



Two Background Papers  
Asia-Pacific Human Development Report 2006  
**TRADE ON HUMAN TERMS**



Human Development Report Unit  
UNDP Regional Centre in Colombo

The award winning Asia-Pacific Human Development Report, *Trade on Human Terms*, was informed in part by a series of technical background papers authored by experts in the field on trade and human development. As a follow-up to this Report, this publication presents two of these papers, prepared by Kamal Malhotra and Chantal Blouin.

The first paper, *National Trade and Development Strategies: Suggested Policy Directions*, by Kamal Malhotra, projects a two-way relationship in which boosting human development also has a catalytic effect on trade and vice versa. This paper, focusing on national trade and development policies in the Asia-Pacific region, draws upon lessons learned from Asia-Pacific countries to identify critical elements for success. It provides options for strategies and avoids 'one-size-fits-all' prescriptions.

The second paper, *Trade and Health in Asia: Challenges of Globalization*, by Chantal Blouin, delves into the pros and cons of approaches to boosting health services and trade. The breadth of issues spans privatization, health tourism and 'brain drain'. Advantages and drawbacks of international commitments are also discussed against the backdrop of changes to General Agreement on Trade in Services (GATS) and Trade-Related Aspects of Intellectual Property Rights agreements (TRIPS).

# **Two Background Papers for the Asia-Pacific Human Development Report 2006**

**Trade on Human Terms:**  
*Transforming Trade for Human Development  
in Asia and the Pacific*

**National Trade and Development Strategies:  
Suggested Policy Directions**  
*Kamal Malhotra*

**Trade and Health in Asia:  
Challenges of Globalization**  
*Chantal Blouin*

Human Development Report Unit  
**UNDP Regional Centre in Colombo**  
*Serving Asia and the Pacific*

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## Foreword

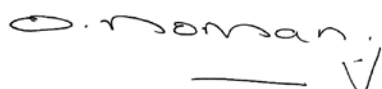
At the dawn of what many have called the 'Asian Century', several countries in the region have gained recognition for the speed with which they are growing. Having achieved such high levels of growth, they now find themselves facing another issue: striving to match economic gains with equally effective poverty reduction, addressing growing inequalities and bolstering human development. In essence, putting a "human face" to trade and growth.

The Asia-Pacific Human Development Report, *Trade on Human Terms*, won the 2007 Human Development Award for Excellence and Innovation for a Regional HDR. This flagship UNDP Report has contributed to the policy debate on how to align trade and economic policies with human development goals based on independent and rigorous research. The present publication aims to continue the discussion by bringing together two extremely relevant technical background papers, both prepared for the HDR.

The first paper, *National Trade and Development Strategies: Suggested Policy Directions*, by Kamal Malhotra, projects a two-way relationship in which boosting human development also has a catalytic effect on trade and vice versa. The paper concentrates on the analysis of national trade and development strategies in the Asia-Pacific region. What makes it unique is its use of lessons learned from Asia-Pacific countries to identify ingredients for success in bolstering human development. The paper provides strategy options and avoids inflexible prescriptions.

The second paper, *Trade and Health in Asia: Challenges of Globalization*, by Chantal Blouin, delves into the pros and cons of approaches to boosting health services and trade. The breadth of issues includes privatization, health tourism and the 'brain drain'. Advantages and drawbacks of international commitments are also discussed against the backdrop of changes to GATS and TRIPS agreements.

In addition to these two authors, numerous individuals have aided in the production of these papers and the booklet that brings them together. In particular, I would like to thank the following members of the Human Development Report Unit of the UNDP Regional Centre in Colombo: Anuradha K. Rajivan, Ramesh Gampat, Elena Borsatti, Rohini Kohli, Niranjana Sarangi, Manoja Wickramaratne, Ruwanthi Senarathne and Omar Siddique for their substantive review and feedback. The production of this publication was led by Omar Siddique. Comments provided by the Asia Pacific Trade & Investment Initiative (APTII) and the Knowledge Resource Committee (KRC) of the Regional Centre in Colombo are acknowledged. Excellent editorial support was provided by Kirsty Hayes, Manisha Mishra and Amaya Gorostiaga.



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## Preface

The Asia-Pacific is at the forefront of globalization and one of the world's most rapidly growing regions. At the same time, inequalities are growing, both between countries and within national borders. Trade is increasingly being subjected to two opposing forces - increased liberalization and increased restrictions - even as the playing field remains unbalanced. The international architecture remains contested and bilateral agreements are proliferating. Yet autarky is hardly an option in this inter-connected world.

Countries of Asia-Pacific are renowned for the speed with which they have developed economically. That was the relatively easy part. Now they find themselves at a different frontier - trying to combine economic success with equally rapid poverty reduction, combating growing inequalities and promoting human development - in other words, trading on human terms.

The two papers in this selection address important aspects of the trade and human development dynamic.

In *National Trade and Development Strategies: Suggested Policy Directions*, Kamal Malhotra considers the impressive performance of some Asian economies, whose gains have been translated into significant poverty reduction and human development advances. Based on a variety of domestic policies and strategies, the paper suggests a purposeful approach to economic integration and globalization. A strategic national trade and industrial policy that focuses on selective and time bound infant industry protection can be catalytic. The paper also hones in on the key role of other sectoral and macro-economic policies, particularly in the area of trade in agriculture and the services.

In *Trade and Health in Asia: Challenges of Globalisation*, Chantal Blouin investigates the pros and cons of approaches for boosting health services and trade. She examines a range of issues spanning privatization, health tourism and the phenomenon of 'brain drain'. Advantages and drawbacks of international commitments are also spotlighted, coming on the heels of changes to GATS and TRIPS agreements. Governments that focus on trade and health services could reap concrete and immediate benefits. Adjusting trade policies to enhance health services is quite an uncharted territory through which many countries in the region are picking their own course, for example by health tourism.

The key, therefore, lies in experimenting while committing in ways that allow change. The ultimate yardstick of success must be quality of people's lives, rather than selling more.



**Anuradha K. Rajivan**

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**National Trade and  
Development Strategies:**  
*Suggested Policy Directions*

*Kamal Malhotra*



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Mr. Malhotra has been with UNDP since August 1999. His portfolio has overall responsibility for UNDP's development policy work on trade, intellectual property and investment as well as its policy work on the global dimensions of debt, capital flows, development finance and migration and development.

Mr. Malhotra has degrees from the University of Delhi in economics, from the Indian Institute of Management in business management with specializations in economics and finance and from Columbia University, New York, USA, in international affairs with a specialization in economic and political development. He has been the lead author, co-author or co-editor of 5 books, contributed chapters to more than 10 other books and published over 70 papers and journal and other articles on development policy issues and the multilateral system. He was the lead author and coordinator of the UNDP co-sponsored publication *Making Global Trade Work for People* (Earthscan, London and USA, 2003), now available in 7 languages, and the coordinator of the recent UNDP co-sponsored publication *Making Globalization Work for the Least Developed Countries* (UNDP, 2008).



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# 1 Introduction

A national trade and development strategy can be defined as one which prioritizes a developmental approach to trade policy rather than a trade led approach to development. The key instruments of such a national trade and development strategy are not limited to narrow trade measures such as tariffs, but include a range of trade related policies and instruments that are designed to actively promote both domestic industrialization and increase the volume of higher value added manufacturing and services exports. Indeed, the primary purpose of both domestic and international trade policy, if it is to be truly developmental in its impact and outcomes, should be to enhance the prospects of achieving a diversified economy and widening and deepening its base, thereby increasing high quality employment opportunities and possibilities. This should be a critical policy objective for all developing countries, since almost every country that has experienced rapid growth in its productivity and standard of living over the last two centuries has achieved this as a result of diversification and relatively high value added industrialization.

In the post World War II period, only a few developing countries have consistently managed to close the economic gap between themselves and economically advanced nations. These countries, located primarily in Northeast and Southeast Asia, adopted a varied mix of domestic investment approaches and unconventional domestic innovations. This stimulated high economic growth rates and extremely rapid, manufacture-based export growth. More importantly, this resulted in high manufacturing value added and significantly increased income in the most successful cases. Gains from these outcomes eventually translated into significant poverty reduction and human development advances. A vast body of literature exists, which has attempted to identify and assess the principal reasons behind the success of these Asian countries. One fact that clearly stands out is that there are no simple, single factor explanations for such a diverse range of experiences and successes.

There is, however, one common theme that exists in all these cases. All the successful Asian countries approached global economic integration in a selective, purposeful and strategic manner, rather than relying on passive and indiscriminate global integration. This has been the principal factor behind both managing globalization successfully, and benefiting from the opportunities it offers to advance poverty reduction and human development objectives.

The real policy debate, therefore, should not be over whether economic integration with the global economy is good or bad, but rather over policies and priorities. The key questions which need to be addressed are:

What is the correct sequence of policies?

Does progressive and deeper external liberalization benefit every country's interests and in all its many dimensions?

What types of public investment will best support trade and industrial policy?

What are the key ingredients of industrial policy in the 21<sup>st</sup> century?

Linked to this, how much priority should deep import liberalization receive?

What types of macroeconomic policies will best support trade and industrial policy?

This paper seeks to address these and other related questions in a policy relevant manner.

**T**here is now a broad consensus across the political and ideological spectrum on the need for governments to make non-targeted, public investments in a range of sectors including health, education and infrastructure. Indeed, such investments have played a critical role in Asian countries, many of which saw their public investment to GDP ratios rise in the 1980s and 1990s. For example, the Republic of Korea's public investment to GDP ratio rose by 14 per cent between the 1970s and 1980s and by an additional 14 per cent between the 1980s and 1990s. Thailand's ratios increased respectively by 16 per cent and 14 per cent between these two periods, while Malaysia's ratio rose by a spectacular 60 per cent between the 1970s and 1980s (UNDP, 2005d, page 52-53). This section highlights the critical role that public investment plays in three important areas: human development, research and development and infrastructure. Significant public investment in these areas can yield enormous dividends for strategic national trade policy. Indeed, liberalization is likely to carry significant risks, if it is not preceded by adequate and appropriate investment in health, education and infrastructure.

### Investing in Human Development

Initial conditions matter. As already indicated, a country's level of human development is an important and useful barometer of the degree to which it is likely to benefit from trade liberalization specifically and from international trade more generally. Countries and people with higher levels of human development are more likely to benefit from trade and economic growth, compounding already existing global and national inequalities.

China's current success can be partly explained by its attainment of relatively good basic human development indicators by the 1970s, prior to its embarking on a gradual economic opening to the world economy in 1978. This was accomplished primarily through the country's provision of universal access to health and education after the communist revolution.

In this context, the huge gaps that exist between eco-

nomically advanced and developing countries remain a concern. This extends not just to basic health and education indicators, but also to the tertiary enrolment ratio, the number of scientific and technical personnel; and research and development expenditure. As a consequence, productivity increases in the developing world are lower than those in industrial countries. The resultant impact on the economic output of developing countries contributes to the growing inequality between the rich and poor world.

Indeed, as the UNDP said over fifteen years ago, "If developing countries are to trade on a more equal basis, they will need massive investments in people – because knowledge and the mastery of new technology are a country's best competitive advantage today" (UNDP, 1992). This argument was made well even before the need for non-targeted public investments in health and education on a non-user fee basis was broadly accepted by the Bretton Woods institutions. Support for active government intervention in areas such as health and basic education now enjoys a broad consensus, although this is still not the case for critical areas such as tertiary education, despite the recognition that this area will be an increasingly important factor in determining a country's competitiveness in the 21<sup>st</sup> century. The international community's blind spot with respect to tertiary education has been reinforced by the Millennium Development Goal (MDG) on universal access to education, which while crystallizing the rights agenda on education, has not allowed a reasoned debate on what the appropriate mix of primary, secondary and tertiary education should be.

This is unfortunate, because there is growing evidence from the Republic of Korea, India and other countries that public investment in tertiary education has high economic returns and is now emerging as a key ingredient of economic success. The government of the Republic of Korea made huge public investments in technology infrastructure together with investments aimed at creating both general and technical skills. The country had the highest rate of university enrolment in the world in 2004 and enrolments in technical areas

at the tertiary level were over twice the OECD ratio. The Republic of Korea produces more engineers every year than India does, despite the much smaller size of its population and India's considerable achievements in tertiary level, technical education (Lall, 2004).

There is also widespread agreement that the principal factor behind the success of India's software and IT industries has been world class technical education at the tertiary level, financed primarily by its national government. The much lamented 'brain drain' associated with this has now been transformed into a combination of 'brain gain' and 'brain circulation'. A significant number of India's engineering graduates who went overseas after graduating have been returning home, either permanently or for large parts of the year. These graduates have not only brought back newly acquired skills and the latest technology but also considerable investment from Silicon Valley in the US and other countries. The sustained public investment made by the Indian government in world class tertiary institutions, such as the Indian Institutes of Technology and Indian Institutes of Management, led to the creation of over 1,800 tertiary educational institutions producing close to 100,000 computer science graduates every year by 2000 (David, 2000). Bangalore's excellent reputation for a number of high quality tertiary technical institutions has contributed significantly to its current recognition as a global IT and R&D hub (Pack and Saggi, 2006).

It is thus clearly apparent that public investment in health and education is valuable, not only because of the inherent importance of these assets, but more importantly as a means for achieving strategic economic goals. Human development improvements in these areas will lead to a perceptible improvement in the capacity of people to contribute to economic growth and trade. A healthier, more skilled and educated workforce is also likely to display greater productivity, which in turn will translate into both higher and greater value-addition exports. It is therefore clear that countries can derive tangible economic benefits from investing in health and education. It naturally follows that public investment in these and other basic human development areas should be viewed as essential.

The formidable challenge facing developing countries

in the 21<sup>st</sup> century is accelerating progress in achieving the MDGs in areas of basic human needs (e.g., basic education, primary health care, food security). Investing in science and technology education along with building technical and managerial skills is also a challenge. Simultaneous public investment in all these areas is essential if countries desire to move beyond low value-added production and trade.

As emphasised in the Millennium Project report, an upward movement in value-added production and trade will not be possible without a substantial increase in public investment in a number of areas, particularly in the poorest countries (UN Millennium Project, 2005). Ranis and Stewart (2005a) have identified three critical public investment ratios, which will need to increase steadily and significantly if developing countries are to meet the challenges they face. These are (1) the public expenditure ratio or the proportion of GNP spent by various levels of government, (2) the social allocation ratio or the proportion of total government expenditure channelled to human development sectors, and (3) the priority ratio or the proportion of total human development sector expenditure spent on priorities identified within these sectors. Drawing on data from various UNDP annual human development reports, they illustrate that while both Kenya and Malawi allocated a similar proportion of their national incomes to public expenditure, Kenya had both a significantly higher social allocation ratio and priority ratio compared to Malawi. As a result, the proportion of GDP going directly to human development enhancing priorities in Kenya was over three times that of Malawi (5 per cent compared to 2 per cent) in the 1980s.<sup>1</sup>

Ranis and Stewart (2005a) persuasively argue further that economic growth and human development are mutually reinforcing. This can result in an upward spiral ('virtuous cycle'), with high levels of human development leading to high economic growth, and higher economic growth further enhancing human development. Alternatively, it can lead to a downward spiral ('vicious cycle'), with low human development investments and outcomes resulting in weak economic growth and consequently poor progress in improving human development indicators. When human development investments are low, even high economic growth is unlikely to lead to an improvement

in human development, since the latter is heavily dependent on the social allocation and priority ratios. A number of East Asian countries have experienced a virtuous cycle. Meanwhile, Ranis and Stewart indicate that the largest number of countries caught in the vicious cycle can be found in Sub-Saharan Africa, although there are also a significant number in Latin America (Ranis and Stewart, 2005a, page 10).

### Investing in Research and Development

Market failures which pertain to knowledge and skills are pervasive, which is why governments of all technologically advanced countries continue to provide public investment and incentives for research and development (R&D) in these critical areas. R&D is a fundamental prerequisite for the ability of developing countries to engage in successful low level adaptation of foreign technology and reverse engineering. This is particularly crucial for technological diffusion over time and across countries. The Republic of Korea had the highest R&D expenditure in the developing world and was also ahead of all but a few leading OECD economies by 2007 (OECD, 2008; OECD, n.d.).<sup>2</sup> Governments have a responsibility to promote R&D. While the private sector has an important role to play, it must be emphasized that the kind of R&D that addresses the needs of poor people risks being neglected unless it is undertaken by the public sector.

A particularly crucial role for governments wishing to pursue strategic national and international trade policy is the conduct of what is sometimes termed 'foresight studies'. These studies attempt to create a more coherent science and technology policy by identifying future demand and challenges that link science and technology policy to the country's economic and social needs. The process creates strategic awareness about the state of technological activity in the country as well as emerging trends worldwide. This enables the government and domestic private sector to assess implications for national priorities and competitiveness. Developing countries which are involved in such studies include India, the Republic of Korea, South Africa, Thailand and several Latin American countries (UNDP, 2001).

In addition to their own direct role in this area, governments can also create incentives for others to in-

vest in R&D. The two most promising avenues for the promotion of technology-oriented research have been the fostering of links between universities and industry, and fiscal incentives to promote R&D by private firms. 'Push' incentives support research by channelling public money to the most promising research activities in public universities and institutions, while 'pull' incentives promise to pay only if a desirable outcome is achieved (such as a tuberculosis vaccine or drought-resistant maize variety), whether produced by a public or private institution. Governments have also used a range of policy options to stimulate R&D within the private sector. One option has been for the government to provide matching funds for R&D, as in Malaysia where the government contributes \$1.25 for every \$1 invested in R&D by private firms. Another approach has been for the government to co-finance R&D through a technology fund which disburses resources as a conditional loan that is to be repaid if a venture succeeds, but is written off if it fails (Ibid).

Actively promoting links between universities and industry can also stimulate R&D and policy-oriented innovation. High-technology companies thrive on state-of-the-art knowledge and creativity as well as the scientific and technical expertise of universities. Meanwhile, public R&D is often needed for new industries to successfully identify, adapt, and obtain technology from abroad. China presents an interesting case in this regard because it appears to have leveraged a variety of government programmes to support R&D which prioritized high technology industry in the 1990s. Tsinghua University, for example, established the Chemical Engineering and Applied Chemistry Institute jointly with Sino-Petrochemical Engineering Company. Simultaneously, the State Torch Programme encouraged enterprises to strengthen their ties with research institutions in an attempt to accelerate the commercialization of research results. Chinese universities have also established science parks. The Shanghai Technology Park acts as an incubator for the rapid application of scientific and technological work in industry. China is also using R&D to improve the productivity of traditional activities in agriculture. For example, the Spark Programme propagates technologies to the countryside and assists farmers in using them for agricultural development (Ibid).

Despite these examples of public-private partnership

in R&D, public R&D still remains the main source of innovation for much of what can be called poor people's technology in both economically advanced and developing countries. Moreover, industry initiatives are no substitute for structural policy responses from governments. Regrettably, however, public R&D has long been under-funded at both national and international levels. No global framework currently exists for supporting research and development that addresses the common needs of poor people. It is difficult to visualise how the current dismal state of affairs with respect to public R&D investment will be reversed since there is an absence of both a dedicated source of funding and an appropriate mechanism for global transfers. Despite clear evidence of high returns, national and international agricultural research in poor countries remains a particularly neglected area. New energy technologies are also under-funded. Research and development spending in this area is low relative to both the direct value of energy spending and the negative environmental impacts of conventional energy sources (*Ibid*).

One area of concern is that, not only is public investment in R&D under funded, but it is also shrinking relative to private R&D investment. This is particularly true in rich countries, where private R&D investment is led by global transnational corporations who respond primarily to the market demand of high-income consumers. Over 60 per cent of research and development in the OECD region was conducted by the private sector by the late 1990s (*Ibid*). While this proportion has been growing, the role played by public R&D in rich countries has been shrinking. The most worrying aspect of the increasing trend towards the privatization of R&D is the neglect of the poor's needs. This is highlighted by the fact that less than 10 per cent of global spending on health research is devoted to the major health problems of 90 per cent of the world's population.<sup>3</sup> The eventual outcome is a sharper increase in inequalities. Another consequence of the privatization of R&D is that basic scientific and technical knowledge has become increasingly privatized. As a result, information that previously used to appear in the public domain is now likely to be patented or copyrighted. Over 90 per cent of new patents issued in any given year are accounted for by OECD countries. The end result of these developments is that access and prohibitive costs are now emerging as major obstacles to technology transfer and innovation in developing

countries. The Trade-Related Aspects of Intellectual Property Rights agreement and the wide and growing spectrum of "TRIPS-plus" bilateral and regional free trade agreements tend to make it even more difficult for developing countries to gain access to key patented products, which are often owned by private firms and universities in industrial countries. This situation needs to be urgently addressed, not only if the Millennium Development Goals are to be met but also if the sharp and widening gap between the developing world's research needs and the rich world's research agenda is to be bridged.

### Investing in Infrastructure

Trade-related infrastructure must prioritize transport, storage and telecommunications systems. Such infrastructural facilities must essentially encompass a functional network of rural and international roads, railways, ports and airports, telephones and internet facilities, as well as efficient storage facilities, and energy and water services. Since some of these needs are regional in nature they cannot be addressed at an individual country level. Most areas however can, and should, be addressed through public investment, which can be complemented by the creation of an enabling environment for greater domestic private investment. However, delivering well functioning markets with the necessary transport, telecommunications, storage and energy infrastructure remains a major challenge for most developing countries, including several countries in the Asia-Pacific region.

A fundamental trade-related issue faced by many developing countries, in particular the poorest, is that they are ill-equipped to take full advantage of new trade opportunities, owing to their supply-side capacity constraints. For example, gaining improved market access is a futile exercise if the countries lack the capacity and transportation to sell. The leading priority for the poorest countries must therefore be to address their export supply capacity constraints through increased investment in infrastructure, and their productive capacities and skills (Helleiner, 2002, page 89; UNCTAD, 2007). The current renewed emphasis on these issues through the prioritization of Aid for Trade in the context of the Doha Round appears to acknowledge much if not all of this, recognizing that a broader definition of competitiveness must include trade related infrastructure issues.



