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MARKKU KOTILAINEN – VILLE KAITILA

ECONOMIC GLOBALISATION IN DEVELOPING COUNTRIES – THE CASES OF NEPAL AND TANZANIA

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ABSTRACT: In this research, economic globalisation is studied from the point of view of developing countries. The main contents of the report consist of case studies for Nepal and Tanzania. The report first examines the concept of globalisation, its history and the effects of globalisation on developing countries. Then indicators of globalisation are reviewed for Finland's long-term development partners Nepal, Tanzania, Mozambique, Ethiopia and Vietnam, as well as for some other developing countries. The final part of the report concentrates on globalisation in two countries, Nepal and Tanzania.

KEY WORDS: Globalisation, developing countries, Nepal, Tanzania.

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TIIVISTELMÄ: Tässä raportissa tutkitaan taloudellista globalisaatiota kehitysmaiden näkökulmasta. Tutkimuksen pääsisältö koostuu Nepalia ja Tansaniaa koskevista tapaustutkimuksista. Raportin alussa selvitetään globalisaation käsitettä, sen historiaa ja vaikutuksia kehitysmaihin. Sitten tarkastellaan eräitä globalisaation astetta kuvaavia indikaattoreita Suomen pitkäaikaisille kehitysyhteistyökumppaneille Nepalille, Tansanialle, Mosambikille, Etiopialle ja Vietnamille sekä muutamille muille kehitysmaille. Tämän jälkeen tutkimus keskittyy taloudelliseen globalisaatioon kahdessa maassa, Nepalissa ja Tansaniassa.

ASIASANAT: Globalisaatio, kehitysmaat, Nepal, Tansania.

PREFACE

Globalisation is one of the hot topics in the media. Its effects, especially on the developing countries, raise strong opinions for and against it. In addition to researchers and the media, also politicians and non-governmental organisations are actively participating in the discussion and taking action on this question. In spite of the differing opinions about it, economic globalisation is a fact of life. It also defines the international economic environment of the developing countries when choosing their development strategies.

Most developing countries want to profit from globalisation through increased foreign trade, foreign direct investment, foreign aid and international borrowing. Liberal economic thinking has won more ground in the developing countries since the early 1990s helping to support this trend. However, globalisation also raises problems in these countries. The problems are often related to fast changes in the economy. These negative effects must also be addressed, in order to profit fully from globalisation.

In this research, economic globalisation is analysed from the point of view of developing countries. First, the phenomenon is studied theoretically. Then the most important indicators of globalisation are studied empirically in several developing countries. The special cases of the study are Nepal and Tanzania, which are two of Finland's long-term development partners. These case studies form the main content of the research.

The research is done by Head of Unit, Dr. Markku Kotilainen and Research Fellow, M.A. (Econ.) Ville Kaitila.

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Helsinki, May 2002

Pentti Vartia

PREFACE OF THE AUTHORS

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The Finnish Embassies in Nepal and Tanzania were very helpful in introducing us to the situation in these countries and in organising contacts during our visits to these countries. In Nepal, Chargé d'Affaires Asko Luukkainen and Project Researcher Caroline Mamia, and in Tanzania, Ambassador Ritva Jolkkonen and First Secretary Martti Eirola contributed greatly to the success of our research trips.

We stayed for about two weeks in both countries, in Nepal in October and in Tanzania in November 2001. In both countries we met several civil servants, researchers and other experts, without whose knowledge and views our research would have been meagre.

In Nepal we met: Joint Secretary Purushottam Ojha, Joint Secretary Kalyan B. Pradhan and Under Secretary Uddhab Kumar Adhikari (Ministry of Industry, Commerce and Supplies); Joint Secretary Maryan P. Silwal (Ministry of Finance); Joint Secretary Hira Lal Singh Dongol (National Planning Commission); Deputy Governor Ram Babu Pant and Executive Director Yuba Raj Khatiwada (Nepal Rastra Bank); Secretary General Badri Prasad Ojha and Deputy Secretary General Hemant Dabadi (Federation of Nepalese Chambers of Commerce and Industry); Professor Bijay K. C. (Kathmandu University School of Management); Executive Director Ananda P. Shestra, Professor Gunanidhi Sharma, Professor Dev Raj Dahal and several of their colleagues (Nepal Foundation for Ad-

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Additionally, parts of the manuscript have been commented by Research Director Kari Alho (ETLA) and M.A. (Econ.) Juuso Salokoski (Juuso Salokoski Ltd). Dr. Anthony de Carvalho has kindly checked our English.

We thank all the above-mentioned persons for their comments, information and views. Any errors and misunderstandings are solely our responsibility.

Our division of work has been as follows. Markku Kotilainen has written Chapters 1, 2, 5 and 6, and has also worked as the coordinator of the project. Ville Kaitila has written Chapters 3 and 4.

Helsinki, May 2002

Markku Kotilainen Ville Kaitila

CONTENTS

SUMMARY

Globalisation is currently a very topical theme of discussion in the context of developed and developing countries. In the case of developed countries the discussion is rather pragmatic, but with respect to the developing countries it is often related to differences in political and social views.

In this report, we analyse economic globalisation from the point of view of developing countries. The main contents of the report consist of case studies of Nepal and Tanzania.

First, we discuss the concept of globalisation, its history and the effects of globalisation on developing countries. Then we present some indicators of globalisation for Finland's long-term development partners Nepal, Tanzania, Mozambique, Ethiopia and Vietnam, as well as for some other developing countries. After that the study concentrates on globalisation in two countries, Nepal and Tanzania. These countries are studied thoroughly in accordance with the framework presented in the beginning of the book.

Economic Globalisation from the Point of View of Developing Countries

In this study economic globalisation is defined as transnational economic activities in the fields of 1) foreign trade of goods and services, 2) foreign direct investment (FDI), 3) other forms of co-operation between firms, 4) international migration, 5) foreign borrowing and lending, 6) foreign aid, and 7) integration of macroeconomic policies. Having extensive foreign trade is a necessary, but not a sufficient, condition for a country to be globalised. It requires the existence of other forms of transnational co-operation, too. Development of modern transport and communication technology has reinforced all forms of globalisation.

Up until now, only a few developing countries have participated extensively in globalisation. Among others, these countries include China, Indonesia and Brazil. Their population totals about 3 billion.

Countries with a total population of about 2 billion have remained outside the globalisation process, and are more or less marginalised.

Most developing countries want to globalise. They want to increase their foreign trade, be members of the World Trade Organisation (WTO) and receive more foreign direct investment. These developments are related to the processes of democratisation, liberalisation and privatisation that started after the late 1980s and which continued at a rapid pace during the 1990s. The collapse of the Soviet Union and socialism in many parts of the world accelerated this process. Despite this greater tendency towards globalisation, the views of the developing countries about the contents and the conditions of globalisation may, however, differ from those of the developed countries.

Indices of economic freedom indicate that while developing countries have become more free especially in East Africa, there still remains room for more progress. This is particularly true in South Asian countries, which are less free than East African countries. In both Nepal and Tanzania, trade, property rights, regulation and the black market are reported as being problem sectors from the point of view of economic freedom. In Nepal, FDI and banking have to be added to this list.

Given the basic choices related to the introduction of a market economy, we argue that globalisation is beneficial for the developing countries. Globalisation also creates problems, however, which have to be addressed by appropriate policy measures.

The developing countries gain from the international division of labour through foreign trade. One of the trends in the global economy has been a decline in tariffs. High tariffs not only decrease foreign trade but also distort the structure of trade and production. Tariffs remain higher in developing countries than in developed countries. Furthermore, there remain such obstacles to trade as countries' financial support to their own agriculture.

The WTO is the most important forum for multilateral trade arrangements. Many LDCs also have regional trade arrangements that increase trade within a limited geographical area and thereby expose companies to competition, making it easier for them to withstand global competitive pressures. In the short to medium term, economic restructuring also creates adjustment costs. The phasing

away of the Multi-Fibre Agreement is changing the geography of textile trade and this has also affected Nepal and Tanzania.

Foreign direct investment brings the developing countries economic resources and technical know-how, which they desperately need in order to solve the problem of poverty.

The extent to which the developing countries benefit from FDI inflows depends on the backward, forward and horizontal linkages between foreign-owned firms and the rest of the economy. The extent and form of these linkages depend on, among other things, the type and length of the investment as well as on the sector in which it is made.

At present, globalisation occurs increasingly at the production level. As such, globalisation tends to fragment different stages of production across different countries. This kind of corporate globalisation is realised through FDI, but also through other forms of co-operation. These include joint ventures with minor equity stakes, the supply of technology or trade marks through licensing, international subcontracting and contracts of franchising.

International migration is a way to react to relative differences in the supply of labour. Developing countries have an abundant labour force in relation to their capital stock. In some developed countries the situation is the opposite. Remittances sent by emigrated workers is an important source of foreign exchange for some developing countries. Migration to the developed countries is, however, limited.

Foreign borrowing and foreign aid are important sources of foreign financial resources in the developing countries. Many developing countries are currently over-indebted, and international efforts to reschedule their debts are going on. Foreign aid has declined considerably in relation to world GDP.

Globalisation also means integration of macroeconomic policies. Free capital mobility leads to a loss of independent monetary policy if the exchange rate is more or less fixed. A floating rate gives some room for independent national monetary policy in the short term. Capital mobility is, however, often not yet fully free in the developing countries. Indebtedness of the countries also leads to some loss in the control of fiscal policy.

Nepal

Nepal has opened up considerably during the past few decades and especially during the 1990s. The country became a multiparty democracy in 1990. As a result of liberalisation and privatisation, the share of foreign trade in GDP has risen. Meanwhile, however, GDP growth per capita has been only about two and one-half per cent per annum due to high population growth, and poverty and income inequality have increased.

One of the important turning points was the trade agreement with India in 1996 guaranteeing free trade between the two countries. As a result, the volume of trade between Nepal and India grew significantly. In addition to free trade, the countries have also, since 1950, granted the other country's nationals the same rights of residence, ownership of property, participation in trade and commerce, and movement as to the nationals of their own country.

The trade agreement expired in late 2001 and its extention proved difficult because of India's reservations, but finally a new trade agreement came into force in March 2002. This time, quotas were introduced on Nepal's exports of certain key products (vegetable ghee, acrylic yarn, copper products and zinc oxide) to India. While the renewal of the agreement is a very positive thing, the quotas will limit growth in the affected sectors in Nepal.

The years 2001 and 2002 have been difficult for Nepal in ways that also hold back its globalisation and economic development. The global recession and the trade concessions made by the United States to Sub-Saharan Africa, along with the escalation of Nepal's civil war, have had a strong adverse effect on Nepal's foreign trade, investment, and economic growth in general. Nepal's exports to industrialised countries consist only of garments and carpets, of which the former sector already is under pressure from the phasing out of the Multi-Fibre Agreement by 2005. The structure of Nepal's goods exports to industrialised countries is in need of diversification.

As a whole, however, the structure of Nepal's goods exports has become more diversified during the 1990s, thanks to exports to India that have grown very rapidly and which may be expected to become even more important in the future if trade remains (at least mostly) free. There has been a structural shift in Nepal's exports away from foodstuffs and crude materials to manufactured goods

during the 1990s. Though Nepal still exports some agricultural goods, mainly to India, it has become a net importer of these products.

Trade with India has been positively affected by the flows of foreign direct investment from India, which account for some 36 per cent of all FDI into Nepal. Another 17 per cent has originated from the United States and 11 per cent from China. Sector-wise, 43 per cent of the FDI has gone into manufacturing, 21 per cent into both tourism and other services, and 14 per cent into energy. Nepal has potential in tourism and hydroelectric power. Furthermore, free trade with India provides the opportunity to produce for the Indian market. The overall FDI stock in Nepal is very small, however, only two per cent of the GDP. Further measures should be taken to increase FDI.

The factors that restrain FDI and hold back the country's growth in general can be broadly short-listed as follows. *First*, the physical and social infrastructure is inadequate. This includes poor roads, bridges and telecommunications, and lack of skilled and trained personnel. Illiteracy rates remain high even among young adults, despite progress made in schooling during the past decades. As a result, the birth rate is too high, there is social stagnation, poverty, and low competitiveness in exports. In order to increase competitiveness, productivity in both agriculture and manufacturing should be raised from currently low levels and product quality enhanced. *Second*, there is widespread corruption that leads to bad governance, non-transparency and unaccountability in business, politics and the judiciary. *Third*, there is the potentially long-lasting civil war, which has its roots in Nepal's intense poverty. The civil war also has a very adverse effect on tourism, which brings vital revenue that helps to partly balance the large deficit in Nepal's goods trade, and on government finances via an increase in security expenditure and a decline in tax revenue.

Nepal is applying for WTO membership. There is some work to be done before Nepal can join, but we see no alternative. Both of its neighbours, India and China, are members. The legal adjustments that Nepal has to make are also important *per se*.

Many Nepalis work abroad, mainly in India. Their remittances are estimated at about 3 per cent of GDP, which is roughly equal to the contribution of tourism.

Foreign aid is important for Nepal. In 1999, it accounted for 43 per cent of central government expenditure, 7 per cent of gross national income, and 34 per cent of gross capital formation. Aid per annum was 15 US dollars per capita, or three times more than the total FDI stock in Nepal. Still, aid in relation to GDP had declined to almost one-half of its peak reached in 1989.

Nepal is a less indebted low-income country. In 2001, outstanding debt was about 47 per cent of GDP and debt service costs were four per cent of exports. The level of indebtedness has been increasing over the long term, however.

The Nepalese rupee has been convertible for all current account transactions since 1993. Since then the rupee has been unilaterally pegged to the Indian currency. Nepal's monetary policy therefore follows India's monetary policy. The real exchange rate between the countries has remained stable during the 1990s.

Tanzania

Tanzania is located in eastern Africa on the Indian Ocean. The country consists of the mainland and of Zanzibar. Tanzania has a wide geographic area, it is about the size of France and Germany put together. The country has several tourist attractions for nature and culture tourists. The climate varies from tropical along the coast to temperate in the highlands. The population is about 33 million.

Tanzania is one of world's poorest countries. Measured by the UN Human Development Index, Tanzania was the 140th out of 162 countries in 2001. According to the national definition of poverty, 48.4 per cent of the population suffered from 'basic needs poverty' and 26.6 per cent from 'food poverty' in 2000.

Tanzania exercised so-called African socialism from the 1960s until the early 1990s. On July 1st, 1992, the one-party system ceased to exist formally. The leading CCM party, however, dominates the political scene. In the elections held in October/November 2000 it won 244 out of the 274 seats in the parliament.

Political liberalisation has been joined by economic liberalisation. The economic liberalisation and privatisation process started after 1992, but it has been more active after 1995.

Tanzania's macroeconomic development has been rather unsatisfactory in the 1990s. During 1989-2000 the gross domestic product

(GDP) grew 3.3 per cent annually on average. Because annual population growth averaged 2.9 per cent, GDP per capita grew by an annual average of just 0.4 per cent. This was especially due to weak export developments. The volume of merchandise exports was in 1999/2000 just 7 per cent higher than in 1990/1991. The weak export performance has been reflected in a low investment ratio, which declined considerably during the 1990s. In 2000, this ratio had fallen to 17 per cent, well below the world average of 22 per cent.

According to the Tanzanian definition, the unemployment rate was 16 per cent during the first part of 2000. Hidden unemployment is high, however. Inflation has declined from above 30 per cent in 1994 to about 5 per cent in 2000. This decline was to a large extent due to stability oriented macroeconomic policies. The public and current account deficits are currently at tolerable levels. Foreign debt, on the other hand, is still unsustainable.

Tanzania has a large non-monetary sector. In the mainland it is about 30 per cent of GDP. This sector consists mainly of subsistence farming. The share of agriculture (monetary and non-monetary) is 45 per cent of total GDP. This share has declined slightly during the 1990s. Manufacturing accounts for a little over 7 per cent and construction for 5 per cent of GDP. Mining and quarrying accounts for 1.5 per cent of GDP. The share of trade, restaurants and hotels is altogether about 12 per cent of GDP.

Globalisation is not very far in terms of foreign trade in Tanzania. The ratio of exports of goods and services to GDP was 15 per cent in 2000. The corresponding share of imports was 24 per cent. Both shares have declined since 1995. In the former case, this decline is due to the poor development of export volumes. Exports sent by the textile and clothing industry have dropped drastically in the face of the liberalisation of the sector. The formerly state-owned firms were not profitable enough to survive. Also exports of cotton have declined significantly due to changes in the quality requirements of foreign customers. Export and import prices have increased modestly in the 1990s and early 2000s.

More than a half of merchandise exports are agricultural products. Minerals accounted for 26 per cent in 2000, while the share of manufacturing exports was 6.5 per cent. According to concentration indices, the product structure of exports is not as concentrated in Tanzania as it is in Nepal. This is due to the large number of goods. The large share of price-sensitive agricultural and mining products gives, however, a reason to increase the value-added of exports and to diversify them further.

Import tariffs have been cut by over one-half since the early 1990s. The current average tariff rate of 16.1 per cent is still high when compared to the average of 11 per cent in the Least Developed Countries (LDCs) or to 4 per cent on average in the industrial countries. Tanzania is a member of the WTO, of the East African Community (EAC) and of the Southern African Development Community (SADC). The EAC and SADC both aim at free trade in the area. In the case of the EAC, the aim is nearer to being realised.

Services account for about one-half of total exports, with travel and transport comprising the most important items. Tourist income accounts for about half of service exports.

Tanzania has a comparative advantage in agricultural products, mining and tourism. The relatively cheap labour and good geographic location are attractive for the labour-intensive manufacturing industry. This sector is currently underdeveloped, however.

Lately, Tanzania has attracted rather much foreign capital. The share of the FDI stock to GDP was 11 per cent in 1999. This is still below the 14 per cent average of all least developed countries. The flow has, however, been high recently, concentrating in the mining sector. It is directed also to agriculture and to manufacturing. In 1999 the FDI flow was almost 14 per cent of total fixed capital formation. In all LDCs this figure was 8 per cent. The most important source countries for FDI are the United Kingdom, the United States, South Africa and Kenya. The FDI is attracted by offering favourable investment and production conditions.

Tanzania is dependent on foreign aid. In 1999 its share was 11 per cent of gross national income, 66 per cent of gross capital formation, and 41 per cent of imports. In the budget year 1999/2000 about a third of total expenditure and 94 per cent of development expenditure was financed by foreign funds.

The total foreign debt was about 76 per cent of GDP in June 2001. Tanzania participates in the Heavily Indebted Poor Countries (HIPC) debt rescheduling program of the IMF and the World Bank.

Indebtedness limits the room for manoeuvring in fiscal policy. Tanzania has a floating exchange rate, which gives some autonomy in monetary policy in the short run. Limited capital mobility in capital account transactions adds to this freedom. Current account transactions are free.

Extent of Globalisation and Its Challenges

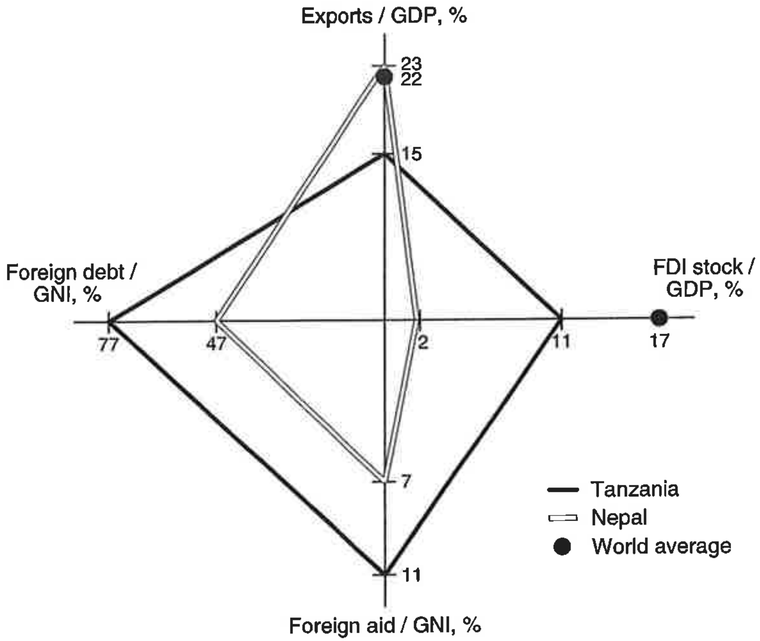
The extent of globalisation in Nepal and Tanzania is not very high. The foreign trade-to-GDP ratio in Nepal is about at the world average, but in Tanzania clearly below that. Foreign direct investment is very low in Nepal in international comparisons. Even in Tanzania it is clearly below the world average of 17 per cent of GDP. The flow in relation to total investment has, however, recently been about the same as in the world on average. This reflects the increased importance of FDI in Tanzania. The importance of remittances received from people working abroad is large in Nepal, but not in Tanzania.

Even though Nepal and Tanzania are not yet very globalised, their economic strategy is based on the benefits of the international division of labour. Both countries have liberalised their economies since the early 1990s to benefit more from the open sector and to attract FDI. The process is underway, but not finished.

On their way to globalisation both countries face several tasks and challenges, which should be emphasised. The most important ones are listed below:

1) Increasing political stability (civil war in Nepal);
2) Lowering birth rates;
3) Fighting poverty and diseases (especially AIDS in Tanzania);
4) Continuing liberalisation of the economies;
5) Improving administrative practices and diminishing corruption;
6) Improving the energy, transport and communication infrastructure;
7) Improving education (primary, secondary and tertiary; vocational training);
8) Support for research and development;

Figure **Extent of economic globalisation in Nepal and Tanzania**



Exports/GDP are from year 2000 and Foreign debt/GNI from year 2001, the rest of the data dates from year 1999.

9) Liberalising foreign trade further;
10) Increasing the degree of processing in production and diversifying the structure of foreign trade;
11) Deepening regional integration;
12) Attracting more FDI and deepening the linkages of foreign investors with the rest of the economy;
13) Improving the efficiency of the financial system;

14) Better responsiveness of the economy and society to structural change;
15) Improving the social safety nets and other policies to counteract the negative effects of globalisation;
16) Continuing stability oriented macroeconomic policies;
17) Improving the social status of women in both countries and of Dalits in Nepal.

1 INTRODUCTION

Globalisation is a concept which has recently raised a lot of discussion among scientists, civil servants, journalists, politicians and the general public. It has many meanings depending on the person who is talking about it. The coverage of the concept and the attitude towards the phenomenon differ between persons, disciplines and organisations. Sometimes globalisation is treated as a mantra, in the name of which people swear in order to motivate any desired political, economic or social aim. Sometimes it is regarded as the devil, to describe all evil that is happening in the world today.

In this research we study globalisation as an economic phenomenon, which, however, has political and social prerequisites and implications. We look at the phenomenon from the point of view of developing countries. Our main focus is on two least developed countries, Nepal and Tanzania.

A political prerequisite for globalisation is that the government in question allows it to occur. The importance of this is seen especially when we look at the phenomenon from a historical perspective. National governments still have power with respect to their citizens and the area of the country, even though the possibilities for isolation have diminished. Globalisation has not occurred without some kind of acceptance by national policy makers. It has also been linked to the liberalisation and privatisation of national economies.

Globalisation affects almost all aspects of human life. In this respect, however, we have to be careful not to thank or blame it for everything that is happening in the world. There are also other important tendencies that impact our economic, political, and social landscape. Several processes are currently intertwined with globalisation, but they would have some impact even without it. These kinds of tendencies include technological progress, economic liberalisation and privatisation, urbanisation, pollution, etc.

In this study, we use a rather wide concept for our definition of economic globalisation. Our concept includes traditional forms of international economic relations, like foreign trade. These forms are, however, not sufficient to define the extent to which an economy is globalised. Further elements of globalisation are foreign direct investment (FDI), other forms of co-operation between firms, international migration, foreign borrowing, foreign aid, and interdependencies of macroeonomic policies.

An important current element in the globalisation process is taking place at the production level in such a way that different stages of production are located in different countries. Sometimes this is realised through FDI, sometimes through several kinds of co-operative agreements. Ownership of firms is also divided between citizens of different countries. This means that many firms are no longer national, but operate in a global framework and have an international ownership structure. This naturally limits the room for manoeuvring of national governments. On the other hand, governments are not powerless in the face of market forces.

Technical development has been a crucial precondition for globalisation. It has made the transport of and communication between citizens and firms easier than before. Firms and factories located in different parts of the world can contact each other faster. The scale of different kinds of operations has widened to cover almost the whole world. Surely, the world has become smaller

Globalisation has positive impacts on the economic development of developing, as well as of developed, countries. This is why governments try to attract foreign direct investment. FDI and several other forms of globalisation bring capital, technology and other kinds of know-how to countries that urgently need them in their development process. Globalisation has, however, also negative effects in several fields. These effects need to be taken into account, too.

Usually the developing countries, at least their governments, think that they suffer from too little rather than from too much globalisation. Nonetheless, they have their own views about how to manage the process. These views are sometimes different from those of the representatives of the developed world. Some developing countries are already well along in the globalisation process.

Others are in danger of being marginalised, which risks delaying development process.

In this study we will first take a general view on globalisation from the point of view of developing countries (Chapter 2). We define what we mean by globalisation, give a short history of its development, and then describe how it affects the developing countries. This framework is applied later in the study.

In Chapter 3, we present several indicators of globalisation in several developing countries that Finland has close development ties with. These countries include Ethiopia, Mozambique, Tanzania, Nepal and Vietnam. Data on some other developing countries and country groups are also presented as a reference. In addition to indicators describing globalisation, general development indicators are presented.

In Chapters 4 and 5 we present case studies on Nepal and Tanzania, respectively. These countries are chosen because they are among the most important development partners of Finland. They have many differences, but they also have many common characteristics. Both are rather small least developed countries. They do not belong to the group of very globalised developing countries. Their aim is, however, to participate fully in the globalisation process. Their governments started a liberalisation and privatisation process in the early 1990s, and the countries try actively to attract foreign capital into the country. The indicators which we focus our main emphasis on are foreign trade, FDI, other forms of globalisation at the firm level, migration, foreign aid, international borrowing and interdependence of macroeconomic policies. We also give some general background information about the countries.

In Chapter 6, we conclude our study of globalisation in Nepal and Tanzania. We compare the experiences of these countries and analyse their common and differing characteristics in relation to each other and to other developing countries. One of the aims here is to present the essential features that should be emphasised when discussing the effects of globalisation on the development process in these countries. In addition to the country specific experiences, there might be more general lessons that are applicable to other developing countries, too.

2 ECONOMIC GLOBALISATION FROM THE POINT OF VIEW OF DEVELOPING COUNTRIES

2.1 What Do We Mean by Globalisation?

Globalisation has many meanings depending on the context and on the person who is talking about it. Generally, it means something that exceeds national boundaries. It can be interpreted as a phenomenon that existed already before the birth of nation states. In this context we can refer to the Roman Empire, or to the Middle Ages, when the Catholic Church controlled wide areas of Europe. Usually, however, globalisation is regarded as a phenomenon that has developed when modern nation states no longer provided a sufficient environment for the desired level of economic, social, political, cultural, and other activity. When using this definition, the birth of globalisation goes back to the second half of the 19th century, although, even at this time, it affected just a small part of the populations of the countries. The current 'modern' globalisation concerns a much wider part of the population. Also the forms of globalisation have changed.

Globalisation is fundamentally an economic phenomenon, but it does have implications for almost all fields of human life. The discipline of the researcher broadly defines the approach taken.

In this study we concentrate on the economic field, but refer sometimes to political and social aspects of globalisation.

Politics of course defines the extent to which agents have room for manoeuvring. If the nation state authoritatively controls its area and the activities of its citizens, it can either allow or deny participation by the agents of that country in international or global activities. It also controls the activities of foreign citizens inside its territory. This has been seen in times of world wars or even in the case of smaller conflicts. Also political regimes affect the extent of internationalisation/globalisation. During the Cold War, the former socialist countries were very much out of the international division of labour. However, they had trans-national activities among themselves in several fields.

Cold-War Albania is often regarded as an extreme example of an isolationist state. Also some other kinds of nationalistic states have limited the possibilities of their citizens to participate in international activities or the activities of foreigners in their countries.

We define economic globalisation as increasing interdependence of economies. We classify the forms of interdependence as follows:

1) foreign trade of goods and services,
2) foreign direct investment (FDI),
3) other forms of co-operation of firms (see Nunnenkamp, Gundlach, Agarval, 1994),
    a) joint ventures with minor foreign equity,
    b) the supply of technology or trademarks through licensing agreements,
    c) international subcontracting,
    d) contracts on franchising,
4) international migration,
5) foreign borrowing and lending,
6) foreign aid, and
7) integration of macroeconomic policies.

As an extreme form, economic globalisation means that economic life is almost totally determined in a world-wide context. This will obviously never happen. There is room for regional, national and local activities. The role of global activity is, however, increasing and covering new areas. A crucial thing behind the globalisation in each of the above mentioned fields is the development of modern transport and communication technology. It has 'made the world smaller' and integrated the world economy.

Foreign Trade

Foreign trade of goods and services is the most common form of economic interdependence. The motivation for foreign trade is based on the benefits of the division of labour.

The traditional explanation for foreign trade is so-called comparative advantage. According to this explanation each country specialises in the production of those products, which it can produce at a low cost relative to other products. A country can have higher costs, in absolute terms, of production of all kinds of products, but because it is profitable for the more competitive country to specialise, there is anyway room for production to take place in the less competitive country.

In the standard theory, comparative advantage is determined on the basis of relative factor endowments. The country which is abundant in land specialises in the production of agricultural products (or raw materials). The country which is abundant in labour specialises in the production of labour-intensive products like clothes. And a country which is abundant in capital specialises in the production of capital-intensive goods like industrial machinery and equipment.

The so-called new trade theory has complemented, and to some extent challenged, the comparative advantage explanation. The background for the new theory was the empirical observation that countries were exchanging goods belonging to the same product categories. This kind of intra-industry trade can occur when industries have increasing economies of scale. Intra-industry trade was first observed in trade between industrial countries.

The new trade theory has been complemented by the new economic geography approach to foreign trade. (See Krugman, 1991.) This approach stresses the importance of scale economies and industrial clusters. Production of a product can start in some country for some rational reason (factor endowments, market access, etc.) or even by chance. But when such production has reached a sufficient scale and when strong clusters have arisen in that area, the process is often self-reinforcing (a virtuous cycle). In some countries there can correspondingly be a vicious cycle, whereby the development does not start or goes backwards. The economic geography explanation for foreign trade can thus be used in explaining development differences between countries (see, e.g., Crafts and Venables, 2001).

The above theories form a complex, where each explanation is present in some form. Some of these can be dominant at each point in time. Even though the modern theories have gained more recognition, the comparative advantage approach is still a crucial starting point in evaluating the success factors of individual economies.

The common conclusion reached by the different theories is that they all explain how international trade is beneficial. Put bluntly, the international division of labour makes the use of resources more efficient and gives a possibility to increase the standard of living. The importance of this fact is only rarely denied. (For empirical evidence on the relationship between openness and growth, see for example Sachs and Warner, 1995.)

The development in transport and communication technologies has increased foreign trade dramatically. Its share in GDP especially in developed countries has increased.

Liberal foreign trade is seen as beneficial by national governments. This has led to a liberalisation process that was realised in the context of several GATT (General Agreement on Tariffs and Trade) negotiation rounds. In 1995 the World Trade Organisation (WTO) was established to continue this work. The WTO has more than 140 member countries, and about 30 countries are negotiating for membership. The WTO countries account for 97 per cent of world trade.

While foreign trade is a necessary element for globalisation, it is not a sufficient condition. An economy with extensive foreign trade can be *internationalised*, but for *globalisation* also other forms of international economic co-operation are needed.

An alternative to mobility of goods and services is the mobility of factors of production. Land is immobile by definition, but capital and labour are in principle mobile, when political authorities just allow for that.

Foreign Direct Investment

Foreign direct investment (FDI) is an important form of co-operation at the production level. It has grown lately four times faster than foreign trade.

Foreign direct investment has existed already since the colonial times, but the form of investments has changed. In the colonial time the investments were often politically motivated. Governments wanted to have strategically important raw materials and they co-operated with big domestic firms. The firms often had a local monopoly. Nowadays investments follow more an economic and

decentralised logic, although in some cases (oil and strategic raw materials) political motivations are also present.

The current upswing in foreign direct investment is a response to the liberalisation of capital restrictions. The end of the cold war and the general widening of liberal economic and political thinking have accelerated the growth of FDI. Nowadays the nationality of the owners of production facilities is not seen as important as before. This view has won support gradually when FDI flows have increased and when globalisation has proceeded. FDI is seen as a way to mobilise domestic resources more efficiently and more quickly than what would be possible just by relying on domestic savings. This is an important point of view especially in developing countries, where domestic savings are small. Currently developing as well as developed countries actively try to attract FDI into the country.

When capital owners of a country do not have suitable investment objects in their 'own' countries, they extend their activities abroad. They usually already have the needed production know-how, for example in mining, and the limits for growth have been reached in the home country. A natural strategy in this kind of a situation is to start producing abroad, either by buying an existing firm or by undertaking a so-called greenfield investment. This globalisation of firms is motivated by economies of scale, which are achieved by specialising in one branch of industry, instead of investing in different industries in the home country.

Foreign direct investment is driven by various factors. These include:

1) natural resources,
2) cheap and/or skilled labour (an optimal wage-skill combination),
3) size of the market of the host country and of neighbouring countries,
4) freedom in foreign trade,
5) international transport connections,
6) size and quality of the production cluster in the host country (economies of scope),

7) general infrastructure of the host country (transport, communication, education, health care, etc.),

8) political and macroeconomic stability of the host country.

Foreign direct investment, like foreign trade, tends to enforce itself. The existence of an educated labour force, infrastructure and of other firms in the same sector or in connected sectors make new investments easier to carry out. In this kind of an environment, the availability of labour, raw materials, other production necessities, and of business services is greater.

