it is not misused (discussed below).

Nepal can also promote exports through various incentive measures of the WTO Subsidies Agreement. Most developing countries provide a number of incentive measures aimed at promoting exports and assisting export-oriented industries, such as tax breaks, currency retention schemes, duty drawbacks, refund of import duties and so on. These measures are listed in Annex 1 of the Subsidies Agreement, and not in the AoA. Nepal also implements a number of these incentive measures. As these measures also have to some extent similar effects like export subsidies, the legality of these measures often comes into question. Indeed, some Members of the Working Party on the accession of Nepal had questioned about the legality of some of the incentive measures in Nepal. It was clarified then that as a LDC Nepal qualifies for using these measures under the SDT of Article 27 of the Subsidies Agreement. In the course of this study, some stakeholders made a suggestion that Nepal should closely monitor the level of assistance given by SAARC countries, and adjust Nepal's assistance in order to maintain some parity and competitiveness. It was also found that there is a great deal of confusion about the manner in which these incentives are given in Nepal to various industries and subsectors, which needs to be clarified.

Limited implications of the WTO rules on export restriction and taxation policies. Nepal's export trade policy is considered to be highly liberal, apart from a tendency to ban the export of some agricultural products from time to time, and some export taxes and export user fees. As regards the implications of the WTO rules, first of all the AoA provision on the export restriction of foodstuffs does not apply because Nepal is not a regular exporter of any food, at least not officially. The restriction on the export of some agricultural raw materials (e.g. hides and skins) attracted the attention of negotiators during Nepal's accession process, when they alleged that this practice was not consistent with some provisions of the GATT 1994. But given that the main focus of the WTO is on export subsidies, and on large trading nations, it is unlikely that this issue would pose any practical problem for Nepal in the WTO. As regards export taxes and export service fees, these are consistent with the WTO rules and so there are no issues. Thus, overall, there are few policy implications of the WTO rules. However, export restrictions and taxes are not the first-best economic policies, and impact various stakeholders differently. The focus of the government in this area, therefore, should be on minimizing the negative effects of these policies.

Nepal is occasionally affected negatively by export subsidization by others. This issue is discussed in the chapter on import surges and their negative effects. Although import surges could occur even without export subsidization by a trading partner the phenomenon is often linked to export subsidies. In Nepal's case, export subsidization by India is much more relevant than by others. As discussed earlier there were several reporting in Nepal that the de-stocking of rice and wheat by the Food Corporation of India during 1999-01 (with transport subsidies) led to import surges in Nepal with negative effects to farmers. The commodity case study on poultry in this volume also raises this issue as a case of dumping of poultry products from India in some seasons of the year. There was also a case where Nepal's lentil market in Sri Lanka was said to have been seriously undermined de to export subsidization by Turkey. Thus, Nepal may not grant export subsidies but stands to be affected negatively. Responding to the problem is not easy. First of all, these episodes have not been documented properly, with facts and figures. There is no unit in the government designated to systematically document the cases, analyse the issues and take response measures.[33] These reports came mostly from the media and farm and trade associations. There are specific guidelines in various WTO Agreements on how to respond to the problem. This is also the case with the Nepal-India Trade Treaty. It is necessary to develop capability in the government to document the problem with facts and figures before any response measures are even thought of.

Domestic policy issues and analytical needs: The main conclusion is as follows. The AoA prohibits Nepal from granting direct export subsidies on agricultural products. Yet there are some indirect ways in which Nepal can subsidize and assist exports and export-oriented enterprises, by virtue of its developing country status. The two main avenues are subsidies to reduce the cost of marketing exports including domestic and external transport costs, and various export incentive measures. Similarly, while export bans would not be WTO compatible except under certain conditions, export taxes are allowed. Overall the WTO provides a good deal of policy space. The challenge is to design and implement policies that best serve the interest of the Nepalese agriculture.

Some suggestions for further analysis and discussion are as follows.

Economic analyses of the effectiveness of various export incentives. It was noted that that there is a great deal of confusion in the manner these incentives are granted to various industries and sub-sectors, notably the rationale and criteria used, the amount of the assistance provided, the duration of the assistance, effectiveness, and so on. A suggestion was also made that Nepal should closely monitor the level of assistance given by SAARC countries, and adjust Nepal's assistance if necessary in order to maintain some parity and competitiveness. This is more of an analytical issue than a WTO-related legal matter.