The principal theme of virtually all the Diagnostic Trade Integration Studies conducted under the six-agency Integrated Framework for Trade Related Technical Assistance for the LDCs (IF) over the past five years has been that transport bottlenecks (e.g. limited storage facilities at the railhead in Lesotho) tend to raise the cost of both exports and imports far more than formal trade policies. According to research conducted by UNCTAD and UNECA, the international transport and insurance costs of landlocked African countries account for an estimated average of 21 per cent of the value of their imports, compared to the world average of 5.4 per cent and a 12.7 per cent average for all African countries. The UNCTAD study also highlights the fact that access to frequent, reliable and low-cost regular liner shipping services largely determines a country's connectivity to overseas markets and thus also its competitiveness in global markets (UNCTAD, 2004; UNECA, 2007). Similarly, work by the World Bank suggests that transport costs are significant for the majority of the US's trading partners (World Bank Operations Evaluation Department, 2004).

The economic case for investment of this kind is, therefore, very strong. Nevertheless, the scale and type of investment needed to overcome the current gaps in trade-related infrastructure is huge and varied. The challenge is more acute for landlocked countries, where transport costs are 50 per cent higher and trade volumes less than half those of similar coastal countries (Commission for Africa, 2005). Astonishingly, transport costs in landlocked countries can account for as much as 75 per cent of the value of exports. Shipping a car from Japan to Abidjan costs US\$1,500, but shipping the same car from Abidjan to Addis Ababa costs US\$5,000 (*Ibid*).

The World Bank has attempted to measure the benefits which have accrued from investments and reforms in four aspects of trade facilitation, including port efficiency and trade-related services infrastructure. The research aims to assess the impact of improvements in these areas on the potential increase in trade among 75 countries. The findings suggest that better trade facilitation would increase trade among the 75 countries by about 10 per cent, or \$377 billion. About \$107 billion of this amount would be generated from more efficient ports, and \$154 billion from enhancing infrastructure in the trade-related services sector (World Bank, 2005, page 13).

A WTO programme – Aid for Trade – will enable developing countries to enhance their competitiveness, through the establishment of appropriate standards and the diversification of their agricultural, industrial and services capabilities and exports. However, such interventions must also take into account the vast spectrum of human, institutional and other productive capacity and supply-side constraints in a comprehensive and coherent manner. For example, it would be a futile exercise to build a port, if the essential infrastructure to effectively manage it is not in place. A significantly enhanced IF and Aid for Trade needs assessments exercises should be used as the basis for identifying larger capacity building projects and proposals for LDCs and other low income developing countries. This exercise will need to be supported by additional measures including a broader 'aid for trade' package.

International support for the trade-related infrastructure needs of developing countries thus requires continuous, long-term commitments in the form of traditional development assistance as a major source of financial resources (which would supplement domestic resource mobilization). The resource implications are estimated as fairly substantial. Current cost estimates for resolving the critical infrastructure bottlenecks in Africa alone are estimated at \$52.2 billion per year in public and private investment, and about half of this financing will need to go towards energy (MDG Africa Steering Group, 2008). This clearly underestimates the actual funding requirement, since it excludes areas such as spending on ports and airports. This is well above the baseline projection made by the OECD-DAC, which indicated that between 2002 and 2005, donors committed an average of \$21 billion per year on aid categories most closely related with Aid for Trade (OECD and WTO, 2007). This aid was committed by donors at the 2005 G-8 Gleneagles Summit, the 2006 G-8 Saint Petersburg Summit, the 2007 G-8 Heiligendamm Summit and, most recently, at the first ever Aid for Trade Global Review in Geneva (November 2007). This represents a significant increase in absolute terms in trade-related assistance<sup>4</sup>, especially if viewed in the context of the major decline in aid for infrastructure and productive capacity building projects in the 1990s. However, it remains sharply below the amount required by Africa, let alone that of the developing world as a whole.

Despite a number of developing country concerns, many of which are clearly reasonable, it is plausible to argue that the current renewed emphasis on aid for trade is legitimate and, if handled appropriately, can be beneficial not only for LDCs but also for all developing countries. However, in order to be more effective, it must be emphasised that aid for trade funding aimed at augmenting trade-related infrastructure should be in addition to and not at the expense of development assistance available for other critical areas of development. These funds can, as has historically been the case, be channelled in the form of grants or concessional loans. Certain areas which have traditionally been neglected should be prioritized. These include cross border projects in infrastructure for landlocked countries and investments in projects addressing cross-border issues. Regional impediments to trade development such as transport corridors,

standards, disease or pest issues should also be given more priority than in the past.

While all developing countries should be eligible for such support, prioritizing low income countries for such aid for trade support is a legitimate priority, so long as such support is not exclusively restricted to these countries. There should also be explicit consensus on the fact that even an ambitious aid for trade package cannot and should not be viewed as a substitute for the development dimensions enunciated in the Doha Round, although it can serve as an important complement to them. There is also a pressing need for a shift in focus away from the current 'conditionality' mindset which seeks to link aid for trade with trade liberalization and integration. The direction should instead be towards using aid for trade primarily for trade development.

### 3 Strategic National Trade and Industrial Policy

Given that agriculture is unlikely to emerge as a major area of comparative advantage within the Asia-Pacific region as a whole in the foreseeable future (even though it is for some products for countries such as Thailand and Vietnam), the principal rationale underlying strategic and selective government intervention in industrial policy formulation is to develop a national trade policy that actively promotes both domestic industrialization and increases the volume of higher value added manufacturing and services exports. This should be a critical policy objective for all developing countries, since almost every country that has experienced a rapid growth in its productivity and standard of living over the last two centuries, has achieved this as a result of industrialization (Murphy *et al.*, 1989, page 1003). It is important to note that the definition of domestic industrial policies used in this paper encompasses both the manufacturing and services sectors of an economy.

Domestic industrial policy can either reinforce<sup>5</sup> or counteract a country's given comparative advantages. Such policies often aim at converting a country's inherent comparative advantage into a dynamic one. If successful, it should not only translate into an increasing share of exports in overall GDP but, more importantly, lead to higher value added contributions from both the manufacturing and services sectors of the economy. The importance of achieving higher value addition and incomes from manufacturing and services cannot be overstated since these are the key ingredients that enable countries to reap the full benefits of globalization, while simultaneously encouraging a virtuous circle of growth, poverty reduction and human development.

Dynamic competitive advantage needs to be built because comparative advantage theory is static in nature and ignores the linkages that exist between present choices and future production possibilities. It thus follows that this theory is not the best guide to the pattern of international specialization which a country should pursue, particularly when there are asymmetric learning opportunities associated with the production of different goods or technology use.

Rather, the choice of what products and technologies developing countries should opt to specialise in and prioritize ought to be based on their potential for long-term growth and industrialization (Succar, 1987), rather than static or short-term possibilities and considerations.

This raises the important question: will specialization raise a country's overall productivity if the country opens its economy? Empirical findings from an important study by Imbs and Wacziarg (2003) indicate that countries begin to diversify after their very initial stages of development. It is only relatively late in the development process that they start the process of specialization. The study suggests that specialisation may not be an essential ingredient of development and, as Rodrik puts it, "the trick seems to be to acquire mastery over a broader range of activities, instead of concentrating on what one does best." (Rodrik, 2004, page 6-7).

The widely accepted critical importance of technological innovation in determining rates of economic growth, combined with the belief that technological innovation is concentrated in the industrial sector (Greenwald and Stiglitz, 2006), are pivotal factors. These factors underlie the rationale for strategic trade and industrial policy. Industrial activity typically takes place in large, stable and densely concentrated firms, as opposed to agricultural and craft production, for example. The latter type of production is highly decentralized among many small, unstable, and short-lived enterprises. Inherent characteristics of industrial enterprises make them the ideal base for knowledge and human capital accumulation; provide a much easier taxable base for government revenue that can be used to enhance education and health care systems, and support public research and development, including in agriculture and other non-industrial sectors. Additionally, positive spillovers from industrial policy and innovation are crucial for growth and dynamism in the agricultural sector (*Ibid.*), similar to the very early crucial stages of development, when agricultural surpluses were crucial for industrialization. These widely acknowledged facts reinforce the rationale for

a strategic national trade and industrial policy. They include the fact that industrial policy requires learning and capability building, and that market failures arising from importing and using technology can only be dealt with by appropriate government intervention (Lall, 2004).

### Infant Industry and Infant Economy Protection

In this context it is important to assess the appropriate role for governments in fashioning such a policy. Although it is acknowledged that governments will need to play multiple roles, the most critical one (which is supported by past literature and trade theory) is that of selective infant industry promotion. If implemented properly (as was done to a large extent in the Republic of Korea and Taiwan, province of China), the tangible outcomes provide a powerful empirical validation of trade theory. Almost every country that has successfully industrialized, either historically or more recently, has passed through an infant industry phase (Shafaeddin, 2006a, page 3).

Bardhan (1971) noted that the infant industry argument is dynamic in nature and provided the first dynamic model of Learning by Doing (LBD) in an open economy. Based upon this, Bardhan derived the concepts of the optimum *extent* and *time path* of protection to the learning industry. Building on this work, Succar (1987) argued that to qualify for assistance, infant industries should demonstrate both *dynamic, learning-by-doing economies* and positive *intra-industry learning* benefit spillovers. She also suggested that the significant positive *inter-industry learning* externalities that are likely to result in developing countries strengthen rather than weaken the case for infant industry protection (*Ibid.*). Thus government intervention to promote industries characterized by LBD economies and those that generate significant and positive intra-industry and/or inter-industry spillovers should be an integral part of strategic trade and industrial policy in developing countries. It also follows that such interventions need to be selective, rather than 'blanket' in nature, primarily because offering uniform protection to all activities makes little sense when learning processes and positive spillovers differ by technology and activities (Lall, 2004).

Baldwin (1969) provides additional arguments in support of infant industry protection. These include the costs of knowledge acquisition by firms even though such knowledge may not be appropriable by them - this is the standard argument for subsidizing R&D. In addition, subsidies would also help to offset on-the-job training costs. Owing to labour mobility, these costs may not be recoverable and the benefits may never materialize for a firm. Another argument put forward by Baldwin in favour of infant industry protection is that static positive externalities will result from the production of a good and investment in new industries. The benefits may become freely available to potential competitors, making it difficult for investors to earn a rate of return high enough to justify their initial investment.

Greenwald and Stiglitz (2006) go even further, arguing that there are often trade-offs between static efficiencies and long-term growth, since markets by themselves do not necessarily or in general lead to overall dynamic efficiency. They suggest that the dynamic benefits of broad trade restrictions may outweigh their static costs, creating a case for time-bound protection of the economy as a whole (termed 'infant economy' protection), rather than just infant industries.

### Tariffs and Industrial Development

It is important to assess the implications of infant industry or infant economy protection for tariff policy. The principal issue that needs to be considered is that a successful industrialization process is both ongoing and cumulative in nature. It involves moving up the ladder, from the basic stage of industrial production to higher rungs that are manifested in higher-value added skills and technology. Typically, this involves moving up the production chain, from resource based and labour intensive manufacturing, to low, through medium, to high technology and skill intensive products (Akyüz, 2005a). All countries do not necessarily start at the resource based end, since this depends on their national endowments, and the process is not strictly sequential. However, the progression from low skill and low technology intensive to high skill and high technology intensive industries described here has been broadly typical of all successful industrialized economies. Those include relatively recent ones such as Japan, the Republic of Korea and Taiwan, province of China.

Therefore, the tariff protection requirements for infant industries at these different stages of labour or technological intensity levels are quite different. Akyüz (2005b), drawing on both theoretical and empirical evidence, argues that the overall tariff protection requirements of an economy at very early stages of development are likely to be low compared to when it is at an intermediate stage of development. This is likely to decrease again when the economy reaches a mature, advanced stage of development. This is attributable to the fact that a country is likely to rely much more on either its natural resource advantages or its pool of unskilled and low skilled workers for labour-intensive manufacturing in which it has a static comparative advantage at very early stages of development. In addition, the industrial tariff protection requirements of labour intensive industries in relatively poor countries with surplus low skilled labour are minimal, and could be phased out after a relatively short period of learning and export expansion, primarily due to the less technologically demanding nature of such sectors.

However, this situation will probably change as a low income country moves on to the next stage of low and medium technology intensive industrial production and attempts to become more competitive in such industries. A new generation of infant industries will need protection at this intermediate stage of development, since investors may be reluctant to venture into more technologically advanced activities unless measures to support and promote them are initiated by the government (Lall, 2004). Moreover, government intervention in support of such industries will most likely need to be of a higher magnitude and for a longer time period. This is due to the increasing technological complexity and the length of time needed for learning and adaptation. There are also myriad disadvantages that late entrants face compared to already established industries in more advanced countries. Akyüz (2005a; 2005b) argues that protection for low labour skill intensive industries should ideally be phased out at this stage, even as protection for low and medium technology intensive industries is increased.<sup>6</sup>

As industrialization progresses further, higher skill and technology intensive industries will need to be phased in under selective protection. Simultaneously protection for some labour intensive and low and medium

technology intensive industries that have become internationally competitive on their own, and other industries that have failed to achieve the required degree of competitiveness will need to be phased out. The situation is likely to undergo a further transformation at more advanced stages of development when the need for protection will be much lower or even non-existent and when competitiveness in a diversified range of high skill and technology intensive industries has already been built and established in an economy.

In broad empirical terms, it was such an approach that underpinned the success of the Republic of Korea which has successfully built up the base for technology intensive industries such as steel, shipbuilding and automobiles in which the country had no prior comparative advantage at the initial stages of its industrialization process. Some of the key ingredients of the Republic of Korea's success include a sustained effort to upgrade and raise productivity along with value added in manufacturing. Exports were also prioritized, while protection of its traditional labour intensive industries was de-prioritized after they had reached a certain stage of development.

Such a strategy requires policy flexibility in both the level and direction of import tariffs for particular products. During the initial stages, imports on which the economy is totally reliant can be tariff-exempt. Afterwards, however, tariffs will need to be established to protect infant industries producing goods that were previously imported. These can be phased out as the industry matures. Technology intensive industries will require higher levels of initial protection and support than resource-based and labour intensive industries for the reasons already indicated. Capability building will result in a shift to more advanced industries. Subsequently, the rate and time period for protection can be lowered for technology intensive industries compared to the initial period and industries, primarily because learning and capability building should become a quicker process. The need for tariff protection should largely cease once an industry matures or approaches maturity. In fact, at this point of development, trade liberalization can actually help foster the competitiveness of industries. The impressive performance of Brazil's aerospace industry is a recent example of successful targeting and selective government interven-

tion followed by liberalization in a technology intensive industry where continued protection at maturity would have harmed its competitiveness (Shafaeddin, 2006a, page 31).

Given that the real world is more complex than this stylized description, industrial policy will need to differ across countries. In reality, product and industry cycles overlap, and the choice and sequencing of industries across countries differs. This depends on a range of diverse factors, including resource endowments, initial conditions and institutional arrangements. Moreover, if product and industry cycles overlap, different industries that share the same imported inputs could be affected differently by tariff protection on a specific product line. In addition, even at relatively early stages of development, tariffs can be beneficial from a fiscal and balance of payments viewpoint. Countries will need to distinguish between tariffs on consumer and luxury goods, on the one hand, and those on capital goods and necessities which are not domestically available (i.e. food and fuel), on the other. At early stages of development, higher tariffs should ideally be imposed on consumer goods rather than capital goods imports. That is because domestic production of consumer goods is likely to be easier and should be selectively encouraged. Meanwhile, high tariffs on imports of investment goods will inevitably result in raising the cost of the overall domestic cost of production and domestically produced consumer goods, in addition to eroding their international competitiveness.

This approach should lead to a pattern of greater sectoral concentration in the initial and advanced stages of development of a country with diversification in the intermediate stages. This is consistent with the empirical findings of Imbs and Wacziarg (2003), and common to all successful industrialisers. Industrial tariff changes may, thus, follow a non-linear path. There are also a number of implications for industrial tariff policy and trade negotiations in the non-agricultural market access (NAMA) area of the Doha Round (Akyüz, 2005a). Specific policy implications include the following:

Infant industry protection will require the co-existence of low and high tariffs on specific products at any given point in time. Different industries will require differing tariff levels, while the tariff requirements within the same industry can vary over time.

Thus, industrial tariffs can be widely dispersed. Such dispersion may rise or fall in a given economy, depending on its stage of industrial development.

Tariffs will either increase or be reduced on particular products, depending on a country's stage of development. As a result, across-the-board progressive liberalization will be neither possible nor desirable.

It is likely that both advanced industrial countries and LDCs will require low tariffs on most products at a given point in time compared to countries at intermediate stages of development. However, a crucial difference between the two is that for LDCs which are seeking to build dynamic competitive advantage over time (rather than merely relying on their static comparative advantage as LDCs), tariffs will need to rise over time for certain industries and products. It will, therefore, be a mistake for such countries to agree to tariff bindings at levels which may be appropriate for early stages of development but not for intermediate stages of development. That is because this will make it impossible for them to move up the technology ladder later and enjoy a virtuous circle of growth, poverty reduction and human development.

It will be difficult to harmonize tariffs and make them uniform across countries, especially on a line-by-line or sectoral basis, since countries are at different stages of the development process and thus have different needs.

Prolonged protection can lead to inefficiencies and the inability of an industry to compete internationally. However, premature and across-the-board import liberalisation is likely to lead to de-industrialization. Such liberalization can also reduce the ability of a country to catch up technologically and add value to its basic labour or natural resource-based static comparative advantages (Shafaeddin, 2006a, page 32).

Thus, a key policy implication for multilateral and bilateral trade negotiations is that countries should not agree to bindings on a sectoral basis. Moreover, the overall bindings agreed should be high enough to accommodate the needs of different sectors at different stages of industrialization. Bound tariff rates at a level equivalent to the maximum average requirement for a country in the course of its industrialization process will provide an inbuilt self disciplining mechanism, since applied tariffs in areas not needed any more will need to be reduced to accommodate higher tariffs in areas where they are needed, to enable the technological upgrading process.

Premature import trade liberalization has had disappointing results, historically as well as in more recent times. The industrial sector of the US suffered when it tried to liberalize prematurely during 1847-61. It subsequently had to revert to protectionism against the UK's imports (*Ibid.*, page 13). More recently, a number of countries, such as Kenya, have undergone rapid de-industrialization as a result of either unilateral measures or external conditionality induced liberalization (UNDP, 2003b).

Retaining policy flexibility on industrial tariffs is of crucial, strategic importance at this stage in international trade negotiations. Such flexibility is even more critical for developing countries that have not already ceded policy autonomy in this area. However, it is important even if countries have already reduced their policy flexibility unilaterally, as a result of loan conditionalities or because of a bilateral or regional free trade agreement. Tariff protection may not always be the most efficient way to promote technologically dynamic industries. However, many effective first best options used for industrial upgrading in the past (e.g. by the Republic of Korea and Taiwan, province of China) are no longer available to developing countries. Reversing commitments made as a result of multilateral or other trade agreements may also be very costly for countries. The NAMA negotiations therefore assume greater significance for policy space in the Doha Round than they would have otherwise for many developing countries, especially late industrialisers.

It is worth recalling at this juncture, that the objectives and principles espoused by the advanced OECD countries on NAMA do not conform to their historical experience (Chang, 2002; Bairoch, 1993) since protectionism was the rule and free trade the exception during their early stages of development and industrialization. The US was amongst the most protectionist countries, across a wide range of industries even till World War II. Japan, although more selective than the US, followed in its footsteps, while the Republic of Korea followed Japan. The Republic of Korea did not begin to significantly liberalize imports till the mid-1980s, which was long after its economic and export success had been firmly established. Against the backdrop of this historical experience, most developing countries today appear to have prematurely compromised much of their policy flexibility in respect of industrial tariffs. This was partly due to the need to fulfil structural adjustment loan conditionalities that required them to rapidly and significantly lower their tariffs. Many of them have also entered into bilateral or regional free trade agreements which are ill-conceived in development terms.

These developments have led some analysts and policy makers to question if the policies discussed in the previous few sections are relevant in today's world. They argue that while competitiveness has always mattered for success, its nature has changed; globalisation of production over the past two decades has resulted in the dramatic growth of international production networks (IPNs). Indeed, the landscape of domestic and global policy-making has been dramatically altered by rapid technological change and the spread of information technology. Shrinking space and time along with disappearing borders caused by widespread trade and financial liberalization have also contributed to this. This has been combined with the growing dominance of global supply and distribution value chains in certain industries. Nevertheless, as the analysis in Box 1 below illustrates, participation in IPNs is not a panacea for most developing countries. Even developing countries that have benefited or can benefit from participation in them, cannot rely on such participation as their only industrial strategy.

### Box 1: Benefits and Limitations of Participation in International Production Networks

The spread of integrated production networks (IPNs) has made it more difficult and risky, in particular for small and medium-sized countries, to adopt the autonomous route to industrialisation taken by Japan, the Republic of Korea and Taiwan, province of China. It is now much easier for most (though not all) countries to attract specific portions of a transnational corporation (TNC) activity rather than build local industry to compete with a TNC affiliate. Integrating into an IPN also allows them, with relatively little effort, to enter into the low end of what are often technologically and organizationally complex manufacturing activities and reap export benefits. Indeed, even small countries such as Samoa can now participate and capture some benefits through IPNs. This is particularly true for labour intensive activities which can yield considerable benefits for countries at an early stage of industrialization when they have surplus labour. Under such circumstances, IPNs facilitate increased employment, exports and per capita income. This can result in a net overall gain even if the manufacturing value added generated is low. Furthermore, such participation can enable countries at very early stages of development to acquire skills and organizational experience. IPNs can also help widen the range of sectors through which industrialization can begin. A number of countries such as Mexico and Thailand have taken this path. They have succeeded in increasing the share of exports in their overall GDP but have been less successful in raising the share of manufacturing value added in the economy.

Despite the benefits, there are clear limits to a strategy of integrating into IPNs. For example, only certain production activities can be carried out through IPNs. Such activities include those that can be readily segregated both technologically and geographically and for which differences in labour costs significantly affect the location decisions of different processes. These aspects are characteristic of only a few low technology industries such as footwear, clothing and toys or medium to high technology industries, such as electronics where horizontal integration through an IPN is possible. This excludes a very large portion of industrial activity which is not driven by global production systems and thus has dim future prospects of becoming part of an IPN. Therefore, most developing countries, in particular LDCs, are unlikely to be able to participate in IPNs and their global production systems to any significant degree. Some LDCs may not be able to participate at all.