Foreign direct investments are nowadays more often related to production sharing. Different phases of production are located in different countries. This is attractive because different phases have their own technological and economic logic. Some phases are labour intensive, some technology-intensive, etc. It is profitable to locate labour-intensive phases in countries, where labour is cheap. Technology- and skill-intensive phases are in turn located in developed countries. This kind of production sharing is made possible by the current advanced transport and communication technology.

Foreign direct investments could, in principle, be a substitute for foreign trade. In practice, however, FDI growth has coexisted with continued rapid growth of foreign trade. This is explained by the fact that FDI has created new trade possibilities. The channels for this are: a) FDI has accelerated the growth of the GDP, and 2) production sharing related to FDI has created trade of intermediate products between countries (inside one firm or between firms). (See Nunnenkamp, Gundlach and Agarwal, 1994.)

Other Forms of Globalisation at the Firm Level

Other forms of international co-operation between firms include a) joint ventures with minor foreign equity, b) the supply of technology or trademarks through licensing agreements, c) international subcontracting, and d) contracts on franchising (ibid.). In this kind of co-operation 'tangible or intangible assets are supplied by a foreign company to a local enterprise, while local interests in the host country retain majority or full ownership' (ibid., 28).

In these forms of co-operation, formal control of the foreign (parent or customer) company is not based on equity. The control occurs through different kinds of agreements or through supplier-customer relationships. The immediate business risks for the 'parent company' are smaller in these kinds of co-operative forms than in FDI. Globalisation by these means is easier for the 'parents' and can be used by smaller firms instead of FDI.

FDI and the other forms of co-operation are related to different business strategies. In the case of FDI, the firm maintains control of the production technology, brand name and quality. This is why firms producing differentiated products prefer it. In the case of the other forms, 'knowledge is embodied in capital goods, production processes are easier to manage, and the R&D intensity of production is low' (ibid., 31). A firm can use different strategies in different activities.

Nunnenkamp, Gundlach and Agarwal (pp. 44-80) study three industrial sectors: 1) the automobile industry, 2) the chemical industry, and 3) the textile and clothing industry. They conclude that FDI continues to be of over-riding importance in human-capital-intensive industries like automobile production. The other types of co-operation are, in turn, dominant in labour intensive industries like the clothing industry. In the case of the chemical industry, FDI seems to dominate in industrial countries, especially in the United States, whereas the other forms seem to dominate in the developing countries (ibid., 68).

International Migration

International migration is another way, in addition to FDI, to move factors of production. Migration has been an important phenomenon through history. The attitude of governments toward it has, however, changed over time. Migration has been important in the settlement of America and Australia, for example. In those days migration was welcomed by the sending as well as by the receiving countries. Currently, the developed countries tend to limit the mobility of people rather strictly.

Labour mobility is, in principle, free inside rather homogenous areas like the EU, where mobility is guaranteed by international treaties. In these kinds of situations, labour mobility is seen as a crucial freedom of the citizens, but especially as a way to allocate resources efficiently. Freedom of mobility of goods and services, capital and labour are all seen as parts of the same package in increasing the economic welfare of citizens. Labour mobility is also seen as important for macroeconomic stability in the case of a fixed exchange rate or a common currency. If the exchange rate does not respond to exogenous shocks, macroeconomic stability is restored by exporting labour to the country, where demand for goods and services has increased, from the country, where the demand has decreased. (Mundell, 1961.)

In practice, however, mobility of labour is very limited between the EU countries, too. There are many frictions like language, culture, differing educational standards, etc. For this reason, the EU attempts to enhance the mobility of labour inside the union.

In the case of less integrated countries, the question of labour mobility is more controversial. In principle, arguments related to allocative efficiency are valid for the whole world economy. Efficient use of resources would favour free mobility of labour. Some countries have excess labour and some countries suffer from shortages of labour. Currently shortages are, however, rare, and many industrialised countries suffer from unemployment. Additionally, the costs of mobility are larger in the case of very heterogeneous countries than in the case of similar countries. The costs include linguistic, cultural and educational differences as well as problems related to large uncontrolled influxes of population to certain countries.

In the future, arguments for more liberal mobility of labour between the developing and developed countries will be more valid. The labour force in developed countries is ageing at the same time as the growth of population continues fast in the developing countries. Costs related to free mobility and political considerations, however, will keep labour mobility strictly regulated and controlled.

Foreign Borrowing and Lending

Foreign borrowing and lending is one way of improving the allocative efficiency between countries. It is thus also a form of globalisation. It gives the borrowers a possibility to obtain foreign resources for purposes of long-term development and short-term stability. For private financial institutions, it is a way to do business internationally and to diversify risks related to lending.

Public financing institutions, such as the IMF, the World Bank and regional development banks, act partly on an altruistic basis. On the other hand, they provide a global public good for the whole world economy, because it is in the interests of the developed

countries, too, that the developing countries develop and maintain macroeconomic stability. Development increases the market of the whole world and diminishes problems related to poverty and instability. These problems are not limited to the poor countries only, but have also international reflections.

Foreign Aid

Foreign aid to developing countries is based on altruistic motivations. But it also has the characteristics of an international public good. On the donor side, foreign aid is a way to take care of global responsibilities. Sometimes aid is tied to exports from the donor country, which diminishes the extent of altruism. On the side of the recipients, it gives a possibility to exceed the limitations of domestic economic resources.

Macroeconomic Integration

The macroeconomic policies of individual countries have become integrated as a result of economic globalisation. On the other hand, this integration itself has been a form of globalisation and has strengthened the globalisation process.

Economic globalisation means that the possibilities to follow an independent macroeconomic policy are substantially limited. Mobile capital reacts if the policy endangers the country's economic stability. If there is a risk of a currency devaluation/depreciation or political instability, capital will flow out, because expected returns decline immediately. The situation is most likely to occur, when the exchange rate is 'fixed but adjustable'. In a floating rate regime, the exchange rate depreciates immediately, and the exchange rate crisis is not as severe. In this case, there is some room for independent national monetary policy in the short term. In the long term, however, capital mobility means that inflation must be kept under control, otherwise the currency continues to depreciate.

The capital market also reacts when the government runs a too expansionary fiscal policy and the external debt increases to an intolerable level. An indebted country is not an attractive target for FDI because indebtedness leads sooner or later to an austerity policy, which deteriorates business opportunities. If a government is indebted to international organisations like the IMF or the World Bank, these institutions try to keep the macroeconomic policies in check. This is done by monitoring the policies regularly and by requiring macroeconomic stabilisation measures as a precondition for their lending.

Sometimes macroeconomic integration itself reinforces the integration and the globalisation process. This is the case in regional economic groupings like the EMU and the West African Union. They are monetary unions, membership of which means total loss of national monetary policy independence and some loss in the independence of fiscal policy. In the case of the East African Community the monetary union is the final aim, too.

Other Effects of Globalisation

Above we have dealt with economic globalisation. Globalisation has, however, effects on almost all fields of human life. The most immediate sectors, in which economic globalisation has strong effects, are those policies that require resources of the national government. Globalisation limits the room for manoeuvring in politics, especially it affects the timing of the measures. This is due to the foreign discipline of the markets and of the international organisations. In the end, however, the available resources are the final constraint. And, usually, the external pressure just prevents a policy, what would have been unsustainable anyway.

If government finances are sound, governments have several options in their economic and social policies. There can be several 'social models', which are consistent with globalisation. The United States and the EU countries (and especially the Nordic countries) present different social models, which operate successfully in the global market economy.

2.2 History of Globalisation

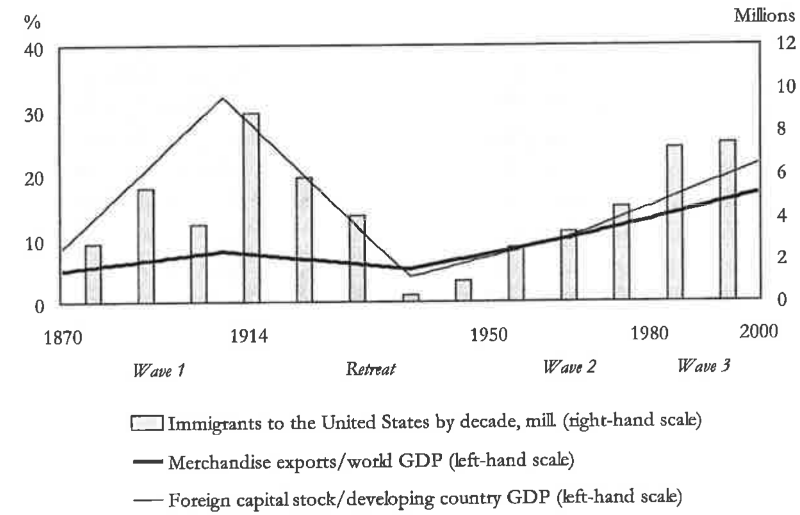
Even though some origins of globalisation can be found very early in history, the start of 'modern' globalisation goes back to the second half of the 19th century. This is a time when nationality as the basis for state formation was already widespread. At this time, the development of transport and communication technology led to a situation, where national borders appeared to be too limiting for several kinds of economic activities. We study here three main components of globalisation: 1) foreign trade, 2) foreign direct investment, and 3) international migration.

The World Bank (2002) classifies the globalisation development since then as follows:

1) the first wave of globalisation: 1870-1914,
2) the retreat into nationalism: 1914-1945,
3) the second wave of globalisation: 1945-1980, and
4) the new wave of globalisation: 1980-.

In Figure 2.1 world trade is measured relative to world income. The capital stock is presented by the stock of foreign capital in developing countries relative to their GDP. Migration in turn is proxied by the number of immigrants to the United States.

Figure 2.1 Three waves of globalisation



Source: World Bank (2002, 23). (Originally: Foreign capital stock/developing country GDP: Maddison (2001), table 3.3; Merchandise exports/world GDP: Maddison (2001), table F-5; Migration: Immigration and Naturalization Service (1998).)

The first wave of globalisation started in 1870 and continued until the beginning of the First World War in 1914. During this period transport connections developed substantially. Sail ships were gradually replaced by steam ships, which were faster and more punctual. Railways were built in several parts of the world that developed domestic transports. This was important for export production but also for the delivery of import goods. The invention of telegraph helped establish contact over long distances. France and Great Britain were pioneers in reducing foreign trade barriers.

The dominant pattern in foreign trade was that land-intensive primary commodities were exchanged for manufactures. Trade was thus based on comparative advantage.

Colonial relationships were an important framework for trade. This was seen also in capital flows, which were directed to the production of primary goods. Capital was exported from the colonising countries to the colonised countries. In 1870, the foreign capital stock in developing countries was 9 per cent of their income. By 1914 this ratio had increased to 32 per cent. Around a half of British savings were channelled abroad during 1870-1914. (World Bank, 2002, 25.)

The widening of the production of primary commodities also required more labour. This was the case especially in America and Australia, where the population at the time was small. Sixty million people migrated from Europe to North America and Australia. Migration from China and India to the rest of Asia was also of the same order of magnitude. The total migration flows during the first wave of globalisation were nearly 10 per cent of the world's population, much larger than thereafter. (Ibid.)

The deepening international division of labour accelerated the growth rates of world GDP. Per capita incomes had increased by 0.5 per cent per year during the previous 50 years. Now the annual growth rate was 1.3 per cent on average. (Ibid.)

Argentina, Australia, New Zealand, and the United States became some of the richest countries by exporting primary commodities and by importing people, institutions, and capital. Wages in these countries tended to decline due to immigration. In the emigration countries wages, in turn, increased. Land-owners in the 'colonies' benefited from the process, whereas land-owners in Europe lost.

The first wave of globalisation ended in the First World War. The period between the First and the Second World War did not mean a return to globalisation. The period 1914-1945 was labelled **a retreat to nationalism**. Even though the technical conditions for transport and communication improved substantially, political nationalism succeeded in limiting international economic relations.

The great depression of the late 1920s and early 1930s led to protectionism, which additionally limited the international division of labour.

By 1950 exports as a share of world income were around 5 per cent, i.e. at the level of 1870. The effect of nationalism on capital mobility was even greater. Most developed countries implemented capital export controls. Many developing countries in turn defaulted on their liabilities. By 1950 the foreign capital stock was only 4 per cent of the income of the developing countries (Figure 2.1). This was less than in 1870.

International migration was also reduced during this nationalistic period. The restrictions were motivated by economic as well as by political factors. Immigration to the USA declined from 15 million during 1870-1914 to 6 million in 1914-1950 (World Bank, 2002, 27).

The growth rate of the world GDP was a third lower than in 1870-1914. Economic inequality between regions increased, too. The incidence of poverty declined more slowly than before. In absolute terms, the number of poor people increased by 25 per cent. Life expectancy, however, increased due to advances in medication and in public health. (Ibid.)

The second wave of globalisation followed the nationalistic period after the war, i.e. in 1945-1980. As a reaction to the horrors of the war, there was much effort to enhance international cooperation. This was reflected in the establishment of the United Nations in 1945 and of the Bretton Woods institutions (the International Monetary Fund and the World Bank) in 1946. In the economic field, however, this globalisation was limited to the industrialised countries and mainly to manufactured goods. By 1980 trade of manufactures was to a large extent freed of barriers. In the case of agricultural products trade was restricted even between developed countries. Imports of products of developing countries were liberalised if they did not compete with those of the developed countries.

Transport and communication technology developed further during this period. Between 1950 and the late 1970s sea freight charges fell again by a third (World Bank, 2002, 28). World trade doubled relative to world income during this time. This was seen as an increase in the trade of manufactured goods between developed countries and as an increase in the exchange of manufactured goods of developed countries for primary commodities of the developing countries. Capital and labour mobility did not recover essentially during this period.

For the developed countries the years 1945-1980 were a period of a rapidly increasing prosperity. The GDP of the OECD countries grew by 4 per cent a year on average in 1960-1980. Specialisation in the production of manufactures deepened between the industrialised countries. This meant a better use of scale economies. Some companies grew into big multinationals. Specialisation was more often based on scale and agglomeration, and not so much on comparative advantage as before. Intra-industry trade was also growing, reflecting increased use of foreign intermediate goods by companies in their production.

During the second wave of globalisation most developing countries did not participate in the trend towards specialisation in the production of manufactured goods. Income differences between the developed and developing countries increased accordingly. The income distribution across developed countries converged as the previously lower income countries caught up to the higher income countries. There was little change in the equality between countries in the developing world. (World Bank, 2002, 31.)

The third wave of globalisation started in about 1980 and this phase still continues today. According to the World Bank (2002, 31) this period has three special characteristics, which separate it from the previous period. These are: 1) a large group of developing countries broke into the global market, 2) other developing countries became increasingly marginalised and suffered from declining incomes and increasing poverty, and 3) international capital movements and migration became substantial. In addition to these, a fourth characteristic could be added: the deepening international specialisation and increasing fragmentation of production (globalisation at the production level). Final goods are nowadays a combination of intermediate products, which are produced in different countries on the basis of complicated production networks and ownership relations. (See Chapter 2.1.)

A group of developing countries with a joint population of 3 billion people have entered the globalisation stage of development. (Ibid.) These countries have gained a competitive advantage in labour-intensive manufactures. The share of manufactures in the exports of developing countries has accordingly increased from 25 per cent in 1980 to 80 per cent in 1998 (Martin, 2001). The countries with a high share of manufactures include China, Bangladesh, Sri Lanka, India, Turkey, Morocco, and Indonesia. Many developing countries have also succeeded in increasing the share of services in their exports (mainly tourism and transport).

The factors behind the successful development include:

1) the liberalisation of foreign trade as well as of the domestic economy,
2) reduced tariffs in the industrialised countries,
3) increased foreign direct investments,
4) improved transport and communication technology,
5) increase in the wage level of developed countries (an improvement in the competitiveness of developing countries),
6) changes in production technology, which allow for a better division of production phases in different locations, and
7) improved infrastructure in these developing countries (education, internal transportation and communication etc.).

Not all developing countries have managed to participate in this globalisation process. They have a total population of about 2 billion people (World Bank, 2002, 38). These countries have become more or less marginalised. In many of these countries, GDP per capita has increased only slightly or declined. This is due to slow economic growth and fast population growth.

There are several reasons why each of these countries has not succeeded. In some cases the countries have unfavourable characteristics, which are difficult to change. These are, for example, poor transport connections (landlockedness, etc.), an unfavourable climate, diseases, an unfavourable internal geography, and demographic heterogeneity. These factors have their impact on the economic, political and social state of the country.

Political instability (even wars) and social unrest are already sufficient factors to prevent development. Most wars today are civil wars taking place in developing countries. Even though there are many structural reasons behind these problems, it is not impossible to change or improve them.

Often the reasons for backwardness are related to infrastructure and economic policy. According to the World Bank (2002, 35) the more globalised countries have improved primary education faster than the less globalised countries. They have also safeguarded property rights and law and order better. They have reduced tariffs more and conducted a more stable economic policy. All these factors affect the development either directly or through foreign direct investment, which tends to be directed to stable and liberal countries with a good infrastructure.

One reason behind the success of some and the failure of others is that there is a limited number of opportunities at each time. The growth of world demand has its limits; also FDI is scarce. Only the most favourable locations can attract enough investments. Some countries face the problem that they have very efficient competitors. China and Brazil, for example, are big countries, which have a big domestic market. Their attractiveness bails out smaller and less efficient producers. The development process tends to force itself through the already existing production clusters and infrastructure. The developing countries compete with each other, and those which have already had some success, have better possibilities than those that are just in the beginning of the globalisation process.

Foreign direct investments have increased considerably (see Figure 2.1). They have been directed to the more globalised developing countries (see UNCTAD, 2001b). Their nature is also different from that in the previous stages of globalisation. They are now more directed to manufacturing. And the trade based on these investments is more of an intra-industry nature.

Migration has also increased. Migration flows consist partly of refugees from countries that have suffered from natural or human catastrophes. But also the economic incentives for migration have strengthened. Wage differences between the developed and developing countries are huge. Hourly wages in China and in India are only 1 per cent of those in Germany (World Bank, 2002, 45). Capital flows are one reaction to this, but another is migration. On the side of the sending countries, the lack of working opportunities is a motive to leave. Wage differentials are an incentive for the emigrants as well as for the employers in the developed countries. In the long run also demographic pressures are a motive to migrate.

2.3 How Does Globalisation Affect the Developing Countries Economically?

Foreign Trade

According to economic theory, foreign trade is beneficial in principle to any country. The international division of labour makes the allocation of resources more efficient and this increases the economic welfare of all countries, at least in the long run. Developing countries want to increase their exports. Rarely anyone argues against this. In the case of a shortage of some strategic goods and foodstuffs temporary export restrictions can, however, sometimes be motivated. What can be criticised the most are the export restrictions of the developed countries in the case of agricultural and labour intensive manufactured products. This is an argument for too little rather than for too much globalisation.

In the case of imports the counter-arguments for liberalisation are more frequent. But it is not simply so that exports are good and imports are bad. Imports are an important channel for raw materials, intermediate goods and technology transfer. Imports are the result of the division of labour. Developing countries specialise in the production of some goods and import some other goods. This is a way of cost saving.

And liberalising imports is a part of the deal: trading partners want that their export restrictions are liberalised, too. Developed countries do not, however, require full reciprocity in trade relations. They give preferential treatment to exports of the developing countries in the form of Generalised System of Preferences (GSP), which many developed countries have. The 'Everything But Arms' proposal of the EU goes a step further by liberalising all other exports of the LDCs (Least Developed Countries) except arms. All these measures can, of course, be criticised for not being sufficient.

In some cases import restrictions can be motivated. A self-evident case are imports of arms and dangerous materials. Imports that endanger the country's own basic food production can also be rather easily restricted. In the case of normal traded goods temporary import restrictions can be justified on grounds of the so-called 'infant industry argument'. According to this argument, in the period of liberalisation some industries might need temporary protection from foreign suppliers. This could be the case when the country in question has a comparative advantage in that sector, but the firms are for some temporary reason not competitive currently. This kind of protection should be used carefully so as not to protect permanently uncompetitive firms and industries.

The developing countries have to increase their volume of foreign trade. Doing so is crucial for advancing economic growth. They must strengthen their production in the existing products and find new products where they have a comparative advantage. One problem, which many developing countries face, is that their products have very volatile prices on the world market. This is due to the large primary good content in their exports. The countries should increase the level of processing in these goods and diversify their exports.

During the past years, developed countries have presented several new items for the WTO negotiation round initiated in the Doha meeting in November 2001. These include environmental requirements and labour standards. Even though the motives behind the suggestions might be honest, developing countries would face serious problems in fulfilling these. They cannot afford the standards, many of which the developed world has fulfilled only recently. The standards can also be used as barriers to trade. Even though promoting environmental and labour issues is important, the international environment and labour organisations (ILO) might be more appropriate fora for these discussions.

Foreign Direct Investment

Foreign direct investment is currently welcomed by almost any country. It gives external resources (capital and technology) to the development of the country. It improves employment (directly and indirectly). It increases exports and thereby improves the current account and contributes to the repayment of the foreign debt. Foreign direct investment is usually criticised for being too small rather than too large. Foreign investment can, for political reasons, however, be criticised for leading to too much foreign control. This kind of criticism has diminished recently, along with the international convergence of economic systems on the basis of market economy ideals. The actions of foreign firms do not differ essentially from those of domestic private firms. They might, however, be somewhat more footloose, which is seen as a faster reaction to changes in the factors of competitiveness.

The main economic criticism of FDI is that it does not have enough linkages to the rest of the economy. The linkages can be divided into 1) backward, 2) forward, and 3) horizontal linkages. Backward linkages exist when foreign affiliates acquire intermediate goods or services from domestic firms. Forward linkages exist when foreign affiliates sell their goods or services to domestic firms. Horizontal linkages involve interactions with domestic firms engaged in competing activities. (See UNCTAD, 2001b, 127.)

The backward linkages are often regarded as the most important ones and the most obvious for production. The other two forms are, however, important in the longer run in the transmission of technology and therefore also in the development of domestic production.

Alternatives to domestic backward linkages are producing the inputs internally in the firm or importing them from abroad. Referring to several existing studies, UNCTAD (2001b, 136-138) argues that the existence of domestic backward linkages depends on:

1) investment motives and strategies of firms,
2) technology and market positions,
3) role assigned to affiliates,
4) age of foreign affiliates,
5) mode of establishment of affiliate,
6) size of affiliate,
7) sector of industry.

Investment motives refer to whether the firm is oriented to the domestic market or to export production. Firms producing for the domestic market tend to have more domestic linkages. This is due to the cost and quality requirements found in export production. In production for the domestic market the local producers also know the priorities of the customers better than in the case of export production.

Technology and market positions affect the linkages so that foreign affiliates making rather standardised products with mature technology tend to prefer domestic outsourcing in developing countries. In the case of technologically more advanced products, the firms either produce the intermediate goods themselves or import them.

An autonomous role assigned to affiliates tends to favour domestic supplier linkages. The more dependent the affiliate is on the international strategy of the firm, the more it imports intermediate goods.

The age of foreign affiliates affects domestic linkages in that the older the affiliate is, the deeper the domestic supplier linkages are. Linkages thus develop over time.

When the mode of establishment of the affiliate is a merger or an acquisition (M&A), the formation of domestic linkages is more probable than in the case of a greenfield investment. When FDI is realised through a M&A the domestic linkages are already present. In the case of a greenfield investment, on the other hand, the firm is not yet anchored in the country.

Large foreign affiliates tend to outsource locally less than small ones. Large firms produce more internally.

Finally, the sector of industry affects the linkages. The crucial factor is how easily production processes can technologically be divided into discrete stages. This is easy in several branches of manufacturing like in the foodstuff industry and in low-tech engineering. UNCTAD (ibid.) argues that in the textile and clothing industry the supply linkages require such a degree of sophistication and scale that domestic linkages are rare.

In agriculture domestic linkages are also rare, because production processes are continuous (not easily separable) and because capital needs are high. In mining there are some possibilities for domestic linkages, for example in electricity and in technical services.

Construction and retailing offer potential for domestic physical input suppliers. Also foreign hotel operators can make significant local purchases of foodstuffs, furniture and fittings. In the case of hotels the outcome depends, however, also on the other criteria presented above.

Domestic linkages are thus important for the evaluation of the success of the FDI. The evaluation criteria are, however, complex, and the situation changes over time. The more anchored the foreign affiliate is in the country, the deeper the domestic linkages are. Low labour costs, short distances and local presence are arguments in favour of domestic supply linkages. Better education and a superior transport infrastructure would strengthen the local linkages further. Economies of scale and the strengthening of international supply networks have the opposite effect. The situation differs, however, between sectors of industry.

International Migration

The developed and the developing countries view international migration very differently. In the developing countries, population growth is fast and unemployment (open and hidden) is high. People can not easily find a job in the home country, leading the developing countries to favour a more liberal migration policy.

In many countries, for example in Nepal, labour income sent home by migrant workers is an important source of foreign exchange for the country. The professional experience received abroad raises know-how and thus supports the argument for a more liberal migration policy, assuming that the emigration is temporary. Permanent emigration of well educated people (so-called brain-drain) is a problem for developing countries.

The differences of opinion will remain also in the future. The ageing of the population in the developed countries will, however, make the migration policy of the developed countries slightly more liberal in the future.

Foreign Borrowing and Lending

Developing countries have usually borrowed too much from abroad. They would like to have more debt relief than what has been agreed on. From the side of the developed countries and the financing institutions, there are three main obstacles for greater relief: 1) the immediate economic loss, 2) the risk of moral hazard in borrowing in the longer term, and 3) the internal problems in the developing countries (political instability, corruption, inequalities, inefficiencies, etc.). Sensible debt relief of highly indebted LDCs is in the interest of the developed countries, because it would promote the growth of the world economy and prevent the transmission of shocks to the developed world – without mentioning the altruistic motives. In the future foreign borrowing must, however, be adjusted to reflect the repayment resources of the developing countries.

Foreign Aid

Foreign aid has declined recently both in relative and at times in absolute terms. It is an important source of resources for the developing countries, commanding a high share of many countries' development expenditure. Foreign aid helps immediately in catastrophes, but it is also an important way of capacity building for the development process of the countries.

The future of foreign aid depends on the economic growth and on the priorities of the developed countries. Altruistic motives, motives for promoting long-term economic growth in the world as well as the prevention of international conflicts, must be measured against the immediate costs of the aid. In addition to the amount of aid, also its distribution inside the developing countries and its efficiency must be emphasised more, in the donor and in the recipient countries. Some achievements have already been made in this respect.

Macroeconomic Integration

International institutions, like the IMF and the World Bank, are often criticised for limiting the sovereignty of policy makers in the developing countries. The loss of independence in macroeconomic policies is, however, a more general characteristic of a globalised world. Developed countries have partly lost their national sovereignty, too, as a consequence of greater capital mobility. A floating exchange rate gives somewhat more independence in monetary policy in the short term. In the long term, a sustainable macroeconomic policy has no alternatives. Developing countries must, however, liberalise their short-term capital movements gradually to avoid macroeconomic instability.

The more indebted a country is, the more dependent it is on the lending institutions and on the international financial markets. The lending institutions monitor the macroeconomies of the debtors because the outcome affects their ability to pay the debt back.

The lending institutions should, however, be careful not to intervene in the priority setting of domestic policy makers. As long as policies are economically sustainable and do not violate certain basic values of mankind such as human rights, it should be up to domestic politicians to set their priorities.

Other Effects of Globalisation

Globalisation has implications for many sectors. But it is not always easy to discern what is really due to globalisation, and what is due to the technical and economic development as such. And, in some cases, the actions of domestic firms or of the domestic government are crucial for the final outcome, not globalisation.

Areas where globalisation has some impact include general politics, the social structure, the labour market, social policy, education, culture, religion, and the environment (see for example World Bank, 2002; Kiely and Marflet, 1998; Hirst and Thomson, 1996). In these fields, however, globalisation does not necessarily determine a certain outcome, but it depends crucially on the domestic and international decisions.

Changes in politics are already a prerequisite for the globalisation process. Politicians must accept the general principles of a market economy. The forms of market economy can, however, differ between countries. There are several kinds of political structures, which are consistent with globalisation. Pressures towards political stability increase, because instability is a disincentive for foreign direct investment. Globalisation tends to decrease corruption, because it is disliked by foreign investors. In the short run, however, globalisation can increase possibilities for corruption.

It is clear that globalisation has some effects on the social structures of the developing countries. This effect, however, coexists with the effects of the general liberalisation process. Globalisation accelerates and modifies this effect. The non-monetary sector tends to diminish as globalisation proceeds. People increase the exchange of goods. Urban centres grow because globalisation tends to favour large units and agglomerations of manufacturing and services. Some production sites are non-competitive, and people gather in competitive production sites.

The labour market is affected by globalisation, because it increases competition and firm turnover. In the beginning of the globalisation process many domestic firms exit the market, because they are not competitive in the face of imports. Also later firm turnover is faster than without globalisation. In addition to the number of exits of firms, the number of firm entries also increases. This creates adjustment needs for wage earners. In the long run, there are, however, clearly more entries than exits. This gives more employment possibilities and increases the wage level.

Needs for social protection also change. They must be evaluated on a new basis, because traditional safety nets are abolished with the monetisation and urbanisation process. This process affects also the family structure and the roles of men and women.

Education needs increase with globalisation. Modern production requires more or less educated employees, depending on the job. The better the population is educated, the better the country can attract high value added phases of production.

Globalisation internationalises the developing countries in the fields of culture and religion. Depending on the strength of domestic traditions and on policies, the foreign impacts either modify and complement the old traditions or substitute them for new ones. When traditional and new cultures meet, also political, and even military conflicts may arise.

In the case of the environment, globalisation can have many kinds of effects depending on the domestic policies and on the type of production. If a country seeks to desperately attract any kind of foreign production at the cost of the environment, the consequences can be bad. But if the environmental requirements of the host country are strict and if the international companies follow environmentally sustainable practices, globalisation as such does not spoil the environment. Economic growth naturally tends to increase pollution through increases in production, consumption and traffic. But economic growth is also a prerequisite for the decline in poverty. Economic growth also gives more resources to spend on environmental protection.

3 A COMPARISON OF FINLAND'S LONG-TERM DEVELOPMENT PARTNERS

This chapter presents a general statistical overview and comparison of the economies of Finland's long-term development partners, Nepal, Tanzania, Mozambique, Ethiopia and Vietnam from the point of view of globalisation. In some cases we will also make comparisons to other economies in East Africa and South Asia. These, mainly India and Bangladesh for Nepal, and Kenya and Uganda for Tanzania, are important because they have partly similar export structures and participate in regional integration initiatives. Vietnam's point of reference is more readily found in South East Asia and is not included in the analysis. In Chapters 4 and 5 we will concentrate more thoroughly on Nepal and Tanzania, respectively. Those chapters also contain some relevant comparisons with neighbouring countries.

3.1 Selected Social Indicators

Table 3.1 presents social data for Nepal, Tanzania, Mozambique, Ethiopia and Vietnam. Like all developing countries, they have both common and distinctive characteristics. In many cases, Vietnam differs a lot from the other four, however.

Total fertility rates are very high in Nepal, Tanzania, Mozambique and Ethiopia. This is combined with extensive poverty, high infant mortality rates, high illiteracy rates, large rural populations, and low life expectancy especially in Africa, where AIDS has started to decrease life expectancy. Our aim is not to go deeper into these characteristics of developing countries more than to the extent that they have a bearing on how the nation in question can deal with increasing internationalisation of its economy as understood here in the wide sense of globalisation. Widespread illiteracy reduces competitiveness and, among other things, exposes the country to too high fertility rates and the spread of HIV/AIDS, which drain its meagre resources and add to poverty.

Table 3.1 Selected social indicators in 1999

Indicator	Nepal	Tan-zania	Mozam bique	Ethio-pia	Viet-nam
Area, 1000 km²	147	945	802	1,104	332
Land use, arable land, % of land area	20.3	4.2	4.0	9.9	17.5
Land use, arable land, ha per person	0.13	0.12	0.18	0.16	0.07
Total population, mill.	23.4	32.9	17.3	62.8	77.5
Total fertility rate, births per woman	4.3	5.4	5.2	6.3	2.3
Population density, people per km²	164	37	22	63	238
Urban population, % of total	11.6	31.7	38.9	17.2	19.6
Life expectancy at birth, years	58.2	45.0	43.1	42.4	68.8
Infant mortality rate, per 1,000 live births	75.4	94.8	131.2	103.7	36.7
Public expenditure on health, % of GDP[5]	1.3	1.3	2.8	1.7	0.2
Illiteracy rate, adult female, % of females aged 15 and above	77.2	34.3	72.1	68.2	9.0
Illiteracy rate, youth total, % of people aged 15-24	41.5	9.4	40.5	47.3	3.2
Population below USD 1 per day, %	37.7[2]	19.9[1]	37.9[3]	31.3[2]	..
Electricity production per person, kWh[5, 7]	55.0	67.1	404.6	26.6	283.1
Electricity production from hydroelectric sources, % of total[2]	90.5	96.5	99.4	97.0	51.2
Personal computers, per 1,000 people	2.7	2.4	2.6	0.7	8.9
Telephone mainlines, per 1,000 people	11.3	4.5	4.0	3.1	26.7

[1] in 1993; [2] in 1995; [3] in 1996; [4] in 1997; [5] in 1998; [6] 28.1 per cent in 1998.

[7] Electricity production per person was 9,841 kWh in the high-income OECD countries. Of this 14.7 per cent was produced using hydroelectric sources.

Source: World Bank World Development Indicators 2001.