An important sub-component of this analysis would have to be the *export support activities of the Nepal Trade Promotion Board*. It is expected that the activities of the Board will expand in the future and become increasingly important for export promotion. It was found that the following activities of the Board require clarification and analysis: range of the services provided; criteria used for identifying commodities and sub-sectors for export support; level of the support itself; effectiveness in export promotion; and the Board's evaluation criteria. Transparency is obviously essential on its own, but also to avoid the usual problem of "rent-seeking". For all these reasons, it is suggested that the Board itself encourages independent analyses of its operations followed by debates involving all stakeholders. This is also essential to make the Board's assistance dynamic and responsive to changing needs and market opportunities. In view of the many agricultural commodities short-listed for export promotion by the Board, the MoAC needs

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[33] The chapter on import surges makes a concrete suggestion for the government to develop necessary institutional capability for monitoring and responding to such problems.

to play a pro-active role in terms of analyses and advice to the Board, as well as to the private sector.

Comparative study on support and incentives to export-oriented commodities and industries: It is clear from this chapter and various commodity studies in this volume that the government provides a number of incentives with the objective of promoting exports. Some of them are of a general nature, i.e. applicable to all commodities, while others are commodity or industry-specific. For example, there is a strong feeling among various stakeholders that tea in particular enjoys much more favourable treatment than other commodities, e.g. exemption from land ceiling up to a level, a “tea-zone” with special credit policy, exemption of import duties on packaging materials, and so on.[34] The reasons for this are not clear, nor are there good analyses that quantify the levels of the support provided. This lack of transparency is not healthy. Therefore, it is suggested that the government undertakes or commissions a comparative study that documents the full range of assistance received and their levels for a selected list of 5-6 prominent export-oriented commodities, including tea.

Studies on the effectiveness of internal and international transport subsidies: It was somewhat frustrating to find that there was not a single study available in Nepal that provided in-depth analysis of the two often-mentioned cases of transport subsidies in Nepal: the Jumla apples; and oranges exported to Bangladesh, discussed in the commodity study on fruits in this volume. While the AoA allows Nepal to grant such subsidies, the main issue is justification of these subsidies on the basis of economic and other considerations. For example, transport subsidies to Jumla apples are often justified on such grounds as poverty reduction and regional development. Yet one could still ask why only Jumla apple? Why not other commodities from similar or more backward regions? In other words, the debate is about the opportunity value of the subsidy. Similar questions may be asked about subsidies to reduce the cost of international transport. For example, the effectiveness of the assistance provided for exporting oranges to Bangladesh remains a mystery. While many in the business were aware of this pilot effort, little is known about the effectiveness, e.g. in what way the assistance helped promote the export, who benefited and how, why was it discontinued, and so on. True, India grants export subsidies for some commodities, e.g. fruits, fresh vegetables, cut flowers etc, this fact alone cannot be a justification for Nepal also providing these subsidies, in the absence of analysis of their effectiveness.

***Economic analysis of export restrictions and taxes*:** As was concluded above there are no WTO implications as regards these policies. However, there is a lack of clarity on their economic effects. Thus, it is suggested that the MoAC undertakes some analyses in this area. First, there is a need for some informed debate in Nepal on the issue of restricting or limiting the export of agricultural raw materials. Although not many commodities are affected currently, there is some tendency in the policy-making circle towards limiting exports form time to time in re-

[34] Note also that in Table 3 (Section II), tea and coffee and leather feature consistently in terms of the level of assistance received from the Nepal Trade Promotion Board, although again the reasons are not clear.

sponse to short-term problems. This is not healthy for investment and trade. The analysis should come out with clear policy guidelines for the future, by identifying the nature and level of the gains and losses, and importantly the incidence of these impacts. For example, what is the net cost to farmers of ban on export of raw hides and skins, relative to net gains for the leather industry? Second, a similar analysis would be useful for sugar. Sugar has attracted some attention in recent years in Nepal in the context of sugarcane pricing and trade policies as well as the export to the EU under the Everything but Arms preferential import regime. The questions asked are similar as above – should Nepal be taking advantage of this scheme? If so, who gains and who loses and what would be the net gain to the economy? What type of compensatory policy would ensure that some of the gains are channeled to losers?

Assessing the impact of food aid: In the AoA, food aid is seen as a possible source for circumventing export subsidy commitments in the sense that as direct export subsidies are disciplined, exporters may dispose off their surplus production in the form of food aid, at the cost of other exporters. For Nepal, however, the relevant issue is the likely negative effects of food aid on the local economy. This concern has been expressed by some stakeholders in Nepal in the context of some commodities, notably dairy products. There is no WTO discipline on preventing the negative effect itself, and so it is up to the government to ensure that food aid has no negative effects. In Nepal, one side of the argument made is that free or cheap food aid in the form of milk powder, for example, has depressed the demand for fresh milk (including through milk holidays) and hurt dairy farmers. The counter argument is that because of the aid or cheap milk powder local dairies have been able to meet milk demand to the benefit of consumers. While both arguments are correct on their own, the net benefit to the economy, i.e. after taking into account the impact on all stakeholders, cannot be predicted in the absence of an economic analysis. The responsibility of clarifying this matter lies on the government.

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