In addition, countries are unlikely to be able to benefit from participating in IPNs beyond the labour intensive and low technology segments of the production process, unless they have undergone their own industrial deepening and learning process. This becomes more apparent when a country attempts to move up from labour intensive and low technology industries to medium and high technology industries. Benefits may dwindle further when a country faces barriers to entry in terms of know-how, technology, design, coordination and management.

This analysis implies that while current patterns of globalization reduce the scope and raise the cost of some previously successful selective industrial policies, they do not eliminate the need for them. Rapid technological change may have increased the cost of bypassing global production systems in a few areas such as clothing, toys, shoes and electronics. However, IPNs do not significantly weaken the case for domestic industrial deepening. They, at best, offer an alternative route to a handful of countries, for some activities but only for a limited time period.

*Sources: Lall 2004; Akyüz 2005a; UNCTAD 2002b.*



Despite some errors in application, selective infant industry protection and the accompanying implications for industrial tariff policy just outlined, appear to have stood the test of time. Even critics of such policies acknowledge that government intervention is the best option to deal with market failures. However, they argue that the requirements in terms of capabilities and institutional capacities are beyond the reach of most governments. They also suggest that government failure would be worse than the market failures it seeks to correct (Pack and Saggi, 2006). The Asia-Pacific region has empirically demonstrated that this has not been true (and remains untrue) for a number of countries in the region. The critics may be more correct about the low capacities of LDCs and countries with weak states but this is, at best, a simplistic tautology. The time bound infant economy argument of Greenwald and Stiglitz (2006), if appropriately applied, should be able to address the concerns of critics even under such circumstances. Infant industry protection will empower governments over time to make strategic and more selective interventions, if combined with a policy of significant investment in building government capacity. The hands off, market *laissez-faire* approach advocated by critics of infant industry protection, will have even more serious repercussions for development in low capability economies and is akin to throwing the baby out with the bathwater.

Tariffs should be broadly and uniformly applied to industrial products in LDCs and other low capability states. No attempt should be made by their governments to pick winners by supporting particular industries at such an incipient stage of development. The main benefit arising from this is that it will avoid the creation of special interest groups, which a state with low capabilities and weak institutions is unlikely to be able to manage effectively. If individual national markets are too small, governments will need to intervene to ensure that their economies can combine with adjacent economies at similar stages of development to form a regional free trade area in which protection is provided through a common uniform external industrial tariff. Such 'infant economy' tariff policies were effectively practiced by the European Economic Community (EEC) in the 1950s. This was during its recovery from the Second World War (*Ibid.*), even though EEC members at that time were far from being LDCs or countries with low capabilities. Important and useful lessons can be learnt from this successful experience

by small and medium-sized developing countries.

### Beyond Protection and Industrial Tariffs

It must be emphasized that infant industry protection and the accompanying industrial tariff policies are but one element of industrial policy, which if implemented in isolation from other policies will eventually prove inadequate, and ineffective. These policies need to be supplemented by selective government interventions in four additional areas if they are to be successful. These are the correction of coordination failures, correction of information externalities, domestic competition policy and export promotion. Each of these areas is dealt with separately below.

Interventions that address negative coordination and information externalities are essential to correct market failures. Neglecting such failures would not only make infant industry protection ineffective but also result in an overall inefficient and sub-optimal outcome. This stems from the fact that information and coordination externalities work as disincentives for productive investment and diversification. What is required is targeted government action focused on specific activities (i.e. new technology or a specific kind of training) rather than on specific industries or sectors since it is these activities that are new to the economy and thus need appropriate support (Rodrik, 2004, page 14).

In contrast to the first two, the last two of these four areas can be considered to be government interventions which can act as safeguards against the complacency which could follow infant industry protection. Both domestic competition policy and export promotion, through a combination of domestic checks and balances and export performance targets, seek to ensure that the domestic private sector is both held accountable at home and compelled to compete with the world's 'best' overseas. Indeed, since the purpose of infant industry protection and industrial tariff policy is to provide insulation against foreign competition in order to build up a domestic industrial infrastructure, governments must simultaneously adopt policies that ensure adequate domestic and foreign competition as a safeguard against complacency, mediocrity, rent seeking and the entrenchment of special interest lobby groups.

Moreover, since infant industry protection is essentially a 'carrot,' it needs to be counteracted by a disciplining 'stick' (other than domestic competition policy). Export competition and performance targets can play such a role most effectively since they compel a country to move towards competing in international markets and face the toughest competition. They have many other potential benefits as well. Government incentives such as export subsidies can aid export promotion. However, these only work well if they are selective and targeted at specific products with significant export potential. They are a good example of performance-based incentives as opposed to input-based ones.

### **Coordination Failures**

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Coordination problems represent the classic 'chicken and egg' situation insofar as they illustrate how and why a particular desirable investment is contingent on another investment being made. This in turn, depends on whether the first investment is actually made. It is therefore quite possible that neither investment will be made without crucial governmental intervention to smooth out and facilitate coordination. Coordinated investments across sectors in certain areas can lead to successful and self-sustaining market outcomes for each of these sectors, even when no single firm or sector would have been able to make such an investment profitable on its own (Murphy *et al.*, 1989, pages 1004, 1005, 1023-1024). The provision of infrastructure, which is essential for industrialization and which governments are best placed to support, is a good example of an area prone to coordination failure. An important and positive facet of the coordination dilemma is that it, more often than not, only requires government investment guarantees (rather than subsidies or other financial outlays) mainly because such investments most often become profitable, if they are simultaneously made (Rodrik, 2004). The key implication arising from this phenomenon is that addressing coordination failures is not likely to have significant budgetary implications for developing countries. Anecdotal evidence also suggests that countries which have implemented coordinated investment programs have been able to achieve the industrialization of each sector at a lower cost, compared with those countries that attempted to industrialize in a more ad-hoc fashion (Murphy *et al.*, 1989, page 1025).

Such coordination failures tend to be more prevalent in factor markets (new skills, risk finance) (Lall, 2004). Infant industry protection is unlikely to be effective in such markets in the absence of effective coordination. Government interventions in these markets will need to be both selective and general in nature. Such interventions should be aimed at sending the appropriate signals to the supplier of the factor in question (e.g. education or capital). Suppliers may then be able to anticipate the needs of producers or gain the necessary information to provide what is required in appropriate quantities or form. In the absence of market coordination, suppliers may undersupply goods and services, particularly if they are unaware of whether or not the other factors that need to be combined with what they are supplying will be provided. Some coordination failures can be best dealt with by general purpose interventions such as technical education which has the potential to simultaneously benefit multiple sectors (e.g. India's IT and health sectors). Other sectors will require selective interventions. Selective interventions are necessary because most coordination failures are activity or product specific. They will therefore need specific responses if they are to be corrected. For example, if a particular activity is to be promoted or a product is to be given infant industry protection, the necessary supplier response will be specific to that activity or product.

### **Information Externalities**

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Information externalities are also an important source of market failure. Although critics have acknowledged this fact, they often argue that governments have imperfect information, and are thus not in a position to deal with the problem. Nevertheless, from a public goods perspective, it is clearly apparent that market and private sector players have less than perfect or complete information compared with governments. Additionally, governments, by their very nature, have a responsibility, and are decidedly better placed, to deal with the public goods dimensions of information. The ideal role for governments is to provide leadership by eliciting the relevant input from the private sector and other stakeholders on their information needs and putting forth potential solutions. Governments will also need to assume responsibility for obtaining and providing information to the private sector and civil society organizations. This information should focus on national objectives and potential solutions

to national problems, with governments simultaneously evaluating outcomes as they emerge. The government leadership should also conduct and support public R&D and the 'foresight studies' mentioned earlier in addition to sharing their analysis and findings with the private sector and other national stakeholders. Such action by governments will be a key factor in effectively tackling the national and global information needs that result from a strategic approach to national trade and industrial policy.

### ***Domestic Competition Policy***

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In essence, domestic competition laws should be designed and enforced to limit or restrain anti-competitive behaviour by large domestic private corporations. These laws should also, in addition to supporting development objectives, be used to either pre-empt or limit abuses of monopoly power by large transnational corporations (TNCs). Judging by empirical evidence, it is apparent that effective domestic competition policy can eliminate or at least significantly reduce restrictive business practices by private enterprises. In essence, such practices include those which limit entry into the market or regulate supply through collusion, mergers, or predatory pricing. The reduction of these practices can occur through a combination of anti-monopoly (anti-trust) and state aid regulations such as subsidies. Such policies clearly establish the conditions for competition, and ensure healthy competition in markets, which eventually translates into an increase in both economic and social welfare.

Domestic competition laws are relatively new in developing countries, primarily because they were not viewed as essential in the period preceding the current environment of deregulation, privatization, and liberalization. In the past, governments assumed the role of 'de facto competition authority', intervening in the functioning of markets when it was deemed necessary. The absence of an independent domestic regulatory competition authority may well have contributed to some of the problems of corruption and excessive rent seeking behavior associated with the lobby group pressure which has been endemic in some cases of infant industry protection. Enacting and effectively implementing domestic competition policy and creating and empowering an independent competition authority will, therefore, be critical. In

fact, this will be an essential complement to the equally necessary selective but time bound infant industry protection policies.

One size does not fit all, nevertheless. Developing countries need to learn the right lessons from the experience of countries that have already achieved industrialization. The US, EU, and Japan have each used different domestic competition policy approaches, modifying these over time, as they deemed necessary. The experience of Japan and other East Asian countries is likely to be the most appropriate for developing countries (UNDP, 2003b). Competition policy in Japan has been evolving since the 1940s. The period most relevant for developing countries is 1950–73, when Japan was in the process of becoming an industrialized country. The Japanese government coordinated its domestic competition policy in a manner which was consistent with its industrial policy during this period of rapid economic growth. Implemented by the Ministry of Trade and Industry (MITI), industrial policy dominated competition policy, which was enforced by the Fair Trade Commission. MITI sought high rates of profit and reinvestment for industry, actively coordinated investment by rival firms and intervened in the entry and exit of firms in particular industries. Japan emphasized dynamic forces, combining elements of both cooperation and competition. Cartels were not viewed in a negative light, and MITI effectively managed the situation by playing oligopolistic firms against one another. MITI also rewarded those with good export performance or technological innovation with subsidies and import protection.<sup>7</sup>

Perhaps the most important lesson from the Japanese experience is that developing countries should ensure that they adopt competition policies that are aligned to their circumstances. Such an approach will require adequate domestic policy space since it is critical that developing countries retain the flexibility to regulate competition in a manner that supports their long-term development strategy. Competition policy in developing countries should be formulated taking into account a number of key issues including the level of development, institutional and technological innovation issues, their labour relation arrangements and institutions as well as their place in the world economy. Given the rapid changes in technology and the heightened mobility of capital today, developing

countries must also incorporate these dynamic factors in developing their competition policies. For example, in Japan's case, MITI's promotion of cooperation and competition among cartels and oligopoly firms may have sacrificed static efficiency. This was done for the sake of maximizing long-term productivity growth (i.e. dynamic efficiency) and has clearly worked in Japan's favour over the years. Another key lesson from the Japanese experience is that selectivity across sectors and firms is important.

On a broader level, domestic competition policy can help mitigate the risks of inward foreign direct investment, especially in today's borderless world. Current patterns of globalisation have changed the nature of competition in important ways. The strategic competitive advantages of large, established corporations whose size and control of technology gives them a significant edge over smaller and newer entrants from developing countries have significantly increased (Shafaeddin, 2006b, page 8). In this context, a specific threat to competition in developing countries is the rise in the number of cross-border mergers, which can increase the market power of transnational corporations, creating more barriers and less market competition. This is more detrimental for late industrialisers, whose firms are still engaged in the process of building the required capacity to compete in international markets. In such circumstances, there is a need for an appropriate and effective domestic competition policy that works to limit the extent of 'national treatment' that foreign corporations receive in what is an increasingly asymmetrical global and national playing field. Domestic competition policy that does not actively address international competition is likely to result in foreign firms crowding out domestic investment and the indigenous private sector, both of which are critical components of an effective national trade and industrial strategy. Growing foreign competition may not only stifle domestic competition and limit growth in domestic productivity, thereby diminishing prospects for domestic industrialization, but also contribute to increased domestic prices.

Even the most effective domestic competition policy on its own will not be able to achieve this. Current patterns of globalization imply that in order to be effective, domestic competition policy should ideally be complemented by an international agreement on

competition policy. Developing countries should coordinate competition policy as much as possible with other countries. Member countries of the European Union have done this, and those of Mercosur and the Asia-Pacific Economic Cooperation (APEC) have also begun sharing information and even harmonizing policy. The APEC agreement is based on a number of core principles such as comprehensiveness, transparency and accountability – some of these can be a good starting point for any coordination agreement.

There is an important reason why such cooperation should be independent of and outside the existing multilateral trade rules. International competition policy should ideally focus on regulatory and social objectives and cover a much broader range of issues than those related to international trade. Its objectives should also be quite different from those of WTO efforts to promote free trade through market access. An international competition policy agreement under the current multilateral trade regime is, therefore, unlikely to provide developing countries with the complement to domestic competition policy that they need from an international agreement (UNDP, 2003b, page 294).

### Exports, Technological Development and Employment

This paper has so far made the case for domestic industrialization through selective infant industry protection and other well-conceived selective government interventions. These include the enactment of domestic competition policy legislation and the creation of an independent body to implement it effectively. While such policies are critical pillars of a strategic national trade and industrial policy, the promotion of high value-added manufacturing and services exports (themselves, most often, an important product of successful domestic industrial policy) is an important, additional pillar.

The problem in many developing countries, however, has been that exports have been made the principal driver of their national development strategy, rather than one element of an overall national investment policy. If its proponents were right, the export-driven paradigm and the massive increase in global trade over the last quarter century that has accompanied it<sup>8</sup> should have resulted in accelerated growth in the world

economy and a drastic reduction in poverty. Instead, the debt and numerous financial crises experienced in the 1990s, combined with the general deterioration in economic performance in Latin American and African countries that closely followed this prescription, has opened the export-led model to criticism. A fundamental problem with the model has clearly been its failure to deliver the expected economic growth and employment that would place countries on a path of sustainable, broad-based human development.<sup>9</sup> Additionally, the emphasis on maximizing export growth, rather than on increasing its value added component, has undermined the potential contribution of exports to higher levels of employment, domestic production, poverty reduction and human development.

Exports have the potential to play many valuable roles in an economy. However, similar to economic growth, greater openness to exports must not be viewed as an end in itself, but rather as a means to poverty reduction and human development. This will require a strategic approach to the overall design of a country's engagement in export activities.

In support of exports, a valid critique of the post World War II decades when import-substituting industrialization was dominant, was that many countries which followed such a policy neglected exports. It is significant to note however, that this was not true of Northeast Asia's success stories in the post World War II period, nor has this been true of China more recently. Governments in the Republic of Korea and Taiwan, province of China established a successful linkage between incentives for domestic industrialization, on the one hand, and the disciplining stick of clear export targets and strategic global engagement, on the other. This distinguished these countries from other import-substituting economies which had prioritized production for the domestic market almost to the exclusion of outward looking policies, thereby providing the former with a sound base for building international competitiveness. It also helped them adopt global best practices, which have been crucial for their sustained and long-term success. These countries, unlike those that prioritized only domestic industrialization policies in the first three post World War II decades, have been able to transcend the dichotomy between domestic and export markets. Successful industrialization cannot occur without strategically engaging global mar-

kets. The need to do this is even more pronounced in today's context of accelerating technological breakthroughs and integrated production networks than it was in the second half of the 20<sup>th</sup> century.

The potential benefits of an export strategy extend well beyond the traditional need to generate foreign exchange earnings to pay for crucial imports and to bridge the balance of payments deficit. Exports can also accelerate learning-by-doing and productivity growth. Large scale production and specialization also makes it easier for firms to overcome high entry costs. The efficiency gains that result from acquiring greater comparative advantage are probably one of the most valuable contributions of export expansion. These can yield unrivalled benefits in the form of accelerated technological development. Such advances can be derived from exposure to foreign competition, marketing, and, in particular, technological diffusion, which would not be possible in a closed domestic market. Additionally, a significantly export oriented economy is likely to attract greater inflows of foreign direct investment (FDI). The overall benefits of exports to the economy will exceed its monetary value provided FDI is selectively attracted and effectively governed. The FDI attracted should also facilitate new and more advanced technologies that will have a positive impact on other domestic economic sectors.

Greater international demand will also stimulate increased capacity utilization if growing export requirements lead to the employment of previously idle or surplus land and labour resources. The establishment of export-oriented, low-skill industries, such as textiles and clothing, for instance, possess tremendous potential for job creation. This can benefit thousands of previously disadvantaged workers and unemployed people, especially women. For example, despite its limitations, Bangladesh's ready-made garment export industry is widely credited with the transformation of the national economy along with women's socio-economic rights and opportunities over the last two decades. When export activities create employment opportunities, they can contribute to the reduction of inequalities within and among groups as well as encourage an increase in their productivity. The additional household incomes that are generated can then be used to improve living conditions and empower women workers by giving them a level of eco-

conomic and social independence. This, in cases like Bangladesh, has been unprecedented. However, this employment may not be sustainable in the long-run unless the increased national revenues from such exports are used for productive value-added investment. This scenario could still unfold in Bangladesh's ready-made garment export sector, in the post-Multi Fibre Arrangement period after 2008, when the restraints on Chinese textiles and clothing exports agreed as part of China's protocol of accession to the WTO are removed.

The employment and equity aspects of export expansion will also be determined to a great extent by the balance between labour and capital intensive exports and its implications for employment generation. A greater emphasis on capital intensive production techniques in developing countries can translate into wage and income inequality and lower levels of employment. Indeed, available data indicates that many countries and regions, including East Asia, which experienced high growth in the last decade, have not been able to achieve a commensurate increase in employment generation. The phenomenon of 'job-less growth' is thus a real consequence of the growing trend in favour of capital intensity, including in the more advanced developing countries. In the Republic of Korea, among the first-tier Asian tigers, 'hollowing out' is occurring in the manufacturing sector, as labour-intensive industries face stiff competition from China. As a result, several companies are opting to relocate to China, in order to take advantage of lower labour costs and higher labour productivity.

**Public-Private Partnerships**

The presence and growth of a domestic private sector is essential for strategic national trade and industrial policy to succeed. In fact, one of the key objectives of strategic, selective government interventions should be to encourage domestic private initiatives, which over a reasonable time period, will result in the creation of a mature domestic private sector. Such an outcome is crucial if a country wishes to achieve the twin goals of sustainable domestic industrialization and export competitiveness. Indeed, most instances of successful industrial policy have been characterized by a combination of concerted government action along with strategic and flexible collaboration between the

national public and private sectors.

Both parties in such strategic public-private partnerships must join hands to learn and understand each side's potentials and constraints so that they can formulate a joint course of action to best serve a broader national interest. Governments must lead this partnership, and guard against becoming hostage to narrow private sector interests. In order to fully exploit the partnership's potential, they will also need to find the correct balance between achieving full autonomy from the private sector (which may not be desirable as this will most likely leave governments isolated from and unresponsive to strategic national trade and industrial policy needs) and being fully responsive to the private sector's every request or whim with all the accompanying implications and dangers that this entails for policy making. Getting this balance right will be crucial, and, if achieved, will make specific government policy choices easier and less problematic. It may also preclude the need to pick 'winners' from among the domestic private sector (Rodrik, 2004).

Some of the key ingredients in establishing an effective public-private partnership strategy include:

- Political leadership at the highest levels of government that not only advocates for but provides active support for such partnerships.
- Identifying the most competent government agencies to implement this strategy. If the government agency tasked with administering the policy is ineffective or corrupt, the result will inevitably be a dilution of policy.
- Effective coordination and monitoring of agencies involved in implementation.
- The establishment of transparent and accountable mechanisms to monitor the process such as an independent ombudsman or domestic competition authority.

Government incentives to the private sector should be time bound and, as far as possible, only directed at new activities spanning several, not specific sectors. They should directly address clearly identified market failures which afflict either new products or new tech-

nologies for producing existing products (*Ibid.*). Activities with potential spillover effects in the economy should also be subsidized.

Critics of government intervention are of the view that the government will inevitably make major errors in choosing its strategic private sector partners. This argument may in certain instances be justified since

in reality such mistakes are bound to occur. Nevertheless, it is important to emphasize that it is far better for a government to make some mistakes, especially if it can identify and correct these early on and eventually produce an industrial policy, than for it not to have any industrial policy at all because it never attempted to embark on one.

## 4 Sectoral Policies

### Agriculture and Food and Livelihood Security

Agriculture plays a central role in most developing economies, primarily because of its contribution to food and rural livelihood security. Although there are significant variations in agriculture's contribution to GDP within the Asia-Pacific region,<sup>10</sup> a common factor is the gradual decline in value addition of the agricultural sector to the economy. Nevertheless, the agricultural sector still accounts for a significant share of employment in developing countries, including in the least developed countries of the region. Poverty and food insecurity within the region remain a pervasive problem, despite economic growth accompanied by an increased engagement in international trade.<sup>11</sup>

However, only a handful of countries in the Asia-Pacific region rely on agricultural trade for a significant portion of their export revenues. China is the world's ninth biggest exporter of agricultural products and countries such as Thailand (rice and poultry) and Vietnam (rice) are generally regarded as natural agricultural exporters. Still, the fact remains that none of the successful economies in the region have achieved high levels of economic and human development by primarily relying on their comparative advantage in agricultural exports. Even natural agricultural exporters, such as Thailand and Vietnam, who seek greater liberalization of agricultural trade in certain products such as rice, in order to secure greater access to export markets are equally focused on industrial diversification. Indeed, the general route adopted by all successful countries in the region has been through diversification into productive industrial and service sectors which have potential for significant value addition. This has been equally true for Thailand and is increasingly the case for Vietnam. As a result, it is reasonable to argue that agriculture is unlikely to emerge as the major pillar of comparative advantage or export strategy for the Asia-Pacific region, unlike for significant parts of Latin America.

On the contrary, the primary concern of most Asian countries with regard to agricultural trade at present,

and for the foreseeable future, is likely to be enhanced domestic food security and rural livelihoods. This is a more pressing concern than increased market access to OECD and other developing countries.