3.2 Gross Domestic Product

Table 3.2 shows income per capita levels by world region. In 1999, the low-income countries had an average gross national income of USD 420, or USD 1,870 when adjusted for their purchasing power. Our five countries are included in this group. Their gross national income per capita varied between USD 100 in Ethiopia and USD 370 in Vietnam. Nepal's GDP per capita was USD 220 and Tanzania's USD 260. When adjusted for purchasing power, Tanzania emerges as the poorest of these countries with a per capita GNI of USD 500, while Ethiopia rises to USD 620, Nepal to USD 1,280 and Vietnam to USD 1,860. None of the countries is among the top-160 countries in the world.

Table 3.2 Gross national income per capita in 1999 by region, World Bank Atlas methodology (US dollars) and PPP (purchasing power parity, international dollars)

Region	Atlas method-ology	% of high income	PPP	% of high income
World	5,020	19.0	6,870	26.7
Low income	420	1.6	1,870	7.3
Middle income	1,980	7.5	5,200	20.2
Lower middle income	1,200	4.5	4,250	16.5
Upper middle income	4,870	18.4	8,770	34.1
Low & middle income	1,240	4.7	3,610	14.1
East Asia & Pacific	1,010	3.8	3,740	14.6
Europe & Central Asia	2,160	8.2	5,980	23.3
Latin America & Caribbean	3,800	14.4	6,620	25.8
Middle East & North Africa	2,060	7.8	5,000	19.5
South Asia	440	1.7	2,110	8.2
Sub-Saharan Africa	490	1.9	1,500	5.8
High income	26,440	100.0	25,690	100.0
Euro Area	22,250	84.2	22,180	86.3

Source: World Bank World Development Indicators 2001.

Table 3.3 Gross national income per capita in 1999 for selected countries, World Bank Atlas methodology (US dollars) and PPP (purchasing power parity, international dollars)

Country	Atlas meth-odology	Ranking	PPP	Ranking
India	440	163	2,230	153
Bangladesh	370	170	1,530	167
Vietnam	370	171	1,860	159
Kenya	360	172	1,010	186
Tanzania[1]	260	187	500	206
Mozambique	220	195	810	192
Nepal	220	195	1,280	176
Ethiopia	100	207	620	201

[1] Mainland Tanzania only.

Source: World Bank World Development Indicators 2001.

The share of agriculture in the GDP of developing countries is typically quite large. According to World Bank World Development Indicators (2001), Ethiopia is the most dependent on agriculture of our five countries with over 50 per cent of GDP originating in that sector. In the case of Nepal and Tanzania, the share of agriculture is a little over 40 per cent. It should be noted, however, that it is difficult to estimate the structure of GDP in developing countries because a large part of the economy is non-monetary subsistence farming.

Out of the five countries, Vietnam is the most industrialised, which is not surprising given its higher income levels, past history, larger inflow of FDI and geographical location in wealthier South East Asia. The share of manufacturing industry in GDP in Nepal and Tanzania is relatively low. Notably, the share of services in GDP is fairly similar in the five countries, varying between 37 and 42 per cent of GDP.

Table 3.4 Value added, % of GDP

Sector	Nepal	Tanzania	Mozambique	Ethiopia	Vietnam
Agriculture	41.7	44.8	33.0	52.3	25.4
Industry	21.3	15.4	25.2	11.1	34.5
Manufacturing	9.3	7.4	13.2	7.0	17.6
Services	36.9	39.8	41.8	36.5	40.1

Source: World Bank World Development Indicators 2001.

3.3 Foreign Trade Arrangements

Up until the early 1980s, import substitution policies were practised in most developing countries. By then these policies had proved ineffective and in many cases they had had an adverse effect on the countries' competitiveness and real GDP growth. Then began a tendency for more liberal and more open trade and economic policy regimes. This can also be seen in Nepal and Tanzania, which became multiparty democracies in the early 1990s. Relevant trading arrangements from the point of view of our five countries include the following, which are discussed more from the point of view of Nepal and Tanzania in Chapters 4 and 5, respectively.

World Trade Organisation

The World Trade Organisation had 144 members at the beginning of 2002. Of our five countries, Tanzania and Mozambique were members, while Nepal, Ethiopia and Vietnam have applied for membership and have observer government status. The WTO is a multilateral trading system. Its fundamental principles are non-discrimination, freer trade, predictable policies, the encouragement of competition, and extra provisions for less developed countries. The Multi-Fibre Agreement (MFA), which was first agreed upon during GATT and which has guaranteed developing countries quotas on their exports of textiles to developed countries, will be phased out by 2005. This will cause structural adjustments in some developing countries, whose textile industry has been protected by the MFA. Other developing countries stand to gain considerably from the phasing out of the MFA, however.

Regional Trade Agreements

Many developing countries are taking part in deepening regional integration with often very far-reaching goals up to and including political and economic unions. Nepal has special trading arrangements with India and it also has a wider regional interest in the South Asian Association for Regional Co-operation (SAARC). Tanzania is involved in the East African Community (EAC) with Kenya and Uganda, and it is also a member of the Southern African Development Community (SADC). Mozambique is a member of SADC, and Vietnam is a member of the Association of Southeast Asian Nations (ASEAN) free-trade area, which is becoming operational. Membership in such free-trade areas is beneficial because it exposes the countries' firms to foreign competition, enlarges the firms' markets, increases consumption possibilities, and encourages more efficient use of limited resources.

Arrangements with Industrialised Countries

The European Union is currently in the process of abolishing all tariffs on imports from 49 least developed countries. This applies to all products except arms, hence its popularised name, Everything But Arms (EBA). Five per cent of LDC exports to the EU face a tariff barrier. According to UNCTAD (2001a), the removal of the remaining tariff barriers will result in a small increase in LDC exports towards the EU. Tanzania will be among the largest beneficiaries, along with Malawi and Zambia. Tanzania's exports to the EU are estimated to grow by about six per cent. Despite the abolishment of import duties, less developed countries still do not face the EU market on an equal footing in some of their most important export products, notably agricultural goods, because of EU subsidies to its own producers. Tanzania is also a member of the Cotonou Agreement with the EU.

The United States is creating new trade and investment policies for Sub-Saharan Africa in the form of its African Growth and Opportunity Act (AGOA). According to AGOA Section 112(a), eligible textile and apparel articles imported directly into the customs territory of the US from a beneficiary Sub-Saharan African country may enter free of duty and free of quantitative limitations. The exporters have to complete quality requirements for textiles and apparel exports to the US, however. AGOA applies to Tanzania but not to Nepal, which is already set to lose with the phasing out of the MFA.

The European Union, the United States, Canada and Japan form the so-called QUAD countries ('Quadrilaterals'). Were the latter three to join the EBA agreement alongside the EU, LDCs would benefit much more, because the remaining tariffs are much higher on LDCs' exports to the US, Canada and Japan than they are to the EU: About five per cent in the EU but more than 50 per cent for the other three countries. For example, from the point of view of Nepal, the abolition of US tariffs on textiles would be good news because US tariffs are relatively high. Tanzania, too, would benefit from an enlarged EBA.

We will analyse the foreign trade arrangements of Nepal and Tanzania more in Chapters 4 and 5, respectively.

Tariffs

During the past few decades there has been a trend towards more open trade relations and lower tariffs. Table 3.5 presents data for some countries relevant to this study. Despite the clear trend towards lower tariffs, the tariffs remain quite high in many countries and much higher in developing countries than in industrialised ones. This limits trade between developing countries. Regional free-trade areas are a way to decrease bilateral or multilateral tariffs.

Table 3.5 Unweighted average tariff rates in selected less developed (LDC) and industrialised (IND) countries, 1980-99, %

Country	Latest in 1980-85	Latest in 1986-90	Latest in 1991-95	1996	1997	1998	1999
Bangladesh	99.9	94.0	42.0	27.4	24.6	23.8	22.2
China	49.5	40.3	36.3	23.6	17.6	16.8	..
Hong Kong	0.0	0.0	0.0	0.0	0.0	0.0	0.0
India	74.3	81.8	41.0	38.7	35.0	30.0	32.2
Nepal	22.1	22.6	11.0	..	..	16.3	17.7
Pakistan	77.0	64.8	50.7	41.7	..	46.5	
Singapore	0.3	0.4	0.4	0.4	0.4	0.0	0.0
South Korea	21.9	13.3	8.9	13.4	13.3	11.1	8.7
Sri Lanka	31.0	28.3	20.0	..	20.0	..	..
Vietnam	..	..	12.7	..	..	..	15.1
Ethiopia	29.0	29.6	16.3	..	..	..	..
Kenya	41.7	43.7	22.0	13.5	..	..	18.0
Mozambique	..	15.6	15.6	15.6	16.9	..	..
South Africa	29.0	11.0	6.2	8.8	8.7	7.2	8.5
Tanzania	23.9	29.7	24.5	24.4	21.8	21.6	16.1
Uganda	..	19.9	17.1	12.8	13.2	..	..
Zambia	..	29.9	23.8	13.6	13.6	6.8	..
Zimbabwe	10.0	10.1	15.6	25.0	24.0	22.2	21.8
European Union	..	8.7	6.8	6.7	6.2	6.0	5.6
Japan	..	6.9	6.3	5.9	5.7	5.5	5.2
Switzerland	..	4.4	4.1	0.0	0.0	0.0	0.0
United States	..	6.3	5.9	5.8	6.6	5.2	4.8
Average LDCs (129)	27.2	23.2	16.1	14.9	13.7	13.1	11.3
Average INDs (23)	..	7.9	6.3	5.3	5.0	4.4	4.0

Source: World Bank.

3.4 Developing Countries' Foreign Trade

Foreign trade is an important channel of globalisation. By specialising in certain products, even a small nation can consume products that it would not be able to produce itself efficiently. We will not analyse LDCs' foreign trade here at the level of products or trading partners. This will be done in Chapters 4 and 5 for Nepal and Tanzania, respectively. Instead, we will discuss a few broader developments of LDCs' foreign trade.

When measured by foreign trade, the openness of the LDCs analysed in our study has increased. From 1990 to 1999, exports of goods and services as a percentage of GDP increased from 11 per cent to 23 per cent in Nepal, from 8 per cent to 12 per cent in Mozambique, from 8 per cent to 14 per cent in Ethiopia, and from 26 per cent to 44 per cent (in 1997) in Vietnam, but remained unchanged in Tanzania at 13 per cent of GDP though it peaked at 24 per cent in 1995. Consequently, of our five countries all but Tanzania have seen their exports-to-GDP ratios rise during the 1990s.

Coe *et al.* (1997) argue in an empirical study that developing countries have been able to increase their productivity by importing a larger variety of intermediate products and capital equipment that embodies foreign knowledge, and by acquiring useful information that would otherwise have been costly to obtain. Indeed, foreign trade is one of the principle channels in the internationalisation of the economy. By importing capital goods, a country can increase its productive capability and possibly improve its productivity and competitiveness in the world market. It should be noted, however, that a high investment rate is not tantamount to high productivity or high income. There exists a possibility of investing too much or making bad investments.

According to Mayer (2000), low-income countries' ability to benefit from globalisation depends on whether they manage to increase technology imports and on the skills of the domestic labour force. They should run policies that sustain incentives for human capital formation and a reduction in the cost of technology adoption. These policies should be co-ordinated, as a mismatch of skills and technology leads to inefficiency and lower total factor productivity. Acemoglu and Zilbotti (1999) argue that productivity differences are likely to be higher in medium-technology sectors, and that the trade regime and the degree of intellectual property right enforcement in less developed countries have an important effect on the direction of technical change and on productivity differences.

The share of trade in GDP reflects the openness of the economies and, as such, the economies' dependence on overseas markets. As a general rule, increased exports raise firms' income because they then have larger markets and can produce more, and increased imports raise the options available to the consumers and the quality of the goods they can purchase. Smaller nations tend to be more open relative to their GDP than larger nations because they can reap larger gains from the comparatively larger foreign markets and therefore usually specialise more in their production and exports.

We can see from Table 3.6 that the five East African nations are, on average, more open than those in South Asia. However, South Asia includes much larger countries than East Africa. Consequently, it is no surprise that trade makes up a larger share of GDP in East Africa. Besides, the differences are not very large.

Table 3.6 Trade integration 1970-1998, % of GDP

Country	1970-79		1980-89		1990-98	
	Exports and imports	Imports	Exports and imports	Imports	Exports and imports	Imports
Nepal	17	11	22	17	35	26
Bangladesh	14	10	18	13	22	14
India	10	5	12	8	17	9
Pakistan	24	15	29	19	32	18
Sri Lanka	40	22	57	35	65	38
Tanzania	43	26	27	20	38	28
Ethiopia	20	11	25	17	23	17
Mozambique	..	..	33	27	47	40
Kenya	49	29	40	25	47	28
Uganda	20	8	15	8	24	17
Median*	38	21	37	22	43	26

* Median of 46 low-income countries.

Source: Mayer (2000).

Nepal was more closed than the other South Asian countries in the 1970s and the 1980s, but more open during the 1990s. Tanzania, on the other hand, has mostly been more open than the other countries in East Africa.

Table 3.7 shows the share of machinery imports in GDP for eleven low-income countries during three decades. A division is made between imports from developed countries and those from advanced developing countries.

There has been a slow, increasing trend in machinery imports. In the 1970s, imports of machinery amounted to 2.7 per cent of GDP in 46 low-income countries. All of these imports originated from developed countries. By the 1990s, machinery imports had risen to 3.3 per cent of GDP, of which 3.0 percentage points came from developed countries and 0.3 percentage points from advanced developing countries.

Table 3.7 Share of machinery imports in GDP, %

Country	1970-79		1980-89		1990-98	
	Developed countries	Advanced developing countries	Developed countries	Advanced developing countries	Developed countries	Advanced developing countries
Nepal	0.5	0.3	1.3	0.5	1.3	1.2
Bangladesh	0.7	0.1	1.1	0.4	0.9	0.8
India	0.7	0.0	1.2	0.1	1.5	0.2
Pakistan	2.6	0.0	2.8	0.3	2.9	0.8
Sri Lanka	1.8	0.3	3.6	0.9	3.0	1.5
Tanzania	3.8	0.2	3.5	0.2	3.7	0.5
Ethiopia	1.8	0.1	2.5	0.1	3.3	0.3
Mozambique	..	..	3.3	0.4	4.0	0.3
Kenya	4.5	0.2	4.0	0.3	4.5	0.6
Uganda	0.8	0.0	0.9	0.1	1.8	0.2
Median*	2.7	0.0	2.9	0.1	3.0	0.3

* Median of 46 low-income countries.
Source: Mayer (2000).

On average, the South Asian economies in the upper part of the table show smaller shares of machinery imports than the East African countries, but the difference has narrowed since the 1970s. Nepal shows lower levels throughout the period than South Asia does on average. Tanzania, on the other hand, has somewhat higher levels than East Africa on average. Another difference that we see is that the share of advanced developing countries in the imports of machinery is by far higher in South Asia than in East Africa. This is probably due to imports from the nearby South East Asia. The share of advanced developing countries has been especially high for Nepal and Bangladesh.

3.5 Economic and Structural Policies

The era of import substituting policies also meant that the economy in question was relatively controlled by the government and the public sector. Launching more open and more democratic policies therefore also means that the economy becomes less controlled from the above. Economic freedom helps firms face tougher foreign competition. By increasing competition it also decreases corruption and improves governance in the long term.

We will review the extent of economic freedom in selected LDCs. Our first source is the Cato Institute's Economic Freedom of the World Report, where 21 criteria[1] are used to produce an index of economic freedom. The data are presented in Table 3.8.

Table 3.8 Overall indicator of economic freedom, 0 = lowest, ..., 10 = highest

Country	1970	1975	1980	1985	1990	1995	1999	Ranking* in 1999
Nepal	..	..	5.33	5.07	4.84	4.99	5.44	89
India	4.11	3.42	4.39	4.00	4.04	4.49	5.31	92
Bangladesh	..	2.93	2.88	3.10	3.12	4.22	4.76	100
Uganda	..	..	2.64	2.69	2.72	4.86	7.13	43
Kenya	5.13	4.77	4.58	5.08	4.98	5.73	6.32	68
Tanzania	4.35	3.24	4.21	3.23	3.61	4.89	5.82	81

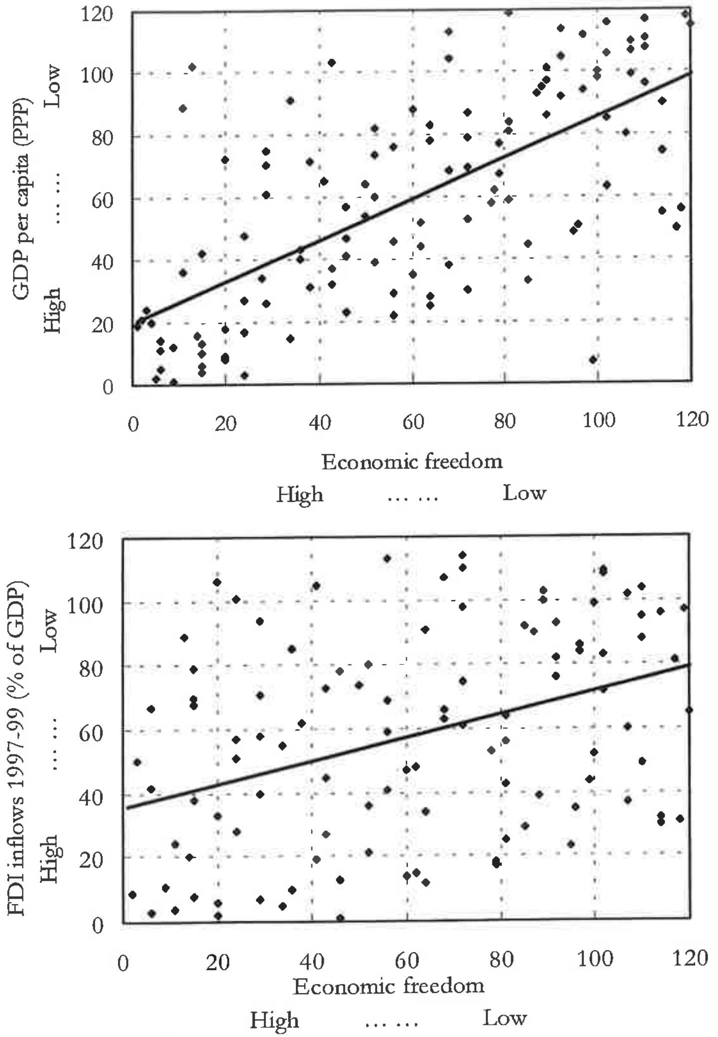
The higher the figure, the more there is economic freedom.
* Ranking out of 124 countries. Vietnam, Ethiopia and Mozambique are not included in the study.
Source: Cato Institute.

The index values of all the six countries presented in the table have risen during the 1990s, thereby showing that, according to the criteria used, economic freedom has increased in them. The South Asian economies are clearly less free than the East African ones. However, Nepal is the freest in South Asia and Tanzania the least free in East Africa.

Figure 3.1 plots the Cato Institute's indicator of economic freedom and countries' GDP per capita (PPP) and FDI inflows. In the lower left corner the countries have the most economic freedom and the highest per capita GDP or the highest FDI inflows. The plot is not very good, but still there is a positive correlation between the variables.

[1] The criteria cover the size of government, the structure of the economy and use of markets, monetary policy and price stability, freedom to use alternative currencies, legal structure and property rights, international exchange, and freedom of exchange in financial markets.

Figure 3.1 **120 countries ranked in order of economic freedom (Cato), 1=most free, and GDP per capita (PPP), 1=highest, (above), and FDI inflows 1997-99, % of GDP, 1 = highest, (below)**



Sources: Cato Institute Economic Freedom of the World 2001 Annual Report; World Bank WDI 2001.

The other source is the freedom indicator published by the Heritage Foundation, who have divided the measure of economic freedom into ten subgroups. In Table 3.9 we have a comparison of four South Asian countries and four East African countries. Only two of the eight countries make it into the top-100 most free economies. Note that the index is reversed from that of the Cato Institute. The smaller the number, the more free the economy.

Table 3.9 **Economic freedom by the Heritage Foundation in South Asia and East Africa, score 1.00-1.95 = free, 2.00-2.95 = mostly free, 3.00-3.95 = mostly not free, 4.00-4.95 = repressed**

	Nepal	India	Bangladesh	Vietnam
Trade	4.0	5.0	5.0	5.0
Fiscal burden	2.0	3.5	2.0	2.5
Government intervention	2.0	3.0	3.0	4.0
Monetary policy	2.0	2.0	2.0	1.0
Foreign investment	4.0	3.0	3.0	4.0
Banking/ finance	4.0	4.0	4.0	4.0
Wages/ prices	3.0	4.0	4.0	4.0
Property rights	4.0	3.0	4.0	5.0
Regulation	4.0	4.0	5.0	5.0
Black market	5.0	4.0	5.0	4.0
Overall	3.40	3.55	3.70	3.85
Ranking in 2002[1]	108	121	131	137

	Tanzania	Ethiopia	Kenya	Mozambique
Trade	5.0	5.0	4.0	3.0
Fiscal burden	3.0	3.5	3.5	3.5
Government intervention	3.0	3.0	3.0	3.0
Monetary policy	3.0	1.0	2.0	1.0
Foreign investment	2.0	4.0	3.0	2.0
Banking/ finance	3.0	4.0	3.0	3.0
Wages/ prices	3.0	3.0	2.0	3.0
Property rights	4.0	4.0	3.0	4.0
Regulation	4.0	4.0	4.0	4.0
Black market	4.0	4.0	4.5	4.0
Overall	3.40	3.55	3.20	3.05
Ranking in 2002[1]	108	121	93	76

[1] Ranking out of 155 countries.

Source: Heritage Foundation.

Within the four South Asian countries, Nepal again fairs the best, but it is still only 108th in the overall country listing. In South Asia, Nepal does well with its fiscal burden, government intervention and monetary policy, but the black market is a bleak spot. Tanzania is at the same level as Nepal, also holding the 108th position. Its best rating comes from foreign investment and the worst from trade. Both Nepal and Tanzania have made efforts to modernise their legislation and improve the market conditions for firms.

Corruption is a major problem in many countries. It also has a bearing on foreign direct investment. Countries that are less corrupt have on average received more foreign direct investment in per-capita terms than corrupt countries. According to the Transparency International, Vietnam is 75th on a list of 91 countries. Tanzania is 82nd on the same list. Corruption is also a major problem in Nepal, both in business and public governance (see e.g. Panday 2000 and publications by Transparency International).

According to Bonaglia et al. (2001) globalisation decreases corruption and improves governance. They argue that the effect of openness on corruption is almost one-third of the effect that the level of development has. The positive effect of increased globalisation and openness also increases transparency and information in the economy, lowers the costs of doing business, and has a positive effect on economic efficiency.

For example, it has been estimated that Bangladesh received 50 per cent less foreign direct investment in 1999 due to corruption, and that corruption at the country's ports costs the economy about USD 1.1 billion per annum (Global Corruption Report 2001).

3.6 Foreign Direct Investment

Global FDI Flows

The flows of foreign direct investment have grown rapidly during the past two decades. While these flows averaged USD 200 billion per year in 1989-94, they reached USD 1,270 billion in the year 2000. Economic integration and further reductions in trade barriers both globally and regionally can be expected to further encourage foreign direct investment.

Table 3.10 presents aggregate data for world foreign direct investment. FDI takes place mostly between industrialised countries.

In the year 2000, 80 per cent of FDI flows went into industrialised countries. The share of these countries has been increasing. European integration has increased FDI flows in Europe.

In the year 2000, 18.9 per cent of FDI inflows went to developing countries (especially into South East Asia and Latin America) but only 0.3 per cent to the least developed countries. The share of both Africa and of the least developed countries in general has declined during 1989-2000. The absolute figures have continued to increase, however.

Table 3.10 FDI inflows, USD mill. and % of total

Region	1989-94 (annual average)	1996	1998	2000
World	200,145	384,910	692,544	1,270,764
Share in total, %	100.0	100.0	100.0	100.0
Developed countries	137,124	219,688	483,165	1,005,178
Share in total, %	68.5	57.1	69.8	79.1
Developing countries	59,578	152,493	188,371	240,167
Share in total, %	29.8	39.6	27.2	18.9
Of which:				
Asia and the Pacific	37,888	94,506	95,850	143,763
Share in total, %	18.9	24.6	13.8	11.3
Latin America	17,506	51,279	83,200	86,172
Share in total, %	8.7	13.3	12.0	6.8
Africa	3,952	5,622	7,713	8,198
Share in total, %	2.0	1.5	1.1	0.6
Least developed countries*	1,430	2,450	3,679	4,414
Share in total, %	0.7	0.6	0.5	0.3

* Least developed countries include Nepal and Tanzania.
Source: World Investment Report 2001.

FDI into South Asia and East Africa

Tables 3.11 and 3.12 present more accurate data on the FDI flows into and FDI stocks in South Asia and East Africa, respectively. Here we can compare some of the countries in these two regions. Data for Vietnam are included in the first table.

First, there are three measures that relate the countries' share in world FDI inflows to their share in world GDP, employment and exports. If the figure is larger than unity, the country's share in FDI inflows is larger than its share in the world economy. In general we would probably not expect this to be the case for the least developed countries, and indeed this is what we can see in South Asia. Even though a little progress has been made, as the figures have mostly become non-zero, they are still a long way from unity. South Asia has not received a lot of foreign direct investment.

East Africa is different, however. Here we see that especially Mozambique has received significant amounts of FDI relative to its size. Tanzania comes second in our small group of countries in Table 3.12. On the other hand, the number of foreign affiliates is very low in these African countries compared to South Asia in Table 3.11.

Even though least developed countries receive only a very small fraction of total global FDI flows, the importance of the flows for many of these economies is large. FDI inflow as a percentage of gross fixed capital formation is very high in some African countries. In 1997-99 FDI was over 30 per cent of gross fixed capital formation in Angola, Swaziland, Lesotho, the Seychelles and Mozambique. In Tanzania it has been rather stable at 13-14 per cent during 1995-99. This shows how important FDI is for total investment in these countries. The respective figures are much lower than this in the South Asian economies.

Likewise, we can see that the inward FDI stock as a percentage of GDP is much higher in the East African economies, varying between 8 per cent in Kenya and 22 per cent in Mozambique. The stock is much smaller in South Asia, only 2-3 per cent of GDP. The East African economies rank as more free in the tables by the Cato Institute and the Heritage Foundation, which we already saw to be positively correlated with FDI inflows.

Table 3.11 FDI data for South Asia and Vietnam

	Nepal	India	Bangladesh	Vietnam
Foreign affiliates (1999)	224	1,416 ('95)	161	1 544 ('96)
Share in world FDI inflow divided by share in world GDP				
1988-1990	0.1	0.1	0.0	..
1998-2000	0.1	0.2	0.1	..
Share in world FDI inflow divided by share in world employment				
1988-1990	0.0	0.0	0.0	..
1998-2000	0.0	0.0	0.0	..
Share in world FDI inflow divided by share in world exports				
1988-1990	0.1	0.2	0.0	..
1998-2000	0.1	0.3	0.2	..
FDI inflows, USD mill.				
1989-94 (average)	4	394	6	651
1995	8	2,144	2	2,336
1996	19	2,591	14	2,519
1997	23	3,613	141	2,824
1998	12	2,614	190	2,254
1999	4	2,154	179	1,991
2000	13	2,315	170	2,081
Inward FDI flows as a percentage of gross fixed capital formation, %				
1989-94 (average)	0.6	0.6	..	..
1995	0.9	2.4	..	..
1996	1.9	2.9	..	..
1997	2.2	3.8	2.9	..
1998	1.2	2.9	3.8	..
1999	..	2.4	3.2	..
FDI inward stock, USD mill.				
1980	1	1,177	63	7
1985	2	1,075	112	38
1990	12	1,667	147	230
1995	39	5,684	180	6,286
1999	97	16,656	703	15,875
2000	111	18,971	873	17,956
Inward FDI stock, % of GDP				
1980	..	0.7	0.4	0.7
1985	..	0.5	0.5	0.5
1990	0.3	0.6	0.5	0.6
1995	0.9	1.7	0.5	1.7
1999	2.0	3.6	1.5	3.6

Source: UNCTAD World Investment Report 2001.

Table 3.12 FDI data for East Africa

	Tanzania	Ethiopia	Kenya	Mozambique
Foreign affiliates (1999)	27	21 ('98)	96	12
Share in world FDI inflow divided by share in world GDP				
1988-1990	0.1	0.1	0.5	0.3
1998-2000	0.9	0.6	0.1	2.6
Share in world FDI inflow divided by share in world employment				
1988-1990	0.0	0.0	0.1	0.0
1998-2000	0.1	0.0	0.0	0.5
Share in world FDI inflow divided by share in world exports				
1988-1990	0.1	0.2	0.4	0.5
1998-2000	1.5	1.0	0.1	3.1
FDI inflows, USD mill.				
1989-94 (average)	15	7	25	21
1995	150	14	32	45
1996	149	22	13	73
1997	158	288	40	64
1998	172	261	42	213
1999	183	68	42	382
2000	193	80	60	139
Inward FDI flows as a percentage of gross fixed capital formation, %				
1989-94 (average)	1.4	0.8	1.5	4.9
1995	14.6	1.6	1.7	8.2
1996	13.9	1.9	0.7	12.9
1997	14.0	27.5	2.1	10.3
1998	12.8	23.4	2.2	24.3
1999	13.8	6.2	2.6	55.5
FDI inward stock, USD mill.				
1980	47	110	391	15
1985	91	114	481	17
1990	93	128	673	42
1995	325	169	736	202
1999	987	808	873	933
2000	1,180	888	933	1,072
Inward FDI stock, % of GDP				
1980	0.9	2.7	5.5	0.5
1985	1.3	2.0	7.8	0.5
1990	2.2	1.6	7.9	2.0
1995	7.0	3.1	8.1	10.4
1999	11.2	12.4	8.2	22.4

Source: UNCTAD World Investment Report 2001.

3.7 Foreign Debt

Many less developed countries have large foreign debts. In some cases even the annual interest payments are crippling for the countries. In these cases, the debt severely constrains the countries' growth and their ability to pay back their loans.

The World Bank classifies Nepal and India as less indebted low-income countries, and Bangladesh and Vietnam as moderately indebted low-income countries. India and Vietnam have managed to improve their indebtedness classifications.

In Nepal, total external debt relative to the exports of goods and services amounted to 220 per cent in 1999, while their present value was 122 per cent of exports of goods and services. Interest payments were 2 per cent of exports.

Table 3.13 Major economic indicators and key indebtedness ratios in 1999, USD mill.

Indicator	Nepal	India	Bangladesh	Vietnam
External debt total (EDT)	2,970	94,393	17,534	23,260
Present value (PV)	1,654	70,451	10,988	21,672
Total debt service (TDS)	107	10,109	788	1,410
Interest payments (INT)	32	3,782	207	362
Export of goods and services (XGS)	1,354	67,479	8,088	14,356
Gross national product (GNP)	5,155	444,158	47,211	28,682
EDT/XGS, %	220	153	236	182
PV/XGS, %	122	114	148	169
EDT/GNP, %	59	22	39	84
PV/GNP, %	32	16	24	77
TDS/XGS, %	8	16	11	11
INT/XGS, %	2	6	3	3

Source: World Bank.

Of the East African countries, the World Bank classifies Tanzania and Ethiopia as severely indebted low-income countries, and Mozambique and Kenya as moderately indebted low-income countries. Mozambique has managed to improve its indebtedness classification.

In Tanzania, total external debt relative to the exports of goods and services amounted to a crippling 549 per cent in 1999, with a present value of 396 per cent of exports of goods and services. Interest payments were 6 per cent of exports. Tanzania is included in the HIPC (Highly Indebted Poor Countries) initiative to lower the debt levels.

Table 3.14 Major economic indicators and key indebtedness ratios in 1999, USD mill.

Indicator	Tanzania	Mozambique	Ethiopia	Kenya
External debt total (EDT)	6,385	1,915	5,551	6,562
Present value (PV)	4,613	1,042	3,529	5,183
Total debt service (TDS)	194	125	159	716
Interest payments (INT)	71	51	57	175
Export of goods and services (XGS)	1,251	624	944	2,681
Gross national product (GNP)	8,725	3,730	6,387	10,475
EDT/XGS	549	359	547	230
PV/XGS	396	195	347	181
EDT/GNP	77	53	87	61
PV/GNP	55	29	55	48
TDS/XGS	17	23	16	25
INT/XGS	6	8	6	7

Source: World Bank.

4 NEPAL

In this chapter we will discuss globalisation from the point of view of Nepal. After introducing basic information, such as geography, population and politics, we will review the latest macroeconomic developments in Section 4.2. In Section 4.3, the structure of GDP will be reviewed with a more detailed discussion of the main sectors of the economy. In Section 4.4, we will discuss Nepal's foreign trade regime and economic integration in South Asia. Then we will review Nepal's foreign trade in Section 4.5 and foreign direct investment into Nepal in Section 4.6. In Section 4.7, government finances, foreign aid and the country's indebtedness are discussed. A large part of the federal budget is financed with foreign aid. Monetary policy is discussed in Section 4.8 as Nepal's exchange rate policy is tied to that of India.[2]

4.1 Basic Facts about Nepal

Geography and Topography

Nepal is a land-locked country situated in the Himalayas in South Asia 28 degrees north of the equator. Its neighbouring countries are India to the east, west and south, and the Tibet autonomous region of the People's Republic of China to the north. The border with India is 1,690 km long and that with China is 1,236 km long. On average Nepal is 885 km long east to west and 193 km wide north to south. Its surface area is 147,181 km^2.

The Himalayas lie along the northern part of the country with the world's highest peak, Mount Everest located in north-east Nepal. Eight out of the world's ten highest peaks are found in Nepal. Still, Nepal's lowest point is at only 70 metres above sea level. Consequently, biological diversity is considerable.

2 Statistical note: Most statistics by Nepal's authorities are by fiscal years that end on July 15th. Consequently, for example data for 1996/1997 are for the period July 16th 1996 to July 15th 1997. Nepal Rastra Bank is the country's central bank.