In this context, the current food crisis has only served to heighten food security concerns in the region. It has highlighted the vulnerability of an over-reliance on international markets in guaranteeing supplies of basic food products, particularly for large populous countries, in periods of tight supplies and high food prices. Countries in the Asia-Pacific region have taken a number of measures in an attempt to address the crisis situation created by soaring food prices. Some of these measures include expanding safety nets for the poor and reducing consumer taxes on staples; taking steps to build buffer stocks of rice, and introducing export restrictions to dampen the impact of the increase in prices in local markets as well as to guarantee adequate domestic supplies and restrict commodities trade in future markets. Further, many of the countries in the Asia Pacific region are Low-Income Food-Deficit Countries (LIFDC). As such, they have been particularly hard hit by the increase in food prices and face significantly higher food (and energy) import bills. Such countries currently require urgent support from the international community including in the form of budget support.

There is overall agreement that, although the price of agricultural commodities will likely go down as a result of the expected supply response to high prices, prices will stabilise at higher overall levels than in the past. Thus, in addition to short-term measures taken by governments and the international community to address the immediate crisis situation, it will also be necessary to address the food security and livelihood needs of many countries in the region in a sustainable manner. This necessitates an understanding of the main causes of the food crisis.

The causes of the current high food prices are multiple and diverse. Some reflect structural factors whose effects have accumulated over the years, and others are



of a more immediate nature, contributing as triggers to the crisis. The latter category includes factors such as poor harvests due to unfavourable weather conditions and financial factors related to speculation and the weakening of the US dollar.

The structural factors leading to the crisis include both the neglect of the agricultural sector in many developing countries over the years and the current asymmetries that exist in agricultural trade at the international level.<sup>12</sup>

The strong emphasis on increasing earnings from the exports of cash crops has also led to the relative neglect of considerations such as food security and rural development resulting in reduced support for agricultural food security, in terms both of national budgetary allocations and international development assistance. As a result, the agricultural production capacity of most developing countries has suffered and many food exporters in the 1970s like the Philippines had become import dependent by the 1990s.

This is also partly a result of the fact that many developing countries liberalized their agricultural markets more deeply than most developed countries, either unilaterally or as a result of structural adjustment loan conditionalities. The availability of cheap imports has undermined national both food security and livelihoods of small-scale farmers. Under these circumstances, it is critical for governments and other policy makers to ensure that further import liberalization of staple and other essential food products takes a back seat when domestic livelihoods and food security are at stake.

Given the importance of rural livelihoods in the region and the difficulties marginalized farmers face in accessing local and international markets, the policy space afforded by tariffs should be retained by developing countries in order to secure the interests of their small farmers. They should also be provided access to domestic and regional markets. In the WTO context, such policy space should be assured through an agreement on a category of 'special products' (identified by developing countries themselves) as well as a special safeguard mechanism incorporating both price and volume triggers, that would be made available solely

to developing countries. These mechanisms will allow developing countries to undertake reform in the agriculture sector taking into account the needs of poor urban and rural households. It will also allow them to respond to volatility in agricultural commodity prices, which is expected to increase in the future for a variety of reasons, including the inextricable relationship between agricultural and energy markets resulting from the biofuel connection, as well as the effects of climate change.

Governments will also need to play an important and much greater public investment role in agriculture than has been the case in recent years. Access to land for small producers is a critical aspect of agricultural policy as is investment in both small-scale community infrastructure projects and processing and storage facilities. Governments should also assist farmers by providing them with a minimum support price to encourage production. They should also extend support to and actively promote state trading enterprises which, if properly managed, can play an effective stabilizing and redistributive role in the agricultural sector by learning from both the successes and problems of previous experiences in this respect.

It will also be critical to address existing asymmetries in international trade which include rich country export subsidies and substantial OECD domestic agricultural support. Indeed, it is abundantly clear that pervasive governmental support to agriculture in the OECD countries has worked as a disincentive for agricultural investment by many developing country farmers over many decades.

Some transitional measures may need to be put in place to cushion the impact of the phase-out of export subsidies on net food importing countries. However, their admittedly difficult situation as a result of increased food prices should not be used as an excuse to delay the change in the rules for world trade in agriculture that were agreed at the WTO's Hong Kong (SAR), China Ministerial meeting in December 2005.

Notwithstanding the fact that agricultural export expansion is of secondary importance for the region, some processed agricultural products can be internationally competitive for Asia, both at the boutique and

large scale level and also have positive human development impacts. Such production for export should be promoted as part of a pro-poor, agro-industrial export-oriented strategy and as a complement to developmentally-oriented domestic agricultural policies. At the international level, action to eliminate agricultural tariff peaks and escalation as well as address non-tariff barriers to agricultural exports from developing countries should remain a high priority in the Doha Round of trade negotiations.

## Services Trade

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Strategic national trade and industrial policy encompasses trade in manufactured goods as well as in services. Although much of what applies to manufactured goods is relevant to trade in services as well, there are some distinguishing characteristics that are worth highlighting. It is also important to note that despite complex non-tariff barriers, global trade in services has grown more rapidly than trade in manufactured goods since the 1980s and has now emerged as the fastest growing sector. It accounts for the predominant share of GDP and exports, not only in many OECD countries but also in some Asian countries such as India.

### *Emerging Services Sectors: The Case of Outsourcing*

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The Republic of Korea and Taiwan, province of China, have successfully increased domestic value addition and made advances in poverty reduction and human development. Their success was primarily due to the pursuit of a process of diversification away from both agriculture and the low-end value textiles and clothing sector into higher value added manufactured goods as well as some areas of services trade.

Technological advances and the deregulation of the telecommunications sector globally have facilitated exceptionally rapid growth in developing countries in the cross border supply of business processes through IT-enabled services. India has taken the lead as an off-shore destination across the spectrum of services. Other Asian countries such as China, Malaysia, the Philippines, Thailand, Vietnam and Cambodia are also emerging as promising entrants. However given the prerequisites of such outsourcing, it is primarily middle income developing countries or low income coun-

tries with large pools of skilled labour such as India and China, which have developed a comparative advantage. Although regional competition in this area is poised to increase further, outsourcing is likely to remain largely limited to these countries rather than spread to LDCs.

From a human development perspective, the rapid growth of global services outsourcing in Asia has so far yielded limited benefits. One positive outcome of global outsourcing has been improved accumulation of human capital. This has been made possible by joint-ventures or other technical arrangements between service providers and client companies that facilitate the acquisition and transfer of knowledge and skills. The potential exists for the development of indigenous capabilities resulting from exposure to advanced technology and research and the subsequent diffusion of productivity-enhancing technologies to other sectors such as agriculture and manufacturing. However, these benefits so far appear to have been largely restricted to the IT and outsourcing sectors. This is primarily due to limited backward linkages and multiplier effects, especially in the rural economy.

The outsourcing industry has made a substantial contribution to the GDP of countries involved in this business. However, it has failed to create - and is unlikely in the foreseeable future to generate - broad-based employment of the magnitude that is urgently required in most Asian economies. This is especially true for countries which have a large pool of low skilled labour. Ironically, given the industry's unique characteristic of combining human skills with enabling information and communication technology (ICT), global outsourcing caters directly and almost exclusively to those sections of society that already possess the capabilities to take advantage of information and communication technology. Despite some negative social impacts, the industry continues to be able to attract skilled workers. This is primarily because the industry offers more organized working conditions and higher wages and benefits than other comparable employment sectors. Since outsourcing, by its very nature, tends to be located in urban areas, which have superior infrastructural facilities, the industry nevertheless also tends to widen the gap between urban areas and poor, neglected rural areas.

Hence it is crucial that governments play a strategic and forward looking role by adopting a balanced mix of fiscal, trade and investment policies with regard to outsourcing. Governments must exercise caution in prioritizing outsourcing at the expense of other sectors of the economy where investments could yield higher and more sustainable economic returns and employment in the long-run. This does not imply an 'either/ or' choice. It is essential to invest in a human resource base that caters to the needs of the growing outsourcing industry across the Asia-Pacific. It is equally important, however, that the priority placed on the higher-end, value-added science and technology education, training and research in countries such as India is not compromised for relatively short-term computer application courses in the process. From a fiscal policy point of view, appropriate tax breaks and other incentives may serve the purpose of attracting clients and encouraging business growth in the outsourcing industry. However, it is just as important to ensure that the industry's profits also benefit other more needy sectors, both in the short and long-run.

### ***Short-Term Movement of Workers***

Individual remittances of workers and the diaspora have assumed an increasingly important role in the economy of several Asian countries. It is important to recognize that the value of these inward remittances in terms of financing and contributing to national development strategies remains greatly underutilized in the absence of an overarching national policy framework which ensures their integration in national development strategies. One of the reasons is limited access to financial services for both remittance senders and their families back home. Some alternatives have started to emerge, particularly in the US, linking commercial banks with microfinance institutions in Latin America, and increasing access to financial instruments that allow for savings and favour local investments. Access to these services will allow the leveraging of remittances to enable the expansion of livelihood alternatives in the countries of origin of migrants. Co-operation between the country of origin and destination will also be important in facilitating the establishment of a conducive environment for co-operation among financial institutions across borders.

At another level, the movement of people is limited by an array of regulations in both 'sending' and 'receiving' countries. This limits the possibility of expanding the flow of remittances to developing countries in a more orderly manner. This remains the case despite the agreement reached at the WTO by the adoption of the General Agreement on Trade in Services (GATS), including the component related to the movement of natural persons (Mode 4).

Many developing countries have advocated for enhanced market access for their service suppliers in the ongoing Doha round negotiations, particularly those in semi-skilled and low skill categories. LDCs such as Bangladesh have put forward a request for the liberalization of services under Mode 4, focusing on such suppliers. Additionally, LDCs submitted a proposal which would provide them with special priority for market access and allow preferential access for LDCs across all modes of services, including Mode 4.

Such an agreement can help in correcting the glaring asymmetry between the mobility of capital and labour in the current globalization process. It could also, if appropriately designed and integrated into national development strategies, result in a significant improvement in human development outcomes in developing countries. Regrettably, Mode 4 discussions at the multilateral level are moving at a glacial pace. They have focused primarily on skilled, not semi-skilled workers, and have been further complicated by security concerns in the post-September 11, 2001 period.

It is important to clarify that the temporary short-term movement of workers does not imply that host governments are expected to open up to permanent migration from developing countries. It does, however, imply the implementation of a "GATS visa" for temporary workers, with guarantees from source country governments that these workers will return to their country of origin within a specified period.

Parallel to the multilateral negotiations on trade in services, progress has been made on bilateral agreements facilitating the transnational movement of workers. These agreements provide for close cooperation between the country of origin and destination throughout the process: from the recruitment

of potential guest workers in the country of origin to their insertion in the country of destination and return. The experience with these agreements is, that if properly drafted and implemented, they can enhance the developmental impact of migration by addressing problems related to brain drain since they guarantee the return of migrants over a specified period of time. They can also enable the protection of migrants in the country of destination and support the diversification of livelihoods for migrants and their families in the country of origin. Nevertheless, such bilateral agreements are costly to negotiate and implement for an individual developing country, and the option to enter into such negotiations may not be open to all such countries. In this sense, progress on Mode 4 at the multilateral level continues to be the preferred option for the large majority of developing countries. Lessons learnt from the experience of countries which have concluded bilateral agreements on the movement of workers could, however, feed into the GATS negotiations and enhance the developmental impact of the liberalization of services in the Doha Round.<sup>13</sup>

The recognition of qualifications is also important for the effective access of Mode 4 service suppliers. This is a particularly important consideration for the category of service suppliers of most interest to LDCs and other poor countries – low and semi-skilled workers. Qualification requirements which prioritize professional degrees and formal studies only disadvantage workers in certain sectors considered low skilled in developing countries, even though many of these workers are qualified and have significant and practical experience and expertise. In this context, flexibility in the recognition of qualifications, keeping in mind the particular circumstances of developing countries and/or the adoption of mechanisms that will facilitate the acquisition by workers of the necessary ‘formal’ qualifications will be very important. In fact, a multilateral agreement on a “recognition system” for the qualifications of both semi-skilled and skilled workers (many of whom also suffer from barriers to the recognition of their qualification but to a lesser degree) will be beneficial.

Measures to facilitate the movement of natural persons, especially in categories of special interest to LDCs have the greatest developmental potential relative to other areas under current negotiations in the

Doha Round. According to one estimate, increasing temporary workers’ permits in industrial countries by 3 per cent of their current skilled and unskilled workforces has the potential of generating gains of \$156 billion for the developing world (Winters, 2003), especially for the Asia-Pacific region. This is equivalent to more than double the combined projected gains from the agricultural and industry sectors. Although these are computable general equilibrium (CGE) model estimates, and should be treated cautiously, they nevertheless are an indication of magnitude of projected gains that are possible from a genuine Doha Development Round which prioritizes Mode 4. Apart from the financial aspect (in terms of increased incomes) what is of equal if not greater importance are the non-quantifiable gains. Such gains could include learning, knowledge acquisition and organizational skills which are hard to quantify accurately, but as already discussed, are vital for domestic industrialization and growth.

### *Basic Social Services*

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Efficient and equitable access to infrastructure and social services is critical for a country’s competitiveness, the well-being of its people, and enhanced human development outcomes. The GATS, therefore, has important potential policy implications for the provision of public services, particularly in those sectors where commercial gains should be secondary to the human development objective of ensuring basic well-being through decent health, education, energy and water and sanitation supplies (UNDP, 2005a, page 66). The provision of these services also has a significant impact on vital concerns such as equity, human rights, social justice and state responsibility (UNDP, 2003b). GATS implementation will also need to be policy consistent with MDG achievement since a number of MDGs themselves relate to the provision of basic social services (eg. health, water, education). Developing country governments cannot afford to leave basic social services entirely or even partly to private - including foreign - competition, for all of these reasons. A dose of policy caution and strategic protectionism is thus justified when liberalizing trade in those service sectors that are directly important for human development advances.

While liberalization in these areas, if properly chan-

nelled to support development strategies can be beneficial, it is necessary to avoid the infringement of the sovereign rights of countries to implement regulatory measures that are in the public interest. Opening basic services to foreign competition and subjecting them to GATS's progressive liberalization framework, 'request-offer' modality and plurilateral bargaining option carry the risks that accompany premature deregulation, especially where regulatory capacity is weak, which is the case in almost all developing countries. For example, rapid privatization and commercialization of health services without regard to equity and accessibility, combined with pressures to reduce public spending in health, can be especially harmful for human development.<sup>14</sup> Privatization of water supply is another area of concern in developing countries, because it can restrict poor people's access to water services. In fact, the commercialization of water sup-

ply has generally produced mixed results at best.

In the energy sector, GATS negotiations are aimed at exploration, production, and transportation of energy. While there clearly are human development benefits to broader energy access, liberalization also implies that governments will no longer be able to apply direct measures in the energy sector in support of human development goals, but will have to pursue these goals through new regulatory structures and actions in the context of private enterprises (*Ibid.*, page 78). Energy liberalization, if undertaken, should be accompanied by compensatory measures and conditions for foreign investors (e.g. requirements for technology transfer, social obligations, and prohibitions on anti-competitive practices) so that, if undertaken, they can beneficially contribute to human development.

## 5 Macroeconomic Policy and Trade

The exchange rate and interest rate are two of the most important macroeconomic indicators in an economy. They are relevant both from the viewpoint of 'internal equilibrium' or moving towards the full employment of domestic resources including labour, which has obvious and important human development implications, and 'external equilibrium' or a sustainable balance on the current account of the balance of payments.

The standard definition of a 'competitive' exchange rate is one that makes imports more expensive and exports more competitive. Thus, one route to increasing the utilization of domestic resources and raising the rate of growth is adjusting the exchange rate to either reduce the current account deficit or create a current account surplus in the balance of payments. The former ensures that demand-inducing domestic expenditures, especially counter cyclical government expenditures, will not be made ineffective due to increased net imports. The latter is part of a strategy of making international demand the stimulus for growth.

Similarly, interest rates can be used as an instrument for stimulating broad-based growth. A low average interest rate can trigger investment and growth if investment is responsive to the cost of capital. Differential interest rates can be used to favour certain sectors or sections of society for growth or distribution reasons.

The use of these instruments in developing countries has not been viewed favourably. The first criticism is that protectionism in many of these countries resulted in 'overvalued' exchange rates that made imports - in particular those of capital goods - cheap, encouraging capital intensive investments that reduce employment growth. The second criticism is that this is further accentuated by policies of 'financial repression' that ensure low or negative real interest rates, with the aim of stimulating aggregate investment.

The principal theme of these criticisms is that the movement towards achieving an equilibrium ex-

change rate and interest rate is often thwarted by government policy intervention. However, even if such an equilibrium exists in a world where countries are integrated through trade, the growing importance of private capital flows to developing countries makes the identification and realization of such equilibrium rates difficult. This is because movements in exchange and interest rates have a distinct and separate impact on the capital and current account. Also, relatively autonomous capital flows influence exchange and interest rates, making management of these instruments extremely difficult in an increasingly globally integrated world. On the other hand, it is extremely difficult for developing countries to successfully and strategically integrate themselves into the world economy without a competitive and stable exchange rate. A managed exchange rate that factors in current and capital account developments and is geared towards ensuring reasonable stability and predictability may be the best option for most developing countries in these circumstances.

### Exchange Rate Policy

The real exchange rate is a widely used barometer of the competitiveness of a country's tradeables sector. It is based on purchasing power parity and equals the product of the nominal exchange rate and the ratio of the foreign to domestic price level. Given this relationship, it is apparent that trade policies cannot be assessed independently of the exchange rate regime.

Exchange rate volatility is not conducive for sustained growth in the traded goods sector. The theory in this regard is confirmed by the experience of successful Asian countries, whose 'miracle' growth was characterized by sustained monetary stability over a relatively long period. The successful trade performance of the Republic of Korea and Taiwan, province of China, was facilitated to a large extent by relatively stable exchange rates which played an important role in their successful and strategic integration into the global economy. This is further substantiated by the more recent experience of both China and India, which have acquired high levels of competitiveness in the world

market at least partly by maintaining relatively stable real exchange rates over long periods. Indeed, it is relatively stable and competitive real exchange rates, complemented by the other policies and strategies discussed in this paper, that have contributed to sustained high growth, without high inflation, in all these economies (UNCTAD, 2005).

The macroeconomic regime, in a broad sense, has thus been and remains an important factor behind much of Asia's relatively good performance compared to Latin America and other parts of the world. Historical evidence suggests that exchange rate devaluation was a common route to seeking greater trade competitiveness in other parts of the world. However none of the countries that primarily or significantly relied on this method achieved sustained improvements in their export and value-added performance to the extent that China, India or even Vietnam have, along with other economies in East Asia (UNCTAD, 2003).

China's case is summarized below because of its global importance and the enormous media attention its exchange rate policies continue to receive.

The balance of payments position of many developing countries has been transformed by macroeconomic adjustments made in an attempt to deal with the effects of financial crises and respond to volatile capital flows. The period since the mid-1990s has seen a transformation of current account deficits into surpluses for developing countries as a group. While this was initially true only for a set of Asian countries, they have since been joined by countries in West Asia, the Commonwealth of Independent States (included by the IMF in the developing countries and emerging markets group) and Latin America, though not Africa and Central and Eastern Europe.

Three questions arise in this context.

1. What are the key factors responsible for the current account surpluses in developing countries?

2. What quantity of their overall balance of payments surpluses are due to developments in the current account?

3. How are these surpluses utilized?

There are three factors that explain developing country current account surpluses. First, there is the Chinese case, where the current account surplus has arisen because the country's competitive position in the international market for goods has yielded a trade balance which more than covers the deficit in services and in income. Second, there are countries like India, which has ensured a current account surplus because its trade deficit has not been significantly increased by its services deficit because of large service income inflows. Moreover, its aggregate deficit in trade in goods and services is more than covered by a surplus in the current transfers account because of large remittances from migrant workers residing abroad. Finally, there are countries like Bangladesh, which while recording significant deficits in their trade in goods and services, have been able to make this up through worker remittances which ensure an overall surplus in the current account. This analysis demonstrates that it is not a surplus in merchandise trade but surpluses from the sale of services through physical migration and/or digital migration (India) that have delivered a current account surplus in the majority of Asian developing countries.

Current account surpluses are also partly attributable to a deflationary fiscal stance adopted by the governments of developing countries. Since deflation curtails growth, it is possible to maintain imports at levels that deliver trade surpluses even with a higher import-to-GDP ratio resulting from trade liberalisation. Furthermore, the desire to increase inflows of foreign capital has compelled many governments to adopt a deflationary stance in order to anchor the confidence of financial investors. These groups of investors do not favour state deficit-financed spending for a number of reasons. First of all, deficit financing by increasing overall liquidity in the money market, is viewed as being potentially inflationary. Inflation is anathema to investors, primarily because it erodes the real value of financial assets. Second, since government spending is 'autonomous' in character, the use of debt to finance such autonomous spending is similar to introducing an arbitrary player (not driven by the profit motive) into financial markets. This is likely to give rise to interest rate differentials which in turn make the determination of financial profits more unpredictable. Third, governments will have an incentive to intervene in financial markets to lower interest rates if deficit spending leads to a substantial build-up

## Box 2: The Exchange Rate Regime: Lessons from China

China devalued its exchange rate in its early reform period, and has had a dollar peg for the last decade. Its exchange rate policies in both periods have proven consistent with healthy export growth but have had differential impacts on poverty reduction and the rural-urban divide.

An over-valued exchange rate is often viewed as penalizing farmers while devaluation is expected to mitigate urban bias. This has not been true in China's case since labour-intensive manufactures comprise a significant share of its exports. Moreover, trade patterns and exposure to international trade vary enormously between different regions of the country, as is well known. As a result, the sharp, real depreciation of the Renminbi between the mid-1980s and 1993 corresponded to a significant increase in the urban-rural income gap. This bias can be largely attributed to the foreign exchange retention and swap systems which favoured industrial goods. The currency's depreciation, therefore, did not benefit the poor, a large proportion of whom are located in interior rural areas. Contrary to conventional wisdom, China's experience suggests, therefore, that devaluation will not benefit rural activities or reduce urban bias in a context of significant intra-regional inequality in both productive assets and trade patterns. It also suggests that, despite some problems, China's policy of maintaining a stable nominal and real exchange rate since the mid-1990s was an appropriate policy choice. The dollar peg has also helped overall macroeconomic stability, in addition to leading to a gradual but effective depreciation in the value of the Renminbi as a result of the weakening of the US dollar. The dollar peg has, therefore, helped ensure that China's adjustment to a more liberal trade regime is gradual, whilst enabling it to avoid a sharp deterioration in its trade balance during this process.

### ***Should China Float its Exchange Rate?***

China should approach a flexible exchange rate regime with caution for a number of reasons. *First*, a significant appreciation of the exchange rate will hurt its export competitiveness. *Second*, it will undermine China's current external financial strength which permits it to borrow abroad and address its continuing domestic financial fragility. *Third*, lower import prices will end up hurting China's import-competing agricultural and industrial producers and industries, leading to losses in farmer incomes and undermining their livelihoods, and have negative employment consequences in China's current trade liberalization context.

China, therefore, has only two policy options for its future exchange rate regime; to adhere to the current fixed peg with the U.S. dollar or to shift towards a 'soft peg'. The 'soft peg' option implies a moderate widening of the currency's trading band, while allowing for central bank intervention when the exchange rate reaches band limits. The Chinese government appears to have adopted this option. A more radical shift towards a 'free float' regime is clearly inadvisable given China's current situation, not least because of its still relatively underdeveloped domestic financial markets and weak banking sector. While the dollar peg may be a potential source of price instability for some products, this can be addressed by pegging the Renminbi to a multi-currency basket (the US dollar, Yen and Euro).

*Sources: UNDP 2004a; Akyüz 2005a.*



of the state's debt and interest burden. This will have implications for financial returns. Financial interests in guarding against such a possibility tend to oppose deficit spending. Finally, the use of deficit spending to support autonomous expenditures by the state amounts to an implicit legitimisation of government intervention, and therefore, a de-legitimisation of the view that the market should dominate. Since global finance seeks to de-legitimise state intervention and legitimise market domination, it strongly opposes deficit-financed, autonomous state spending.

In accounting terms, a current account surplus, in effect, implies that savings in these countries exceed investment. The continuing surpluses also imply that, despite the low level of per capita income in these countries, the potential opportunities represented by current account surpluses are not being channelled towards productive investments - investments that would raise the growth rates of both aggregate and per capita incomes. Since a number of countries with current account surpluses are also net recipients of substantial magnitudes of inflows in the capital account (e.g. India), total savings (domestic and foreign) now exceed investment by an even larger margin for a number of Asian developing countries.

The accumulation of foreign exchange reserves resulting from the factors cited above are now increasingly being used as a basis to argue that the exchange rate in many developing countries is 'undervalued'. In the Asian context, this argument is particularly directed at China whose productivity, growth and strength, it is argued, derive from its maintenance of a stable, but undervalued currency. While China has not indulged in ad-hoc devaluations which can lead to volatility and instability, it does appear to have relied on systematic undervaluation, whilst maintaining currency stability. This also appears to have been an important strategy, at least in the initial stages of export development and diversification of Japan in the immediate post World War II period, and more recently, in other East Asian economies. This may have served them well with China being the most recent beneficiary of such a policy in recent years. However, it is possible to argue that such an exchange rate policy can have a negative impact on the export competitiveness of the least developed and other developing countries in the region, especially in an area such as textiles and clothing trade

in the post-Multi-Fibre Agreement (MFA) period.

Nevertheless, a closer examination of the debate on exchange rate regimes and exchange rate levels in developing countries reveals that the perception of undervalued exchange rates in China and other developing countries represents a dramatic reversal of the argument that has dominated the development dialogue in the past three decades. It is indeed ironic that many of the same countries were being accused of pursuing inward looking policies and of being too interventionist in their trade, exchange rate and financial sector policies, until quite recently. As a result, their exchange rate regimes were characterized as 'overvalued' to conceal their balance of payments weaknesses. An 'overvalued' rate is seen as making imports cheaper and exports more expensive. This results in an encouragement of investment in areas that do not exploit the comparative advantages of the country concerned in the medium-term. It eventually leads to an inefficient and internationally uncompetitive economic structure.

What was required, it was argued, was substantial liberalization of trade, a shift to a more liberalized exchange rate regime, less all-round intervention, and a greater degree of financial sector openness. Many of these countries have since put in place such a regime, partly at the behest of or under pressure from developed country governments and international financial institutions. Now they stand accused of having 'undervalued' exchange rates.

Those who put forward such arguments fail to appreciate that the adoption of a liberalized economic regime in which output growth had to be adjusted downwards to prevent current account difficulties and attract foreign capital has certain consequences. It has required governments to borrow less to finance deficit spending, which has often led to lower growth, inflation and import demand. Combined with or independent of higher export growth, these effects have manifested themselves in either reduced deficits or actual surpluses in the external trade and current accounts of many developing countries. Combined with increased capital flows, this has resulted in the peculiar distribution of global current account deficits and surpluses and global foreign reserves that exist in the world today.

An important additional policy lesson from the Asian experience, including the 1997 Asian financial crisis, is that currency movements, whatever their initial drivers, have often been associated with significant volatility and instability. This, together with the key lessons from Asian countries that have achieved success, suggests that government management of the exchange rate may be more important than using devaluation as an instrument of trade and competitiveness policy or appreciation as an instrument to deal with reserve accumulation resulting from capital flows or export success. If the exchange rate is left unregulated, periods of high capital inflows will lead to exchange rate appreciation and a concomitant bias against exports and tradeables. The reverse situation will, on the other hand, lead to a liquidity crunch and economic slump. In the worst case scenario there could be a full-fledged economic and financial crisis. A key policy lesson is that governments should maintain the basic stability of the exchange rate. This is equally valid for the current period, during which the large foreign exchange reserves of many Asian countries have led to pressures and calls for an upward revaluation of their exchange rates. Even if some changes are seen as necessary, these must be carefully managed by the central bank to prevent volatility.

A rather different lesson emerges from the experience of significantly aid-dependent LDCs and natural resource export dependent economies. Continued aid inflows and low absorptive capacities in productive activities leave them vulnerable to the so-called 'Dutch-disease'. This is especially true in the short-term, or until these countries have diversified their economies and built up their industrial and other capacities. 'Dutch disease' results in a significant appreciation in the value of a country's currency and an over-valuation of its real exchange rate. This makes its exports more expensive and imports cheaper than they would otherwise be. This phenomenon has afflicted Asian countries such as Nepal, Cambodia and even Bangladesh at different times and is viewed as a current risk for Afghanistan. Continued foreign aid inflows have led to an over-valuation of the real exchange rate in these countries, resulting in endemic trade deficits. This is due to the combined effects of the exchange rate's bias against exports and the production of tradeables on the one hand, and the inability of domestic producers to compete against cheaper imports, on the other. Trade liberalization, in

this context, can only lead to a worsening of the balance of payments situation (Ghosh, 2004, page 18-19). A longer-term and more serious danger of the 'Dutch disease' is that it will inhibit the emergence of a competitive tradeables sector, with potential negative implications for productivity, growth and poverty reduction (Nébié, 2006).

A *laissez-faire* approach to exchange rate determination also appears to have accentuated similar 'Dutch disease' problems for some natural resource exporters in Asia. For example, countries such as Cambodia and Timor-Leste face a resource related currency appreciation. In the Asian context, this was also identified as a problem in some of the tsunami affected countries. Natural disaster-related aid inflows have led to an appreciation in their exchange rates; this could adversely affect their competitiveness. The 'Dutch disease' effect can also be significant as a result of overseas workers remittances, if these are spent on consumption and not productively managed to build a diversified industrial base.

A broader 'Dutch disease' related dilemma which is implicit in all the situations just described, is the challenge of comparing the competitiveness costs of large aid inflows with the potential benefits of additional investment in growth and human development that may result from them. An interesting and controversial implication of this dilemma is that trade liberalization could compound competitiveness problems in situations where 'Dutch disease' effects are in evidence. Should liberalisation efforts in such countries be put on hold while donors significantly scale up their aid, including aid for trade? This could become an important sequencing policy question for LDCs and other low income countries in some circumstances.

All of these considerations merely reinforce the importance of understanding the vital influence of exchange rate policies in terms of providing protection against imports and promoting exports, thereby enhancing a country's trade competitiveness and export success. As a result, exchange rate management should be given much higher priority than other aspects of trade policy such as import liberalization. This is particularly important for sustained economic and export growth under open trade regimes.

## Foreign Exchange Reserves

Reserves of foreign exchange have traditionally been held to cover the current account of the balance of payments. Prior to 1990, developing countries held reserves equivalent to 3-4 months of their import requirements. These holdings have since increased significantly for developing countries. They have not changed for industrialized countries, however. While this difference can partially be attributed to the greater increase in trade openness of developing countries compared to industrialized countries in the past two to three decades, the real reason appears to be related to changes in financial magnitudes, not import quantities (Rodrik, 2006a).

The main motives for keeping large foreign exchange reserves are either precautionary in nature or mercantilist. Empirically, however, it is the precautionary motive that appears to have dominated during the 1980-2000 period. Trade openness (imports as a percentage of GDP) remains important as an explanatory factor. Meanwhile, reserve stockpiling is no longer motivated primarily by the need for a buffer against current account shocks, but because of the increased frequency of financial crisis since the 1980s.<sup>15</sup> The financial crises phenomenon goes a long way towards explaining the perceptible increase in the foreign exchange holdings of developing countries (Aizenman and Lee, 2005) since 1990, when financial liberalization is often regarded as having begun. In the Asian context, financial liberalization since 1990 was reinforced by the Asian financial crisis of 1997-98 as a major motive for accumulating large foreign exchange reserves. Such stockpiles can be viewed as a form of self-insurance both against preventing and minimizing the cost of future crises. Large reserves also reduce the likelihood of self-fulfilling speculative attacks on a country's currency (Garcia and Soto, 2004). Moreover, Aizenman and Lee argue that a precautionary strategy of holding reserves saves liquidation costs and leads to large welfare gains of a first order magnitude while the accompanying reduced welfare costs of liquidity shocks change from a first order to second order magnitude as a result of such a strategy (Aizenman and Lee, 2005).

The mercantilist motive is often seen as the principal factor behind China's large accumulation of foreign

exchange reserves. It is argued that export competitiveness concerns have led to its large accumulation of reserves. These have been used to slow down currency appreciation, absorb surplus labour, create better jobs and promote exports (*Ibid.*). The empirical evidence, however, does not support this thesis for developing countries as a whole, including China. While some commentators still believe that this motive is significant in China's case, it should not be overstated since it is only of limited relevance for countries such as China who still actively manage their capital accounts. Another reason why the mercantilist motive cannot be viewed as significant is that the desire to maintain export competitiveness and export growth is not new. In contrast, large foreign exchange reserve holdings are a relatively new and developing country-specific phenomenon, traceable only from the 1990s.

The foreign exchange reserves of developing countries have increased significantly, from 6-8 per cent of GDP in the 1970s and early 1980s, to 10 per cent in the late 1980s, to 32 per cent by 2007 (IMF, 2008c). Likewise, the reserves to external short-term debt (STD) ratio increased from 2.5 to 5 between 1990-2002. Four Asian countries, China, the Republic of Korea, Malaysia and Thailand held 30 per cent of the world's foreign exchange reserves by the end of 2007 (IMF, 2008a). While China's reserves had been less than 10 per cent of its GDP in 1990, they increased to greater than 47 per cent of GDP by 2007 (IMF 2008a and IMF 2008c). The Republic of Korea's reserves never exceeded 5 per cent of GDP until the Asian financial crisis. They then increased significantly after 1998, reaching 27 per cent of GDP in 2007. Malaysia, on the other hand, maintained average reserves of 30 per cent of GDP through the 1990s which had reduced immediately preceding the Asian financial crisis but rose again thereafter, reaching 51 per cent by 2007 (*Ibid.*; Garcia and Soto, 2004).

While such large foreign exchange reserves are often viewed as primarily a Chinese or broader Asian phenomenon, this is not true. Emerging market economies as a whole increased their reserve to GDP ratios from 5 to 16 per cent between the late 1980s and 2002. They increased their reserves to STD ratio from 1 in 1990 to 2.4 in 2002. More surprisingly, Africa's rise in foreign exchange reserves is as striking as that of Asia since, according to IMF data Africa's reserves were

equivalent to about 8 months of imports by 2004 (Rodrik, 2006a).<sup>16</sup> This suggests that increased foreign exchange reserves are not just an emerging market phenomenon but one that now also characterizes the world's poorest countries. What is true, however, is that this is a developing country, not industrialized country phenomenon, since the latter have maintained a reserve to GDP ratio of approximately 6 per cent since the 1980s, not significantly different from the 5 per cent average they have maintained since the 1950s (Garcia and Soto, 2004; *ibid.*). This lends greater credence to the argument that large foreign exchange reserves are primarily a developing country strategy to self-insure themselves against the costs of financial globalization.

Is this a sensible strategy? Is it economically rational? Garcia and Soto of the Central Bank of Chile demonstrate that the recent trends in reserve accumulation by some Asian countries are a sensible way to deal with the risks of financial globalization. Using three different crisis scenarios,<sup>17</sup> they conclude that the level of reserves held by the Republic of Korea, Malaysia and Thailand in 2003 were justified, even if the cost of a future crisis was low. They go further and argue that even doubling these relatively large reserves would be rational to insure against a mild crisis. Moreover, the current higher reserves to STD ratios in these countries are sub-optimal. The same conclusion is reached for these countries if the severity of the crisis that the reserves are intended to cover is implied from their actual levels.

While this is also true for China if World Bank estimates are used, it is not if Bank of International Settlement (BIS) criteria are used. According to the World Bank, China's reserve holdings are consistent with what would be rational for it to hold against the risk of a mild to strong crisis. On the other hand, BIS criteria suggest that China's actual requirements are significantly less than what it currently holds since its reserve level is consistent with a severe crisis while the probability of any type of crisis, mild or severe, is extremely low. It should be noted, however, that this conclusion is based not on the high cost of carrying reserves but on the low benefits associated with them, given that a crisis is viewed as only a remote possibility in China (Garcia and Soto, 2004).

Rodrik (2006a) agrees that there is convincing evidence that the liquidity provided by foreign exchange reserves reduces the probability of future financial crises and that the high national output cost and social dislocation caused by such crises make such large foreign exchange reserves reasonable despite their high cost. He even acknowledges that large foreign exchange reserves may have the added benefit of reducing a country's external borrowing costs. However, he cautions that only focusing on building large foreign exchange reserves ignores other ways in which liquidity can be increased. Liquidity can also be enhanced through the creation of a collateralized credit facility or by reducing short-term external debt. While developing countries appear to have concentrated on increasing foreign exchange reserves, a more optimal response would have been to increase foreign exchange reserves whilst simultaneously reducing short-term external private sector borrowing and taking concrete steps to build a regional collateralized credit facility.

This is appropriate policy advice if the real social cost of holding large foreign exchange reserves is determined by estimating the spread between the proceeds of investing them in low-yielding US Treasury and other securities and the interest rates charged on short-term external liabilities accumulated by the domestic private sector.<sup>18</sup> While the costs of the latter, unlike the benefits of the former, are difficult to estimate accurately in the absence of clear benchmark interest rates for private sector borrowing, the available data suggests that this spread is at least a few percentage points. As a result, the social costs of excess reserves held as insurance against the costs of financial globalization was estimated at close to 1 per cent of annual GDP for developing countries as a whole.<sup>19</sup> This cost is clearly very large and is equivalent to the World Bank's projected gains for developing countries as a whole from a successful Doha Round of trade negotiations.

Nevertheless, as empirically demonstrated, maintaining such large foreign exchange reserves is economically rational even in the face of such a significant social cost. However, these holdings do imply that financial liberalization has proven extremely expensive for developing countries. This is partly because accumulating excessively large foreign exchange reserves does not appear to be the optimal policy response.

A more optimal policy response would be for developing country central banks and governments to increase liquidity in all the three ways mentioned. For example, in addition to increasing foreign exchange reserve holdings, developing countries should reduce their private, short-term foreign liabilities and create a regional collateralized finance facility such as the Asian Monetary Fund proposed by the Japanese in the immediate aftermath of the 1997 Asian financial crisis.

However, contrary to what may have been expected, short-term debt to GDP ratios increased in emerging market developing countries between 1990 and 2004. Some speculate that these increases can be explained mostly by increases in trade credits due to greater trade openness. Nevertheless, there are no empirical studies to support this claim and the benefits of accumulating such short-term private debt are far from clear since they have, by and large, not led to productive domestic investment. This seems to suggest that accumulating increasing amounts of short-term external private debt may serve the objectives of private national and international financial interests even if they do not serve the national public interest of developing countries. If correct, this is a difficult political economy issue which should be prioritized. It also demonstrates that developing countries as a whole have overly focused on accumulating foreign exchange reserves to the detriment of actively managing their capital accounts. The IMF and other international financial institutions have also neglected this area. They have traditionally neither advocated, nor given priority to capacity building support for capital account management techniques in developing countries (*Ibid.*). It was also only relatively recently that the IMF acknowledged that countries should be cautious about liberalizing their capital accounts prematurely.

The idea of an Asian Monetary Fund was also unfortunately shelved for a number of years after 1997 when it was first aired, because of strong resistance at the international level. Nevertheless, the Asian financial crisis demonstrated that there is no equivalent to national central banks at the international level in times of national crises. This implies that there is no effective international lender of last resort that can provide foreign currency to solvent countries who have temporarily lost liquidity. The IMF is unable to fulfil this

role appropriately both because of its onerous conditionalities and its limited capital (Feldstein, 1999). While the creation of a regional monetary fund in Asia will not address all these problems, it could help fill an important gap at the regional level and mitigate at least some of them. It will be most effective if pursued in conjunction with the other two liquidity enhancing strategies. Its creation should reduce the need for excessive foreign exchange holdings by national central banks. Such a regional monetary facility in Asia is certainly possible, given the level of foreign exchange reserves currently available in the region and strong regional technical capabilities. In 1999, Association of Southeast Asian Nations (ASEAN) plus Three leaders (leaders of ASEAN nations and China, Japan, and the Republic of Korea) agreed to enhance self-help and support mechanisms in East Asia. As a result, finance ministers of ASEAN plus Three reached a historic agreement to establish an Asian Monetary Fund in May 2007. This multilateral currency swap scheme is to materialize by multilateralizing the Chiang Mai Initiative, a network of bilateral currency swaps in the region to supplement the existing international facilities that have been launched and developed since 2000 (Arner, Lejot and Wang 2007).

In summary, most thoughtful analysts believe that it is clearly economically justifiable for countries to build up their foreign exchange reserves in this era of accelerating financial globalization for the reasons discussed in this section. One important remaining policy question, however, is whether the large costs of holding such foreign exchange reserves as self-insurance against financial liberalization are greater than the benefits of such liberalisation. It is reasonable to argue that the opportunity cost which they represent is too high for the majority of developing countries since the empirical evidence suggests that advocates of financial liberalization in the 1990s overstated its gains whilst simultaneously understating many of its costs. Despite this, however, some developing countries may believe that the opportunity cost of holding large foreign exchange reserves are less than the financial, social and political costs associated with IMF lending. Large reserves certainly allow developing countries to become more self-reliant. Nevertheless, the combination of lower foreign exchange reserves, a reduction in short-term private external borrowing and the creation of a regional monetary facility would be a more balanced and less costly policy option. In

the long-run, it will also be more effective in helping Asian developing countries build and sustain the economic self-reliance they desire.

## Monetary Policy

If countries want to pursue a development oriented policy, a key ingredient is the maintenance of a low interest rate regime since high interest rates tend to discourage productive investment. Not surprisingly therefore, developing countries that have chosen to intervene in financial markets have, by and large, attempted to keep interest rates low, in particular for those sectors that have a proven high social rate of return. A long standing policy objective of developing countries has been to ensure that low rates do not affect credit access, or pre-empt savings and their direction to chosen sectors and sections of society. A number of developing countries have, therefore, made quantitative rather than price driven credit allocations a central plank of their development policy. Overall, a managed interest rate structure, and differential interest rates along with pre-emption and direction of credit have been key elements of the preferred monetary policy stance taken by these countries.

It is indeed true that low real interest rates, by reducing the relative cost of capital, can encourage capital-intensive investments which in turn can have adverse employment implications. However, the choice between alternative capital intensities, especially when producing for export, is limited in many sectors. This is because technologies are often accessed from the international shelf which displays a capital intensive bias and because specific (and desired) product characteristics are associated with specific technologies. Furthermore, where choices exist, as in textiles, alternative means can be used to influence a more labour-intensive technology choice.

One of the predictions of the proponents of financial liberalization measures in the 1990s was that such reforms would eventually result in reductions in real interest rates, though they would initially rise to redress the excessively low interest rates that had resulted from the policies of "financial repression". This was argued to be both necessary and welcome because it was expected to lead to more efficient use of borrowed resources and higher rates of domestic saving.

Nevertheless, it was argued that greater access to capital from international markets would bring real interest rates closer to global levels subsequently, resulting in lower real rates of interest for entrepreneurs. This, in turn, would spur investment. Thus financial liberalization was seen as a means of generating both lower real interest rates and higher real investment rates.

These outcomes have clearly not always, or even frequently, been realized in Latin America and elsewhere. In the case of Latin America, investment and savings rates did not increase significantly in the aftermath of financial liberalization nor did real interest rates decline. The Southern Cone experience of the late 1970s and early 1980s suggests that deregulation in those countries did not lead to stable interest rates, that interest rates on the whole remained very high and way above "reasonable estimates of the socially optimal shadow real interest rate." On the contrary, the "... combination of free capital movements, and domestic and external financial systems characterized by moral hazard and other imperfections ... set the stage not only for significant misallocation of credit, but also for macroeconomic instability" (Diaz-Alejandro, 1985).

## Fiscal Policy

The case for prioritizing appropriate public investment in human development, research and development, and infrastructure has already been made earlier in this paper. Public investments of this kind will, however, require a sustainable financing strategy. More specifically, governments will need to secure as much fiscal space as possible.

Most policy research on fiscal reform has thus far focused on the efficiency of public expenditures, effective tax administration, enhancing efficiency in tax collection, and debt management. Nevertheless, the concept of fiscal space has received increased attention in recent years. This stems from the recognition that macroeconomic stabilization objectives were over-emphasized relative to growth and poverty reduction in the 1980s and 1990s. The focus on stabilization not only diverted attention from growth and poverty reduction, but also led to tight fiscal policies that were detrimental to long-term growth, such as restricting the use of public finance for domestic public capital formation in a bid to reduce fiscal deficits.