Figure 4.1 Map of Nepal

From south to north there are three main topographical regions[3]:

- The Terai is an alluvial and fertile plain, 26 to 32 km wide, that lies between 70 and 305 metres above sea level in the south of the country extending from east to west. It occupies about 23 per cent of the total land area. Some 49 per cent of the population live in the Terai and its share has been on the rise since the 1970s.[4]
- The extensively cultivated hill region is situated north of the Terai. Some 44 per cent of the population live in the hills that cover about 42 per cent of the total land area. Kathmandu Valley is situated here at 1,310 metres above sea level.
- The Himalayan mountain region, which covers 35 per cent of the total land area, with altitudes ranging between 4,877 and 8,848 metres, is north of the hill region. Some seven per cent of the population live in this region.

The climate varies from cool summers and severe winters in the north to subtropical summers and mild winters in the south. The monsoon contributing 80 per cent of the annual rainfall, is in the

[3] Figures are from the Statistical Yearbook of Nepal 2001 and the Population Census of 2001.

[4] Malaria was largely eradicated in the early 1960s from the Terai and this made possible its more extensive use for both habitation and agriculture.

summer from June to August. The infrastructure is affected by the monsoon rains that cause landslides, destroy roads and bridges, and disrupt traffic and commerce. Monsoons also worsen health problems, like cholera. The damage caused by the monsoon is a burden on the country's limited financial resources.

Population and Social Indicators

There are many ethnic groups and languages in Nepal. According to the Ministry of Population and Environment, the National Ethnic Groups Development Committee has identified 65 different caste and ethnic groups and the National Language Policy Advisory Commission has listed 60 languages. Most of these are very small entities. The official language, Nepali, which is closely related to Hindi, is spoken by about 50 per cent of the population as their first language and as *lingua franca* by almost the whole population.

According to Population Census 2001 by the Central Bureau of Statistics of Nepal, the total population is 23.2 million with almost as many men as women. The growth rate of the population is about 2.3 per cent, or 530,000 people annually. The rate has declined from 2.6 per cent in 1990. Still, it is quite high and the demographic pyramid is dominated by a large young population. Those aged 14 or less represent 40 per cent of the population and only 3.5 per cent of the population are aged 65 or more. The infant mortality rate is 74.1 per 1,000 live births. Some 86 per cent live in rural areas and, according to FAO, 93.0 per cent belong to the agricultural population. The population of Kathmandu is 1.1 million, up from 675,000 in 1991. The population in the rest of the Kathmandu Valley adds to this.

Population density is 157 inhabitants per km^2, a relatively high figure especially given that the mountain region covers 35 per cent of total land area. Indeed, population density is 225 inhabitants per km^2 in the Terai and the hill regions. With 86 per cent of the total population living in the countryside, rural areas are densely populated. The World Bank projects total population to rise to 35 million by 2020 and further to 48 million by 2050.

Life expectancy has risen to 58 years currently – 0.9 years higher for men than that for women – and it has not been affected by AIDS as has happened in many African countries. HIV/AIDS is relatively rare in Nepal. According to UNAIDS, the number of patients may have reached 38,000 by the end of 2001. The country presentation by the Government of Nepal at the third UN Conference on the Least Developed Countries in May 2001 was fairly pessimistic of the AIDS/HIV situation in Nepal, expecting that the number of cases could reach 200,000 by the year 2010. Still, this would be a relatively low figure when compared to Sub-Saharan Africa.

Table 4.1 Selected social indicators for Nepal

Indicator	1970	1980	1990	1995	1999
Total population, mill.	11.3	14.5	18.8	21.3	23.4
Population growth, %	2.2	2.6	2.5	2.5	2.3
Urban population, % of total population	3.9	6.5	8.9	10.3	11.6
Labour force, % of total population	51.1	48.5	46.5	46.1	46.4
Women in labour force, %	39.3	38.8	40.4	40.4	40.5
Labour force, children 10-14, % of age group	63.1	55.6	48.3	45.2	42.7
Total fertility rate, births per woman	6.1	6.1	5.3	4.6	4.3
Infant mortality rate, per 1,000 live births	166.0	131.8	101.2	79.0	75.4
Malnutrition in children under age of 5, %	69.1[3]	..	..	48.5	..
Life expectancy at birth, years	42.4	48.0	53.6	56.3	58.2
Public expenditure on health, % of GDP	..	..	0.8	0.7	1.3[1]
Physicians, per 100,000 people	1.95	3.36	5.07	5.42	4.04[1]
Public expenditure on education, % of GNI	0.6	1.8	2.0	3.3	3.2[2]
Pupil-teacher ratio, primary	28.7[3]	38.4	39.2	39.5	..
Illiteracy rate, female aged 15 and above, %	96.4	92.8	85.9	81.4	77.2
Illiteracy rate, youth total aged 15-24, %	74.8	66.0	53.9	46.4	41.5

[1] in 1998; [2] in 1997; [3] in 1975.

Source: World Bank World Development Indicators 2001.

Illiteracy is a major obstacle for development in Nepal. The illiteracy rate among the total adult population aged 15 and above was 60 per cent in 1999 (77 per cent of women and 42 per cent of men were illiterate). Young adults are not much better off: 59 per cent of women and 25 per cent of men aged 15-24 are illiterate. The very high rate of illiteracy among the young, and especially among women, contributes to the high birth rate, high infant mortality rate and possibly increasing spread of HIV/AIDS. The latter is aggravated also by the openness of the border with India.

The population is predominantly Hindu (81 per cent) with Buddhist (11 per cent) and Muslim (4 per cent) minorities. There are no

religious conflicts in the country. The caste system, though not legal, is still strong. The Dalits, or the 'untouchables', make up 20 per cent of the population. The caste system is a source of social inequality. The UNDP Human development index for Nepal's Dalits was 0.239 in 1996, about half of that for Brahmins (0.439).

The UNDP Human Development Report 2001 lists Nepal as a country with low human development, but it is very close to the group of medium human development. In its technology achievement index, the UNDP lists Nepal as a marginalised country. Internet connections are very expensive. The number of users is small but growing rapidly.

Reducing poverty, raising literacy, and improving health care and physical infrastructure are very important issues in all developing countries. In Nepal, some 42 per cent of the population live below the poverty line. Using the international income threshold of one (1993 PPP) US dollar per day, 38 per cent of the population fail to rise above poverty.

According to the World Bank, 41.5 per cent of Nepal's total road network of 7,700 km were paved in 1996. There were only 19 metres of paved road per km^2 in 1990 while in India the respective figure was 231. The number of motorised vehicles is low.

The development goals of Nepal as submitted to the UNDP are: the reduction of extreme poverty, increasing food security, reducing child mortality, improving access to education, promoting gender equality in education, improving reproductive health, increasing access to basic household amenities, reducing the incidence of HIV/AIDS, and improving the environment for sustainable development. With target dates mainly set for 2015, the country report submitted in 2001 is optimistic about Nepal reaching the target set for basic amenities, and it also sees some potential for reaching the targets for reproductive health and child mortality. The other targets are unlikely to be reached. For example the share of the population living in poverty has risen during the 1990s. Almost one in two children under the age of five suffer from malnutrition and almost 43 per cent of children aged 10-14 are in the labour force. The latter figure is the seventh highest in the world according to the World Bank World Development Indicators. In Tanzania it is 37 per cent.

Income inequality has increased in Nepal. In urban areas the Gini coefficient rose from 0.26 in 1985 to 0.43 in 1996, and in rural areas from 0.23 to 0.31. Average household income varies by region, and the urban/rural disparity is large. In the rural areas, western Nepal has lower incomes than the eastern and central parts. Incomes are lower in the Terai (high Gini coefficient of 0.66) than in the hills. Regionally, the worst income distribution is found in the central region with a Gini coefficient of 0.66.[5]

According to Cockburn (2001), trade liberalisation has increased income inequality in Nepal. He argues that urban households have gained as initial tariffs were highest in agricultural sectors. Consequently, poverty falls in urban areas and increases in rural areas, particularly among the moderately poor.

The high population growth rate holds back growth in GDP per capita. A larger population in principle means a larger domestic market and larger domestic demand for goods and services, and therefore also increased production and employment. However, as 86 per cent of the population live in rural areas and largely survive on subsistence farming, there is no comparable increase in demand. Given the great need for investment in physical infrastructure (roads, bridges and buildings) as well as in social infrastructure (education, healthcare, etc.) this constrains the nation's very limited resources.

The large and fast growing local population needs an increasing amount of land and natural resources. According to FAO, forests cover 39,000 km^2 or 26.5 per cent of the land area, and average annual deforestation was 782 km^2 or 1.8 per cent in 1990-2000. There is increasing erosion, loss of wildlife habitat, and a fall in the level of ground water.

History, Polity, and Politics

Let us briefly review the political development in Nepal.[6] In 1768, several kingdoms of the Kathmandu Valley were unified by King Prithvi Narayan Shah. A commercial treaty was signed with Britain in 1792, and another in 1816 after over a year of conflict with the British East India Company. Nepal became a quasi-British protectorate. In 1846, Jung Bahadur seized political control following the so-called Kot massacre. He took the title of Rana, proclaimed himself prime minister for life, and later made the office hereditary.

5 Data by the Asian Development Bank.

6 Information herein has been gathered from several sources.

In 1923, Britain recognised the independence of Nepal but foreign relations were still controlled by the British. Nepal remained a closed country as it had been since 1816.[7] The Rana system of hereditary prime ministers lasted until 1951 after having come under pressure following the independence of India. King Tribhuvan was made ruler after some civil unrest. He formed a government comprising of Ranas and members of the then newly formed Nepali Congress Party. King Tribhuvan died in 1955.

In 1959, under Tribhuvan's son and successor King Mahendra, Nepal's first constitution was adopted providing for a bicameral parliament and a popularly elected lower house. The first democratic elections were held in 1959 and B. P. Koirala became Prime Minister. Differences between the king and the prime minister led to a royal coup in December 1960, and a new constitution was adopted in 1962 setting up a 'partyless' panchayat (village council) system in which the king selected the prime minister and the cabinet, and appointed a large part of the rubber-stamp national assembly.

This system came to an end in 1990 after a popular uprising. King Birendra, in power since 1972, dissolved his cabinet, legalised political parties and invited the opposition to form an interim government. Since 1990 Nepal has been a multiparty democracy and a constitutional monarchy. The legislative power consists of a bicameral Parliament with the National Council and the House of Representatives.[8] The cabinet is appointed by the king on the recommen-

7 Remoteness is characterised by the fact that the first road to India that could be used by motorised vehicles was not opened until 1956 and international air service only began in 1974.

8 The National Council has 60 seats of which 35 are appointed by the House of Representatives, 10 by the king, and 15 are elected by an electoral college. One-third of the members are elected every two years for a six-year term. The House of Representatives has 205 elected members from national single-member constituencies. The members are elected with a popular vote for a five-year term. The last elections of the House of Representatives were held in May 1999. The largest party is the Nepali Congress Party (37.3 per cent of the popular vote and 113 seats) and it forms the government. The main opposition party is the Communist Party of Nepal - United Marxist-Leninist (31.6 per cent of the popular vote and 69 seats). There are five other parties in the House of Representatives.

dation of the prime minister. The leader of the majority party or that of the majority coalition is usually appointed prime minister.

Currently, the hereditary monarch and the chief of state is King Gyanendra Bir Bikram Shah who succeeded to the throne on June 4th 2001 after the massacre of the former king and his family. The Prime Minister has been Sher Bahadur Deuba of the Nepali Congress Party since July 22nd 2001. The main opposition party is the Communist Party of Nepal - United Marxist-Leninist, or CPN-UML. The main political parties are market oriented.

In 1950, the important Treaty of Peace and Friendship and Treaty of Trade and Commerce were signed with India. The governments have granted the other country's nationals the same rights of residence, ownership of property, participation in trade and commerce, and movement as to the nationals of their own country. We will discuss these agreements more in Section 4.4.

A civil war, the so-called people's war, began in 1996. It is being waged by a Maoist guerrilla group with the aim of abolishing the constitutional monarchy and founding a communist state. After a four-month cease fire to find a peaceful solution to the conflict, violence erupted again in November 2001. The government then declared a six-month state of emergency and mobilised the army against the guerrillas. Some of the constitutional rights and freedoms were suspended. By the end of 2001 the war had left over 2,000 Nepalis dead and the death toll was rising fast in the beginning of 2002. In late May 2002, the parliament was dissolved because it did not want to extend the state of emergency. New elections were called for November 2002. The situation may be a threat to the nation's democracy and the people's civil rights.

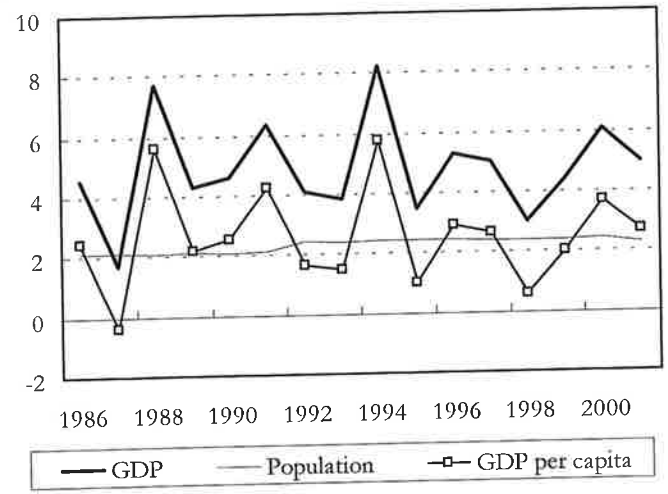
The civil war has a negative effect on FDI inflow, and on private domestic demand and investment. The government will have to spend its scarce administrative and financial resources increasingly for security and military purposes. The budget for internal security is likely to be about NPR 15 billion (about EUR 230 million) during the fiscal year 2001-02. This is 25 to 30 per cent of total development funds. The government cut 25 per cent off its development expenditure due mainly to shrinking revenues and rising security expenses. (Kathmandu Post, February 15th 2002.)

According to the US Committee for Refugees,[9] there were 109,000 Bhutanese and 20,000 Tibetan refugees in Nepal at the end of 2000. About 99,000 of them lived in refugee camps in eastern Nepal. The Bhutanese refugees are ethnic Nepali Hindus from southern Bhutan. In the early 1990s they fled what they termed ethnic cleansing by Bhutan's government, which primarily represents the country's majority Buddhist population.

4.2 Latest Macroeconomic Developments

Especially relative to the 1970s and 1980s, GDP growth has been fairly stable during the 1990s at around 4-6 per cent. Due to high population growth, GDP per capita at constant local currency prices has grown by an average of just 2.6 per cent per annum since 1990, however.

Figure 4.2 GDP and population growth rates 1986-2001



GDP at constant 1984/85 factor costs.
Source: Asian Development Bank.

GDP growth slowed down in 2001-02. Manufacturing industry, especially ready-made garments, pashmina products and carpets, which make up more than 90 per cent of total exports to third

9 See http://www.refugees.org/world/countryrpt/scasia/nepal.htm

countries (i.e. exports other than to India), were struck by the global economic slowdown, the US AGOA initiative (see Section 4.4 or Chapter 5 below) and the civil war in Nepal. Also the temporary uncertainty over the future of the Indo-Nepalese trade treaty had an adverse effect on the economy (see Section 4.4 below).

During the latter half of 2001, the overall manufacturing production index declined by 2.9 per cent year-on-year. (Kathmandu Post, March 14th 2002.) Still, in its Asian Development Outlook 2002, the Asian Development Bank forecasts a GDP growth rate of 3.5 per cent for 2002 and 5.0 per cent for 2003. This presumes, among other things, a calming down of the security problems.

During the first four months of 2002, garment exports declined by 52 per cent year-on-year due to the US recession and a diversion of orders to Caribbean and Sub-Saharan African countries that have duty and quota-free market access to the US market. Some 85 per cent of total garment exports are sent to the US. The volume of orders was also very low. According to the Kathmandu Post, March 7th 2002, over 75 per cent of the firms in the garment industry had closed down and the rest were running capacity utilisation rates of less than 50 per cent.

In the longer term, the phasing out of the Multi-Fibre Agreement will also have an adverse effect. The exports of pashmina products declined by three-quarters year-on-year during the first nine months of the fiscal year 2001/02 due to a decrease in demand in the US. Carpet exports have been adversely affected by the economic slowdown in Germany. Tourism and public sector finances have been negatively affected by political events and the economic slowdown, too. Tourism was down by about 50 per cent year-on-year. (Kathmandu Post, May 3rd 2002.)

The inflation rate is only a few per cent and it has declined during the 1990s. The Asian Development Bank expects inflation to rise to five per cent in 2002-03. As the rupee is tied to the Indian currency,[10] the inflation rate, too, has to be fairly close to that of India for the exchange rate linkage to function as it has done during the 1990s.

The unemployment rate is low, only two per cent in 1999 according to the Asian Development Bank, or about five per cent according to some other sources. Their definitions of unemployment may differ. On the other hand, underemployment is high, 45-50 per cent of the labour force. Only about one in five workers are wage labourers.

[10] See Section 4.8 on monetary policy.

Nepal has had a current-account deficit since the mid-1970s. It has been mainly of the order of 5-8 per cent of GDP since the early 1980s, but peaked above 10 per cent after the mid-1990s. The trade deficit has been partly compensated by a service account surplus. The aforementioned difficulties led to a rapid surge in the current-account deficit towards the end of 2001. The Asian Development Bank expects a current-account deficit of five per cent in 2002-03.

Table 4.2 shows that the share of consumption in GDP has declined during the 1990s, while gross domestic saving and investment have risen. The economy has become much more open as exports have risen from 12 per cent of GDP in 1990/91 to almost 24 per cent in 1999/2000 and imports have risen from 23 per cent of GDP to 32 per cent. Since 1996/97, both exports and imports have declined relative to the GDP. All foreign trade is not shown in the official statistics. There is also a lot of unofficial trade especially with India.

Table 4.2 Nepal's macroeconomic indicators

	1990/91	1993/94	1996/97	1999/00
Consumption, % of GDP	90.4	85.3	86.0	84.1
Gross domestic saving, % of GDP	9.6	14.7	14.0	15.9
Investment, % of GDP	20.8	22.4	25.3	24.1
Exports, % of GDP	11.8	24.0	26.3	23.5
Imports, % of GDP	23.1	31.6	37.7	31.7
Exports/imports	0.51	0.76	0.70	0.74
Average exchange rate NPR/USD	36.0	49.3	57.0	69.0
GDP per capita, USD	183	206	234	246

Source: Statistical Yearbook of Nepal 2001.

Exports have become quite important for Nepal's GDP and, as India is by far its most important trade partner, economic developments in South Asia are important for Nepal. India's GDP has grown by about five per cent per annum in 1999-2001, and the forecast by the Asian Development Bank is 6.0 per cent and 6.8 per cent for 2002 and 2003, respectively. India's foreign trade is expected to grow by 12-14 per cent annually.

4.3 Gross Domestic Product

In this section we will analyse the structure of Nepal's gross domestic product. After a general overview we will discuss more specifically agriculture, manufacturing industry, tourism, the generation of hydroelectric power, and banking.

Structure of GDP

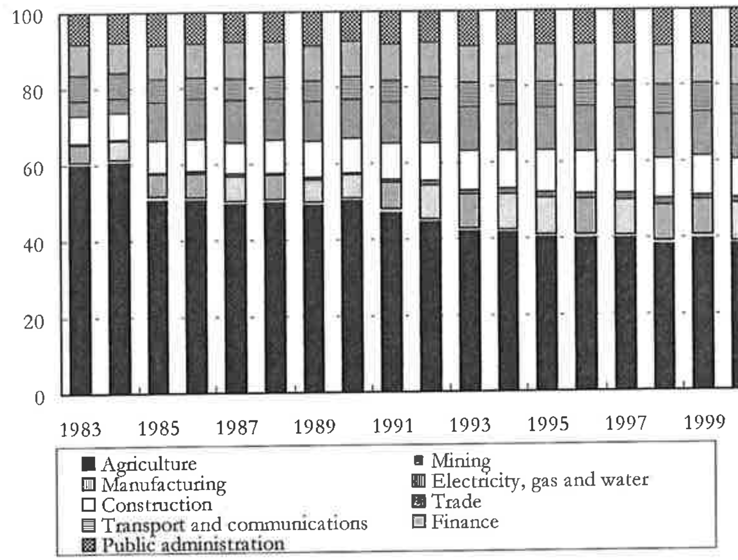
Private consumption dominates Nepal's GDP. Its share has declined a little from 81 per cent in 1983 to 75 per cent in 2000, with a peak of 83 per cent in 1990. Government consumption, on the other hand, has been quite stable at around 9 per cent of GDP. Gross fixed capital formation has varied between 16 and 23 per cent with the highest figures during 1993-98. In 2000, it was again down slightly at 19 per cent of GDP. The share of exports and imports in GDP has increased significantly.

Agriculture is the main source of value added in Nepal's economy. It accounted for 39 per cent of GDP in 1999/2000. Its share has declined from 60 per cent in 1983 and 51 per cent in 1990. Some 12 per cent of GDP originates in trade, restaurants and hotels, 10 per cent in finance and real estate, 10 per cent in manufacturing, 10 per cent in construction, 8 per cent in transport, communication and storage, less than 2 per cent in electricity, gas and water, and less than one per cent in mining and quarrying.

Since 1983, there has been a 22 percentage-point decline in the share of agriculture and a rise in the other sectors. The abrupt 10 percentage-point fall in 1985 may probably be explained by a new survey of the economy as they are not done annually. The largest relative rise has been in manufacturing industry with its share rising from a little less than five per cent to a little less than ten per cent. Between 1994/95 and 1999/2000, there was much less structural change than during the preceding five-year period.

Some 81 per cent of the work force are employed in agriculture, 2 per cent in manufacturing industry, 11 per cent in services, and 6 per cent in other activities. These figures depend on the source. For example, manufacturing industry has also been argued to employ up to 6 per cent of the labour force.

Figure 4.3 GDP (less imputed bank service charges) by industrial origin at current factor cost 1983-2000, %



Source: Asian Development Bank.

Agriculture

Agriculture is by far the most important single sector of the economy measured in terms of employment (81 per cent) or GDP (39 per cent). Agriculture – and therefore also the GDP – is influenced by the monsoon and other weather conditions in particular years.

The population density is 225 inhabitants per km^2 in the Terai and the hill regions, which are the fertile and populous areas. According to the Census of 2001, 76 per cent of the 4.2 million households in Nepal have agricultural land and 72 per cent of them have livestock and fowl. About half of Nepal's households have less than 0.5 hectares of land and a large part of the population lives on subsistence farming. A land reform is being planned to limit the maximum size of farms. About one-fifth of the total land area is now arable. The share of arable land in total land area has risen since 1970, but it has not kept up with population growth. Farming is very low-tech, most people in the countryside are illiterate, rural families are large relative to their urban counterparts, and there is a lot of underemployment.

Table 4.3 Arable and irrigated land 1970-1995

Item	1970	1980	1990	1995
Arable land, 1000 ha	1,953	2,290	2,286	2,898
Arable land, % of land area	13.7	16.0	16.0	20.3
Arable land, ha per person	0.172	0.158	0.122	0.136
Irrigated land, 1000 ha	117	520	950	1,134
Irrigated land, % of cropland	5.9	22.4	40.4	38.2

Data given for 1996-1999 is unchanged from 1995.
Source: World Bank.

According to the World Bank World Development Indicators 2001, value added per worker in agriculture in Nepal was USD 162 in 1979-81 and USD 189 in 1996-98 in constant 1995 dollars. The respective figures were 275 and 406 dollars in India, and 175 and 227 dollars in Bangladesh. Consequently, not only is value added lower in Nepal than in India or Bangladesh, it has also increased more slowly. In all low-income countries (excluding China and India) value added per worker in agriculture averaged USD 348 in 1996-98.

In the 1980s, Nepal was a net exporter of agricultural products but now there is a food deficit (Chand 2000) and the country imports a lot of basic foodstuffs. Still, some agricultural products have remained important in exports to India, especially vegetable ghee (22.1 per cent of exports to India in 1998/99). Rice has a 5.3 per cent share in imports from India. The shares of different products in Nepal's exports and imports are very volatile from year to year, however.

Between 1961 and approximately the mid-1980s, the development in crop yields was, one average, rather poor in Nepal. Especially, yields of maize declined substantially and the other crop yields remained relatively stagnant. Up until the mid-1980s population growth outstripped growth in yields of, e.g., rice and maize.[11]

[11] These statistics are by FAO. According to the World Bank World Development Indicators, value added per hectare of agricultural land in constant US dollars declined between the late 1960s and 1980, but then started to rise rather fast. The development of value added per worker has been much more stable. This shows that while it has been possible to extract more value added from one hectare of land, the rise in agricultural work force has limited the rise in value added per worker.

Since the mid 1980s, yields have improved. Between 1985 and 2000, Nepal's population grew by 45 per cent. Meanwhile, total agricultural production grew by 56 per cent. Output in different sectors grew as follows: food grains 49 per cent, cash crops 91 per cent, other crops 72 per cent and livestock 51 per cent.

The yields in Nepal and India are compared in Figure 4.4. The data are presented as moving three-year averages so as to smoothen out the effect of abnormal weather conditions. When the index exceeds 100, yields are higher in Nepal than in India, and in the early 1960s, this was typically the case. However, as yields were declining or stagnant in Nepal, India caught up to the extent that the yields of wheat and rice were higher in India already by the 1970s. When yields started to increase in Nepal in the mid-1980s, the deterioration in its relative yields stopped, but Nepal has not gained ground against India's agriculture. This leaves yields of wheat about one-third and yields of cereals and rice about one-tenth below those in India. Yields of maize are about the same in the two countries.

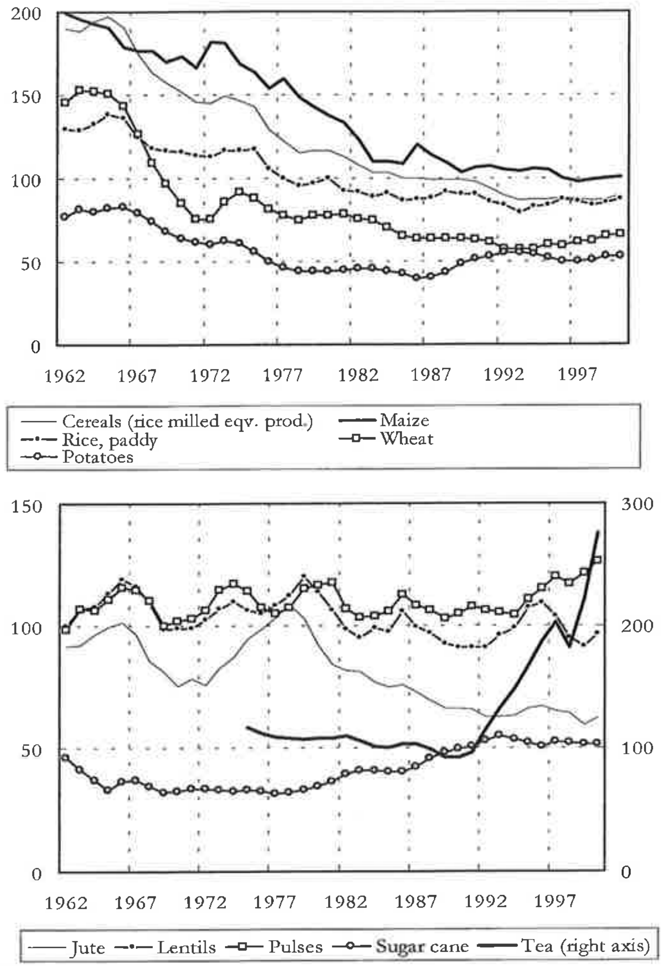
In the lower portion of Figure 4.4 we see that relative yields of pulses have been volatile but slightly higher in Nepal than in India and that there has been a significant improvement in the relative position of Nepal in the late-1990s. Yields of lentils have declined slightly over the years, but they are about the same in the two countries. The relative yields of jute have declined considerably in Nepal and they are now almost 40 per cent lower than in India.

Tea is by far the strongest performer in Nepal and yields are now much higher than in India. Tea is listed as a product in which Nepal has export potential. The value of actual exports is very small, however: USD 277,000 in 1995/96, USD 396,000 in 1996/97 and USD 185,000 in 1997/98, according to the Trade Promotion Centre.

Nepal is a traditional exporter of crude herbs, and it could have potential as an exporter of medicinal and aromatic plants. There are about 700 plant species in Nepal with medicinal value. Commercial cultivation of some medicinal plants has become important. According to FAO and the World Bank, over 90 per cent, or about USD 8.6 million per annum, of the medicinal plants exported from

Nepal go to India. Some 470,000 households are involved in commercial medicinal plant collection.[12]

Figure 4.4 Yields per hectare in Nepal relative to India 1961-2001, 3-year moving averages. Yields are the same when index = 100.



Source: FAO.

[12] See Traffic Bulletin Vol. 18, April 2nd 2000.

According to FAO (1994), exporting large quantities of medicinal plants and crude drugs is impossible, however, as regeneration cannot occur fast enough. Consequently, the exports of medicinal and aromatic plants diminished between the mid-1980s and the mid-1990s and product quality declined. Quality is uneven and often poor.

Manufacturing Industry

Manufacturing industry accounted for 9.7 per cent of Nepal's GDP in 1999/2000, up from 6.0 per cent ten years earlier. Manufacturing value added (MVA) was USD 500 million in 1999. According to UNIDO, the real average annual growth rate of MVA was over 10 per cent during the 1990s. Meanwhile it was a little over 7 per cent in India and a little less than 7 per cent in developing countries on average. Also MVA per capita increased quite rapidly in Nepal from 8 dollars in 1980 to 11 dollars in 1990 and further to 20 dollars in 1998, all in constant 1990 prices. These are low levels, however. In 1998, MVA per capita was 83 dollars in India, 291 dollars in developing countries on average and 4,880 dollars in developed countries.

Table 4.4 International comparison of manufacturing value added (MVA) at constant 1990 prices in USD

	Year or period	Nepal	India	Developing countries[1]	Developed countries
MVA per capita USD	**1980**	8	36	161	3,712
	1990	11	60	203	4,430
	1998	20	83	291	4,880
Real average annual growth rates of MVA, %	**1970-80**	3.4	4.6	6.8	2.9
	1980-90	6.6	7.4	5.3	2.8
	1990-98	10.2	7.4	6.9	2.2
Real average annual growth rates of per-capita MVA, %	**1970-80**	0.9	2.3	4.5	2.1
	1980-90	3.9	5.2	3.1	2.1
	1990-98	7.5	5.5	5.2	1.5
MVA per GDP, %	**1980**	5.0	14.2	19.5	22.9
	1990	5.8	16.6	21.2	22.0
	1998	8.9	17.7	24.0	21.4

[1] Excluding transition economies.

Source: UNIDO.

In 1996, Nepal's manufacturing industry employed almost 187,000 people, or a little less than 2 per cent of the labour force. Table 4.5 shows value added and employment in 1986 and 1996 in the manufacturing sector in Nepal in thousands of current US dollars with value added measured in producer prices. Unfortunately, more up-to-date data are not available. A Census of Manufacturing Establishments is made every five years in Nepal and the most up-to-date data are for the fiscal year 1996/97.

Table 4.5 Value added, USD mill. current producer prices, and employment (in thousands) in selected manufacturing sectors in Nepal

Manufacturing sector (ISIC)	Value added		Employment	
	1986	1996	1986	1996
Total manufacturing (300)	210.9	384.1	136.8	186.6
% of total				
Food products (311)	32.5	13.7	17.6	10.8
Beverages (313)	2.9	9.1	1.2	1.0
Tobacco (314)	14.8	12.1	6.5	1.7
Textiles (321)	13.5	26.1	17.7	38.9
Wearing apparel, excl. footwear (322)	4.1	6.3	6.2	8.0
Leather products (323)	1.7	0.9	0.4	0.3
Wood products, excl. furniture (331)	2.0	1.4	2.6	1.8
Furniture, excl. metal (332)	1.0	0.9	1.8	1.8
Paper and products (341)	0.7	1.7	0.9	1.8
Printing and publishing (342)	1.6	1.3	2.0	1.2
Other chemicals (352)	4.5	5.9	3.8	2.6
Rubber products (355)	0.4	1.3	0.5	0.3
Plastic products (356)	1.0	1.7	0.8	1.3
Other non-metallic mineral prod. (369)	12.4	7.2	32.5	22.8
Iron and steel (371)	2.3	1.7	0.9	0.5
Fabricated metal products (381)	2.7	5.0	2.9	2.5
Machinery electric (383)	1.2	2.5	0.5	0.9

Only sectors with more than a one-per cent share in either value added or employment in either 1986 or 1996 are presented. This leaves out footwear (324), industrial chemicals (351), petroleum refineries (353), glass and glass products (362), non-ferrous metals (372), machinery, excluding electrical (382), professional and scientific equipment (385), and other manufactured products (390). Also the following tables exclude these sectors of manufacturing industry.

Source: UNIDO.

Between 1986 and 1996, MVA increased from USD 211 million to USD 384 million in current producer prices. There occurred quite significant changes in the structure of manufacturing. The share of food products declined from 32 per cent to 14 per cent, the share of beverages increased from 3 per cent to 9 per cent, and the share of textiles increased from 13 per cent to 26 per cent. The production of textiles encountered severe difficulties in 2001-02. Also the share of other non-metallic mineral products has declined from 12 to 7 per cent between 1986 and 1996, and the share of fabricated metal products has risen from 3 to 5 per cent.

Manufacturing employment increased from 137,000 in 1986 to almost 187,000 in 1996. The share of food processing and of other non-metallic mineral products declined and that of textiles increased. The share of beverages in total MVA increased considerably but there is no comparable change in employment.