The recent acknowledgement by the international financial institutions of the need for more fiscal space is welcome. However, their recommended framework for increasing such space is hampered by the continued focus on short-term solvency and stability as binding constraints and a bias towards infrastructure investment. In effect, this implies that incremental public expenditure should only be incurred on projects which demonstrate high economic growth returns. Although this is acknowledged as important, the fact remains that this approach will not address the other public investment needs identified in this paper, especially those related to human development. An additional weakness in this approach to fiscal space is that it is also likely to result in restrictive policy recommendations that emphasize short-term, efficiency enhancing measures whilst neglecting the potential for long-term resource mobilization. Policy advice based on such an approach will, therefore, greatly restrict the options available to policy makers in developing countries.

Debt-financed public investment has, historically, spearheaded resource mobilisation for growth and development in both developing and industrial countries. The 'rules' for fiscal deficits advocated by former British Chancellor (and current Prime Minister) Gordon Brown, for example, allow governments to borrow for critical public investments. Consistent with this objective, Roy and Heuty (2005) define fiscal space as identifying concrete policy actions for enhancing resource mobilization, and the reforms necessary to secure the enabling governance, institutional and economic policy environment for the effectiveness of such policy actions. This definition regards efficiency gains as *necessary but not sufficient* to achieve development policy objectives and proposes a framework for addressing structural bottlenecks to enhance fiscal space.

The approach to fiscal policy which flows from this definition, recently operationalised by UNDP (Roy, Heuty and Letouzé, 2008), emphasises the distributional and developmental aspects of fiscal space, rather than limiting incremental spending to areas that can be financed by efficiency gains. It also requires an assessment of the impact of public expenditure on long-term aggregates and trends. It views short-run deviations from the trend as acceptable as long as these translate into positive outcomes in the long-run. Fiscal policy is seen merely as a means to an end,

rather than an end in itself and a key policy implication is a wider range of fiscal policy options available to developing country policy makers in both the short and long-term. An assessment of such 'fiscal space' should facilitate the development of a menu of policy actions designed to widen it.

UNDP's recent empirical work at the country and regional level has confirmed the relevance of this approach to fiscal space (UNDP 2005e). However it is important to identify and design modes of domestic resource mobilization strategies that are pro-poor in nature. Equity will be central to the design of such strategies. The instruments chosen should, therefore, minimize the net incidence of incremental domestic resource mobilisation on the disposable income of the poor. This will involve designing a progressive tax system but also devising ways to access resources from relatively well-off segments of the population through recourse to non-tax instruments, including public borrowing.

Such an approach to fiscal space, when operationalised, should help secure a significant, sustainable and pro-poor domestic resource base. This can then be complemented by appropriate international resources which would include both concessional transfers and development-enabling public and private resource flows. It is important to note, however, that while such resources can complement domestic resources for development, they can neither substitute nor even serve as the principal source of development assistance in the long-term. This is increasingly being recognized in development circles. For instance, the Zedillo report makes the point that "the domestic economy is virtually always the dominant source of savings and investment" (UN, 2002).

Long-term strategic thinking on fiscal space and domestic resource mobilization possibilities should ideally receive much more emphasis than they command at present. Policy makers need to encourage the mainstreaming of such thinking in documents like Poverty Reduction Strategy Papers (PRSPs), so that important potential sources of development finance are not overlooked by exclusively relying on short-term doctrinal evaluations of a country's domestic fiscal sustainability.

An assessment of current trends suggests that passive liberalisation has exacerbated inequalities and promoted increased divergence rather than convergence between and within economies (Wade, 2004). Where liberalisation has been indiscriminate and unstrategic, it has also made little contribution to economic growth, poverty reduction and human development in the vast majority of developing countries in sub-Saharan Africa, Latin America, parts of Asia and elsewhere. The key to success in the 21<sup>st</sup> century, however, will not lie in a retreat from globalization, but in its successful management. This will require selective and strategic global economic integration which maximizes the opportunities afforded by globalization whilst simultaneously minimizing its risks.

**In this context, the most important lesson for future trade and development policy in the Asia-Pacific region, and in general, is that international trade can facilitate a two-way virtuous relationship between human development and economic growth.** Countries with higher levels of human development indicators are far more likely to benefit from trade liberalization as a policy, and international trade more generally, than countries and individuals with low or even medium human development indicators. Since economic growth is often used as a proxy indicator for mediating the relationship between trade and development, it will be essential to demonstrate and ensure not only that international trade generates broad based economic growth but that there is a strong two-way relationship between economic growth and human development. There is strong evidence that economic growth is not sustainable without improvements in human development, and that if improvements in the latter are postponed, any economic growth achieved will not be sustainable. Both will need to be simultaneously promoted if advances in either are to be sustained (Ranis and Stewart, 2005a; 2005b).

Ensuring broad-based growth that results in human development gains has become increasingly challenging over the last two or three decades. This challenge has assumed greater importance in the current context of accelerating globalization, since efforts to

maximize growth increasingly run the risk of delivering growth that is ruthless (plunder by a few at the expense of the many) and jobless. Such growth can also be rootless (lacking social integration or backward linkages in the domestic economy), voiceless (when a few dominate decision-making and its benefits), and futureless (especially for those who are already poor and marginalized) (Jahan, 2000).

Nevertheless, and in spite of these potential dangers, growth can contribute to poverty reduction and human development at both the household and national levels. First, employment-led, broad-based economic growth raises average household income and consumption. The additional income that accrues as a result can raise the level of human capabilities if it is spent on children's education, improved nutrition and health care and on acquiring or enhancing skills. All the empirical evidence confirms that this is more likely if the additional household income is managed by women (UNDP 1995). Second, growth can increase government spending. Human development will benefit from increased government revenue particularly when this is directed towards reducing income and gender inequality and enhancing education and health care systems at the national level (UNDP, 1996). While economic growth can provide the resources to advance human development objectives, human development on the other hand enhances the capabilities of the economic agents who contribute to economic growth. It is important to emphasize this two-way symbiotic relationship between growth and human development. Balanced strategies, incorporating well-designed, mutually supporting elements of both pro-growth and human development-oriented policies, have the highest chances of success (Ranis and Stewart, 2005a).

However in instances of slow economic growth, and a corresponding reduction in the available amount of public resources, governments committed to enhancing human development levels in their countries may face two options. The choice is often likely to be between channelling scarce resources towards raising people's opportunities and capabilities at the expense of growth or using them to directly raise economic



growth, at least in the short run. Forward-looking governments should choose to do the former in such circumstances, since higher human capabilities will enhance human development and will eventually lead to enhanced levels of economic growth (*ibid.*). It will be equally important to simultaneously tackle the redistribution of physical and other assets such as land.

The 2006 UNDP Asia-Pacific Human Development Report empirically demonstrates that while East Asia “stands out as a successful case of high growth, high trade and high human development,” the South Asian experience illustrates that substantial economic growth can occur with a much lower level of international trade engagement than is commonly assumed. Moreover, while growth may be a prerequisite for poverty reduction, it is not enough (*ibid.*). India’s experience demonstrates how steady advances in human development can help ensure that even modest trade liberalization can lead to a higher trend rate of economic growth. Additionally, its recent experience in the information technology sector, in particular, demonstrates how public investment in a critical human development area (e.g. high tertiary level technical education and skills) can directly translate into high international trade competitiveness, as well as export and overall economic growth.

**A second important message is that a coherent strategy of raising the returns to investment through a range of government policies is a key to success. These strategies should prioritize domestic industrialization but link this effectively to a diversity of high value added manufactured and services exports. The role of public investment in raising the returns to private investment is a vital element of such a strategy, while blanket import trade liberalization, at least until a country has industrialized or a particular industry is reaching maturity, is not.** Overall, developing countries will need a system of cascading tariffs because tariffs should either rise or fall on particular products in line with the country’s stage of development. Moreover, different industries will require different tariff levels, while the tariff requirements of the same industry will vary over time. Prolonged protection can lead to inefficiencies and the inability of an industry to compete internationally. The flip side of the coin, however, is that premature and across-the-board import liberalisation is likely to lead to de-industrialization and undermine

the ability of a country to climb up the technology ladder or add value to its products.

**A third important message that naturally follows the previous one is that both selective and more general government interventions are essential to improve market outcomes.** Indeed, the empirical evidence demonstrating that the most successful Asian countries have relied on both selective government interventions in trade policy, FDI, technology transfer (e.g., through licensing agreements) and domestic resource allocation (see Pack and Westphal, 1986; Amsden, 1989; Wade, 1990; Lall, 1992) in addition to more general government interventions in the areas of health, education, agrarian reform and infrastructure provision, is overwhelming and indisputable.

Moreover, the relevant lessons for future policy, based on the experiences of the most successful Asian economies (including more recent ones such as China, India and Vietnam), appear to contradict conventional wisdom in important ways. They demonstrate at least the following: selective and general government interventions can play vital roles in generating growth fuelled by a dynamic industrial policy which encompasses both manufactures and some services; both types of interventions are important and need to be used in complementary fashion; industrial and technological deepening are directly and positively correlated to selective government interventions; governments are capable of designing and implementing a myriad of complex interventions effectively; and the capabilities of governments to do this can be built over time (Lall, 2004). It is worth emphasizing here that general purpose, non-targeted public investments in health, education and other human resource and infrastructural areas, while necessary, will not be sufficient. Such investments need to be complemented by selective governmental policy interventions to diversify production and livelihoods in a sustainable manner if a high probability of overall success in poverty reduction and desirable human development outcomes is to be achieved.

**As a result, there is a fourth key lesson and important task for both national governments and the international development community. Priority should be placed on equipping states and governments with the required capabilities to make appropriate and effective public investments as well**

**as selective interventions that stimulate a virtuous circle of economic growth, poverty reduction and human development.**

The need for strategic government interventions is also indirectly demonstrated by a comparison of the Asian and Latin American experience. Evidence for this can be found in the largely disappointing growth and development experience of much of Latin America since the 1970s where free market reforms and non-intervention by governments in market outcomes went furthest and were implemented most rapidly. What successful Asian and disappointing Latin American experiences have in common is that they illustrate that while markets are powerful forces and can play useful roles, they are far from perfect.

**A fifth important lesson is that the key to determining success or failure is not whether governments intervene but how they intervene** (*Ibid.*; Rodrik, 2004).

Success will be predicated on the simultaneous presence of a critical mass of the following attributes even in the absence of determined and visionary government leadership: selectivity in choosing activities with significant technological value-added and linkages in the economy rather than indiscriminate blanket choice; a 'carrot' approach to providing incentives whilst simultaneously using exports as a disciplining 'stick' in addition to domestic accountability measures; ensuring policy coherence through centralized strategic decision-making with an economy-wide perspective; ensuring policy flexibility and learning; a high quality government bureaucracy which progressively becomes more effective in managing such interventions; ensuring regular engagement with, but autonomy from, a vibrant indigenous private sector; partnerships between the public sector and an indigenous private sector which is established by using the public sector to fill important gaps caused by market failure or high risks; investing heavily in institution building, skill creation, infrastructure development and coordination between key actors; addressing information externalities; and attracting FDI selectively but governing it effectively.

While this is clearly a demanding list of attributes, the successful fulfilment of many (even if not all) of them by a number of Asian countries, both large and small, in the past and at present, amply demonstrates that many governments can make appropriate policy interventions with positive effect. Asia's many success

stories contrast with Latin America's disappointment with free market reforms. There is a widespread view in that region, captured in a UNDP report (2004a) and elsewhere that such reform in Latin America delivered less than what was promised and resulted in far less than what was accomplished during the earlier more interventionist, higher growth period of more active industrial policy. Latin America's experience demonstrates that it is very difficult, if not impossible, for countries to sustain growth and translate this into equitable poverty reduction and human development gains without a strong, forward-looking and agile developmental state which actively pursues public investment and selective interventions in a strategic manner.

**A sixth key message is that there is a vital link between a country's macroeconomic policies and its trade competitiveness. This relationship needs to be properly understood and addressed.**

Empirical evidence suggests that management of the exchange rate is far more important than using devaluation as an instrument of trade and competitiveness policy or appreciation as an instrument to deal with reserve accumulation resulting from capital flows or export success. A key policy lesson is that governments should maintain the basic stability of the exchange rate. This is equally valid for the current period, when the large foreign exchange reserves of many Asian countries have led to pressures and calls for an upward revaluation of their exchange rates. Even if some changes to exchange rate policy are seen as necessary, such changes must be carefully managed by central banks to avoid volatility.

These six messages remain as relevant and important in the current context of accelerating globalization as they were to the post World War II success of Japan, the Asian "tigers," and China. They are also consistent with India's experience and that of other successful economies including many of the now economically advanced OECD countries during the 18<sup>th</sup>, 19<sup>th</sup> and first half of the 20<sup>th</sup> century when they were in their early stages of development. It is true that the type of interventions needed may not be exactly the same because the accelerating globalization of the late 20<sup>th</sup> and early 21<sup>st</sup> century has reduced the need, relevance or viability of some strategies while increasing those of others. Nevertheless, the essential ingredients of success have not altered much.

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## Endnotes

- 1 *Ibid* based on data in UNDP HDR 1991 and 1996
- 2 It is also worth noting that the ratio of the Republic of Korea's R&D to its GDP in 2007 was 3.2 per cent, which is considerably higher than most OECD countries whose average R&D to GDP expenditure ratio was 2.2 per cent in 2007.
- 3 Center for Global Development, 2005. The 1996 report of the WHO Ad Hoc Committee on Health Research also concluded that the central problem in health research was what has now become widely recognized and quoted as the "10/90 gap" (less than 10 per cent of global spending on health research being applied to 90 per cent of the world's health problems). The expression continues to serve as a symbol of imbalance in the allocation of global health research resources.
- 4 Between 2002 and 2005, total aid-for-trade commitments from bilateral and multilateral donors rose by 22 per cent in real terms, from USD 17.8 billion to USD 21.7 billion (OECD and WTO, 2007).
- 5 Through, for example, clustering in existing sectors which already demonstrate comparative advantage (see Rodríguez-Clare, 2005).
- 6 He acknowledges, however, that this does not often happen in the real world. An example of continuing protection of an industry which should have been phased out a long time ago is the textile and clothing industry in the USA.
- 7 The case of Japan displays some similarities with Germany, where the government encouraged rather than opposed cartels in many instances.
- 8 The importance of exports in the world economy has continued to grow. Their value has more than doubled in the past ten years (\$5.3 trillion in 1997 and an estimated \$11.8 trillion in 2006), since they have been growing faster than production. Their share in GDP has also increased – global exports now account for nearly a quarter of world GDP. For sub-Saharan Africa, exports now comprise one-third of GDP (WTO 2007; UNDP 2005b, page 114).
- 9 One core theoretical criticism is that the export-led growth model suffers from a *fallacy of composition* whereby it assumes that all countries can grow by relying on the growth of demand for the same product in other countries. Industrial country markets for developing country exports are limited. In such a demand-constrained world, there is a serious danger of a beggar-thy-neighbor outcome in which each developing country simply rivals another to displace its exports from developed country markets, making it impossible for all developing countries to reap the benefits of export-led and dependent growth (Palley, 2003, page 2; UNCTAD 2002b).
- 10 In 2005, this varied from 46 per cent in Laos to just 4 per cent in the Republic of Korea. In 2005, agriculture accounted for 56 per cent of GDP in Myanmar, 45 per cent in Bhutan and 40 per cent in Afghanistan. Similarly, the share of agricultural employment in total employment in 2005 varied from close to 60 per cent in Vietnam and 67 per cent India to less than 1 per cent in Hong Kong (SAR), China, Macau (SAR), China, and Singapore (FAO, 2007; UNDP, 2007).
- 11 The Asia-Pacific region is home to 65 per cent of the world's food insecure, and 53 per cent of the world's 1.2 billion absolute poor who subsist on less than \$1 per day (UNDP, 2006).
- 12 This is manifested not only in high agricultural tariff peaks and escalation, and production and trade distorting export and domestic subsidies in developed countries, but also increasingly in their recourse to technical and non-tariff barriers to trade, such as sanitary and phyto-sanitary measures, which work against developing country exports.
- 13 For more details on the content and assessment of bilateral and regional agreements on the movement of natural persons see UNDP 2008.
- 14 Combined with reduced state participation and regulation of health services, intellectual property protection has been known to lead to high prices, restricted access to medicines and the demise of domestic pharmaceutical production in de-



veloping countries. Moreover, because of heavy reliance on reverse engineering which patent protection agreements no longer permit, domestic manufacturing of pharmaceutical products in developing countries could come to a halt. (UNDP, 2005d, page 80).

- 15 Since the so-called first debt crisis which broke in Latin America, specifically Mexico in 1982, there have been increasingly frequent crises in emerging markets, attributed by many to accelerating financial globalization which particularly took root in 1990. The list of such crisis is long and includes Mexico again (1995), East Asia (1997), Russia (1998), Brazil (1999), Turkey (1994 and 2001) and most recently, Argentina (2002) (*Ibid.*).
- 16 Over the past ten years, sub-Saharan Africa's international reserves have grown fivefold, from \$21 billion in 1996 to \$108 billion in 2006, equivalent to about 6 months of imports (IMF, 2008b).
- 17 Mild (currency crisis) with a cost of 5 per cent of GDP, moderate (currency crash) with a cost of 10 per cent of GDP and severe (banking crisis) with a cost of 15 per cent of GDP. These estimates are based on empirical IMF data which has estimates of 7.6 per cent, 10.7 per cent and 14 per cent of GDP, respectively, for these three scenarios.
- 18 *Ibid.* Excess reserves exclude reserve holdings necessary to ensure 3 months import requirements. Social cost calculated in this manner is different from more conventional estimates of the fiscal cost of holding reserves which are not relevant from a national standpoint or the social opportunity cost of public capital (which will need to be calculated if the reserves were to be used for domestic investment) which Rodrik argues is a concept which is hard to operationalize. He believes, in any case, that short-term external borrowing by the private sector reflects a more accurate measure of opportunity cost for excess foreign exchange holdings. The spread between the cost of such borrowing and the rate of return on excess foreign exchange holdings invested in US Treasury and other securities was estimated at 5 percentage points for the purposes of this calculation.
- 19 *Ibid*





**Trade and Health in Asia:**  
*Challenges of Globalization*

*Chantal Blouin*



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Despite the reforms adopted in recent decades, health systems in Asia continue to face formidable challenges (WHO, 2003). Financing health systems remains a key issue, both in terms of the quantity of resources available for health care and promotion as well as the equity of financing arrangements. In the poorest countries, the level of public health funding is low in absolute terms and health infrastructure is generally weak. For instance, although the Cambodian government allocates a proportion of its budget to health that is on par with that of Australia and Canada (16 per cent), this represents only 7 dollars per person for public expenditures on health in Cambodia, (for a total of 7 dollars per person of health spending), a very low level of funding if one considers that the WHO Commission on Macroeconomics and Health evaluated that 34 dollars per person would be necessary to scale-up health services in low-income countries sufficiently to achieve the MDGs. The problems of insufficient funding for health services is common to many countries in the region, but is most critical in Bangladesh, Cambodia, Nepal, Lao, Myanmar and India (Table 1).

In higher income countries, although there is greater overall availability of financial resources, health financing arrangements are often inequitable. Indeed, a large proportion of health expenditures in Asia are financed by out-of-pocket payments by the patients, which is the most inequitable mechanism of financing (WHO, 2003). Out-of-pocket payment for health services is one of the leading factors that drag poor households down into greater poverty (Wagstaff *et al.* 2001). Private expenditure dominates health spending in most Asian countries with out-of-pocket payments accounting for as much as 80-100 per cent of these costs (Table 1). In China, out-of-pocket payments rose from 37 per cent of total health expenditure in 1990 to more than 60 per cent in 2001 (Shi, 2003). By contrast, private pre-paid plans, such as health insurance, remain limited in the region.

In some Asian countries, the shortage of health personnel is the key obstacle that needs to be overcome. Bhutan, Nepal, Cambodia, Indonesia and Bangladesh need more physicians and/or nurses to provide health services to their population (Table 2). On the other hand, some countries like the Philippines have trained

large numbers of health professionals, in particular nurses. This has ironically further exacerbated the shortage as it has led to a growing trend in outward-migration by Filipino nurses to other countries.

Finally, a major challenge facing health systems in the region is the inequitable access to care. The poorest countries are again at a distinct disadvantage, with very limited access to health services for a significant part of the population. If the percentage of births that occur in a health facility is taken as a proxy for access to health services, it is observed that the majority of least developed countries (LDCs) in the region have a low level of access. This clearly will have consequences on the achievement of the Millennium Development Goal regarding improvements in maternal health (Table 3). Access is even more limited among the poorest citizens of poor countries (Anwar *et al.*, 2004). In those countries where general access is better, some groups or regions of the country may be excluded from the provision of health services. Typically, patients in urban areas have much better access to services than in rural areas. For instance, in the Philippines' urban areas, more than 78 per cent of births are assisted by a medically trained person compared to just 28 per cent in rural areas (Gwatkin *et al.*, 2005).

Would the problems faced by Asian health systems be alleviated by trade in health-related services? Can the liberalisation of trade in this sector partially remedy the issue of inequality in financing and access to services, as well as the shortages in health human resources? These are the key questions examined and discussed in this paper.

For example, foreign investors are more likely to channel new resources into services that benefit higher-income groups, rather than the poorest citizens. However, it is worth highlighting that foreign investment can help decrease the general reliance on out-of-pocket expenditures through private health insurance schemes. It still remains unclear as to whether foreign investment will help narrow the gap in terms of access between the urban and rural areas. Another issue that needs to be examined is the impact of trade in health services on the availability of health personnel. The promotion of health tourism in the region poses the real risk of exacerbating the shortage of physicians and nurses in some countries.

Several countries in the region have, in recent decades, witnessed an increase in private sector participation in the financing and delivery of health services (UNDP, 2003; World Bank, 2002). Private expenditure accounts for the bulk of health expenditure in most Asia-Pacific countries with the public expenditure-GDP ratio remaining very low (World Bank, 2002, page 31). The growing trend towards private provision is reflected in the number of private providers. A majority (60 per cent) of physicians in Asia are in the private sector (Hanson and Berman, 1998), and there

related services can be identified, based on the General Agreement on Trade and Services (GATS) classification.

With the growth of information and communication technology, the cross-border supply (Mode 1, Figure 1) of health services has become increasingly feasible and convenient. For instance, telemedicine services, such as diagnostic or advisory services, can be offered by using communication networks that does not require either the physical movement of the patients

### Box 1: Trade in Health Services: The Four Modes of Supply

#### Mode 1: Cross-border

A user in country 'A' receives medical advice, diagnostic health information or distance training from abroad through the telecommunications infrastructure.

#### Mode 2: Consumption abroad

Nationals of 'A' move abroad as tourists or patients to consume health services.

#### Mode 3: Commercial presence

Health service is provided by a clinics or hospitals affiliated to or subsidiary of a foreign-owned and controlled company.

#### Mode 4: Movement of natural persons

A foreign national provides a service within 'A' as an independent supplier (e.g. consultant, health worker) or employee of a service supplier (e.g. consultancy firm, hospital).

is a high level of utilization of services by these private providers (Berman and Rose, 1996; Thi Hong Ha *et al.* 2002). The growth in private sector participation in health can be linked to the rise in foreign private investment, which has come to play an active role in the region's national health system.

Available information demonstrates that trade in health services assumes many forms (Table 1). However, evidence on the level of foreign participation and investment in the health sector is still partial and limited. Four broad categories of trade in health re-

or the provider. Currently, some of the principal areas of application are e-education in health, databases of medical literature and health information websites for physicians and the general public (Singh *et al.*, 2002). However, the electronic supply of health-related services is still in its infancy in developing countries. Exceptions are medical transcription, medical insurance and claim processing, and back-office services which are becoming an increasing large export industry in India and the Philippines (Singh, 2003; Singh *et al.*, 2002)<sup>1</sup>.

<sup>1</sup> Under the GATS, health education and health data processing and storage services are not classified under health services, but respectively under education and computer-related services.

The second form of supply (Mode 2, Box 1) is through the physical movement of consumers of health services to the country of the supplier. Mode 2 includes the following: consumers who travel abroad to receive medical care, tourists who incidentally need medical care while abroad, retirees abroad, temporary workers, cross-border commuters who may have multinational coverage options, and residents of multi-national areas with integrated health systems (Warner, 2003). The focus here is on consumers who travel to developing countries expressly to receive care, which is generally termed as health tourism. It is estimated that this segment represents 1.3 per cent of total travel expenditures, and is equivalent to an estimated \$6.5 billion per annum (Karsenty, 2002).

Trade in health services in developing countries can also take the form of inflows of foreign investment through the establishment of a commercial presence (Mode 3, Box 1). Such investments can occur in hospital and management services, or health insurance. Again, there is still limited information on the volume of investment in this sector. Although existing evidence indicates that the level of foreign participation is relatively low, it is prevalent in an increasing number of countries. In Thailand, 24 of the 302 private hospitals have received some foreign investment, primarily

from investors in countries such as Japan, Singapore, China and Europe (Buddhasri *et al.*, 2003).

Finally, exports of health services can also occur by the temporary movement of health professionals (Mode 4, Box 1) such as doctors and nurses. The UK, the United States, Australia, Canada, Norway and Middle-East countries are the main recipients of these services. The Philippines, Bangladesh and India are leading 'exporters' of health professionals. In the Philippines, one indicator of the scale of the movement of nurses is the large number of nurses that graduate, but do not register with the national professional association. For example, over 30,000 nurses that graduated in 2000 did not register (Blouin *et al.*, 2006). It must be emphasised that a significant proportion of the cross-border movement of health professionals consists of permanent migration which is not included in trade in health services. This trend has given rise to concerns that the growth of trade through Mode 4 may exacerbate the current outflows of health professionals from developing countries which are currently facing shortages of such personnel. The following sections focus on the human development impact of growing trade in health services through commercial presence and health tourism.



## 3

## Foreign Investment in Health Services: New Resources for Health vs. Equity Concerns

The establishment of foreign providers and insurers in developing countries potentially presents a number of possible positive and negative consequences for the national health system and human development. However, given that foreign investment and private provision in health services are still relatively new phenomena, knowledge on their actual impact is limited. Nevertheless, what empirical literature exists can shed some light on the potential impact of expanding the role of foreign providers. It is worth noting that domestic and foreign private investment on the national health system may produce different impacts. For example, a foreign hospital management firm may bring new management techniques that are not domestically available. However, given the limited evidence available, literature on the impact of privatisation will be relied on as a proxy for assessing the impact of trade in health services through Mode 3.

One positive outcome of the inflow of foreign capital is that it provides additional resources to invest in the health care infrastructure and services of the country. However, the principal beneficiaries of liberalisation are usually those households that can afford to pay for the services offered by foreign suppliers. These could take the form of new services that were not previously offered by the domestic providers. For instance, experiences of liberalisation in the provision of health services in Chile led to rapid growth in the supply of new high-technology services (Léon, 2003).

The inflow of foreign capital into certain parts of the health system could also contribute towards reducing the burden on government resources, thereby allowing the public sector to re-allocate its resources towards those patients who have less ability to pay. In other words, when higher income individuals receive care from a foreign-owned private hospital, the public sector does not have to provide services to them. Additionally, if these individuals buy their health insurance from a foreign insurance company, the state would not have to cover the health expenses borne by

these individuals. Thus, newly freed resources can be channelled towards other patients.

Therefore, the resources brought by foreign investors may not only benefit richer citizens of a country. For example, in South Africa, a chain of private clinics catering to the employed but low-income segment of the population is viewed as having the potential to allow the public sector to concentrate its provision of services on the poorest groups (Palmer *et al.*, 2003). In Vietnam, since the legalisation in 1989 of the private provision of health services, the private sector has become the leading provider of health services, encompassing all income groups in both urban and rural areas (Thi Hong Ha *et al.*, 2002).

At the other end of the spectrum however, evidence from foreign-owned hospitals in China suggests that most of these hospitals are established in urban coastal areas and not in the rural areas where the additional resources would be most needed (Shi, 2003). In South Africa, private clinics only offer a limited range of services (i.e., no emergency services), along with weak preventive care and chronic care services, raising doubts about their capacity to remove a burden from the public sector (Palmer *et al.*, 2003).

Another element to bear in mind when considering the liberalisation of the health sector is to assess the likely impact on political decision making in the field of health. For instance, in countries that possess relatively well-developed public sectors offering broad access to health services, such reforms can break or weaken political coalitions that support the public system. When politically powerful groups benefit from a universal social programme, they will see it in their interest to defend the quality and the funding of the programme. The poor and other groups with low political power will benefit, from the interventions of the richer and more powerful. When powerful groups opt out of the public system, the political support to improve coverage and quality is diminished. The im-

## Box 2: Foreign Private Investment and Export Capacity in Health in Low-Income Countries

The prospects for foreign investment in the health sector of least-developed countries presents analysts and policy makers with a paradox: although these countries are the ones that most need additional capital and resources, they are the least likely to receive it. Indeed, LDCs are faced with acute needs for investment in health (Commission on Macroeconomic and Health, 2001). However, there is little likelihood that foreign investors will establish a commercial presence in the health sector of these countries. Foreign investors are attracted by social and political stability, ready markets, high rates of return, inexpensive and skilled labour, cheap local inputs and adequate infrastructure (Schmidt and Culpeper, 2003). Therefore, in general, foreign investment disproportionately goes to higher income developing countries. That is because those countries tend to have bigger domestic markets, an educated labour force and better infrastructure.

Nevertheless, there are cases of LDCs such as Angola, Lesotho, Mozambique and Cambodia where FDI flows (relative to GNP) are fairly high. There is also growing incidence of trade in health services in LDCs, such as foreign-owned clinics opening in Vietnam (Vietnam Investment Review, 2002). However, national governments in these countries have to examine whether they have the regulatory capacity to ensure that trade in health services translates into benefits for the national health system as a whole and is not restricted to a small segment of the population.

The export capacity of LDCs in the field of health services is extremely limited, given their constraints in infrastructure and human resources. When there is a low supply of health professionals (e.g. less than 25 physicians per 100,000 people in Bangladesh, Nepal, Cambodia), it is difficult to see how offering services to foreign patients would be possible, without further reducing access to services for the local patients.

pact of allowing foreign providers of health services and insurance can be the weakening of the political configuration in support of the public health system.

On the other hand, in many developing countries, the existing public health system does not offer equal access and services to all citizens. Often, public spending on health concentrates on the richer sections of the population (World Bank, 2003). For instance, the poorest fifth of the population in India received 10 per cent of public spending on health whereas the richest fifth received 32 per cent during 1995-96 (Filmer, 2003). Under these circumstances, national policymakers need to examine if opening the sector to foreign providers will create an opportunity to rebalance the system, by reducing public health spending on richer groups who can afford the services of the foreign providers and insurers, and by increasing the resources and services offered to the poorest groups.

One of the key issues regarding the privatisation of

health services (including privatisation through the inflows of foreign investment) is the aspect of equity in access to services. The principal concern is that high-quality services offered by foreign-owned establishments would be available only to certain groups. Those would include patients with private or social insurance covering the expenses incurred, or the high-income patients able to disburse a large out-of-pocket payment.

There is a strong consensus among research analysts that user fees for health services result in reduced access to health services among poor people. In virtually all cases, the increase or introduction of user fees was accompanied by a concomitant decrease in service utilisation. The magnitude of the drop in utilisation was more pronounced and of a longer duration, for the poor sections of the population (Bennett and Gilson, 2001, page 11). Numerous case studies and comparative studies document this impact; in some cases the reduction in utilization reached as much as 50

per cent (Yoder, 1989; Creese, 1991; Moses *et al.* 1992; McPake, Hanson and Mills, 1993; Mwabu *et al.*, 1995; Haddad and Fournier, 1995; Creese and Kutzin, 1995; Gertler and Hammer, 1997; Kipp *et al.* 2001; Meuwissen, 2002; Nanda, 2002; Paphassarang *et al.*, 2002; Ridde, 2003). The impact of user fees on the utilisation of services has also led to negative health outcomes. In China, the introduction of user fees has been made for preventive services such as immunizations and treatment of infectious diseases. This resulted in less immunization and higher prevalence rates of diseases such as measles and polio (Liu and Mills, 2002).

In principle, such inequitable outcomes can be addressed by regulatory measures. However, the measures used to address this problem have proven difficult to implement. The literature on the introduction of user fees shows that in most cases, exemptions from fees were in principle available to the poor, but in reality the implementation of these exemptions was ineffective (Gilson *et al.*, 2001; Gilson, 1997; Gilson and Mills, 1995; Mills, 1998; Meuwissen, 2002). Nevertheless, the experience of Cambodia, which had an earmarked fund entrusted to an independent third-party, clearly illustrates that institutional solutions to the problem of access for the poor caused by cost-recovery can be found (Hardeman *et al.*, 2004).

Trade in health services can also take the form of foreign investment in health insurance. Expansion of private health insurance via the channel of foreign investment is one available option to reduce the heavy reliance on out-of-pocket payments, which is probably the most acute problem afflicting health systems in the region (WHO, 2000). Health insurance also allows for pooling or spreading financial risks among participants. Private health insurance funds are still rare in Asia, and judging from the experiences in other regions, it seems unlikely that its expansion will have a significant impact on human development in Asia. The World Bank reports, "Because of the cost and pronounced market failure that occurs in private health insurance, this is not a viable option for risk pooling at the national level in low-and middle income countries" (World Bank, 2002, page 8).

The evidence from Latin America shows that private insurers (foreign or domestic) will tend to serve only the higher income and low risk groups which can afford to make relatively high financial contributions to

receive coverage (Baeza and Cabezas, 1999; Barrientos and Lloyd-Sherlock, 2000). This is illustrated by the experience of Chile, where elderly people and women of fertile age face much higher premiums (Sanhueza and Ruiz-Tagle, 2002). "By charging a premium contingent on age and gender, as families become older, and there are more female members in fertile age, the cost of the insurance rise, and low income people get excluded from the private health insurance system" (Ibid, page 178). In countries like Chile, the negative impact on women is mitigated by the fact that the public insurance system is available and affordable to low income women.

Regulation can be introduced to curtail behaviour such as selection biases by insurers. However, the expansion of private health insurance through foreign involvement also poses an additional risk of fragmenting the pool. A limited number of large pools or a single pool are better than small pools as they allow for a greater spread of risks and can benefit from economies of scale with regard to administration. However, the World Health Organisation reports the following:

*Health system policy with regard to pooling needs to focus on creating conditions for the development of the largest possible pooling arrangements. When a particular country lacks the organizational and institutional capacity to have a single pool or large pools for all citizens, ... policymakers should promote pooling arrangements whenever possible, as a **transitional** stage towards the future aggregation of pools. Even small pools or pools for segments of the populations are better than pure out-of-pocket financing for all (WHO, 2000, page 103, emphasis added)*

Adopting this pragmatic approach, policymakers have to consider whether private insurers (foreign or domestic) or community based pooling organizations are the most likely to support such transition.

Another aspect that policymakers need to consider when contemplating trade liberalisation in health services is whether they are in a position to harness the potential of foreign investment to achieve the MDGs in health. They need to assess whether they have the capacity to put in place regulatory and finan-

cial mechanisms to ensure that foreign-owned clinics and hospitals provide maternal and child health care to poor patients. They also need to consider what policies should be adopted to ensure that these providers are full partners in the fight against HIV-AIDS, malaria and tuberculosis. The government has to determine whether it can adopt measures to prevent pool fragmentation and risk selection as a result of the opening of the health insurance market to foreign investors. Finally, governments must also attempt to leverage foreign investment in health insurance as a means to affect a transition from out-of-pocket payments toward more equitable financing for health care. There

is however no universal solution for these issues, as there are large variations in the problems facing nations in the region, and their capacity to implement mitigation measures.

In conclusion, foreign investment in health services has the potential to increase the financial resources available to health systems, one of the key challenges we noted in the introduction. However, it is unlikely to address the problem of inequitable access in health care without complementary government action to ensure that public resources are diverted to the least well off.

### **Box 3: Trade in Health Services in China: Foreign Hospitals and Clinics**

Between 1989 and 2000, China adopted several policies and regulations to facilitate foreign investment and trade in health services through joint ventures. In 2003, the Ministry of Health conducted a national survey on health trade and investment in China. Of the 46 Sino-foreign health facilities surveyed, 57 per cent were specialized hospitals or clinics, such as ophthalmology hospitals, reproductive health centres, tumour hospitals, and dental clinics. The total foreign investment was relatively small: for 41 per cent of the surveyed health facilities, the foreign investment component stood at less than \$600,000. A mere six establishments received investments above \$12 million. The joint ventures were basically between Chinese public hospitals and private investors from the United States or Hong Kong (SAR), China.

The survey revealed an extremely skewed regional distribution of these Sino-foreign health facilities. The vast majority (78 per cent) of these health facilities were located in large cities in the coastal areas rather than the Central and Western Provinces where the health infrastructure, manpower and the technical capacity were insufficient to meet the health needs of the population.

Nevertheless, despite their small scale, a positive outcome from these joint venture establishments was the introduction of new concepts of health management and services, advanced medical technology and an enabling hospital environment. Their presence also led to competitive pressures on the public hospitals. Although these establishments mainly catered to foreigners working in China or other high income groups, a few of them also provided essential healthcare services to the community. They provided basic health services to the ordinary population, by using innovative strategies to attract patients. For instance, the service charges were set in line with the market environment, taking into account the level of user fees charged by the public hospitals. A large number of public hospitals learnt valuable lessons from the Sino-foreign Joint-venture hospitals. The net result was an improvement (through imitation and learning) in the quality and management of health services.

*Source: Shi, 2003.*

## 4 Health Tourism: Can it Improve Access to Health Care in Asia?

Every year, millions of patients travel overseas to receive medical care. What is now termed as 'health tourism' encompasses the provision of a wide spectrum of services ranging from health check-ups, hip replacement, cardiac or eye surgery, to maternal deliveries. This trade has been hailed as one service sector in which developing countries have considerable export potential. The comparative advantage of these countries derives from a combination of lower costs and availability of qualified personnel, and in some cases, a naturally conducive environment for convalescence. Singapore, India, Thailand and Malaysia have been the frontrunners of this emerging and expanding industry in Asia.

In 2000, an estimated 150,000 foreign patients travelled to Singapore for health care and spent approximately \$345 million. In 2003, the government adopted a strategy to further develop this sector, targeting revenues of \$3 billion in foreign patient expenditures by 2012. This is estimated at being roughly equivalent to more than 1 per cent of the GDP and is expected to generate an additional 13,000 jobs, primarily in nursing and paramedical employment. Singapore's private hospitals offer a broad range of specialties, with a large number of visitors travelling specifically to receive care in cardiology, oncology, urology and obstetrics (HSWG, 2003a).

In Malaysia, although health tourism is still in an early stage of development, the government has initiated several measures to promote this new sector. These include tax incentives for hospitals that upgrade their equipment, the creation of a National Committee to promote health tourism through trade missions and the relaxation of advertisement rules (Medical Tribune, 2002). Based on the information provided by seven of the 33 private hospitals catering to foreign patients in Malaysia, more than 72,000 foreign patients received treatment in 2001 (Jui Meng, 2002). In India, it is estimated that 150,000 foreign patients visit annually to receive medical care, and that number is growing at the rate of 15 per cent a year (Lancaster, 2004). Cardiac surgery, knee/hip replacement and dentistry have been the main areas of focus, although the use of ay-

urveda and spa resorts is also rapidly gaining ground in the industry (Financial Express, 2005).

In Thailand, the government has been actively promoting the export of health services by embarking on a campaign aimed at encouraging foreigners to receive treatment and services in Thailand. In 2001, the Department of Export Promotion, Ministry of Commerce conducted a survey of 20 private hospitals, which catered largely to foreign patients. The seven hospitals which responded received 470,000 foreign patients, mainly from Japan, US, Taiwan, UK and Australia, although numbers coming from the Middle-East and other Asian countries are also climbing (Pachanee and Wibulpolprasert, 2003). By 2004, this number had reached 1.1 million foreign patients. About 60 per cent of them are expatriates working in Thailand, or neighbouring countries where health services are inadequate (Pachanee and Wibulpolprasert, 2007).

In order to further promote this sector and improve quality, Thailand created the Institute of Hospital Quality Improvement & Accreditation (HA-Thailand). To date, there are 50 hospitals accredited nationwide, of which 10 are private hospitals. In addition, the government also promotes other health-related services such as health spas, long stay and Thai traditional medicine (including Thai traditional massage). For health spas, the government and Spa Association jointly provide accreditation to the spa facilities that meet the requisite standards to ensure an acceptable quality of services. The Thai Long Stay Management Corporation was established to promote long stay programmes in 2002. Foreigners, in particular the elderly, are encouraged to visit Thailand and stay for a longer period, participating in several activities, including medical examination, sports and recreation, and cooking classes. An additional strategy to promote health tourism took place during trade negotiations, where Thailand requested Japan to widen health insurance coverage for Japanese patients to include treatment in Thailand (Arunanondchai and Fink, 2007).

There are several positive benefits arising from the growth in health tourism. Exports of health services

can become an important source of foreign currency for developing countries. It is not only a source of employment and income for health workers but also for workers in the tourism sector: people travelling to receive health services are also likely to consume tourism-related services such as hotels, transport, and restaurants. The additional incomes thus generated can contribute to economic growth and poverty reduction. According to estimates, medical tourism is likely to generate an additional \$1.1-2.2 billion in annual revenue to India by 2012 (The Economist, 2004). Singapore hopes to generate \$3 billion a year in additional revenue by the same year. These additional incomes can also have a more direct impact on health, particularly if they are harnessed to benefit the health system of the country and the poor. For instance, they can be taxed and allocated to improve the supply and quality of health services in the public sector.

Another potential benefit of health tourism is to widen the range and improve the quality of services offered in a country. Indeed, in order to attract foreign patients, developing countries have to offer quality services which often involve an upgrading of human and physical resources (Adams and Kinnon, 1998, page 42). If these service providers and facilities are available to local patients as well as foreign patients, an overall improvement in the quality of care in the country can be achieved. Additionally, the creation of centres of medical excellence to attract foreign patients could also help stymie the 'brain drain' of qualified medical personnel from developing countries, who often migrate overseas in search of better wages.

However, the growth of health tourism also raises concerns about its impact on the overall health system of the recipient countries. A leading concern is that it can create a dual market structure within the health care system: one higher quality, expensive segment catering to wealthy nationals and foreigners, and a lower quality segment with limited resources offering services to the rest of the population (Chanda, 2001). For instance, the growth of health tourism in Singapore may widen the existing disparity in the distribution of medical personnel and expertise between the public and the private sectors. About 48 per cent of the physicians work in the public sector, caring for almost 80 per cent of all in-patients. By comparison, the private sector admits almost four times fewer in-patients but has more doctors (HSWP, 2003b). Singapore's expert

group focused on the problems linked to the dual structure recommended a possible solution. That is to facilitate the use of the private hospitals by nationals by making the Government's healthcare subsidy portable, to be used in the hospital of the patient's choice.

The most pressing concern regarding the impact of health tourism centres on *internal* 'brain drain'. Physicians and nurses from the public sector or those offering services in rural areas, move to the urban facilities to take care of wealthy, usually foreign, patients. The case of Thailand provides a clear example of this problem. The resources required to service one foreign patient are approximately equal to what is used to service 4-5 Thai patients. Thus, the workload is equivalent to 3-4 million Thai patients or around 3 per cent of the total systems workload in 2001. If the growth trend continues at the current rate, the workload for servicing foreign patients could rise to as much as 12 per cent of the total workload in 5 years. This will require an additional 3,000 full-time equivalent doctors to service urban private hospitals, further exacerbating the shortage of health professionals in rural areas (Pachanee and Wibulpolprasert, 2003).

There are also concerns that the current drive towards making Singapore the regional hub for medical tourism may lead to a severe shortage of physicians. Indeed, expert groups have projected that there could be a shortage based on domestic needs alone (HSWG, 2003b). In addition to these shortages, the rapid growth in health tourism is likely to result in human resource allocation constraints within the public healthcare system. The Health Summit Working Group reports the following:

*A booming private sector may recruit trained specialists too aggressively from the public sector and further drive up public healthcare expenditures as the public sector strives to match private sector salaries, to retain these specialists. This would put pressure on the policy objective to contain the Government's healthcare expenditure at 1 per cent of GDP (HSWG, 2003b, page 8)*

One proposal to stymie the flow of professionals from the public sector is to permit physicians to work part-time in the private sector, thereby reducing the incen-

tive for these professionals to completely abandon their jobs in the public sector.