Table 4.6 shows value added and wages per employee in Nepal in 1986 and 1996 in current US dollars. For comparison, these data are also shown for India in 1999. Let us take a closer look at some of the sectors. There are large differences between sectors, but it should be noted that a sector may contain different kinds of activities and the internal structure of the sectors may differ between Nepal and India and may also have changed between 1986 and 1996 in Nepal. For example, the important textile sector is likely to be heavily influenced by the pashmina industry in Nepal, while basic textiles are likely to have a larger weight in India.

The highest value added per employee in Nepal was in the beverage sector in 1996. It has risen fast and is significantly higher than in India or Bangladesh (not shown in the table). Though value added per employee had quintupled, there is hardly any change in wages per employee. Also, wages in Nepal in 1996 were only half of what they were in India in 1999 and about two-thirds of what they were in Bangladesh in 1992.[13]

Tobacco had the second-highest MVA per employee in Nepal in 1996, over 14-fold compared with the level in India in 1999. The share of beverages in total value added of manufacturing in Nepal in 1996 was 9 per cent and that of tobacco was 12 per cent. Thus,

13 The figures from the different years are not fully comparable, but they are the latest figures available for the countries.

these two sectors with relatively high value added per employee are also relatively important sectors in total value added.

Table 4.6 Value added and wage rates per employee in selected manufacturing sectors, USD current prices

Manufacturing sector (ISIC)	Value added			Wages and salaries		
	Nepal		India	Nepal		India
	1986	1996	1999	1986	1996	1999
Total manufacturing (300)	1,542	2,058	4,259	340	382	1,340
Food products (311)	2,847	2,591	2,379	357	433	789
Beverages (313)	3,709	18,302	6,873	585	558	1,188
Tobacco (314)	3,507	14,731	1,047	374	572	354
Textiles (321)	1,171	1,379	2,082	404	392	1,019
Wearing apparel, excl. footwear (322)	1,021	1,635	2,070	438	445	738
Leather products (323)	7,500	5,282	2,775	404	498	846
Wood products, excl. furniture (331)	1,182	1,624	1,197	427	399	559
Furniture, excl. metal (332)	867	1,005	2,027	359	447	914
Paper and products (341)	1,172	1,995	2,836	359	415	1,298
Printing and publishing (342)	1,221	2,309	3,596	477	478	1,979
Other chemicals (352)	1,818	4,698	7,641	431	573	1,532
Rubber products (355)	1,515	8,681	5,394	469	625	1,404
Plastic products (356)	1,832	2,556	4,440	453	400	1,211
Other non-metallic mineral prod. (369)	589	650	3,798	202	224	1,119
Iron and steel (371)	3,706	6,436	9,449	507	490	2,070
Fabricated metal products (381)	1,422	4,060	3,066	505	521	1,329
Machinery electric (383)	3,514	5,434	6,278	602	531	2,057

Source: UNIDO.

The largest sector in 1996 was textiles, which suffers from low productivity. Value added per employee was low and up only slightly from 1986. Total value added in textiles has risen by 250 per cent in 1986-96. Given the data shown in Table 4.6, Nepal's textile industry does not seem to be overly non-competitive, especially when we note that the wage level seems to be much higher in India, but reports of Nepal's textile industry do indicate that low productivity relative to costs is a major problem for the industry.

Foodstuffs are also important in total MVA, 14 per cent in 1996, but its share is down from almost 33 per cent in 1986. Value added is down also in absolute terms in current prices. Furthermore, value added per employee has fallen.

Value added per employee has risen the most in rubber products, beverages, tobacco and fabricated metal products. Comparing the value added figures for Nepal in 1996 and India in 1999, Nepal seemed to have an edge in beverages, tobacco, leather products and rubber products. These do not appear among Nepal's top export products, however. Average value added per employee in manufacturing industry was still less than half of that in India.

Nepal's highest value added relative to wages is in beverages and tobacco, which had the highest value added per employee in 1996. Textiles and clothing, which are often referred to as sectors in which Nepal has a comparative advantage and which are also the most important export sectors to industrialised countries, are sectors with low value added per employee and relatively high wages per employee, which reflect these sectors' low competitiveness.

Capacity utilisation rates are not particularly high. In 1998/99, the capacity utilisation rate was 55 per cent in sugar, 85 per cent in cigarettes, 48 per cent in beer, 53 per cent in matches, 21 per cent in shoes (in 1997/98), 47 per cent in cement, and 46 per cent in jute products. Capacity utilisation rates are relatively volatile from year to year. (Statistical Yearbook of Nepal 2001.)

Information technology (IT) is sometimes listed as a potential growth and export sector for land-locked Nepal. IT has become a relatively significant sector for India. However, even though some basic programming or coding could be outsourced into Nepal, the country lacks vocational training in the field as well as a special comparative advantage in IT.[14]

Tourism

From a tourist's point of view Nepal is abundant with sights and natural scenery. There are diverse ethnic groups and several natural parks situated in topographical and natural environments that range from rain forests to the highest peaks of the world. There is a wide range of sights listed in the World Heritage list[15] by UNESCO.

14 In April 2002, Nepal and India signed a memorandum of understanding on setting up an optical fibre cable network between eastern Nepal and mid-western Nepal (Kathmandu Post, April 13th 2002).

15 These sites are the Kathmandu Valley with seven groups of Hindu and Buddhist monuments and three residential and palace areas, Sagarmatha National Park, Royal Chitwan National Park, and Lumbini (the birthplace of the Lord Buddha).

Table 4.7 International tourism statistics for Nepal

	1980	1985	1990	1995	1999
Expenditures (current USD mill.)	26	29	45	136	78[1]
Receipts (current USD mill.)	52	39	64	117	168
Expenditures (% of total imports)	7.1	5.6	5.9	9.0	4.7[1]
Receipts (% of total exports)	23.3	13.0	16.9	11.0	14.6
Number of arrivals (1,000s)	163	181	255	363	492

[1] In 1998.

Source: World Bank.

According to the World Tourism Organization,[16] Nepal's market share of tourism in South Asia was 8.5 per cent in 1999. In 2000, it had declined to 7.0 per cent.[17] The receipts from international tourism were USD 168 million in 1999, or 3.7 per cent of total receipts from international tourism in South Asia. Nepal's share in tourist arrivals was therefore more than twice its share in the tourist receipts.

Tourism accounts for around 3 per cent of GDP, about 18 per cent of foreign exchange earnings[18], and 34 per cent of export earnings. Tourism employs over 200,000 people. In trekking and mountaineering 21 per cent of employment consists of porter services. (See e.g. Chand 2000.)

In 1999 there were 16,700 rooms and 32,200 beds in the 785 tourist-rated hotels. Tourism has a lot of potential as a source of income for Nepal. In 1999, gross earnings from tourism amounted to USD 168.1 million. This is up from USD 116.8 million in 1995 and USD 63.7 million in 1990. (Statistical Yearbook of Nepal 2001.)[19]

16 See http://www.world-tourism.org/.

17 Total international tourist receipts in South Asia were USD 5.1 billion in 2000, which is 1.1 per cent of total global international tourist receipts. South Asia had 6.4 million international tourist arrivals (0.9 per cent of the world total). World Tourism Organization forecasts that the annual growth rate of international tourist arrivals is 4.1 per cent per annum in 1995-2020 in the world on average and 6.2 per cent in South Asia.

18 Eleven per cent in 1998 according to the Embassy of India in Kathmandu.

19 Much higher figures are provided by World Travel and Tourism Council (see http://www.wttc.org/), who estimate that the share of travel and tourism (T&T) *industry* would have been 4.5 per cent of Nepal's GDP in 2001 (without the adverse global and internal development), rising by 7.9 per cent per annum in real terms to 5.7 per cent of GDP by 2011. The share of T&T *economy*, which includes indirect effects, would rise from 7.7 per cent of GDP in 2001 to 9.7 per cent in 2011. They also estimate that T&T economy

The number of tourists in Nepal almost doubled during the 1990s and in 1999 almost half a million people visited the country. They stayed for 12.8 days on average. Between 1980 and 1999, the average length of stay has fluctuated between 9.3 days in 1991 and 13.5 days in 1996.

Almost 30 per cent of all tourists are from India as there are locations in Nepal that are important for Hindus. Americans, Japanese and British visitors each make up about 8 per cent of all tourists. The share of Japanese visitors has risen, while that of British and French tourists has declined a little since 1990. The purpose of most visits is pleasure and trekking.

Table 4.8 Tourism, arrivals by nationality and by purpose of visit per year, % of total

	1990	1993	1996	1999
TOTAL	254,885	293,567	393,613	491,504
NATIONALITY, % of total				
India	23.4	28.4	31.1	28.6
United States	8.4	6.9	6.4	8.0
Japan	5.9	6.1	7.3	7.9
United Kingdom	9.4	8.0	7.5	7.5
Germany	7.3	10.9	6.3	5.4
France	7.8	5.8	5.1	5.0
Other	37.8	33.9	36.2	37.6
PURPOSE OF VISIT, % of total				
Pleasure	63.5	58.0	53.2	59.2
Trekking and mountaineering	15.7	23.7	22.6	22.0
Business	4.6	6.6	6.4	4.8
Pilgrimage	2.6	3.6	1.2	3.9
Official	10.4	5.4	5.1	4.9
Other	3.1	2.7	11.5	5.2

Source: Statistical Yearbook of Nepal 2001.

According to Chand (2000), 62 per cent of all tourist expenditure falls on imported products. Poor infrastructure and services outside urban areas are the main factors that decrease the potential for

employs about 860,000 people or 8.4 per cent of the labour force growing to 10.6 per cent of the labour force by 2011. T&T industry, on the other hand, would have employed 507,000 people in 2001 or 4.9 per cent of the labour force, which would rise to 6.3 per cent by 2011. Travel and tourism was expected to have generated almost 20 per cent of total exports in 2001, which would grow to 27 per cent by 2011.

tourism. Poor local management and insufficient vocational skills add to these.

Both international and national air traffic are important in developing tourism in Nepal as the local physical infrastructure is poor. Nepal does not have an open-skies agreement with India. The countries have an agreement on the number of seats on flights between them. In June 1997, Nepal and India signed a new air transport agreement increasing the number of seats by 50 per cent to 6,000 per week but it was not enough to meet peak demand. Domestic air transport routes were privatised in the early 1990s and domestic air traffic quadrupled. In 1996, the first steps were taken to re-assign international air routes held by the state-owned Royal Nepal Airlines Corporation to private carriers. Necon Air, a private airline, was given permission to carry passengers to and from Calcutta and Varanasi in India. (U.S. Department of State 2001.)

Ecological concerns should also be considered in tourism. Air pollution, almost completely due to traffic, is fairly bad and getting worse in the Kathmandu Valley. Water pollution is created by the urban population along with certain sectors of the manufacturing industry. According to the World Bank, food industry was responsible for 43 per cent of total BOD (biological oxygen demand) emissions in 1996, followed by the textile industry (39 per cent) and paper and pulp industry (8 per cent). Sewage is unprocessed and waste management is deficient even in urban areas.

The year 2001 was not good for Nepal's tourism. According to the Nepal Tourism Board, monthly tourist arrivals were down by 34 per cent year-on-year in October and by 42 per cent in November. During the whole year, tourist arrivals declined by 21 per cent, with Indian tourist arrivals sliding by 42 per cent.

Several incidents have had a negative effect on tourism. Nepal's civil war, the so-called people's war waged by a Maoist guerrilla group (see subsection above for politics), has not been directed against foreigners, but it had left over 2,000 Nepalis dead by the end of 2001. Political instability and security risks are having a negative effect on tourism.

There have also been other adverse incidents during the past years. Indian Airlines flight IC 814 en route from Kathmandu to New Delhi was hijacked after it left Kathmandu on December 24th 1999 and flown to Kandahar, Afghanistan. Nepal's Royal family

was slain on June 1st 2001, in somewhat unclear circumstances by Crown Prince Dipendra. On top of these events, the terrorist attacks in the United States on September 11th 2001, their effect on tourism and air travel world-wide, and the ensuing war against the Taliban in Afghanistan had a negative effect on tourism in Nepal even though the country was not directly affected by the events. Given that it remains unclear how long and how intensive the 'war against terrorism' will be, it is difficult to assess for how long the international situation will adversely affect the tourism sector. A lot also depends on the development of Nepal's civil war.[20]

These episodes not only have a negative effect on tourism but also on the internationalisation of the economy from the point of view of the country's ability to attract foreign direct investment.

There is increasing erosion, loss of wild life habitat, and a fall in the level of ground water. Given that nature is one of Nepal's assets in tourism, the development will have a negative effect on the long-term potential of the tourism industry. The share of trekking and mountaineering tourists has risen from one per cent in the early 1970s to 22 per cent in 1999 (FAO; Chand 2000).

Asia Invest (2001) argues that tourism is well-exploited in the Kathmandu Valley but that it has plenty of growth potential elsewhere in the country, if pollution is taken seriously and eco-tourism is effectively promoted.

Hydroelectric Power

Nepal's electricity production capacity in 2000 was 390 MW, of which 85.4 per cent was hydropower and 14.6 per cent diesel power. Nepal has a huge potential in hydroelectric power, which is estimated at 83,000 MW (of which about 44,000 MW is economically viable). Thus, only about one per cent of total potential has been tapped.[21]

20 Possible future shocks for tourism and the economy as a whole include earthquakes. Nepal lies along the fault line between the Indian and Eurasian tectonic plates and, according to experts, a major earthquake is overdue. The last major earthquake to hit Nepal was in 1934. It left 9,000 people dead. Another danger is the melting of glaciers in the Himalayas that enlarges glacial lakes, which may burst their banks and cause severe flooding downstream.

21 Source: Statistical Yearbook of Nepal 2001. See also e.g. Chand (2000), U.S. Department of State (2001), World Bank (2001c), and Energy Information Administration http://www.eia.doe.gov/ for information about Nepal's power sector.

Nepal's hydroelectric power potential remains largely unused. There is a shortage of energy and the cost of electricity is one of the highest in South Asia. The per-capita electricity consumption of 42 kWh per annum is one of the lowest in the world. Only about 15 per cent of Nepal's total population has access to electricity. In the rural areas this figure is about five per cent. In 1995/96, traditional fuels (wood, agricultural waste and animal dung) accounted for 98 per cent of energy consumption in the rural areas and 77 per cent in the urban areas. The high cost of energy, and the lack of infrastructure and appropriate facilities are constraints in the development of the domestic market. Electricity would improve health and working conditions and it would be beneficial for education. By 2020, Nepal's total domestic power demand is estimated to be 1,650 MW, which still leaves a lot of potential unused for construction and exports. On the other hand, it also means that capacity has to be built to meet growing domestic demand. (World Bank 2001c.)

India is short of energy and Nepal's hydropower could be a major export product to the Indian subcontinent. This would require large investments into hydroelectric infrastructure. In reality, Nepal is a net importer of electricity from India. In 1999/2000, electricity exports amounted to 99 GWh and imports to 197 GWh. There is a discrepancy of 428 GWh between the supply (production and imports from India) and consumption (domestic consumption and exports) of energy. The loss in transmission and due to theft is 27 per cent of electricity consumption in Nepal. Meanwhile, imports accounted for 13 per cent of the consumption of electricity. The Indian Central Electricity Authority has estimated that there will be a shortage of about 10,000 MW in its Northern Grid Region by 2007. However, there are constraints for Nepal's electricity exports also on the Indian side as many Indian State Electricity Boards are effectively bankrupt. There is also competition from power generating projects in India. (World Bank 2001c.)

Nepal's government has laid down the legal basis for full-scale private development of the hydropower resources and for the private exports of hydropower to India (U.S. Department of State 2001). The government offers a five-year tax exemption for hydroelectric projects, a ten-year tax exemption for transmission, and a five-year tax exemption for operations and maintenance.

World Bank (2001c) identifies four key constraints in the development of the power sector. First, there are overlaps in policy, regulatory, and operational functions of public institutions operating in the sector. Second, the existing institutional structure of the National Electricity Authority is not adequate for the future needs of the power sector. Third, the institutional arrangements for the promotion of power trade are insufficient. Finally, there is weak institutional support for improving electricity access to rural areas. The report argues that the elimination of the conflict of interest, improvement of creditworthiness, and appropriate regulatory framework should attract private investments and give an opportunity to create a policy environment for independent power producers that is also favourable for medium-sized export projects.

FDI is essential for building Nepal's hydropower. For example the 60 MW Khimti I hydropower project that started production on March 31st 2000 cost USD 139 million, and the 144 MW Kali Gandaki 'A' hydropower project has been estimated at USD 453 million. There are several projects under construction. The environmental impact of the hydroelectric projects is limited as most of them are 'run-of-river' with only one storage project so far.

Financial Sector

Nepal's financial sector is becoming increasingly internationalised. The two largest banks are Nepal Bank Ltd., which is 40 per cent government owned, and Rastriya Banijya Bank, which is 100 per cent government owned. Together these two banks accounted for some 60 per cent of the banking system's deposits and loans in mid-2001 (U.S. Department of State 2001). Both of these banks have very large non-performing loans and are technically insolvent. Problems in the banking sector include bad corporate governance, auditing, and legal matters.

In early 2002, it was announced (see Kathmandu Post, January 13th 2002) that these two banks are to be given over to private foreign management. Management at Rastriya Banijya Bank is to be turned over to the US-based management company Deloitte Touche Tohmatsu and that at Nepal Bank Ltd. to ICC Bank Ireland, both for a two-year period, which may be extended to three years. New management will be responsible for the day-to-day running of the banks, for providing immediate help to stabilise the banks' operations and for restoring their financial health to acceptable levels.

Nepal opened up its commercial banking sector for foreign banks in the 1980s. Consequently, several joint-venture banks were established. These include Nepal Arab Bank (NABIL Bank, now a Nepal-Bangladesh joint venture), Nepal Indosuez Bank (Credit Agricole Indosuez, the French partner of NIB, is set to sell its 50 per cent share in NIB to the Prithvi Bahadur Pandey Group), Nepal Grindlays Bank (now Standard and Chartered), State Bank of India, Bank of Kathmandu (Nepal-Thai joint venture), Everest Bank, Nepal Sri Lanka Merchant Bank, and Nepal Bank of Ceylon.

The two largest banks operate nation-wide, while the new, smaller banks, whose balance sheets are in better shape and are by and large profitable, operate in urban areas. There is also a large number of finance companies.

In 1994, the government also expanded the role of the Stock Exchange and allowed private brokers to operate. In June 1996, the government announced that it would permit foreign institutional investors to hold up to 25 per cent of the shares of listed firms in certain sectors such as tourism and power.

Nepal's financial system is fairly undeveloped. Most of household borrowing is from informal sources. According to Besley *et al.* (2001) 'formal' lenders (commercial banks and agricultural development banks) only accounted for 16 per cent of borrowing in urban areas and 12 per cent in rural areas in 1995/96. The 'informal' sources (moneylenders, landlords, shopkeepers, friends and relatives) accounted for 77 per cent in the urban areas and 82 per cent in the rural areas, with the remaining 7 per cent in the urban areas and 6 per cent in the rural areas falling on 'other' sources (e.g. Grameen-type banks, other financial institutions, local groups, NGOs and relief agencies). Besley *et al.* do not expect this situation to change 'anytime soon'.

4.4 Foreign Trade Regime and International Integration

In this section we will discuss the international agreements that form the trade regime in which Nepalese products compete in the world market. First we will discuss the trade relations between India and Nepal. Then we will review regional integration in South Asia. After that we will broaden our sphere to include global issues with the World Trade Organisation, which Nepal is not yet a member of. Finally, we will review some specific topics, first the Multi-Fibre Agreement (MFA) that is being phased out and the US AGOA initiative that affects Nepal, and then some trade issues with the European Union and China. We will discuss Nepal's foreign trade in Section 4.5.

Nepal's government seeks to minimise the role of the public sector in exports. The basic policy is one of 'a liberal and dynamic trade policy' with an emphasis 'on modernising management and technology, on promoting markets and on attracting foreign direct investment in order to identify and develop new products as well as raise the production and quality of the traditional products.'

Indo-Nepalese Trade Relations

As discussed in the next subsection, Nepal and India co-operate within the framework of the SAARC countries (see the next subsection). In addition to this, Nepal and India have special bilateral relations. The basis of these are the Treaty of Peace and Friendship and the Treaty of Trade and Commerce, both signed in 1950.

According to Article 6 of the Treaty of Peace and Friendship, 'Each Government undertakes, in token of the neighbourly friendship between India and Nepal, to give to the nationals of the other, in its territory, national treatment with regard to participation in industrial and economic development of such territory and to the grant of concessions and contracts relating to such development.'

According to Article 7, 'The Governments of India and Nepal agree to grant, on a reciprocal basis, to the nationals of one country in the territories of the other the same privileges in the matter of residence, ownership of property, participation in trade and commerce, movement that privileges of a similar nature.' The treaty provides for a passport-free entry and exit to the citizens of both countries across the common border. Alas, there are no statistics on how many people work and visit across the border regularly.

The Treaty of Trade and Commerce guarantees 'Nepal full and unrestricted right of commercial transit of all goods and manufactures through the territory and ports of India.' As a land-locked country, Nepal depends upon Indian territory for its foreign trade transports. According to Frankel (2000) land-locked countries are engaged in less trade by a factor of about 1/3, holding other factors equal. Meanwhile, two adjacent countries trade about 80 per cent more than two otherwise similar countries.

The port of Calcutta is Nepal's overseas shipment knot about 1,150 km from the border. Overseas exports are cleared in Calcutta (c.i.f.). There are no railways in Nepal[22], so exports and imports are transported with lorries at least to/from the Indian border. It takes about one day to transport goods from Kathmandu to the border. From there lorries take several days to transport goods to the port of Calcutta.[23] Recently, the port of Haldia, situated close to Calcutta, has emerged as a rival for the latter in the transportation of Nepal's trade with third countries.

Three Inland Container Depots (ICDs) are or will be operational along the border in Birgunj, Bhairahawa and Biratnagar. The largest of them in Birgunj, with an annual capacity of 40,000 containers, is financed jointly by the World Bank (over 80 per cent of the costs) and the government of Nepal. According to the Kathmandu Post (December 17th 2001), almost 130 truck containers transport goods between Birgunj and Calcutta daily and each truck is charged up to NPR 25,000 (almost EUR 400) per trip.

The ICDs will have a positive impact in that clearance is moved from the port in Calcutta to Nepal's border. It is estimated that this will decrease transportation costs to/from third countries by about 30 per cent. The ICDs also simplify transit procedures and improve the efficiency and organisation of transit trade documentation and exchange of data. The private sector will be responsible for operating all three depots and it will also be represented on their regulatory board.

There are some problems slowing down the project as India has been delaying the signing of a railway operation agreement, which would put Nepal's foreign trade on rail between the border and Calcutta. The rail connection would decrease trade costs. Birgunj is expected to be operational in May 2002 if there are no complications. The other two ICDs in Biratnagar and Bhairahawa are already fully operational.

22 Except for a 52-km long railway line that connects Janakpur and Jayanagar.

23 SAARC Chamber of Commerce and Industry puts the average transit time through India at between three and eight days.

The 1996 free-trade treaty between India and Nepal led to a rapid increase in the countries' bilateral trade. Before the treaty there was a 50 per cent local material content requirement for Nepalese goods, which was now replaced by a certificate of origin. The treaty guaranteed duty and quota-free access to the Indian market for all commodities manufactured in Nepal. There has occurred a structural shift in the composition of Nepal's exports from primary products to manufactured products after 1996, but Nepal's terms of trade have not changed.[24 25]

Judging by the increase in trade between Nepal and India, the trade agreement was successful. Bilateral trade between the countries is of course far more important for Nepal than for India. Nepal's exports to India were NPR 27 billion (USD 363 million) in 2000/01, up from NPR 4 billion (USD 72 million) in 1995/96. Meanwhile, imports increased from NPR 24 billion (USD 430 million) to NPR 46 billion (USD 618 million).

Free trade opened up the large Indian market for Nepal's products. Fiercer competition forces firms to improve upon their business practices and it also has a positive effect on the ability to compete on third markets. India's relative closeness as a market and high tariffs have a negative effect in this respect, however. Even though the market for Nepal's products increased substantially, it only increased in markets sheltered from global competition.

The trade treaty expired on December 5th 2001. Its renewal was supposed to be automatic, but India argued that the trade treaty had been beneficial for Nepal and detrimental to India, and there were allegations of transit exports and smuggling from third countries. India felt that Nepal's importing of intermediary products and raw materials from third countries was not in line with the principles of the agreement. The treaty was extended for a three-month period by the Indian government.

A new treaty was finally signed and it came into force on March 6th 2002. A 25 per cent value-added requirement on material and labour content was imposed on Nepalese goods for duty-free ac-

24 Both Nepal's and India's trade statistics show a trade deficit for their respective countries.

25 Kathmandu Post, December 11th 2001, quoting the Director of Nepal Rastra Bank.

cess to India in the first year, rising to 30 per cent from the second year onwards. Furthermore, provisions were included for measures in case there is a surge in exports from either country. India has claimed that this has taken place in four items in Nepal's exports: vegetable ghee, acrylic yarn, copper products and zinc oxide. These comprise almost 20 per cent of Nepal's exports to India. According to the new treaty, they will be allowed to enter free of basic customs duty into the Indian market on fixed quotas. The annual quotas are 100,000 tons for vegetable ghee, 10,000 tons for acrylic yarn, 7,500 tons for copper products and 2,500 tons for zinc oxide. The quotas will affect the sectors adversely in Nepal. Furthermore, the latest Indian budget imposed a four per cent special additional duty on vegetable ghee, acrylic yarn, zinc oxide and copper wire, among others, also in Nepal's exports. There were delays in the implementation of the new treaty during the spring of 2002, which led to a decline in Nepal's exports to India. (Kathmandu Post, March 3rd 2002, March 26th 2002 and May 22nd 2002.)

In addition to formal trade between Nepal and India, there is a lot of informal trade that is not visible in the statistics. For example, foodstuffs are traded both formally and informally. Nepal's formal and informal exports to India differ structurally from one another. Informal exports originate by and large from third countries – China, Japan, Thailand, Hong Kong and Singapore. Nepali traders operating through the informal channels differ from those in the formal channels by their smaller firm size, lower transaction costs, lower educational levels, and third-country imports. On the Indian side, the differentiating characteristics are transaction costs, ethnic linkages, and educational levels. (Pohit and Taneja 2000.)

The risk of getting caught for informal trading is reported to be very low and transaction costs in trade are lower in informal than in formal trade. The firms engaged in trading through informal channels are smaller than those trading through formal channels. There is no paperwork, bribes are lower and the realisation of payments is quicker in the informal sector than in the formal one. Bribes have also increased during the 1990s. Firms generally expect informal trade to increase in the future. The main sources of transaction costs are due to delays from miscellaneous procedures, transportation, banks and custom authorities. (Pohit and Taneja 2000.)

Regional Integration: The SAARC Countries

The South Asian Association for Regional Co-operation (SAARC)[26] was established in December 1985. The member countries are Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. The countries are extremely heterogeneous in the size of their populations and economic power: India's population is estimated at 1.03 billion, while that of the Maldives is only 310 thousand. GDP per capita is low in all the member countries.

The objectives of the SAARC are: to promote welfare in South Asia and to improve the quality of life; to accelerate economic growth, social progress and cultural development; to provide all individuals the opportunity to live in dignity and to realise their full potentials; to promote and strengthen collective self-reliance among the countries of South Asia; to contribute to mutual trust, understanding and appreciation of one another's problems; to promote active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields; to strengthen co-operation with other developing countries; to strengthen co-operation among themselves in international forums on matters of common interests; and to co-operate with international and regional organisations with similar aims and purposes.

The heads of state or government of the SAARC countries are to meet at least once a year. These summits are the highest authority in the SAARC. Decisions are taken on the basis of unanimity. The Council of Ministers, consisting of the foreign ministers of the member states, is to meet twice a year. The functions of the Council of Ministers are the formulation of policies, the reviewing of the progress of co-operation, decisions on new areas of co-operation, the establishment of additional mechanisms, and decisions on other matters of general interest.

The Standing Committee comprises of the foreign secretaries. It monitors and co-ordinates SAARC programmes of co-operation, approves projects and their financing, and mobilises regional and external resources. It meets at least twice a year and reports to and refers policy matters for decision to the Council of Ministers. Action Committees may be set up when needed.

26 Information has been gathered from the homepages of SAARC and the World Bank, http://www.saarc-sec.org/ and http://www.worldbank.org/, respectively.

There are technical committees that are responsible for the implementation, co-ordination and monitoring of the programmes. The SAARC also has a Secretariat, which is based in Kathmandu. The Secretariat co-ordinates and monitors implementation of the activities, prepares for and services meetings, and serves as a channel of communication between SAARC and other regional organisations and inter-governmental institutions. The Secretary-General is appointed from the member countries on a rotational basis.

During the first seven years (1985-1992), the SAARC countries focused mostly on non-controversial programmes that were of symbolic significance and avoided issues such as trade, finance and investment. In December 1995, the SAARC countries established the South Asian Preferential Trade Agreement (SAPTA). The SAPTA framework consists of periodic rounds of trade negotiations for the exchange of trade concessions on tariff, para-tariff and non-tariff measures. SAPTA also contains provisions giving special and favourable treatment to the LDCs (Bangladesh, Bhutan, Nepal and Maldives) in the SAARC region.

SAPTA also incorporates provisions for rules of origin to be eligible for preferential treatment. Rules of origin have been a controversial issue during the initial rounds of negotiations. India has favoured relatively high ratios while the other SAPTA members have argued for lower ones. Currently, the requirement for local content for preferential treatment is 40 per cent of f.o.b. for non-LDCs (India, Pakistan and Sri Lanka) and 30 per cent for the others.

Three rounds of negotiations have been concluded under SAPTA. A cautionary product-by-product method of negotiations was favoured during the first round, which was completed in April 1995 with 206 tariff lines exchanged for concessions. In the second round, concluded in 1997, a combination of product-by-product and sector-level approaches was adopted encompassing 1,871 tariff lines. In the third round, which was concluded in November 1998, another 3,456 tariff lines were exchanged for tariff concessions. However, the trade coverage of these sectors is rather low.

A Committee of Experts is negotiating a draft for establishing a South Asian Free Trade Area (SAFTA). In the more distant future, a customs union, a common market and an economic union are also visualised. Deeper integration in trade and other fields requires ever more established and professional institutions.

Integration has not evolved as speedily in reality as sometimes visualised. Political problems within and between some member countries, including civil wars in Sri Lanka and Nepal, and the perpetual political tension between India and Pakistan that sometimes breaks out in armed conflicts, are holding integration back. The 11th SAARC summit was originally due to be held in Kathmandu in November 1999, but it was eventually postponed until January 2002 due to tension between India and Pakistan. Bilateral issues are not debated in SAARC and therefore the unsettled issues between India and Pakistan cannot be raised to the fore there. Economic integration could be a way to a more stable South Asia.

SAFTA was originally envisaged for the years 2001-05, but according to World Bank sources, it is now envisaged to become operational in 2008 for the non-LDC members (India, Pakistan and Sri Lanka) and 2010 for the LDC members (Bangladesh, Bhutan, Nepal and Maldives). Depending on the political development in the area even these dates may be overly optimistic.

SAARC countries' trade structures are relatively similar with respect to exports of labour-intensive products such as textiles and agricultural goods and imports of capital-intensive goods. For example, India is increasingly exporting manufactured goods. Even though India is extremely important in Nepal's foreign trade, intra-regional trade within SAARC countries is limited. In 1999, intra-regional exports only accounted for about 5 per cent of the total exports of the SAARC countries.[27] The formation of a free-trade area is likely to increase intra-regional trade substantially, but its initial economic impact on the member countries may be relatively small. Increased competition would, however, force firms to enhance their activities and improve their technical and business competence. Meanwhile, the still relatively high import duties of India shield local industries and therefore also limit the extent to which free trade within the SAARC will expose the region's firms to global competition.

27 According to UNCTAD, the share of intra-regional exports has increased steadily from 3.2 per cent in 1990 to 5.3 per cent in 1998, but then declined to 4.2 per cent in 2000. The share of intra-regional imports increased from 2.0 per cent in 1990 to 4.8 per cent in 1998 and then declined to 3.8 per cent in 2000. In current US dollar terms, intra-SAARC exports grew by 219 per cent to USD 2.76 billion between 1990 and 2000, while imports grew by 312 per cent to USD 3.12 billion.

World Trade Organisation

Nepal applied for membership in GATT, the predecessor of the World Trade Organisation (WTO), in May 1989, but did not become a member before the WTO was founded in 1995. In December 1995, Nepal became an observer government seeking membership in the then newly established WTO. A Working Party on the accession of Nepal to the WTO was established in June 1999 and its first meeting took place in May 2000. Market access negotiations started in September 2000. The next meeting of the Working Party is expected to be held in the second half of 2002.

The fundamental principles of the WTO agreements in the foundation of a multilateral trading system are non-discrimination (most-favoured-nation (MFN) treatment and national treatment), freer trade, predictable policies, the encouragement of competition, and extra provisions for less developed countries.

Membership in the WTO will give Nepal protection against possible arbitrary trade measures by other countries and a more stable international trade environment. Also under the WTO, Nepalese products are entitled to transit facilities, which are of course already guaranteed under the Indo-Nepalese treaties. India is a founding member of the WTO, while Nepal's other neighbour, China became a member in December 2001.

Under the MFN principle, a favour to one member country has to be extended to all WTO member countries. There are exceptions, however. Countries can set up regional free-trade agreements that do not apply to goods from outside the group. Consequently, Nepal and India can continue to have their bilateral preferential trading agreement. The same concerns trade between the member countries of SAPTA. However, if goods produced in third countries are exported via Nepal to India for example, as the latter has been claiming, the MFN principle is violated.

Karky (2001) argues that Nepal should have no difficulties in implementing the WTO regulations for the MFN clause, the national treatment principle, or the transparency of laws and regulations. However, Karky identifies three areas where new laws and better implementing institutions need to be enacted: the Agreement on the Application of Sanitary and Phytosanitary Measures (the SPS Agreement), the Agreement on Technical Barriers to Trade (TBT),

and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

The SPS agreement is an agreement on food safety and animal and plant health standards that complements the TBT agreement, which seeks to ensure that regulations, standards, testing and certification procedures do not create unnecessary obstacles to trade.

The TRIPS agreement covers five broad issues: 1) application of the basic principles of the trading system and other international intellectual property agreements, 2) adequate protection to intellectual property rights, 3) adequate enforcing of the rights, 4) dispute settlement between members of the WTO, and 5) special transitional arrangements. TRIPS covers copyright and related rights, trademarks (including service marks), geographical indications, industrial designs, patents, layout-designs (topographies) of integrated circuits, and undisclosed information (including trade secrets). Least-developed countries are given an option for an 11-year transition period. Karky (2001) argues that there is a lack of effective enforcement mechanism and institutions under Nepal's Patent, Design and Trademark Act of 1965, which has led to disrespect of intellectual property rights (see also Guru-Gharana 2001).[28]

Guru-Gharana (2001) argues that WTO membership may have negative implications through erosion of quotas, price rises, additional costs for new products, processes and technology, and costs in adjustment, restructuring, monitoring, policing, reporting and participation for WTO compliance. However, Guru-Gharana recognises that most of these costs would materialise regardless of the WTO and that membership also opens opportunities.

Not joining the WTO is not really an option for Nepal. Both of its big neighbouring countries are already members, and Nepal is a small and poor land-locked country, which needs exports in order to increase its GDP and imports in order to raise its potential output. Membership in the WTO provides an international framework, which would protect Nepal's trade interests. Increased international transparency also supports better governance in a country where corruption is a problem. Better management would help in benefiting from the membership. Increased competition will result in structural adjustment pressures in the short to medium term.

28 According to the Heritage Foundation, the black market is rife especially in consumer goods, labour, construction, currency and the smuggling of weapons.

According to Anderson and Yao (2002), South Asia (and Sub-Saharan Africa) will gain significantly from participating in the removal of the remaining post-Uruguay round trade distortions. They argue that especially manufacturing but also other sectors in South Asia would benefit from a removal of the region's own distortionary policies, because it will increase the efficient use of resources.

Other Trade Regime Issues

Multi-Fibre Agreement

There has been a quota for Nepal's clothing exports under the Multi-Fibre Agreement (MFA) put into force in 1974 under GATT. The MFA resulted in a complex system of bilateral quotas on exports and imports of textiles and clothing between industrialised and less developed countries. On January 1st 1995, the MFA was replaced by the WTO Agreement on Textiles and Clothing. A ten-year transition period for the removal of the MFA quotas then began and the MFA will be phased out in stages by January 1st 2005.

The phasing out of the protective MFA agreement will increase the exports of textiles and clothing by less developed countries to industrialised countries. India and especially China are likely to be among the biggest gainers. Nepal, on the other hand, will lose at least in the short term when its industry faces fiercer competition as it is not very competitive (see Section 4.3). The MFA has guaranteed Nepal's products a quota in the imports of industrialised countries. On the other hand, such quotas distort competition and the production structure of countries.

European Union

The European Union has granted a derogation from its normal rules of origin to, among other countries, Nepal. Accordingly, Nepal may use imported raw materials from neighbouring countries[29] when producing woven or knitted garments and these products are still regarded as originating from Nepal. Consequently, they can be exported to the EU duty free under the Generalised System of

29 ASEAN (except Myanmar), SAARC or countries belonging to the ACP-EC Partnership Agreement.

Preferences (GSP) scheme. Some exports of textile products from Nepal to the EU are free of quantitative limits.[30]

In February 2001, the EU approved the Commission's proposal for the so-called Everything But Arms (EBA) initiative, to eliminate quotas and duties on all products[31] except arms imported from the world's 49 least developed countries.[32] Nepal is one of these countries. In June 2000, The EU signed an agreement in Cotonou with African, Caribbean and Pacific (ACP) countries to ensure free access for 'essentially all' products from all LDCs by 2005 at the latest. Nepal is not one of these countries but faces competition from them in the EU market.

United States: From MFA to AGOA

The US is now working on the AGOA pact that will create new trade and investment policies for Sub-Saharan Africa. According to the pact, eligible textile and apparel articles imported directly into the customs territory of the US from a beneficiary Sub-Saharan African country may enter free of duty and free of qualitative limitations. Nepal is not included and therefore faces fiercer competition from Africa in addition to, among others, India and China.

China

Nepal established formal relations with China in 1956, and since then their bilateral relations have generally been very good. In 1960, a Treaty of Peace and Friendship was concluded between the two countries. There is only one road north via Kodari into Tibet and further into China. The distance from Kathmandu to the border at Kodari is approximately 116 kilometres. The population of Tibet is 2.6 million and the road is in fairly poor shape. About 80 per cent of all Nepal's imports from China arrive through this road. China is reported to be building a railroad into Tibet by 2005.

30 EC No. 1615/2000; Official Journal L 185, 25/07/2000, p. 54-61. See also 200A0207(01): Agreement between the European Community and the Kingdom of Nepal on trade in textile products; Official Journal L 032, 07/02/2000.

31 The full liberalisation of sugar, rice and bananas will have a transition period. Duties on rice will be reduced by 20 per cent on September 1st 2006, by 50 per cent on September 1st 2007 and by 80 per cent on September 1st 2008 and eliminated at the latest by September 1st 2009.

32 Despite quota and duty-free access to the EU markets, least developed countries often bring up EU agricultural subsidies as a trade barrier.

Duties and Tariffs

Nepal's trade with India is duty free, but otherwise Nepal charges duties in its foreign trade. According to the World Bank, Nepal's mean tariff in 1999 was 12.4 per cent, down from 16.3 per cent in 1998.[33, 34] The standard deviation of tariff rates decreased from 15.5 to 11.3 and the weighted mean tariff declined from 18.6 to 15.7 per cent. For primary products the average tariff declined from 9.2 to 8.4 and for manufactured products from 18.3 to 13.5 per cent.

Nepal's import duties vary between 0 and 140 per cent. Live animals, fish, and most primary products are exempt. Machinery and goods related to basic needs are charged a five per cent import duty. Products hazardous to health such as cigarettes and liquor are taxed at 110 per cent. (U.S. Department of State 2001

Typically a service charge of 0.5 per cent of export value is levied. The rate is 0.25 per cent in case of certain products, e.g. woollen carpets, readymade garments, leather, pulse and jute products.'[35]

4.5 Current Account and Foreign Trade

Next we will review Nepal's current account developments and foreign trade in goods and services. There are some statistical ambiguities.[36] Consequently, all data presented here should be approached with some caution. Furthermore, there is a lot of informal trade especially between Nepal and India that is not included in the trade statistics. We discussed informal trade in Section 4.4.

Current Account Developments

Nepal has had a current-account deficit since at least 1975. This is no surprise and as such does not need to be a problem, because the country is short of capital and needs to import capital goods. According to data by the World Bank, the current-account deficit

33 The mean tariff for all products was 32.9 per cent in India.

34 According to the Heritage Foundation, Nepal's average tariff rate was 10.4 per cent in 2001, up from 8.6 per cent in 2000.

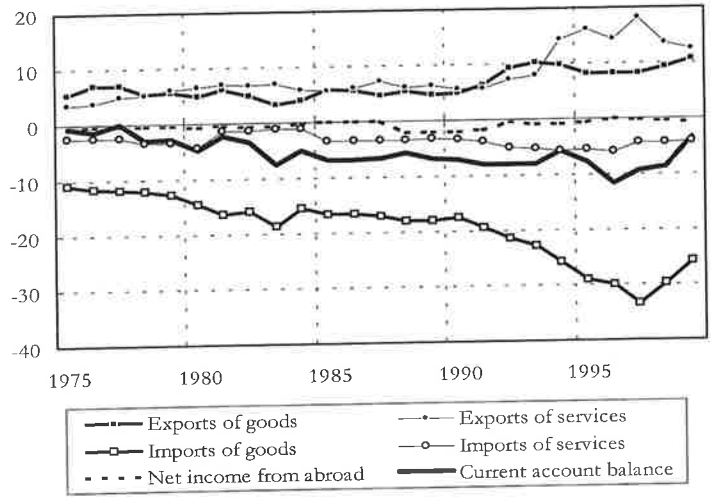
35 See http://www.tpcnepal.org.np/t-ap/tariffinformation.htm for general and good-specific export and import tariffs. Some of these tariffs are fairly high.

36 For example, data provided by the World Bank shows that the exports of services have for a long time been larger than the exports of goods. According to Singh (2001), the exports of services are equal to 31 per cent of total exports. Data provided by UNCTAD is again somewhat different. There may be differences in the definitions here.

reached almost 12 per cent of GDP in 1996, but it has declined since then. Nepal's goods trade deficit is large, 15.3 per cent of GDP in 1999, down from a peak of 25.3 per cent of GDP in 1996.[37] The deficit in goods trade is not worrying because it is largely compensated for by the surplus in the service sector: 8.4 per cent of GDP in 1999, down from a peak of 13.9 per cent in 1997. The important issue is the current account, which can be financed with foreign direct investment. Lack of FDI is a problem, however.

Dollar and Kraay (2001) compare growth in trade relative to GDP between 1975-79 and 1995-97 and the decrease in weighted average tariffs between 1985-89 and 1995-97. There Nepal is a 'globaliser' especially in the former respect. Its average trade (exports and imports) per GDP ratio has risen from 17 per cent in the early 1970s to 60 per cent in the mid-1990s. Meanwhile, its weighted average tariff rate has declined from 22 per cent in the mid-1980s to 11 in the mid-1990s.

Figure 4.5 The current account 1975-1999, % of GDP



Source: World Bank.

37 According to Nepal Rastra Bank, imports from India were 81 per cent higher than exports to India in 1999/2000, while in trade with third countries the figure was 128 per cent.

Table 4.9 Items of the current account 1975-99, % of GDP

	1975-79	1980-84	1985-89	1990-94	1995	1996	1997	1998	1999
Balance, goods trade	-5.9	-11.8	-12.3	-13.7	-21.0	-22.0	-25.3	-20.5	-15.3
Exports	6.0	4.5	5.1	8.5	8.1	8.0	8.1	9.2	10.5
Imports	-11.9	-16.3	-17.4	-22.1	-29.1	-29.9	-33.4	-29.7	-25.8
Balance, services trade	1.9	4.9	3.0	4.0	10.6	8.5	13.9	9.4	8.4
Exports	4.8	6.6	6.3	8.7	16.2	14.3	18.2	13.7	12.5
Imports	-2.9	-1.6	-3.3	-4.8	-5.5	-5.8	-4.3	-4.3	-4.1
Net income from abroad	-0.5	-0.4	-1.0	-1.0	-0.7	0.1	-0.1	-0.3	-0.5
Current account balance	-1.6	-4.7	-6.5	-7.1	-7.8	-11.7	-9.4	-8.7	-3.4

Source: World Bank.

One source of foreign currency are the Nepalis who are working abroad. There were 168 recruiting agencies involved in foreign employment activities in 2001. According to the Census of 2001, 762,000 Nepalis were residing abroad, 77 per cent of them in India. Nepalis were also working in for example Saudi Arabia, Qatar, United Arab Emirates, Malaysia and South Korea. Furthermore, some 160,000 Nepalis have been estimated to be involved in foreign employment without government approval (Kathmandu Post, December 5th 2001). Meanwhile, there were 117,000 non-Nepalis in Nepal, of whom 87 per cent were from India.

The World Bank has estimated that workers' remittances amounted to USD 152 million in 1999, or 13 per cent of the exports of goods and services, 10 per cent of the imports of goods and services, 90 per cent of the current-account deficit and 3 per cent of GDP. These are very high figures and the shares more or less correspond to those of tourism.

Table 4.10 Workers' remittances, USD million

	1975	1980	1985	1990	1995	1999
Workers' remittances, receipts	19.6	29.8	39.0	61.0	101.4	151.8
% of exports of goods and services	14.1	13.3	13.0	16.1	9.5	13.2
% of imports of goods and services	9.4	8.2	7.5	8.0	6.7	10.1
% of current-account deficit	171.9	32.1	21.9	24.3	29.6	90.4
% of GDP	1.2	1.5	1.5	1.7	2.3	3.0

Source: World Bank.

Goods Trade

Foreign Trade Partners

Exports of goods as a per cent of GDP grew very fast around the mid-1990s. Since then the pace has slowed down. The growth of imports has been a longer-lasting trend, but there, too, the direction was one of decline in 1998-2000. The notable feature has been the increase in the importance of India in Nepal's foreign trade. This is more a return to earlier realities as India's share in Nepal's foreign trade diminished considerably from the early 1970s,[38] when it was much higher than today, up until the early 1990s.

Nepal's most important export and import countries are shown in Tables 4.11 and 4.12. If we combine goods exports and imports we find that India's share in total goods trade in 2000 was 30 per cent, China's (including Hong Kong) 13 per cent, Argentina's 12 per cent, United States' 11 per cent, Germany's 5 per cent and Singapore's 5 per cent. India's importance is likely to increase further. Overall, developing countries are much more important than OECD countries in Nepal's foreign trade.

Since 1992 the share of different export countries has changed significantly. Germany's share in goods exports has declined from 44 per cent by 30 percentage points. The share of other EU countries has remained more or less unchanged. Also Switzerland has lost its importance in Nepal's exports. Meanwhile, the share of the United States has risen to 33 per cent. Overall, the share of developed countries has declined from 85 per cent in 1992 to 61 per cent in 2000.

The share of developing countries has increased from 15 per cent to 37 per cent. India's share in Nepal's goods exports has risen from 6 per cent in 1992 to 26 per cent in 2000 after having peaked at 33 per cent in 1998.

38 According to Nepal Rastra Bank, India's share in Nepal's exports declined from 75 per cent in 1975/76 to 62 per cent in 1980/81 and further to 21 per cent in 1990/91 and 18 per cent in 1994/95 just before the trade treaty with India was signed. By 1999/2000 India's share in Nepal's exports had again risen to 44 per cent. Likewise, India's share in Nepal's imports was 62 per cent in 1975/76, 49 per cent in 1980/81, 32 per cent in 1990/91, and 31 per cent in 1994/95. By 1999/2000 it had again risen to 47 per cent. These data differ from the international sources that we will use below.

Table 4.11 Exports by region 1992-2000, USD mill. and % of total

	1992	1993	1994	1995	1996	1997	1998	1999	2000
WORLD	353	368	351	324	3601	397	444	570	675
% of total									
DEVELOPED COUNTRIES	85.4	92.8	93.3	89.1	74.9	71.8	61.3	59.9	61.2
EU	54.4	58.7	53.7	53.2	42.7	42.5	33.1	26.2	23.0
- Germany	43.5	48.6	42.2	41.7	33.9	33.8	24.8	16.2	13.4
- UK	2.7	2.4	2.8	2.2	1.4	1.3	1.1	2.8	2.9
- France	1.6	1.1	1.4	2.2	1.7	1.8	2.3	2.3	2.1
- Italy	1.3	1.1	1.4	2.2	1.9	1.5	1.8	0.7	1.3
- Austria	..	1.9	2.3	1.5	1.1	1.3	1.1	0.7	..
United States	23.0	27.2	33.3	30.6	28.6	26.2	25.9	30.8	32.8
Japan	0.6	1.0	0.8	0.5	0.4	0.5	0.7	0.8	3.1
Other	7.5	6.0	5.7	4.9	3.3	2.8	1.8	2.3	2.6
- Switzerland	6.0	4.1	4.0	3.4	2.2	1.5	0.9	1.2	1.1
DEVELOPING COUNTRIES	14.5	7.0	6.4	10.7	21.5	26.0	36.7	38.2	37.0
America	0.0	0.3	0.9	0.5	0.2	0.2	0.2	6.7	6.5
- Argentina	..	0.0	0.0	0.0	0.0	0.0	0.0	6.7	6.3
Other Asia	14.4	6.5	5.2	10.0	21.2	25.8	36.6	31.4	30.4
- India	5.9	4.6	3.7	7.7	18.6	23.2	32.9	27.1	25.8
- Bangladesh	0.1	0.0	0.0	1.2	1.9	2.3	2.3	1.4	0.3
- China	..	0.5	0.6	0.0	0.0	0.0	0.0	1.4	..
Unallocated	0.0	0.0	0.2	0.2	3.5	1.9	1.8	1.6	1.6

Sources: UNCTAD Handbook; IMF Direction of Trade Statistics Yearbook 2000; Asian Development Bank 2001.

Table 4.12 shows Nepal's imports by country of origin. The share of developed countries has declined from 40 per cent in 1992 to just 12 per cent in 2000. The share of the EU has declined from 15 to less than six per cent, that of Japan from almost 14 to two per cent and that of New Zealand from eight per cent to just one per cent. The US has been insignificant during the period examined.

Meanwhile, the share of developing countries has risen from 59 per cent in 1992 to 86 per cent in 2000. India's share has almost doubled to 32 per cent. China's share (including Hong Kong) has risen from 15 per cent to 19 per cent. Singapore's share has halved

to six per cent. Argentina has become the third most important import country (if China is considered as one).[39]

Table 4.12 Imports by region 1992-2000, USD mill. and % of total

	1992	1993	1994	1995	1996	1997	1998	1999	2000
World	477	542	616	753	1,348	1,640	1,434	1,501	1,667
% of total									
DEVELOPED COUNTRIES	40.0	38.6	31.8	27.3	19.5	18.3	17.2	11.0	11.8
EU	15.3	12.4	12.6	9.7	8.2	7.5	7.5	5.3	5.6
- Germany	..	2.4	2.6	3.7	3.3	1.2	1.7	1.1	..
- France	..	2.0	2.3	1.1	0.7	0.5	0.7	0.9	..
- UK	..	3.7	2.6	1.7	1.4	3.4	1.5	0.8	..
United States	..	1.1	1.3	1.5	1.0	0.9	1.5	1.6	..
Japan	13.7	13.8	11.8	8.8	6.1	4.2	3.1	1.9	2.3
Other	..	11.4	6.4	7.6	4.4	5.9	5.7	2.6	..
- New Zealand	8.2	9.0	4.1	4.9	3.2	2.4	1.7	0.9	1.2
- Switzerland	..	0.4	0.5	0.4	0.1	2.5	2.1	0.3	..
DEVELOPING COUNTRIES	58.9	61.3	66.0	72.4	80.1	78.7	80.7	87.9	86.1
America	1.5	0.1	0.6	0.5	1.6	0.9	0.3	13.2	13.6
- Argentina	0.3	0.0	0.0	0.0	0.5	0.2	0.1	13.1	13.6
West Asia	1.7	0.9	0.6	1.9	4.5	9.1	11.0	8.5	9.5
- UAE	..	0.0	0.0	0.0	1.3	6.0	4.9	4.6	4.6
- Saudi Arabia	0.7	0.0	0.2	0.4	1.4	1.8	2.2	2.0	2.0
Other Asia	55.6	60.3	64.8	69.9	74.0	68.7	69.4	66.2	63.0
- India	16.8	15.3	15.1	15.7	32.8	26.6	30.7	31.0	32.3
- China	8.1	6.8	7.1	7.8	4.2	3.2	4.7	15.2	11.8
- Hong Kong	7.1	7.6	8.4	10.9	15.7	21.6	10.5	6.4	7.2
- Singapore	12.0	11.6	12.2	12.4	14.2	10.6	14.2	6.4	6.3
- South Korea	..	2.8	0.0	0.0	1.5	1.0	2.1	1.9	..
- Thailand	5.5	12.9	17.7	18.9	1.4	1.8	2.0	1.5	2.0
Unallocated	0.0	0.0	1.9	0.0	0.3	2.8	1.5	0.7	1.8

Sources: UNCTAD Handbook; IMF Direction of Trade Statistics Yearbook 2000; Asian Development Bank 2001.

39 Data by the World Bank indicate that Argentina has been an important import country since at least 1992.

Product Structure of Foreign Trade

Concentration indices by UNCTAD for Nepal's foreign trade show how concentrated the goods' structure of trade is. Reproduced in Table 4.13, we see that exports are much more concentrated than imports. This is natural because, as a small nation, Nepal cannot be expected to produce as large a variety of goods for exports as it needs to import. On the other hand, we see that the concentration index of Nepal's exports has declined and that that of its imports has risen. From the lower part of the table we can see that using 3-digit SITC data the number of commodities in exports has increased from 33 in 1990 to 40 in 1998. Meanwhile, the number of commodities in imports has declined from 172 to 113. It is a positive sign that exports have become less concentrated during a time of increasing trade and openness in the global market.

Table 4.13 Concentration indices[1] of exports and imports

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Concentration index									
Exports	0.453	0.500	0.519	0.551	0.559	0.437	0.461	0.451	0.373
Imports	0.108	0.152	0.160	0.189	0.272	0.253	0.211	0.320	0.255
Number of commodities									
Exports	33	29	29	35	31	38	37	35	40
Imports	172	114	112	113	104	124	118	118	113

[1] The trade concentration index is a modified version of the Hirschmann index. It is calculated as the square root of the sum of the ratios (raised to the power of two) of each of the 239 products at the 3-digit SITC (Rev. 2) to total exports or imports. The result is then normalised by the square root of 1 over 239. The index varies between 0 and 1 (maximum concentration).

Source: UNCTAD Handbook.

Figure 4.6 shows the structure of Nepal's exports and imports using one-digit SITC trade data from 1983-2000. The share of food and live animals has declined considerably from a peak of 36 per cent of total exports in 1985 to about 10 per cent. Also the share of crude materials has declined from 30 per cent in 1983 to almost zero by the year 2000. The share of basic manufactures increased from 32 per cent in 1983 to 60 per cent in 1993 but it has since then declined back to 32 per cent in 2000. On the other hand, there has been a considerable increase in the share of miscellaneous manufactured goods from just 4 per cent in 1983 to 43 per cent in 2000. Also chemicals have emerged as an export product towards the end of the 1990s. Overall, there has been a structural shift away from food, live animals and crude materials to manufactured goods.[40]

There were no major changes in the structure of Nepal's imports in 1983-2000. Basic manufactures are the most important import products with a 32-per cent share. The share is the same as in 1983, but it peaked at 49 per cent in 1997, which was a year of very high imports. The second most important group of import products are machines and transport equipment, whose share was 19 per cent in 2000 as in 1983, but which peaked at 30 per cent in the late 1980s.

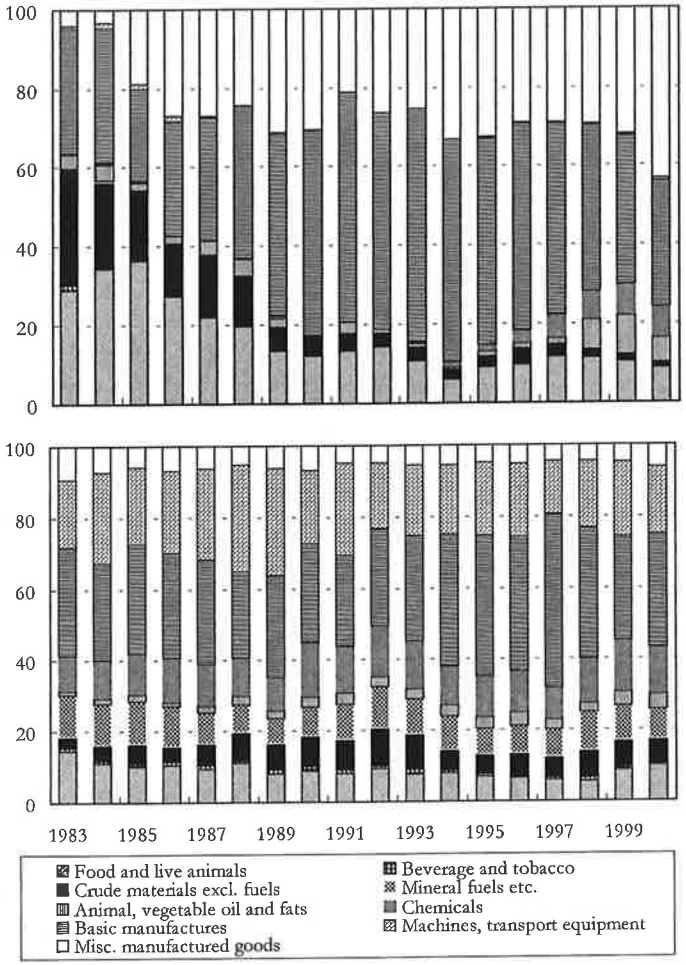
Trade with India vs. Trade with Third Countries

Nepal's exports can be divided into two distinct groups: exports to India and exports to industrialised countries. Above we saw that the share of food and live animals has declined in Nepal's overall exports. These have never been important in other than the Indian market, where their share in Nepal's exports has declined from 53 per cent to 20 per cent during the 1990s. Also the share of crude materials has declined in exports to India. Vegetable oils first became less important during the 1990s, but their share had increased substantially by the end of the 1990s. Vegetable oil (ghee) is one of the products whose imports from Nepal the Indian authorities have been concerned about. The share of basic manufactures has risen to about one-quarter and that of miscellaneous manufactured articles jumped to 20 per cent in 1999/2000. This latter was due to exports of pashmina, not traditionally exported to India.[41]

[40] In 1999/2000 the most important export products were ready-made garments (22 per cent), woollen carpets (21 per cent), pashmina goods (14 per cent), vegetable ghee (6 per cent), tooth paste (5 per cent), and jute (2 per cent). (Nepal Rastra Bank.)

[41] The most important export products to India during 1999/2000 were pashmina (23 per cent), vegetable ghee (20 per cent), tooth paste (16 per cent), jute goods (8 per cent), soap (8 per cent) and pulses (7 per cent). (Nepal Rastra Bank.)

Figure 4.6 Exports (above) and imports (below), SITC, 1983-2000, % of total



Source: Asian Development Bank.

Exports to third countries are dominated by miscellaneous manufactured goods (including garments), which accounted for 60 per cent of Nepal's total exports to third countries in 1991/92 and 36 per cent in 1999/2000, and basic manufactures (including car-

pets) whose share has risen from 29 to 59 per cent during the 1990s.[42]

Table 4.14 Composition of Nepal's exports to India (above) and overseas (below) 1991-2000, %

Product	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
Food and live animals	52.6	46.6	38.4	42.1	33.4	33.5	19.4	16.3	19.9
Beverages and tobacco	0.1	0.3	0.2	0.1	0.0	0.0	0.2	0.3	0.4
Crude materials, excl. fuels	19.8	20.1	12.1	12.4	7.3	7.3	3.7	2.8	2.1
Mineral fuels etc.	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.0
Animal, vegetable oils etc.	7.9	10.4	5.5	6.7	2.9	2.9	22.5	26.9	14.6
Chemicals products	0.7	0.9	8.4	8.2	25.4	25.5	22.2	22.2	17.7
Basic manufactures	17.0	19.5	34.0	29.0	29.0	29.1	29.0	25.9	25.3
Machines, transp. equip.	0.0	0.1	0.0	0.1	0.5	0.2	0.1	0.2	0.8
Misc. manufactured goods	1.9	1.9	1.4	1.4	1.4	1.4	2.7	5.3	19.2
Other	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
India's share in Nepal's total exports, %	10.6	9.4	12.5	17.7	24.4	23.1	32.0	35.1	43.8

Product	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
Food and live animals	9.6	7.1	1.4	1.7	4.2	5.2	7.6	7.3	3.1
Beverages and tobacco	0.1	0.0	0.1	0.1	0.0	0.1	0.0	0.0	0.0
Crude materials, excl. fuels	1.2	1.3	0.8	0.7	2.7	1.6	0.8	0.5	0.2
Mineral fuels etc.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Animal, vegetable oils etc.	0.4	0.0	0.0	0.0	0.7	0.9	0.8	1.0	1.0
Chemicals products	0.1	0.1	0.1	0.3	0.1	0.1	0.1	0.1	0.2
Basic manufactures	59.6	63.8	59.8	57.6	56.9	54.6	48.5	44.5	35.5
Machines, transp. equip.	0.0	0.0	0.0	0.2	0.1	0.3	0.3	0.3	0.7
Misc. manufactured goods	29.0	27.6	37.8	39.4	35.3	37.2	41.8	46.3	59.2
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Statistical Yearbook of Nepal 2001.

[42] In 1999/2000, exports to third countries were almost totally made up of only three articles: readymade garments (51 per cent), woollen carpets (36 per cent) and pashmina (10 per cent). In 2000/01, the respective figures were 49, 30 and 18 per cent. (Nepal Rastra Bank.) Between 1998/99-2000/01, the volume of carpet exports declined from 2.60 million m² to 2.51 million m² and further to 2.24 million m² (Kathmandu Post, February 12th 2002).

There are quite large swings in the exports of many trading products even when the data are very aggregated as is the case here. This is partly due to the relatively low volume of Nepal's exports despite the relative openness of the economy when measured as a percentage of gross domestic product. The decline in the UNCTAD concentration index that we saw earlier, i.e. less concentration in exports, is really only taking place in the Indian market.

Table 4.15 Composition of Nepal's imports from India (above) and overseas (below) 1991-2000, %

Product	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
Food and live animals	21.6	20.7	17.9	14.4	13.4	14.7	12.3	17.2	17.0
Beverages and tobacco	2.5	3.6	2.0	2.4	1.8	2.2	2.5	2.0	1.7
Crude materials, excl. fuels	2.3	3.2	2.3	3.3	3.6	2.8	3.7	4.3	3.9
Mineral fuels etc.	2.9	2.9	2.6	1.9	1.8	2.0	1.8	1.6	1.9
Animal, vegetable oils etc.	0.1	0.0	0.1	0.1	0.2	0.4	0.0	0.1	0.2
Chemicals products	16.8	15.6	14.5	14.7	14.5	16.4	19.3	17.1	17.9
Basic manufactures	29.3	30.1	34.8	37.6	38.8	36.1	36.3	32.6	34.8
Machines, transp. equip.	20.0	18.6	21.1	21.6	21.7	20.3	18.9	20.7	17.0
Misc. manufactured goods	4.6	5.2	4.7	4.0	4.1	5.1	5.0	4.3	5.6
Other	0.0	0.1	0.0	0.0	0.0	0.0	0.2	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
India's share in Nepal's total imports, %	35.2	31.5	33.0	30.8	32.8	26.6	30.7	36.7	38.3

Product	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
Food and live animals	2.5	1.8	3.0	3.7	3.0	2.5	2.5	3.8	5.7
Beverages and tobacco	0.0	0.1	0.1	0.1	0.1	0.1	0.2	0.3	0.4
Crude materials, excl. fuels	15.3	13.4	7.9	6.1	7.9	7.0	9.7	8.8	8.5
Mineral fuels etc.	16.1	13.0	12.7	9.8	10.2	9.7	14.7	14.8	12.6
Animal, vegetable oils etc.	3.9	4.1	4.2	4.6	5.6	3.3	3.3	5.9	6.6
Chemicals products	13.2	12.6	8.9	9.8	10.3	6.4	9.4	12.6	12.3
Basic manufactures	25.6	28.8	38.3	40.7	37.3	52.1	36.8	27.4	29.0
Machines, transp. equip.	17.6	20.3	18.6	19.9	20.0	12.7	18.8	20.6	20.1
Misc. manufactured goods	5.0	5.8	6.0	5.1	5.6	4.0	4.2	5.3	4.6
Other	0.9	0.1	0.3	0.0	0.0	2.2	0.5	0.5	0.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Statistical Yearbook of Nepal 2001.

Looking at imports from India, basic manufactures accounted for a little over one-third of all imports from India in 1999/2000. These are followed by food and live animals, chemical products, and machines and transport equipment, which accounted for 17 per cent each. The shares have been relatively stable during the 1990s.

The structure of imports from third countries has been fairly stable. Basic manufactures account for about 30 per cent of total imports with a peak at 52 per cent in 1996/97. Machines and transport equipment have a 20-per cent share, followed by mineral fuels and chemical products with a share of a little over ten per cent each.[43]

Trade with the United States

The United States is Nepal's most important export country, but the exports consist of only a few garment products. The US AGOA initiative discussed above is threatening Nepal's already weak competitiveness in that market area.

Overall, garments accounted for 73 per cent of all US imports from Nepal in 1998 and textile yarn and related products accounted for another 21 per cent. Figure 4.7 shows at a more disaggregated four-digit level the share of Nepalese goods in three product groups important in US imports from Nepal, namely men's trousers, overalls, shorts etc. (21 per cent of US imports from Nepal), carpets and other knotted textile floor coverings (17 per cent), and men's shirts (13 per cent). These three product groups accounted for 50 per cent of all US imports from Nepal and their share has risen during the 1990s.

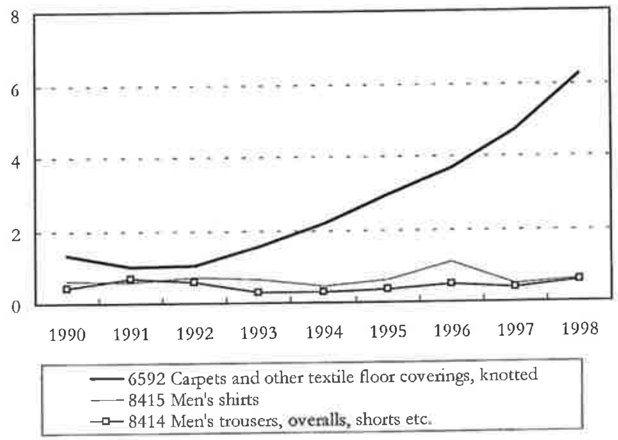
Exports to the United States are very important. About 85 per cent of Nepal's total garment exports went to the US in the year 2000. France accounted for approximately 5 per cent and Germany 3 per cent. According to Garment Association of Nepal, in November 2001 garment exports to the US had declined by 40 per cent year-on-year. During the first 11 months of 2001 the decline was 14 per cent year-on-year.