In conclusion, there is limited evidence to demonstrate how the additional income and resources from health tourism have been leveraged to improve the overall national health system and achieve develop-

ment objectives in health. Therefore, for now, we cannot claim that health tourism has improved access to health care services for most people in Asia and therefore, addressed one of the challenge facing most of the countries in the region. In the other hand, it is clear that providing health services to foreign patients has constrained the availability of health personnel.

The promotion of health tourism and the participation of private foreign providers and investors in national health systems is an issue that needs careful and in-depth consideration by national governments. Another related, but distinct, question is the impact of subscribing to binding health policy reforms in trade agreements such as the GATS. The GATS has been at the centre of much controversy, as it is perceived by several civil society organizations as undermining the quality of public services.

The current level of commitments at the GATS on health-related services is relatively low, compared to other sectors (Adlung and Carzaniga, 2006). In Asia, only twelve countries made commitments regarding health-related services (Table 4). This group includes high-income countries like Australia, Japan, and Singapore as well as low-income countries such as Cambodia and Nepal. The sectoral commitments are confined mainly to hospital and professional services, provided by physicians and dentists. Each commitment is limited and determined according to the modes of supply and by conditions attached to market access and national treatment commitments. For instance, India's market access commitment pertaining to hospital services is limited by a foreign equity ceiling of 51 per cent. In Cambodia, the commitment regarding medical and dental professional services is limited to specialized services provided through mode 3 and through joint ventures with Cambodian juridical persons. The government did not make commitments pertaining to cross-border supply, such as tele-medicine. In China, the commitment to medical services also included a requirement for joint ventures to provide services with an addendum that "the majority medical personnel of the joint venture hospital and clinics shall be of Chinese nationality". China also made a commitment for supply through the movement of foreign doctors (Mode 4), once they obtain a license from the Ministry of Public Health. A number of countries in the region (Indonesia, Korea, the Philip-

pinas, Sri Lanka, and Thailand) however refrained from making any commitments in these sectors.

Given the relatively low level of commitments, a WHO-sponsored team of legal scholars appointed to review the implications of the GATS on the capacity of national governments to promote public health, assessed that the impact is very limited at present (Fidler and Drager, 2003). However, if the level of commitments in the health-related sectors rises and new multilateral disciplines are negotiated in the future, the agreement may have far more serious implications for the capacity of governments to design and implement public health policies.

The key problem identified with GATS commitments is the danger of policy lock-in. Indeed, if an unsuccessful policy decision is bound in a trade commitment, it becomes difficult to reverse. For example, if an experiment with foreign private hospitals leads to a shortage of physicians and nurses in rural areas and reduces access for the poorest citizens, a national government may decide to reverse its policy and ban the entry of more foreign hospitals. However, if the liberalisation of hospitals services was listed in the country's GATS commitments, such reversal can become very difficult to achieve.

The main question that arises is why governments in Asia would consider making GATS commitments, given the risks involved. The two arguments that support making these commitments are (1) the contention that GATS commitments can serve to attract foreign investment in the health-related sectors by providing a degree of predictability and certainty for foreign suppliers, and (2) the view that they could serve as an important bargaining chip in wider WTO negotiations (Nielson, 2006). There is no available evidence to support the first assumption, but it is possible to visualize a scenario in which commitments in health-related service sectors would be made in exchange for mar-



ket access gains. Gains could be made in agriculture or other sectors have the potential to deliver economic benefits, which in turn could contribute to human development.

Developing countries experimenting with options to improve their national health systems and outcomes need to have policy flexibility and space. A high degree of certainty is required before countries decide to make any commitments under GATS. In a recent handbook on GATS and health services prepared under the aegis of the WHO, it is recommended that WTO members who would like to open their health sector to foreign providers should consider 'experimenting' with liberalisation outside of GATS before making GATS commitments (Blouin, Drager and Smith, 2006). Such unilateral liberalisation would allow WTO members to experiment with policies in a manner that permits them to change course if the experiment produces unsatisfactory results. Although such an approach is not without risks, the key point is that if the reforms have negative impacts and there are no trade commitments in the relevant services sector, the liberalization will not be "locked-in" and policy reversal will be much easier.

In making GATS commitments in health-related sectors, national governments must ensure that all the market access and national treatment restrictions designed to promote health are taken into account. As in other sectors, regulatory measures which are not included in the schedule of commitments are subject to the 'list it or lose it' rule. This in effect means that restrictions must be included with the original sectoral commitments or the government stands to lose its capacity to maintain or adopt such measures. The Malaysian GATS commitments to hospital services provide an interesting example of carefully designed limitations and conditions that ensure that foreign participation contributes to the national health system and enhances local participation (Mashayekhi *et al.*, 2006). In the case of private hospital services provided through Mode 3, access is conditioned by an economic needs test and is permitted only through locally incorporated joint-venture corporations with foreign shareholding being limited to 30 per cent. In

addition, the joint venture can operate a hospital only if it provides a minimum of 100 beds. Within professional services, Malaysia has also made some commitments, but only in a few specific medical speciality services, such as forensic medicine, nuclear medicine, and geriatric micro vascular surgery.

Asian countries are also involved in a number of regional and bilateral trade agreements, some of which involve trade in health services. Few commitments to health services have been undertaken so far. Seven members of ASEAN (Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam) scheduled partial commitments in health insurance during the past two rounds of negotiations, but none to health services (Hiong and Djandam, 2002). Since 2005, the negotiations at ASEAN have include health services as one of the priority sectors for trade liberalisation, to progressively achieve free trade in services by 2020 in the region (Pachanee and Wibulpolprasert, 2007). The negotiators agreed to focus on Mode 3, more specifically liberalisation in private hospital services, since it was subject to most restrictions, but there have been no significant liberalisation of health services under ASEAN yet, except for a weak mutual recognition agreement on nursing services.

In addition to sector specific trade commitments, it is essential for policymakers to be aware of the impact of commitments undertaken in bilateral investment treaties or in investment provisions of trade treaties. Indeed, the experience with the North American Free Trade Agreement (NAFTA) provides a good illustration of how the space to adopt health policy measures can be reduced by foreign investor protection (Johnson, 2004; Sanger *et al.*, 2004). For example, NAFTA's investment provisions on expropriation can pose an obstacle to the expansion of the Canadian public health insurance system into new areas such as the coverage of prescription drugs or home care. These provisions on measures equivalent to expropriation have been used by foreign investors (in ways that go far beyond the intention of the parties) to challenge public policies that imposed costs on the investors, such as environmental policies.

#### **Box 4: Foreign Investment in Private Hospitals: Indonesia's Cautious Approach**

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The Indonesian government has identified specific areas in which foreign investment could contribute to strengthening the health sector. These include investment in private wings in teaching hospitals and in tertiary care hospitals, especially in cities other than Jakarta. The government hopes that such investment will not only benefit the higher income groups which desire access to sophisticated and expensive equipment, but also the population as a whole. For instance, the provision of private wings should result in a broad-based improvement in services in government teaching hospitals, as the revenues generated by services offered to richer patients can cross-subsidise services offered to the general population by the same highly qualified health professionals working in these teaching hospitals.

Indonesia has not made any commitments on health services at the WTO and has not made offers on health services in the current General Agreement on Trade and Services (GATS) negotiations. However, its current investment rules allow for foreign investment in (a) hospitals, (b) medical checkups, (c) evacuation and transportation, (d) mental rehabilitation centres, (e) clinical laboratories, (f) hospital management, and (g) maintenance and calibrations for medical equipment. The domestic rules specify that the foreign companies have to enter into a joint venture with Indonesian companies. There have been few measures to actively promote investment in these sectors. However, as the government strives to attract health care investors on islands other than Java and the major cities (such as the Nusa Tenggara isles including Timor Island, Mollucas, Sumatra, Papua), it imposes fewer regulatory requirements on foreign investors in regions with weak public health infrastructures.

Although exact data on foreign investment is unavailable, anecdotal evidence suggests that foreign investment in Indonesia's health sector is limited. Only 12 of 500 hospitals are actually owned and operated by private enterprises or a limited foreign company. Investment in the health sector is dominated by Singaporean, Malaysian and Australian companies. The government is very cautious in opening its market or making commitments on health services at the GATS, as it is intent on ensuring that regulations are in place before completing liberalisation. At present, the principal concern is the regulation of the health profession. Many regulations for licensing, standardization, competency tests, competency-based education are still in the process of being formulated. It is only once a solid regulatory framework is in place, that the government will consider further, albeit still gradual, liberalisation.

*Source: Untung Suseno Sutarjo, 2003.*

## 6

## Reducing Access to Drugs but Improving Health Research? The Importance of Taking Advantage of the TRIPS' Flexibilities

The impact of the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) on access to medicine for poor people has been at the centre of an important international controversy. The debates within and outside international organizations led to the adoption of the Doha WTO Ministerial Declaration on TRIPS and Public Health in 2001. It recognized that patents lead to higher drug prices which, in turn decrease the ability of poor to access drugs. Therefore, WTO members stressed that the TRIPS agreement does not preclude members from adopting measures to protect public health. The Ministerial Declaration also highlighted the importance of TRIPS' flexibilities, including the provisions that allow for making exceptions to patent rights on pharmaceutical products, such as parallel importation or compulsory licensing (WHO and WTO, 2002).

The TRIPS agreement has been implemented in most countries in the region. The transition period for developing countries ended in 2000 and for LDCs in 2006. With respect to pharmaceutical patents, LDCs have been given the flexibility to request an extension of the transition period to 2016. Countries like India and Pakistan which did not have patent protection for drugs at the time of the signature of the TRIPS, had to provide such protection beginning January 1, 2005. A closer examination of the implementation of the TRIPS into national legislation in Asia reveals that most countries did not take full advantage of the flexibilities of the Agreement (Thorpe, 2002; Villanueva, 2004). For instance, among ASEAN members, only the Philippines, Vietnam, Cambodia and Thailand have expressly included public health as the basis for the issue of a compulsory licence. Moreover, even when included in legislation, national authorities have tended to under-utilize TRIPS flexibilities. In the Philippines, the failure to resort to these provisions led to higher drug prices, not only when compared to prices in a country like India that did not have patent protection on pharmaceuticals, but even in comparison with Malaysia and Thailand (Villanueva, 2004).

Even though countries have not taken full advantage of TRIPS flexibilities, there has been a number of cases where countries have used these provisions to ensure equitable access to essential drugs. For instance, in Malaysia, the government decided in 2003 to import generic antiretroviral drugs (treatment for HIV/AIDS) under the "government use" provision of the TRIPS. The Ministry of Health faced strong opposition in doing so, as there were internal pressures not to do so, for fear that it would deter future foreign investment in Malaysia (Munsungu and Oh, 2005).

Thailand is another case where the government have been using TRIPS flexibilities, despite international pressure against it. In 2006 and 2007, the Ministry of Public Health issued three compulsory licences: two for antiretrovirals, and one a drug for heart disease (ICTSD, 2006, 2007). The country is importing generics from India until domestic production by the state-owned Government Pharmaceutical Organisation comes on line. These two cases highlight the importance of the leadership role of the Ministry of Health in ensuring policy coherence between trade and health objectives, when it comes to the issue of access to drugs.

In addition to building their knowledge and capacity to take full advantage of the existing flexibilities, policymakers have to be wary of the trend towards patent protection that goes beyond the TRIPS. Indeed, there is a growing number of bilateral and regional trade agreements and negotiations which include 'TRIPS-plus' standards (Vivas-Eugui, 2003). Within the region, the bilateral agreement between the US and Singapore includes TRIPS-plus commitments. Thus, compulsory licences can only be used in situations of anti-competitive practices or national emergencies (Article 16.7 of US-Singapore Free Trade Agreement). The provisions in these bilateral and regional agreements can pose a major hurdle to improving access to medicines.

Although strong patent protection is sometimes presented as the price to pay in order to encourage the discovery of new drugs and vaccines that are relevant to the needs of developing countries, empirical evidence does not substantiate this claim. In its study on the evidence, the International Commission on Intellectual Property Rights (IPR) stressed that the use

of TRIPS flexibilities to weaken patent protection on drug will not diminish “the incentives for research on diseases specific to developing countries, because it is the lack of demand rather than the IPR system which is the determining factor” (Commission on Intellectual Property Rights, 2002, page 39).

## 7 Policy Recommendations: National Impact Assessment of Trade in Health Services

**G**iven the growing importance of trade in health services, policymakers in Asia need to integrate the trade dimensions into their national health policymaking. A country-specific assessment should identify the ways to mitigate the potential negative impact of trade in health services. Those impacts include the strain health tourism sometimes places on health personnel availability in rural areas and public institutions. “Any negative impact from trade in health services on access to essential care for local people must be met with a prompt reaction. The shortage of doctors and health personnel in the rural areas of Thailand is a good example. Financial incentives as well as non-financial incentives – for instance, compulsory public service – or better opportunities for career development have been implemented in order to retain medical doctors in the public sector, particularly in rural areas. Massive increases in the education of medical doctors, to compensate for their loss through international trade, have been implemented” (Pachanee and Wibulpolprasert, 2007, page 163). In order to design such policy responses, policy makers in the region need to have a better understanding of the nature of trade in health services in their country.

Such assessment also needs to consider how to leverage the opportunities coming from foreign capital and technologies to ensure that these support the achievement of the MDGs on health. Analysts reviewing the policy and business literature on trade in health services have stressed that the potential financial resources gained from such trade can be re-allocated to national health systems or to public policies improving the conditions for good health (clean water, sanitation, housing) (Bookman and Bookman, 2007). However, we have yet to see many concrete examples of how this is being done. A national assessment should develop an explicit strategy on how to ensure such re-allocation and harnessing of the potential benefits from trade in health services.

The WHO is currently developing a diagnostic tool

which would enable Ministries of Trade and Health to work together to conduct such a national assessment (WHO-SEARO, 2007). The tool does not only look at trade in health services, but also linkages between trade and health such as the health impacts of trade in harmful products e.g. tobacco and trade in food (food security, diet and nutrition). A draft version of the tool can be made available to interested parties.

In the implementation of such a national assessment on trade in health, it is crucial that policymakers engaged with a broad range of stakeholders and civil society organizations. Such involvement in the national and international dialogue improves the awareness of policymakers on the links between trade agreements and human development. For instance, in Pakistan, a wide consultation on negotiations on trade in services, including with the Pakistan Medical and Dental Council, the Pakistan Nursing Council, led the government to languages in the offer the country was making on trade in health services (Tuerk and Mashayekhi, 2007). “One of the concerns related to the government’s ability to provide essential services to the poor and marginalized and whether a full market access and national-treatment commitment would compromise this ability. [...] It was in response to these concerns that the final version of initial offer – in those sector that relate to health - was designed to effectively exclude “services provided by public institutions whether owned and operated by federal, provincial, district, Tehsil or municipal authorities” from the scope of the commitment” (Ibid, page 269).

### Caution on Trade Commitments

The key problem identified with GATS commitments or other trade commitments related to health services is the danger of policy lock-in. Policy flexibility is needed by developing countries experimenting with options to improve their national health systems and outcomes. A far higher threshold of certainty is

required before countries decide to make any trade commitments. National governments who would like to open their health sector to foreign providers should consider experimenting with liberalisation outside of GATS, or regional trade agreements, before making trade commitments. Such unilateral liberalisation allows WTO members to experiment with policies in a way that permits them to reverse course if the experiment produces unsatisfactory results. The questions to be considered when deciding to undertake trade commitments related to health services can be summarized as follows:

1. "Will increased trade in these services lead to better health outcomes?"
2. Will increased liberalization of trade (more competition from foreign private health care companies) lead to better health outcomes?"
3. Will making a GATS [or other trade] commitment in these sectors offer any additional advantage that will lead to better health outcomes?"

Of course, the implication here is clear: if the answer to any of these is negative, or in doubt, then a country should not make GATS [or other trade] commitments" (Smith, Blouin and Drager, 2006, page 13).

## Lessons on Policy Coherence in Trade and Health

In order to ensure that trade policies contribute to human development, and more specifically to achieving national health objectives, national governments have to strive for policy coherence, i.e. to engage in a process where conflicts between different policy priorities are minimized and synergies maximised (Blouin, 2007a). "A degree of incoherence may sometimes be inevitable, but trade-offs should be made transparent and appropriate measures taken to mitigate negative impacts" (OECD, 2005, page 17). To achieve such coherence, it is important that Ministries of health take a leadership role and work closely with Ministries of Trade or Finance to ensure that the "health-lens" is well-represented and the health impacts of trade policy decisions well-understood. Institutional mechanisms to ensure such collaboration need to be created at the national level. These mechanisms may take more or less formal form, depending on the country, but the key point is to create incentive for collaboration, and with time, build trust among actors which have very different perspectives and views on this topic. One preliminary step to build trust is to design opportunities for dialogue and joint fact-finding between trade and health officials at the national, regional and global level. Such exercise does not result in actors sharing the same views, but it can clarify the trade-offs that are at stake and the potential policy responses to minimize negative health impacts.

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**Table 1** | *Private Expenditures on Health and Out-of-Pocket Payments (2005)*

	Private expenditure on health as % of total expenditure on health	Out-of-pocket expenditure on health as % of private expenditure on health	Per capita government expenditure on health (US dollars)
<b>Bangladesh</b>	70.9	88.3	3
<b>Bhutan</b>	29.0	100.0	37
<b>Cambodia</b>	75.8	79.3	7
<b>China</b>	61.2	85.3	31
<b>India</b>	81.0	94.0	7
<b>Indonesia</b>	53.4	66.4	12
<b>Lao People's Democratic Republic</b>	79.4	92.7	4
<b>Malaysia</b>	55.2	75.7	99
<b>Myanmar</b>	89.4	99.4	Less than 1
<b>Nepal</b>	71.9	87.0	4
<b>Phillipines</b>	63.4	80.3	14
<b>Singapore</b>	68.1	93.8	301
<b>Sri Lanka</b>	53.8	86.0	24
<b>Thailand</b>	36.1	76.6	63
<b>Vietnam</b>	74.3	86.1	10

Source: WHO Statistical Information System. [<http://www.who.int/whosis/en/index.html>]  
Last accessed on 22 September 2008.

**Table 2** | *Human Resources for Health  
in Selected Asian Countries, Density per 1000*

	Physicians	Nurses	Year of latest data
<b>Bangladesh</b>	0.30	0.28	2005
<b>Bhutan</b>	0.02	0.32	2007
<b>Cambodia</b>	0.16	0.85	2000
<b>China</b>	1.42	0.96	2003
<b>India</b>	0.60	1.27	2004
<b>Indonesia</b>	0.13	0.82	2003
<b>Lao People's Democratic Republic</b>	0.35	0.97	2004
<b>Malaysia</b>	0.71	1.81	2002
<b>Myanmar</b>	0.36	0.98	2004
<b>Nepal</b>	0.21	0.46	2004
<b>Pakistan</b>	0.80	0.45	2005
<b>Phillipines</b>	1.15	6.12	2002
<b>Singapore</b>	1.50	4.40	2003
<b>Sri Lanka</b>	0.55	1.73	2004
<b>Thailand</b>	0.37	2.83	2000
<b>Vietnam</b>	0.56	0.77	2002

*Source: WHO Global Atlas of the Health Workforce [<http://www.who.int/globalatlas/default.asp>]  
Last accessed on 22 September 2008.*

**Table 3a***Access to Reproductive Health Care  
in Selected Asian Countries*

	<b>Birth attended by skilled health attendant (%)</b>	<b>Year</b>
<b>Australia</b>	100	2006
<b>Bangladesh</b>	20	2006
<b>Bhutan</b>	51	2005
<b>Cambodia</b>	44	2004
<b>China</b>	98	2006
<b>India</b>	47	2006
<b>Indonesia</b>	66	2003
<b>Japan</b>	100	2004
<b>Korea, Republic of</b>	100	2006
<b>Lao People's Democratic Republic</b>	60	2001
<b>Malaysia</b>	100	2005
<b>Mongolia</b>	99	2005
<b>Myanmar</b>	57	2001
<b>Nepal</b>	19	2006
<b>Philippines</b>	60	2003
<b>Singapore</b>	100	2006
<b>Sri Lanka</b>	97	2000
<b>Thailand</b>	97	2006
<b>Vietnam</b>	88	2006

*Source: WHO Statistical Information System. [<http://www.who.int/whosis/en/index.html>]  
Last accessed on 22 September 2008.*

**Table 3b***Access to Reproductive Health Care  
in Selected Asian Countries*

	<b>Maternal mortality ratio (per 100 000)</b>	<b>Year</b>
<b>Australia</b>	4	2005
<b>Bangladesh</b>	570	2005
<b>Bhutan</b>	440	2005
<b>Cambodia</b>	540	2005
<b>China</b>	45	2005
<b>India</b>	450	2005
<b>Indonesia</b>	420	2005
<b>Japan</b>	6	2005
<b>Korea, Republic of</b>	14	2005
<b>Lao People's Democratic Republic</b>	660	2005
<b>Malaysia</b>	62	2005
<b>Mongolia</b>	46	2005
<b>Myanmar</b>	380	2005
<b>Nepal</b>	830	2005
<b>Philippines</b>	230	2005
<b>Singapore</b>	14	2005
<b>Sri Lanka</b>	58	2005
<b>Thailand</b>	110	2005
<b>Vietnam</b>	150	2005

Source: WHO Statistical Information System. [<http://www.who.int/whosis/en/index.html>]  
Last accessed on 22 September 2008.

**Table 4** | *GATS Commitments of Asian WTO Members to Health-Related Services*

Members	Medical & Dental S.	Nurses, Midwives etc.	Hospital Services	Other Human Health S.	Health insurance
Australia	X			X	
Brunei Darussalam	X				X
Cambodia	X		X		
China	X				X
Chinese Taipei			X	X	
Hong Kong (SAR),China					X
India			X		
Japan			X		
Malaysia	X		X	X	
Nepal			X		
Pakistan	X		X		
Singapore	X				X

Source: WTO Services Database; WTO accession webpage; and Adlung and Carzaniga, 2006.





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