43 The most important import products from third countries in 1999/2000 were petroleum products (19 per cent), gold and silver (18 per cent), threads (9 per cent), other machinery and parts (8 per cent), chemical fertilisers (6 per cent), and transport equipment and parts (6 per cent) (Nepal Rastra Bank).

In US imports of carpets, Nepal occupied fifth place in 1998 after India, China, Pakistan and Turkey. In fact, 97 per cent of all imported knotted carpets to the US originated from these five countries. Nepal's share in imported men's shirts and men's trousers has remained more or less stable at around 0.5 per cent. Nepal has had a quota under the MFA as discussed above in Section 4.4.

A US firm importing textiles from Nepal pays an average of 18-21 per cent duty.[44] In addition to that, Nepalese garments cost 15-20 per cent more that garments produced in India or Bangladesh (Kathmandu Post, December 4th 2001.) The industry is in difficulties also in Bangladesh, however.

Figure 4.7 Nepal's share in US imports of products important in Nepal's exports to the USA, %



Source: OECD.

Trade with the European Union

In 2000, EU imports from Nepal amounted to EUR 178.4 million and exports to Nepal to EUR 85.7 million.[45] A total of 58 per cent of EU imports from Nepal went to Germany followed by the UK (11 per cent), France (10 per cent), Italy (6 per cent), the Netherlands (5 per cent) and Belgium (4 per cent). Of EU exports to Nepal, 27 per cent originated from France, followed by Germany (22 per cent), the UK (15 per cent), Italy (13 per cent), Belgium (7 per cent) and the Netherlands (5 per cent).

[44] According to Schavey (2001), Nepal faces an average US tariff of 13.2 per cent due to its textile and apparel exports.

[45] Statistics by Eurostat.

In the year 2000, 60 per cent of EU imports from Nepal were carpets and other textile floor coverings and 27 per cent clothing accessories. Germany's imports from Nepal are particularly dominated by carpets with an 82-per cent share. In fact, 79 per cent of all EU imports of carpets from Nepal went to Germany. On the other hand, garments were important in France's imports (75 per cent of France's imports from Nepal), British imports (62 per cent) and Italy's imports from Nepal (50 per cent).

The EU countries' exports to Nepal were more heterogeneous with 18 per cent consisting of boilers, machinery etc., 17 per cent of aircraft and parts thereof, 14 per cent electrical machinery and equipment etc., 6 per cent optical instruments and apparatus, 5 per cent articles of iron and steel, 4 per cent pharmaceutical products, and 3 per cent essential oils and resinoids.

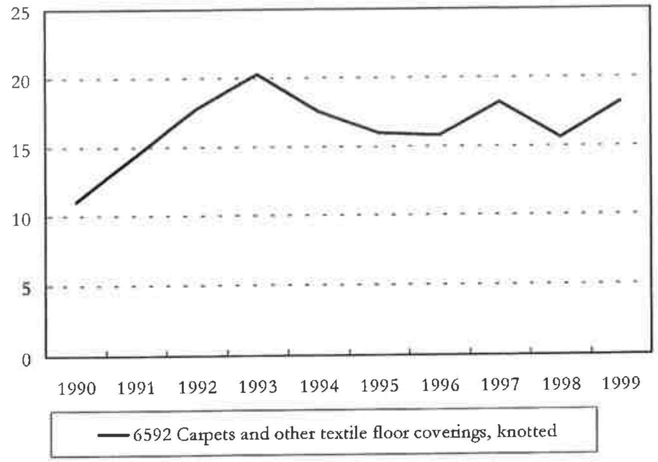
Nepal's share in total German imports is of course very small. It rose from almost 0.03 per cent in 1990 to almost 0.06 per cent in 1993, but has since then declined steadily. In 1999, Nepal's share was 0.02 per cent. Consequently, Nepal has actually lost aggregate market shares in Germany during the 1990s.

There is one product group, where Nepal has a significant market share in Germany. Carpets accounted for 91 per cent of all German imports from Nepal in 1999. This share has been slowly declining during the decade from 97 per cent in 1990.[46] Figure 4.8 shows Nepal's market share in the German imports of these goods. We see that after a growth period in 1990-93, Nepal's share in German carpet imports has stabilised at about 16-18 per cent. Nepal was third, after Iran and India, in Germany's carpet imports.

About 95 per cent of the wool used to produce carpets in Nepal is imported from New Zealand. Furthermore, cotton thread is imported from India. Production is labour intensive with a little over 50 per cent of local value added.

[46] These statistics are by the OECD. According to Eurostat, 82 per cent of Germany's imports from Nepal were carpets in the year 2000.

Figure 4.8 Nepal's share in German imports of carpets, %



Source: OECD.

Trade with China, Hong Kong and Singapore

China, Hong Kong and Singapore are important in Nepal's imports, but quite unimportant as export markets. In 2000, one-quarter of Nepal's imports originated from these three countries. According to data by the World Bank, 46 per cent of Nepal's imports from China were textiles in 1999, 6 per cent radio, television and communication equipment, and 6 per cent other electrical apparatus and supplies.

The main import products from Hong Kong were textiles (15 per cent of imports from Hong Kong), products of printing and publishing (11 per cent), office computing and accounting machinery (10 per cent), other electrical apparatus and supplies (10 per cent), radio, television and communication equipment (10 per cent), and photographic and optical goods (9 per cent). Some 68 per cent of imports from Singapore were petroleum products.

Trade in Services

So far we have analysed Nepal's trade in goods. Trade in services is also very important and needs to be analysed separately. Unfortunately, adequate statistics for international trade in services are often hard to come by. As was mentioned earlier, there are different estimates of the share of services in Nepal's total foreign trade.

According to UNCTAD, services have accounted for between 33 and 66 per cent of total exports of goods and services during the 1990s. There are large swings in the share. If we compare these data with those by the World Bank presented at the beginning of Section 4.5, there are some differences. The overall picture that emerges, however, is that services account for about half of Nepal's total exports. In imports, the share of services is considerably lower, a little over 10 per cent.

Nepal's share in the global trade of services is small. According to UNCTAD, Nepal's share in exports increased slightly between 1992 and 1997 but then fell back to 0.02 per cent by 1999. Its share in global imports has been rather stable at about 0.02 per cent. Even though Nepal has a very marginal role in the global trade of services, it has managed to hold its overall market share during the 1990s.

Table 4.16 Share of services in Nepal's total foreign trade

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Share in Nepal's total foreign trade										
Exports	44.9	44.9	36.3	42.5	59.2	63.1	63.8	66.2	47.7	33.1
Imports	19.1	19.1	22.1	21.7	20.0	18.6	14.4	11.3	13.2	12.4
Share in total world trade in services										
Exports	0.02	0.02	0.02	0.03	0.05	0.05	0.05	0.06	0.03	0.02
Imports	0.02	0.02	0.02	0.03	0.03	0.03	0.02	0.02	0.01	0.02

Source: UNCTAD.

The structure of Nepal's service exports is very volatile as can be seen in Table 4.17. Relative to world averages, government services are over-represented. Tourism was discussed earlier in Section 4.3. It would be very important for the exports of services to develop Nepal's tourism.

The structure of service imports, shown in Table 4.18, is less volatile. In 1999, transport and travel accounted for about one-third of total service imports each, with other business services accounting for one-quarter. The structure is relatively similar to world averages.

Table 4.17 Exports of services

Sector	1990	1992	1994	1995	1996	1997	1998	1999
Sectors' share of total exports of services in Nepal, %								
Transport	2.9	14.4	8.0	8.1	10.0	6.3	10.5	11.2
Travel	53.4	40.0	29.7	26.1	21.2	16.8	33.5	34.6
Other business	25.1	22.3	53.3	52.9	58.5	68.7	32.6	13.9
Government services	18.6	23.4	9.1	12.8	10.3	8.2	23.4	40.3
Total services	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Nepal's share of world total, %								
Transport	0.00	0.02	0.02	0.02	0.03	0.02	0.02	0.02
Travel	0.04	0.04	0.05	0.05	0.04	0.04	0.05	0.04
Other business	0.03	0.03	0.12	0.13	0.15	0.18	0.06	0.02
Government services	0.08	0.13	0.12	0.19	0.17	0.16	0.29	0.48
Total services	0.03	0.03	0.06	0.06	0.06	0.07	0.04	0.03

Source: UNCTAD.

Table 4.18 Imports of services

Sector	1990	1992	1994	1995	1996	1997	1998	1999
Sectors' share of total imports of services in Nepal, %								
Transport	38.7	38.2	32.3	35.3	22.9	27.7	28.6	34.7
Travel	27.1	23.1	37.9	43.5	51.4	46.0	39.6	33.6
Other business	26.1	33.8	24.6	15.5	22.4	22.4	28.0	26.8
Government services	5.0	2.2	2.4	2.7	3.2	3.9	3.8	4.9
Total services	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Nepal's share of world total, %								
Transport	0.03	0.03	0.03	0.03	0.02	0.02	0.02	0.02
Travel	0.02	0.02	0.04	0.04	0.03	0.03	0.02	0.02
Other business	0.03	0.04	0.03	0.02	0.02	0.02	0.02	0.02
Government services	0.02	0.01	0.02	0.02	0.02	0.02	0.02	0.02
Total services	0.02	0.02	0.03	0.03	0.02	0.02	0.02	0.01

Source: UNCTAD.

4.6 Foreign Direct Investment into Nepal

Countries of Origin and Sectors of Destination

There is a positive relationship between productivity growth and private capital flows (see e.g. World Bank 2001a). This relationship has strengthened over time. Productivity is enhanced through the transfer of technology and management techniques and the stimulation of financial sector development. These are significant in countries where a developed physical infrastructure, a strong business environment, and an open trade regime have eased the absorption of private capital flows, but not otherwise. Nepal lacks the first two of these factors, however.

There have not been large FDI inflows to Nepal despite the government's policies of liberalising and opening the economy during the 1990s. The FDI stock was 2.0 per cent of GDP in 1999 and it peaked at 20 per cent of exports in 1997 but, due to the strong export performance, the ratio declined to 14 per cent by 2000. The per-capita stock is only five dollars. The FDI flows are extremely small compared to the global levels or even to those of most other LDCs. The annual inflows of FDI peaked at 0.5 per cent of GDP in 1997, but in 1999 the inflows were only 0.1 per cent of GDP. These are partly tied to privatisation, which has not evolved fast in Nepal.

Table 4.19 Inward FDI in Nepal

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
STOCKS											
% of GDP	0.3	0.4	0.5	0.6	0.8	0.9	1.3	1.6	2.1	2.0	..
% of exports	5.7	5.4	4.8	6.2	8.5	11.2	15.0	20.0	19.6	16.2	13.7
% of imports	1.7	1.9	2.3	2.7	2.7	2.9	4.1	4.8	7.5	6.8	7.0
% of world total	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Per capita, USD	1	1	1	1	2	2	3	4	4	4	5
FLOWS											
% of GDP	0.2	0.1	0.1	0.2	0.2	0.2	0.4	0.5	0.3	0.1	..
% of exports	2.9	0.9	1.1	1.6	1.9	2.3	5.0	5.7	2.5	0.7	1.6
% of imports	0.9	0.3	0.5	0.7	0.6	0.6	1.4	1.4	1.0	0.3	0.8
% of world total	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Per capita, USD	0	0	0	0	0	0	1	1	1	0	1

Source: UNCTAD.

India is by far the most important source of FDI in Nepal. In late 2001, investment from India covered 35 per cent of the total of almost 700 projects, 36 per cent of the total cost of projects, one-third of total fixed investment, 36 per cent of foreign investment, and employed 40 per cent of the total of a little over 85,000 people who were employed in joint ventures. The United States is the second most important investor with a 17-per cent share, followed by China (11 per cent).

Over 43 per cent of the total FDI inflow has gone into manufacturing. These investments are relatively labour-intensive as manufacturing employs 65 per cent of those employed in joint ventures. There is no data as to whether the firms with foreign capital are more efficient than those under local control, but as was seen above, the overall competitiveness of Nepal's manufacturing industry is rather poor.

Tourism and other services have each received a 21-per cent share of total foreign investment. They both employ less people than this, 16 and 11 per cent of total employment in joint ventures, respectively. Of the total FDI, 14 per cent has gone into the energy sector, which we identified above as a potential export sector.

Table 4.20 FDI stock by country of origin and by destination sector in August 2001, % of total

	No. of industries	Total project cost, NPR mill.	Fixed investment, NPR mill.	Foreign investment, NPR mill.	Employment
TOTAL	698	76,946	64,837	20,134	85,490
COUNTRY OF ORIGIN, % OF TOTAL					
India	35.0	36.3	33.4	35.8	40.0
United States	10.3	15.1	16.4	17.1	8.1
China	7.7	9.9	9.8	10.9	7.8
British Virgin Islands	0.6	4.5	5.1	6.4	1.4
Norway	0.7	8.5	9.1	4.9	0.2
Japan	10.5	3.5	3.6	4.2	5.5
South Korea	3.9	1.9	1.9	3.6	2.8
Other	31.3	20.3	20.7	17.1	34.2
SECTOR, % OF TOTAL					
Manufacturing	50.3	42.3	36.9	43.3	64.9
Tourism	23.9	20.1	22.7	21.0	16.0
Services	21.5	14.4	14.3	20.8	11.1
Energy	1.4	20.9	23.5	13.7	5.1
Other	2.8	2.4	2.5	1.1	3.0

Source: Nepal Rastra Bank.

In Table 4.21 we find the FDI originating from India and the USA. Indian FDI has been directed into manufacturing more than

the total FDI on average. Of the Indian FDI, 55 per cent is in manufacturing. This is at least partly due to Indian firms producing goods in Nepal for exports to the Indian market. About one-third of Indian FDI goes into services and 12 per cent into tourism. Investment from the United States has been more equally divided, with manufacturing covering 38 per cent of total US FDI into Nepal, followed by energy (31 per cent) and services (22 per cent).

Table 4.21 FDI stock by destination sector in August 2001 originating from India and the United States

Sector	No. of industries	Total project cost, NPR mill.	Fixed investment, NPR mill.	Foreign investment, NPR mill.	Employment
FDI FROM INDIA					
Total	244	27,954	21,660	7,207	34,208
Of which, %					
Manufacturing	69.7	55.9	51.0	55.1	77.4
Services	16.0	24.3	25.1	32.4	9.1
Tourism	12.3	15.5	18.7	11.6	9.8
Other	2.0	4.4	5.2	0.8	3.8
FDI FROM THE UNITED STATES					
Total	72	11,608	10,607	3,439	6,909
Of which, %					
Manufacturing	33.3	26.4	22.3	37.7	38.6
Energy	1.4	41.0	44.1	31.1	17.9
Services	34.7	17.3	17.4	21.7	11.3
Tourism	29.2	15.3	16.1	9.3	32.2
Other	1.4	0.1	0.1	0.1	0.0

Source: Nepal Rastra Bank.

Motivation for Investing in Nepal

In general, FDI is made either to meet demand in the local market or to produce goods for exports, or both. The local market is very small in Nepal. GDP per capita is USD 240 per year, and 88 per cent of the population live in the countryside, largely surviving on subsistence agriculture. Regardless, there are some investments made for the local market, such as the Nepal Coca-Cola bottling plant in Kathmandu. Also, Gorkha Brewery Ltd. brews and bottles Carlsberg and Tuborg. Its parent company is Carlsberg and Tuborg

International A/S, which has a 48 per cent participating interest in Gorkha (Carlsberg Annual Report 1999/2000).

According to UNCTAD, the largest foreign affiliates in Nepal in 1999 were Hoechst Nepal Private Ltd. of France, which is in pharmaceutical preparations, Nepal Hokke (Pvt.) Ltd. of Japan, which is in the hotel business, Nepal Grindlays Bank Limited of Australia, Hotel Himalaya Pte Ltd. of Japan, and Trans-Himalayan Tour of Japan, which is in tourism and hotels.

Investment for export purposes is limited by Nepal's land-locked location. There is only one road north to Tibet, which is poor and sparsely inhabited and as such not a significant export destination. For exports to the north, it is more sensible to invest directly into China, where labour is abundant and more skilled than in Nepal.

India is a somewhat different case and there mostly lies Nepal's potential as an export base. The countries have an open border and therefore it could be sensible to produce goods in Nepal for the neighbouring Indian regions. However, the renewal of the trade treaty proved difficult in early 2002, casting uncertainty over how lucrative it is to invest in Nepal in order to export to India. The trade treaty was finally renewed and a new treaty came into force on March 6th 2002. The process created uncertainty and did not strengthen the investment climate. Furthermore, as India is opening up its market, Nepal's attractiveness is likely to diminish.

Some Indian companies have already invested in Nepal with the purpose of exporting their products to India, however. Examples of these include Colgate Palmolive Nepal and Kodak Nepal Private Ltd. Colgate Palmolive Nepal in Heutada near the Indian border employs around 120 people and manufactures toothpaste and tooth powder. Tooth paste is relatively significant in Nepal's exports to India. Commercial production started in July 1998. The company is a 100-per cent subsidiary of Colgate Palmolive (India) Ltd, which is a 51 per cent subsidiary of Colgate Palmolive, USA.

On the other hand, Kodak Nepal Private Ltd., an Indo-American joint venture, closed down its entire operations in Nepal in 2001. It had started to manufacture colour negative paper in 2000 but had to suspend production as it did not receive a certificate of origin, a requirement under the trade treaty between India and Nepal, to export the paper to India on a preferential basis with customs duty benefits. The Indian government listed the black market and cheap

Chinese Kodak products branded as Nepalese products as reasons for the denial of the certificate of origin.

The U.S. State Department lists hydropower and tourism, but also aviation, the environment, computer hardware and telecommunications as attractive sales and investment sectors. According to Asia Invest (2001), hydropower, tourism, agro-foods and IT software industries are the most favourable options for investors. The large and growing Indian market, to which Nepal's exports have duty-free access, is recognised as a factor that makes Nepal a potentially attractive business location. A working free-trade agreement between Nepal and India would therefore be an asset especially for the former.

Investment Climate in Nepal

The government of Nepal has reformed and liberalised the economy during the past decade, and the main political parties (the Nepali Congress Party and the CPN-UML) are market oriented. Since 1990, Nepal has privatised a number of public enterprises[47], eliminated public monopolies in air transport and hydropower generation, eliminated price controls on most products, reduced consumer subsidies, established a convertible currency for current account transactions, modernised commercial and company laws, and set in place a programme to attract foreign investment, especially in the generation of hydroelectric power. The government has also started tax reforms, introduced a new value-added tax and simplified both corporate income taxation[48] and customs duties. (U.S. Department of State 2001.)

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47 According to Asia Invest (2001) only 16 public enterprises have been privatised, however. Planned privatisations include state-owned enterprises in the tea, power and cement sectors, and Nepal Telecommunications Corporation. In early 2002, the government tried to privatise Nepal's largest textile factory, the financially bankrupt Hetauda Textile Industry, but did not receive any bids from private investors (Kathmandu Post, February 16th 2002).

48 According to the Federation of Nepalese Chambers of Commerce and Industries (http://www.fncci.org/), the general corporate tax rate is 25 per cent, and for banks and financial institutions 30 per cent. However, industries other than tobacco, alcohol and beer will not be imposed more than 20 per cent income tax on their industrial income. Royalties, technical service fees and management fees are taxed at a rate of 15 per cent. The dividend tax rate is 5 per cent. Income tax on export earnings is levied at 40 per cent of the prevailing tax rate, but it cannot exceed 0.5 per cent of total export turnover. There are agreements to avoid double taxation with India, Norway, Thailand, Mauritius and Sri Lanka. Value added tax (10 per cent) is levied on all goods and services unless exempt from it, e.g. exports. Personal income is taxed at two brackets: 15 and 25 per cent. There were some modifications to taxes in early 2002. According to Kathmandu Post (January

The government has plans to develop new bankruptcy and debt-recovery laws and new intellectual property rights legislation, particularly in the area of patents and trademarks, to open Nepal's market to international accounting and auditing firms, to license foreign branch banks, to develop the legislative framework for an international financial centre, i.e. an offshore banking centre, and to establish an Asset Reconstruction Company as a joint venture of the central bank and the private sector. However, tax administration remains arbitrary with tax authorities imposing levies which may not have any relation to the company's or the individual's true financial situation. Furthermore, access to foreign exchange, even for trade purposes, is restricted. There remain many restrictions on trade, payments and investment that require constant interaction with government officials at all levels of bureaucracy. Facilities granted under certain Acts or policies are often either contradicted or negated by another set of rules or policies. (U.S. Department of State 2001.)

FDI is not allowed in business and management consulting, accounting, engineering, legal services, the defence sector, alcohol or cigarettes, in 'cottage industries', in travel and trekking agencies, or in retail sales. Furthermore, the Investment Promotion Board[49] will not license foreign investments that are considered to be either hazardous to general health or the environment. There is strong political opposition against foreign investment into media.

There are no restrictions on the repatriation of profits. Foreign investors, who have received permission to invest in convertible currency, may repatriate the proceeds from the sale of that investment, the profits or dividends from the investment and the principal and interest paid on any foreign loans.

Nepal has no Export Processing Zones. However, any firm that exports at least 90 per cent of its products is entitled to privileges equivalent to those normally provided by such zones, i.e. no tax, duty or fee is levied on the machinery, tools and raw materials utilised by the firm in manufacturing export products. The firm may

18th 2002), 'the government hiked the customs duty on various goods, raised numerous special fees, while imposing some new fees, and also increased the excise duties on other goods.'

49 Investments above one billion rupees have to be approved by the Industrial Promotion Board, which is chaired by a minister.

also enjoy bonded warehouse facilities. (U.S. Department of State 2001.)

Despite the government's efforts to attract foreign investment, the inflow of FDI into Nepal has been small. By combining information from Dahal (1999), Guru-Gharana (2001), Asia Invest (2001), U.S. Department of State (2001), and Kathmandu Post (January 10th 2002), we can list at least the following problems and deficiencies in view of foreign investment. These factors also inhibit domestic investment.

- Physical and social infrastructure
- – Land-locked geography and limited access to the outside world.
- – Poor physical infrastructure (roads, bridges, telecommunications) in Nepal but also on the Indian side en route to the nearest harbour. Higher transport and investment costs than in neighbouring countries.
- – Lack of skilled and trained personnel (high illiteracy[50] even among the young). Lack of entrepreneurial, managerial, accounting, marketing and technical skills. Weak technological adaptability.
- – Weak power sector especially outside Kathmandu Valley, energy shortages and high cost of energy. Scarcity of raw materials. Insufficient water supplies.
- Politics and administration
- – Bad governance, high corruption (also in the judiciary) and bureaucracy, and inadequate reforms. Government policies seeking to simplify bureaucracy between local authorities and investors have not been very successful. The government's one-window policy is not working in practise. Government procedures are complex and opaque.
- – Bankruptcy rules are not clear and they are not properly implemented. Tax administration is non-transparent and unpredict-

50 According to World Bank (2001b) the levels of literacy and educational attainment remain low. Access to all levels of the education system has increased, but participation remains unequal across income and social groups and the benefits of public subsidies are not equally distributed. Also, the quality of education is low. There are high repetition and drop-out rates throughout the educational system. The system does not serve the labour market well.

able, and commercial legislation is inadequate and obscure. Rules regarding labour relations are unclear.[51]

- Implementation of laws is often not in accordance with the letter of the law. High-ranking government officials are helpful and oriented towards privatisation, but middle and low-ranking civil servants, who implement the policies, can be more obstructive. There is arbitrariness in dealing with companies.
- Problems in registration process, visas and work permits; long and complicated repatriation procedure for foreign personnel.
- Civil war. Maoists have also attacked foreign affiliates.[52]

• Economy

- Low productivity, weak competitiveness.
- Fragmented domestic market. Low local purchasing power.
- Weak financial intermediation and expensive credit. Low domestic savings rate. Weak corporate governance.
- Tax administration is arbitrary, and access to foreign exchange has restrictions. There remain many restrictions on trade, payments and investment that require constant interaction with all levels of bureaucracy. Facilities granted under certain Acts or policies can be contradicted or negated by others.

4.7 Government Finances, Foreign Aid, and International Indebtedness

We will now discuss briefly Nepal's federal budget, because a large part of it is financed via foreign aid. In this context we will also discuss Nepal's mounting but still controllable foreign debt.

51 According to a report by General Federation of Nepalese Trade Unions (as quoted in the local daily, Space Time Today, October 16th 2001), 46 per cent of firms do not abide by the prevailing labour laws. The carpet industry is the worst sector in this respect.

52 The Colgate Palmolive Nepal factory was bombed in June 2000 and the Nepal Coca-Cola factory in November 2001. The attacks have been directed against the machinery in the factories and therefore intended to damage the production capacity. There have also been other attacks against private firms. Furthermore, the Maoists have carried out extortion in exchange for 'protection' for private firms.

Government Finances

Nepal's federal budget can be divided into two parts: regular expenditure and development expenditure. During the fiscal year 1999-2000, 51 per cent of the federal budget went into regular expenditure and 49 per cent into development. The share of regular expenditure has risen during the 1990s by almost 20 percentage points. Government consumption has been equal to a little less than ten per cent of GDP during the 1990s.

Almost one-fourth of regular expenditure goes into social services and primarily education. Police and the army take up almost 20 per cent of regular expenditure. With the state of emergency declared in November 2001 this will rise at least in the short term. This has led to an increase in regular expenditure at the expense of development expenditure. Almost 30 per cent of regular expenditure goes into loan repayments and interest payments. About 18 per cent of the development expenditure goes into roads, etc., 17 per cent into electricity, 14 per cent into local development and 10 per cent into irrigation.

Nepal has run a budget deficit throughout the 1990s. The deficit is large relative to expenditure, but it has not been alarming relative to GDP. The deficit has declined from 45 per cent of total expenditure (4 per cent of GDP) in 1990/91 to a little less than 30 per cent in 1999/2000 (2.5 per cent of GDP). Almost 90 per cent of financing comes via revenue (tax and non-tax revenue), while the rest comes via foreign grants. The deficit is financed with foreign loans (71 per cent in 1999/2000) and domestic borrowing (29 per cent). The Asian Development Bank expects the fiscal deficit to increase to six per cent of GDP in 2002-03.

Tax revenue accounts for almost four-fifths of total revenue. Here the most important sources are the sales tax and import duties, which both account for approximately one-fifth of total revenue. Income tax receipts from salary earners account for only seven per cent of total revenue, but the share has been slowly rising. Half of all non-tax revenue is acquired via principal and interest payments.

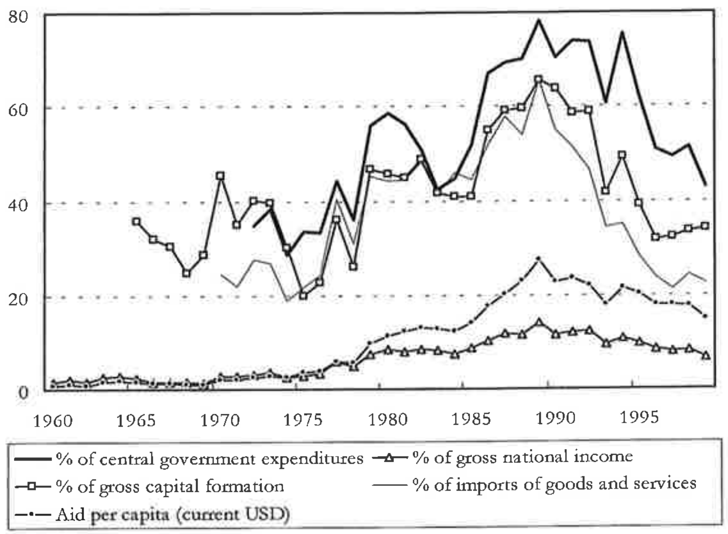
State-owned manufacturing industries made losses in every year during the 1990s except in 1991/92. At their largest, the losses were equal to 3.3 per cent of manufacturing value added. Between 1997 and 2000, public enterprises also made losses in services.

Public utilities were estimated to make a fairly considerable profit of USD 34 million in 1999/2000, however. (Statistical Yearbook of Nepal 2001.) According to the Heritage Foundation, the public sector received 11 per cent of its total revenues from state-owned enterprises and government ownership of property in 2000.

Foreign Aid and International Indebtedness

Nepal receives significant amounts of foreign aid, which comprises one channel of globalisation. Our purpose here is not to evaluate how successful foreign aid has been in Nepal. We can see in Figure 4.9, however, that aid has been substantial relative to the size of the economy for at least three decades. There have been considerable advances in, for example, schooling and health care. Still, even these are not at adequate levels as we have seen, and Nepal continues to rank as one of the poorest countries in the world. Poverty has increased during the 1990s.

Figure 4.9 Foreign aid in Nepal 1960-1999



Source: World Bank World Development Indicators 2001.

The importance of foreign aid in Nepal's economy increased until 1989. Aid peaked at almost 80 per cent of central government expenditure, at 65 per cent of both gross capital formation and imports of goods and services, at 14 per cent of gross national income and USD 27 per capita in current prices. By 1999, aid had declined by almost one-half relative to these.

In 1999, Nepal received foreign aid worth 6.7 per cent of its gross national income. The figure has declined from a peak of 14.0 per cent in 1989. Still these are not particularly high figures. In 1999, disregarding small island nations, Nicaragua received foreign aid worth 33.0 per cent of its gross national income. The respective figure for Guinea-Bissau was 25.7 per cent, Mongolia 25.4 per cent, Malawi 25.1 per cent, and Mauritania 23.6 per cent. In South Asia, Bhutan received 16.1 per cent of foreign aid relative to its gross national income, Bangladesh 2.5 per cent, Pakistan 1.2 per cent, and India 0.3 per cent. On the other hand, relative to central government expenditure, Nepal was fifth on the list of receiving countries.

In 1999/2000, Japan was the biggest contributor of aid into Nepal with a 40-per-cent share in the total grants worth USD 176 million. Norway's share was 14 per cent, followed by the European Union (13 per cent), Germany (12 per cent), China (8 per cent) and Finland (6 per cent). Furthermore, the Asian Development Bank granted a USD 51 million loan and the World Bank one worth USD 60 million.

According to the Asian Development Bank, dependence on foreign assistance became more pronounced in 2001. Foreign grants and loans financing increased to 58 per cent of development expenditures, up from 47 per cent in the previous five years.

Table 4.22 shows the net flows of official development assistance (ODA) and other official flows (OOF) to Nepal during the 1990s in millions of US dollars and as a percentage of all ODA and OOF received by all developing countries.

In current US dollar terms there has been a slow downward trend in ODA, which covered almost 98 per cent of all the net flows in the 1990s. Three-fifths of the net ODA has been bilateral and the rest multilateral. The share of multilateral flows has slowly risen.

Table 4.22 **Net official development assistance (ODA) and other official flows (OOF) to Nepal, USD mill. and % of aid received by all LDCs**

	1991	1992	1993	1994	1995	1996	1997	1998	1999
OFFICIAL DEVELOPMENT ASSISTANCE									
ODA, net	451.3	433.0	363.4	447.9	431.8	390.4	400.7	404.4	343.7
% of LDCs	0.76	0.74	0.66	0.76	0.74	0.73	0.84	0.82	0.68
Bilateral	290.4	275.7	245.6	269.2	266.1	236.2	233.5	212.7	204.8
% of LDCs	0.71	0.67	0.65	0.68	0.67	0.65	0.73	0.61	0.55
Multilateral	161.9	160.0	121.4	182.0	166.9	155.4	167.0	189.3	137.2
% of LDCs	1.02	0.94	0.76	0.99	0.91	0.94	1.10	1.32	1.05
OTHER OFFICIAL FLOWS									
OOF, net	-0.8	0.1	2.9	0.9	-0.3	8.4	22.1	36.2	21.1
% of LDCs	-0.01	0.00	0.02	0.01	0.00	0.09	0.13	0.13	0.07

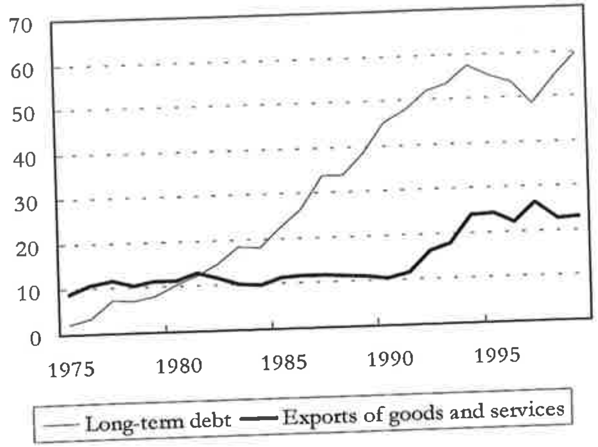
ODA includes loans administered with the main objective of promoting the economic development and welfare of LDCs. They have a grant element of at least 25 per cent and are 'concessional'. OOF includes loans with a target other than economic development and welfare of the recipient. They have a grant element of less than 25 per cent and are 'non-concessional'. The grant element reflects the financial terms of the transaction, i.e. the interest rate, maturity and grace period (interval to the first repayment of capital).
Source: UNCTAD Handbook.

Nepal's outstanding debt was USD 3.0 billion in 1999, or almost 60 per cent of GDP. Debt service costs were USD 80 million in 1998, a little less than 8 per cent of exports.[53] Nepal's long-term debt has risen fairly steadily relative to its GDP since the mid-1970s and has completely outpaced the exports-to-GDP ratio. Still, the World Bank lists Nepal as a less indebted low-income country along with India and Bhutan in South Asia.

According to the Asian Development Bank, the debt-to-GDP ratio declined to less than 47 per cent in 2001 and the debt service ratio fell to just 3.9 per cent of exports thanks to the concessional nature of Nepal's external debt.

53 According to U.S. Department of State (2001), Nepal's foreign debt was USD 2,745 million at the end of 2000 or 49.6 per cent of GDP.

Figure 4.10 **Long-term debt and exports of goods and services 1975-1999, % of GDP**



Source: World Bank.

Table 4.23 **External long-term debt and debt service**

		1990	1992	1994	1996	1997	1998	1999
Debt outstanding	**- USD bill.**	1.68	1.97	2.38	2.43	2.44	2.70	3.02
	- % of GNP	45.4	55.6	57.6	53.2	48.8	54.6	58.5
Debt service	**- USD mill.**	71.2	67.3	78.0	84.5	80.4	80.3	..
	- % of exports	16.9	10.3	8.2	7.4	6.3	7.7	..

Source: UNCTAD Handbook.

4.8 Monetary and Exchange Rate Policies

The Nepalese rupee has been convertible for all current account transactions[54] since February 1993. Since then the rupee has been unilaterally pegged to the Indian currency at the rate of 1.6 NPR/INR. Earlier, the NPR was pegged to a currency basket.

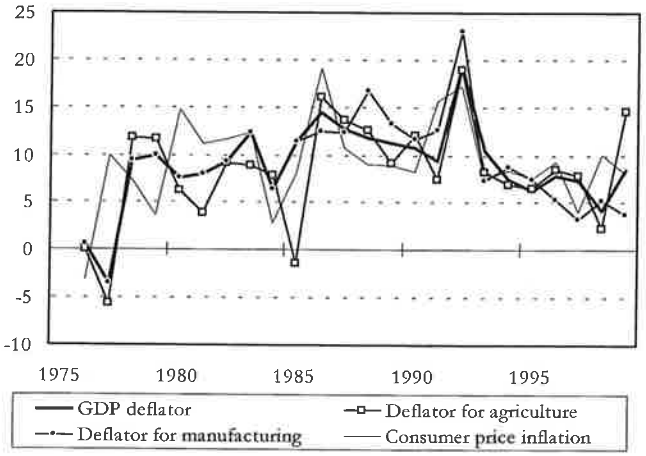
Nepal's exchange rate policy is sensible given India's importance in its foreign trade and FDI inflows, and the openness of their border.[55] Meanwhile, it ties Nepal's monetary policy to that of India.

54 Still, the rupee is not completely convertible.
55 There is increasing use of the Indian currency in transactions in Nepal. It has been estimated to have exceeded 25 per cent of the total money supply (Kathmandu Post, January

Due to the size difference between the countries, India is not concerned over how its monetary policy affects Nepal. Furthermore, India is not committed to defending the exchange rate. As capital movement between the countries is low, there is room for some divergence in monetary policies (Maskay 2000). Also the undeveloped monetary economy in Nepal shields it from disturbances.

The inflation rate has decelerated in Nepal in recent years. In 1998/99 it was 11.4 per cent, in 1999/00 3.5 per cent and in 2000/01 2.5 per cent. Figure 4.11 shows the development of price deflators after the first oil crisis.[56]

Figure 4.11 Price inflation in Nepal 1976-1999, %



Source: World Bank World Development Indicators 2001.

As the exchange rate between Nepal and India is fixed, changes in relative prices directly determine the real exchange rate. If prices rise faster in Nepal than in India, Nepal's real exchange rate appre-

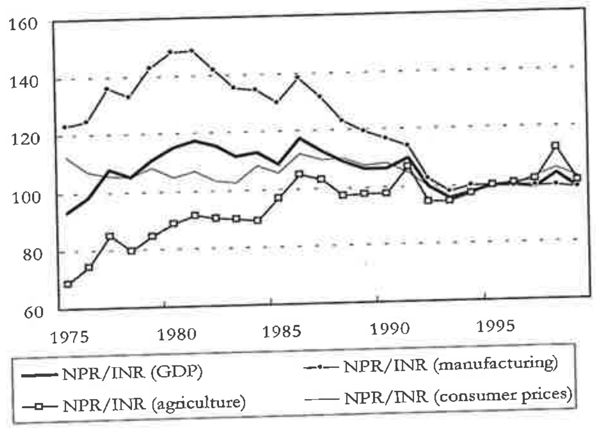
2nd 2002). Sharma (1998), as quoted in Maskay (2000), has estimated that the Indian currency is used in almost 41 per cent of all business transactions in Nepal.

56 Of the urban consumer price index (with base year 1995/96), the weight of food and beverages is 53.2 per cent, of housing 14.9 per cent, clothing and footwear 11.1 per cent, medical and personal care 8.0 per cent, education and recreation 7.1 per cent, and transport and communication 4.0 per cent (Nepal Rastra Bank). A lot of economic activity lies outside the monetary economy. Price controls have been abolished (Asia Invest 2001).

ciates and its competitiveness declines. Up until the early 1990s, the GDP deflator rose faster in Nepal than in India with consumer prices and the manufacturing deflator rising fast, and agricultural prices staying comparatively stable. This was mostly a period when agricultural yields declined relative to those in India. Since the mid-1990s, relative prices have been rather stable between the countries, which supports the fixed exchange rate regime providing that productivity development is similar in the two countries.

The real exchange rate has remained stable since the early 1990s. Before that, Nepal's real exchange rate appreciated when measured with manufacturing prices and depreciated when measured with agricultural prices.

Figure 4.12 Real exchange rate in 1975-99 between Nepal and India using different price deflators, 1995=100



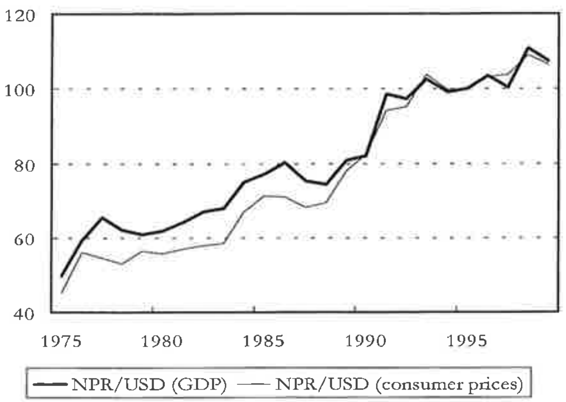
A rise in the curve means that Nepal's rupee is depreciating in real terms.

Sources: Nominal exchange rate from Maskay (2000); price deflators from the World Bank World Development Indicators 2001.

Maskay (2000) expects that the present exchange rate arrangement supports GDP growth in Nepal as India's GDP is forecast to grow relatively fast during the foreseeable future. The peg is also considered to be credible. Low capital mobility shields the arrangement. The slowing performance of Nepal's economy towards the end of 2001 and the internal troubles may have implications for the credibility of the exchange rate peg.

The real exchange rate between Nepal and India has been stable, but against the US dollar, the rupees have been depreciating constantly since at least the mid-1970s (see Figure 4.13). Between 1975 and 1999 the exchange rate of the rupee against the US dollar depreciated at the same rate as inflation advanced in Nepal.

Figure 4.13 Real exchange rate in 1975-99 between Nepal and the United States using the GDP deflator and consumer prices, 1995=100



A rise in the curve means that Nepal's rupee is depreciating in real terms.
Source: World Bank World Development Indicators 2001.

If Nepal Rastra Bank needs to support the fixed exchange rate, it may have to use its foreign exchange reserves.[57] According to U.S. Department of State (2001), Nepal's foreign exchange reserves were USD 1,133 million in 1998/99, USD 1,297 million in 1999/2000, and USD 1,468 million in 2000/2001. The reserves are about one-quarter of the GDP and cover about seven months of imports, which is a relatively good level. According to the Asian Development Bank, foreign exchange reserves were about USD one billion at the end of 2001, equivalent to about seven months imports.

[57] In 1999/2000 Nepal Rastra Bank intervened 11 times in the foreign exchange rate market injecting USD 70.3 million during seven interventions and selling USD 28.2 million during another four interventions.

Table 4.24 International reserves

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Annual change in reserves (millions of dollars)											
	84	102	70	173	54	-107	-15	54	130	87	103
Number of months of imports											
	5.2	6.4	6.8	7.6	6.8	5.2	4.5	5.2	6.9	6.8	6.9

Source: UNCTAD Handbook.

4.9 Nepal and Globalisation: A Summary

We have analysed globalisation from the point of view of Nepal and concentrated on the economy but without forgetting politics and social issues. Nepal became a multiparty democracy in 1990. The main political parties are market oriented and the governments have sought to reform legislation and privatise the economy during the 1990s. The 1990s have also been a period of relative globalisation for Nepal. Still, globalisation remains fairly superficial, affecting only a small part of the population.

India is by far the most important single foreign country for Nepal's globalisation. India's share in Nepal's total foreign goods trade is 30 per cent, Indians' share in tourists arriving in Nepal is about 30 per cent, India's share in total FDI in Nepal is about 35 per cent, there are a lot of people working across the open border, and Nepal's exchange rate policy is linked to that of India.

Social Issues

Nepal's main challenges include the reduction of poverty (42 per cent of the population live in poverty) and of underemployment (45-50 per cent of the labour force are underemployed). The birth rate remains too high, though it is slowly declining, and infant mortality also remains high despite advances. Almost 50 per cent of children under the age of five suffered from malnutrition in 1995. Almost 43 per cent of children aged 10-14 were included in the labour force in 1999. Income inequality has increased during the 1990s. Some 20 per cent of the population are Dalits, or 'untouchables'. High illiteracy, especially among women, keeps birth rates and infant mortality rates high.

The physical infrastructure (roads, bridges, etc.) is poor and affected by natural disasters (annual monsoon and the odd earthquake). There is some erosion and deforestation, and pollution is becoming a problem in the Kathmandu Valley. High population growth and high population density are a strain on the environment.

GDP and Productivity

Agriculture accounts for 39 per cent of the GDP, followed by trade, restaurants and hotels (12 per cent), finance and real estate (10 per cent), manufacturing (10 per cent), construction (10 per cent), and transport, communication and storage (8 per cent). Public spending is 9 per cent of GDP. Due to high birth rates, GDP per capita at constant local currency prices has grown by an average of 2.6 per cent per annum in the 1990s, which has not been enough to reduce poverty. In terms of purchasing power, the growth rate of GDP per capita has been about one percentage point higher.

Agriculture and manufacturing industry have low productivity and low value added, costs are high, and there is a shortage of capital. Value added is the highest in beverages and tobacco, but quite low in Nepal's main export products to industrialised countries. The clothing industry is not competitive and the quality of the products is not particularly high.

In 2001-02, manufacturing industry and tourism were struck by the escalation of the civil war, the terrorist attacks in north-east United States in September 2001 and the ensued 'War on Terrorism', the slowdown in the global economy and the uncertainty over the extension of the trade treaty with India. In the medium term, clothing exports are adversely affected by the phasing out of the MFA agreement, which brings increasing competition especially from China. A decline in exports also means a decline in Nepal's ability to import the manufactured capital goods it needs to expand and modernise its production.

Framework for globalisation

The framework of Nepal's globalisation is based on some international agreements. The Treaty of Peace and Friendship and the Treaty of Trade and Commerce were signed between Nepal and India in 1950. They have given the other country's nationals the same rights of residence, ownership of property, participation in trade and commerce, and movement, as to the nationals of their

own country. Consequently, Nepal and India have an open border. In 1996 the countries signed a free-trade treaty, which led to a rapid increase in trade. After difficult negotiations, the trade treaty was finally renewed in March 2002.

In the new treaty, a 25 per cent value-added requirement on material and labour content was imposed on Nepalese goods for duty-free access to India in the first year rising to 30 per cent from the second year onwards. Furthermore, India placed annual quotas on four important Nepalese exports goods: vegetable ghee, acrylic yarn, copper products and zinc oxide. The quotas will constrain growth in these sectors and distort the production structure. Otherwise, Nepal has duties in its trade with third countries. Nepal's import duties vary from 0 to 140 per cent and the average tariff rate was 10.4 per cent in 2001.

In 1995, the SAARC countries established the South Asian Preferential Trade Agreement (SAPTA), which consists of rounds of trade negotiations for the exchange of trade concessions. There is still very little intra-SAARC trade, but a free-trade area is planned and stronger economic links could help to stabilise the whole area. Political problems inhibit advances in integration, however.

Nepal is an observer government seeking membership in the WTO. Both of its huge neighbours, India and China, are already members. Not joining the WTO is not really an option for Nepal. However, some new laws and better implementing institutions need to be enacted before it can join the organisation.

Nepal has had a quota in clothing exports under the Multi-Fibre Agreement (MFA), which is being phased out in stages by January 1st 2005. The US is creating the AGOA pact to allow duty and quota-free imports of textile and apparel articles imported from Sub-Saharan Africa. Nepal is not included and faces fiercer competition from Africa, in addition to India and China.

The EU has approved the so-called Everything But Arms (EBA) initiative to eliminate quotas and duties on all products except arms imported from the world's 49 least developed countries. Nepal is one of these countries.

Foreign Trade

Nepal's government seeks to minimise the role of the public sector in exports. It targets 'a liberal and dynamic trade policy' with an emphasis 'on modernising management and technology, on promoting markets and on attracting foreign direct investment in order to identify and develop new products as well as raise the production and quality of the traditional products.'

Foreign trade relative to GDP has increased significantly during the 1990s. In 2000, the exports-to-GDP ratio was 25 per cent. The most important export countries were the United States (33 per cent), India (26 per cent), Germany (13 per cent) and Argentina (6 per cent). The most important import countries were India (32 per cent), Argentina (14 per cent), China (12 per cent), Hong Kong (7 per cent) and Singapore (6 per cent). The imports-to-GDP ratio was 34 per cent. The share of developed industrialised countries in both exports and imports has declined during the 1990s.

Both the structure of, at a very aggregated level, and the importance of individual products in exports have been quite volatile, but overall Nepal's export structure has become more varied. This is due to the increase in exports to India. There has been a structural shift in Nepal's exports away from foodstuffs and crude materials to manufactured goods. Though Nepal still exports agricultural goods mainly to India, it has become their net importer. There has been no comparable change in the structure of Nepal's imports. Exports to the EU and the US consist almost completely of clothing and carpets.

Nepal's foreign trade with third countries depends upon Indian territory for transit. Nepal is building three Inland Container Depots of which two are operational. These should decrease third-country transportation costs by about 30 per cent as clearance is transferred from Calcutta to Nepal. India has been delaying the signing of a railway operation agreement, however.

Nepal's large goods trade deficit is partly offset by a surplus in the service account. Services account for almost half of Nepal's total exports. Nepal attracts foreign visitors with its varying scenery, landscapes and cultural sights, and heterogeneous culture. Tourism accounts for about 3-4 per cent of GDP.

Nepal's future trade potential lies in hydroelectric power, which would require substantial FDI inflows, tourism, which is affected adversely by the civil war, and producing for the market south-of-the-border in India, which also requires FDI inflows. Exports to industrialised countries depend too much upon garments and carpets and should be diversified. Especially the garment sector is facing severe difficulties.

Foreign Direct Investment

Nepal has reformed and liberalised its economy during the past decade. Some public enterprises have been privatised, public monopolies in air transport and hydropower generation have been eliminated as have price controls on most products, consumer subsidies have been reduced, a convertible currency for current account transactions has been established, commercial and company laws have been modernised, and a programme to attract foreign investment has been set in place. The government has also started tax reforms, introduced a new value-added tax and simplified both corporate income taxation and customs duties.

Still, FDI into Nepal has been very limited. The stock is about two per cent of GDP, only five US dollars per capita. The peak inflow was in 1996-97. Some 36 per cent of FDI has originated from India, 17 per cent from the US and 11 per cent from China. Sectorwise, 43 per cent of FDI has gone into manufacturing, 21 per cent into both tourism and services, and 14 per cent into energy. Free trade with India gives a possibility to produce for the Indian market.

There are many reasons for the small inflows of FDI and these factors are largely the ones that are constraining the country's growth in general. Physical and social infrastructure is inadequate. This includes poor roads, bridges and telecommunications, and lack of skilled and trained personnel. Illiteracy rates are high even among the young (59 per cent of women and 25 per cent of men aged 15-24 are illiterate). While access to all levels of education has increased, participation remains unequal across income and social groups. Also, the quality of education is low and it does not serve the labour market well. Despite the potential in the generation of hydroelectricity, the power sector is weak especially outside the Kathmandu Valley. There are energy shortages and the cost of energy is high. Even water supplies are insufficient. In addition to these, the civil war has multiple negative effects and Maoists have attacked foreign affiliates. Even the country's land-locked geography is a constraint on FDI.

Politics and the civil service at large are grave problems despite the government's reforms. Even the reforms are sometimes complex and opaque, however. Implementation of laws is often not in accordance with the letter of the law. High-ranking government officials are reported to be helpful and oriented towards privatisation, but middle and low-ranking civil servants, who implement the policies, can be more obstructive. There is also arbitrariness in dealing with companies.

Bankruptcy rules are not clear and they are not properly implemented. Tax administration is not transparent and it is unpredictable. Commercial legislation is inadequate and obscure. Rules regarding labour relations are unclear. There are problems in registration process, visas and work permits, and there are long and complicated repatriation procedures for foreign personnel.

Bad governance and corruption are rife at all levels of bureaucracy and also within the weak judiciary, and there is no legal accountability. The black market is large. Good governance would include transparency, simplicity of procedures, responsibility, fighting corruption, individual freedom and collective expression, and independence of the legal system. The reforms need to be continued and the civil service as a whole should support them.

As for the economy, agriculture and manufacturing industry are suffering from low productivity, weak competitiveness, and bad governance. Local purchasing power is low, and the domestic market is fragmented. Furthermore, financial intermediation is weak and credit is expensive. The financial system remains undeveloped and 'formal' lending only accounted for 16 per cent of borrowing in urban areas and 12 per cent in rural areas in 1995/96. The banking sector is under restructuring.

Other Forms of Globalisation

Many Nepalis are working abroad, mainly in India but also in other countries. Their remittances are estimated at about three per cent of GDP, which is roughly equal to the contribution of tourism.

In 1999, foreign aid accounted for 43 per cent of central government expenditure, 7 per cent of gross national income, 34 per cent of gross capital formation, and 23 per cent of imports of goods and services. Aid per annum was 15 US dollars per capita, which is three times more than the total FDI stock in Nepal. Still, the aid-to-GDP ratio had declined to almost one-half of its peak in 1989.

Nepal is a less indebted low-income country. According to the Asian Development Bank, the debt-to-GDP ratio declined to less than 47 per cent in 2001 and the debt service ratio fell to just 3.9 per cent of exports. Indebtedness has increased over the longer term, however.

The Nepalese rupee has been convertible for all current account transactions since 1993. Since then the rupee has been unilaterally pegged to the Indian currency. Nepal's monetary policy therefore follows India's monetary policy. The real exchange rate between the countries has remained stable during the 1990s.

Problems in a Nutshell

The main factors holding back Nepal's development and globalisation can be short-listed as follows. *First*, there are the structural problems of high illiteracy and poor education that lead to high birth rates, high child mortality rates, social stagnation (the Dalits' and women's poor social status), poverty, low productivity and low competitiveness in exports. Poor physical infrastructure, such as roads and bridges, is also a problem. *Second*, widespread corruption leads to bad governance, non-transparency and unaccountability in business, politics and the judiciary. *Third*, the potentially long-lasting civil war, which has its roots in Nepal's intense poverty, leads to, among other things, less tourism revenue, less foreign direct investment and a deterioration in public sector finances. It may also threaten the nation's democracy and civil rights.

5 TANZANIA

5.1 Basic Facts about Tanzania

Geography

Tanzania is located in eastern Africa between longitudes 29° and 41° East. It has a frontier with Kenya and Uganda in the north, with Rwanda, Burundi and Democratic Republic of Congo in the west, with Zambia and Malawi in the south west, and with Mozambique in the south. In the east, the country is bordered by the Indian Ocean.

The country consists of the mainland (Tanganyika) and of the Zanzibar islands. The mainland covers 883,600 sq. km, and Zanzibar 2,500 sq. km, for a total area of 886,100 sq. km. The area is thus about 2.5 times that of Finland, i.e., about the size of France and Germany put together.

The topography of the country is very varying. There are mountain areas, including Africa's highest mountain Kilimanjaro (5,895 metres above sea level). There are also plains, forests, and waters. In addition to the Indian Ocean the waters include the large Lakes Victoria in the north, Tanganyika in the west and Nyasa in the south.

The varying geography together with the rich fauna offers Tanzania many tourist attractions. The country has several natural parks, of which Serengeti in the North and Ruaha in the middle of the country are the largest. The size of the Serengeti natural park is 14,750 sq. km, and that of Ruaha 13,000 sq. km. In addition to natural parks there are several game reserves, of which Selous is the largest, with an area of 50,000 sq. km.

Tanzania is sparsely settled, and distances between urban areas are long. This has implications for the country's need of transport infrastructure, too.

Tanzania has plenty of natural resources, including water and coal resources for the production of energy. Rich mineral resources also offer a basis for exports. Tanzania produces gold, diamonds, gemstones and several other valuable minerals (see the sections on GDP and on foreign trade).

Figure 5.1 Map of Tanzania

The climate varies from tropical along the coast to temperate in highlands. There are two rainfall regimes in Tanzania. One is unimodal (December-April), and the other is bimodal (October-December and March-May). The former is experienced in southern, south-western, central and western parts of the country. The latter is found in the north and on the northern coast. In the bimodal regime the March-May rains are called the long rains (Masika), whereas the October-December rains are generally known as the short rains (Vuli). The rainfalls are the most plentiful on the highlands in the north-eastern and the south-western parts of the

country, where a rainfall of more than 2,000 mm per year has been recorded. Central-Tanzania is semi-arid, with some parts receiving an annual rainfall of less than 400 mm per year.

Population

The total population of Tanzania is estimated to have been 32.8 million in 2000. Of this the mainland contributed 31.9 million and Zanzibar 0.9 million. The estimated annual population growth rate in 2001 was about 2.6 per cent. Population density is 37 persons per sq. km.

In the mainland 99 per cent are native Africans, of whom 95 per cent are Bantu consisting of more than 130 ethnic groups. The remaining 1 per cent consists mainly of Asians, Europeans and Arabs. On Zanzibar the population comprises Arabs, native Africans, and mixed Arabs and native Africans.

There are about 800,000 refugees from neighbouring countries in Tanzania. The number of them varies depending on the political and social situation.

In the mainland, Christians account for 45 per cent of the population, Moslems 35 per cent, and indigenous beliefs 20 per cent. About 97 per cent of Zanzibar's population are Moslems.

Kiswahili, or Swahili, and English are the official languages. Kiswahili is the *lingua franca* of most people and is used in lower education. Kiswahili has a Bantu origin, but it draws on Arabic, too. It has become the *lingua franca* of the whole central and eastern Africa. English is used in secondary education and in institutions of higher learning. English is also the main language used in commerce and in administration. Arabic is also spoken in Zanzibar.

Poverty is a problem in Tanzania. Measured by the UN Human Development Index, Tanzania was the 140th out of 162 countries in 2001. In the Mainland 48 per cent of the population suffered from 'basic needs poverty' in 2000. The situation is the worst in rural areas, where 57 per cent of inhabitants suffered from poverty. In Dar es Salaam the rate was below 2 per cent. For 'food poverty' the rate was 27 per cent in Mainland Tanzania. (National Bureau of Statistics, 2000, 12.)

Life expectancy at birth was 45 years in 1999. It has decreased by 5 years from 1990 due to the HIV/AIDS problem. According to the Human Development Report 2001 by the UNDP, 8.1 per cent of the Tanzanian population between the ages of 15 and 49 were infected by HIV or AIDS in 1999. AIDS is now the leading cause of mortality among adults aged 15-59. Infected persons occupy more than half of all available hospital beds and constrain the limited resources.

Table 5.1 Social indicators in Tanzania

SOCIAL INDICATORS	1970	1980	1990	1995	1999
Total population	13.7	18.6	25.5	29.7	32.9
Urban population (% of total)	6.7	14.8	20.8	26.9	31.7
Total fertility rate (births per woman)	6.8	6.7	6.3	5.7	5.4
Public expenditure on health (% of GDP)	..	..	1.6	1.2	1.3[1]
Public expenditure on education (% of GNI)	..	..	2.8	3.3	3.4
Life expectancy at birth (years)	45.5	50.0	50.1	48.5	45.0
Infant mortality rate (per 1,000 live births)	129.0	107.6	114.8	106.6	94.8
Illiteracy rate, adult female (% of females ages 15 and above)	79.8	65.7	48.5	40.5	34.3
Illiteracy rate, youth total (% of people ages 15-24)	45.6	30.2	16.3	12.2	9.4

[1] In 1998.

Source: World Bank: World Development Indicators 2001.

History

Most of the known history of mainland **Tanganyika** concerns the coastal area. The interior has, however, a number of important prehistoric sites.

The African population had trading contacts with the Arabs at least since the 1st century AD. There are indications of early contacts with India, too. The coastal trading centres were mainly Arab settlements. The relationship between the Arabs and the native people seems to have been fairly good at this time.

The Portuguese arrived on the coastal area in the late 15th century, but they made little effort to penetrate into the interior. They lost their positions in the early 18th century as a result of an alliance between the coastal Arabs and the ruler of Muscat on the Arabian Peninsula.

The French also showed interest in slave trade in Tanganyika in the 1770s. They operated in the ancient town of Kilwa. The Arabs, too, became more active in slave trade at this time and began to penetrate further to the interior of the country. In addition to slaves, ivory was an important article for trade. The slaves were usually shipped to Zanzibar, from where they were transported further.

Africans are known to have inhabited **Zanzibar** before the birth of the Christ. They had small and separate village communities. These small communities remained vulnerable to foreign conquest. Early visitors to Zanzibar included Persians, Indians, Jews, Arabs, Phoenicians and possibly Assyrians. The African population was adaptive to foreign influence, many of whom intermarried especially with the Persians.

The Arabs from Oman established a colonial state on Zanzibar in the nineteenth century. Their influence on the country was important. For example, one-third of the words of the official language Swahili is said to derive from Arabic. In 1832 the ruler of Oman, Seyyid Said bin Sultan, moved his palace to Zanzibar. This is regarded as the birth of modern Zanzibar. In the early and mid-19th century agreements were made between the sultan of Zanzibar and the western powers, especially Great Britain, to limit slave trade. But it was not until 1919 when slavery was finally abolished.

The Germans became active in East Africa in the 1880s by making contracts with local tribal chiefs. In 1886 Germany and Great Britain divided Eastern Africa, with Great Britain receiving the northern parts, i.e., what is currently Kenya. Germany got the southern parts, i.e., the area known today as Tanganyika. In Zanzibar the British established their protectorate in 1890. The colonial powers used East Africa mainly for the production of agricultural products and for the utilisation of mineral resources. In the beginning, German rule was harsh, but later on softer means were used. The Germans improved transport connections by building railways in Tanganyika. World War I, however, put an end to German rule in East Africa.

After the First World War the British established their Tanganyika Territory. To develop the transport infrastructure, the British concentrated on improving the road network. They also invested in agriculture, and developed education and health care. In 1947 the

British government decided to place Tanganyika under UN trusteeship. The economy of the country developed under the British rule, but the development was unequal. Also racism was a problem. Demands for independence rose widely. The channel for these demands was the Tanganyika African National Union (TANU) party, which was founded in 1954.

Tanganyika became independent peacefully with the consent of the British on December 9, 1961 under the leadership of the TANU party. Julius Nyerere was the first prime minister. Zanzibar received its independence on the 10th of December 1963. The People's Republic of Zanzibar was established the 12th of January 1964.

The United Republic of Tanzania was formed out of the union of two sovereign states, Tanganyika and Zanzibar on 26th April, 1964. However, the Government of the United Republic of Tanzania is a unitary republic consisting of the Union Government and the Zanzibar Revolutionary Government. After the independence until his death in 1998 Mr. Julius Nyerere was the key political figure of the country. He was president in 1962-1985. After retiring from presidency he continued as the chairman of the ruling party until 1990. The president of Tanzania is chief of state and head of government. He appoints the cabinet ministers, including the prime minister. Zanzibar has its own president, who is head of government for matters internal to Zanzibar.

Politically the leaders tried to develop new participation forms based on old local traditions. Economically, the early years of independence did not differ much from the rest of the new independent African states. Big farms continued to operate as before. Farming of the African population was advanced by improving agricultural guidance, and by establishing marketing co-operatives and special development villages. The industrial strategy was based on attracting foreign investments.

The success of this development strategy was not regarded as satisfactory. Foreign investments were less than was expected. The costs of marketing co-operatives and development villages got out of control. Corruption was also a problem. The poor price development of important export products was an additional factor of dissatisfaction. Socially the unequal income distribution continued. This was not regarded as the aim of the policy of the TANU party.

A new course for the policy was given the 5th of February 1967 by the so-called Arusha declaration. The main themes of it were socialism and self-determination. Julius Nyerere defined his African socialism as 'ujamaa', or familyhood. The objective was that 'the main means of production are in the hands of the peasants through their government and their co-operatives'. Emphasis was put on the development of agriculture. The basis for development was 'the people and its hard work'. The policy of the TANU party was a form of the so-called African socialism. This policy led to an important state-ownership of industrial firms. In 1977 the TANU party and the Afro-Shirazi party of Zanzibar merged. The name of the new party is 'Chama Cha Mapinduzi' (CCM). Tanzania became in those days a one-party system.

The development aims based on this new policy were not a success, however. The economy suffered from inefficiency. The public service sector grew at the cost of the primary and industrial sectors. Democracy was seen as insufficient. Even coercive means were used in teaching people how to live in socialism. And the high moral, which was the aim of the policy, was not that easy to put into practice. Corruption was still a problem.

The collapse of the Soviet Union in the early 1990s decreased the attractiveness of socialist ideas globally. This was seen also in Tanzania. A process of liberalisation and privatisation started in 1992, but it was mainly realised after 1995. A large amount of formerly state-owned firms has now been privatised. This process continues still.

5.2 Current Political Regime

The liberalisation and privatisation process was connected to a political democratisation. The one-party system ceased formally on July 1st 1992. This was realised by changing the constitution and laws regulating the formation and operation of political parties. Twelve new parties, in addition to the ruling party CCM, were registered.

In the unicameral National Assembly the total number of seats is 274, of which 232 are elected every 5 years from 1 seat constituencies. Thirty seven of the seats are allocated to women nominated by the president, and 5 seats are allocated to the members of the Zanzibar House of Representatives.

Some elections were already held in the 1990s and early 2000s. The CCM party won a clear majority in each of them. In the parliamentary elections in October/November 2000 the CCM Party won 244 seats out of 274 seats. The Civic United Front, which has its main support from Zanzibar, is the second largest party by 15 seats.

The president and the vice president are elected on the same ballot by popular vote for five-year terms. In the presidential elections of 2000 the incumbent president, Benjamin William Mkapa, was elected President of United Republic of Tanzania by 71.7 per cent of the votes, and Hon. Amani Abeid Karume the President of Zanzibar by 67 per cent of votes. Mkapa has been President of Tanzania since 1995.

The capital is, in practice, Dar es Salaam, where most of the administration is located. Dodoma is the official capital. Some governmental institutions are based there, and the National Assembly meets there on regular basis.

5.3 Latest Macroeconomic Developments

During 1989-2000 the Gross Domestic Product (GDP) has grown annually by 3.3 per cent on average. The population has grown during the same period by 2.9 per cent on average. GDP growth per capita has thus been minimal. (Figure 5.2.)

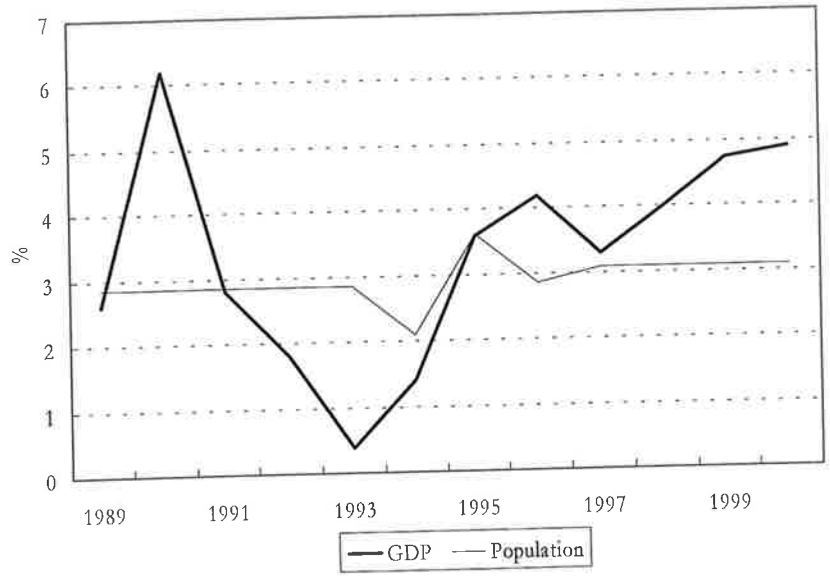
In agriculture, which accounts for 45 per cent of GDP, the growth rate was 3.5 per cent on average. Annual variations are large, especially in crop production, where weather conditions have crucial importance. In manufacturing the annual growth was 3 per cent on average. Mining was an important growth sector, growth being 13.4 per cent on average. In construction annual variations have been large, with growth averaging 2.5 per cent. Growth accelerated during the second half of the 1990s. (For economic development according to type of activity, see Table 5.4.)

The investment ratio was lower in the late 1990s than in the beginning of the decade (Figure 5.3). This applies to building as well as to equipment investments. Foreign direct investment has been increasing.[58] But domestic investment has grown slowly, among

[58] In 1989-1994 the share of FDI flows in gross fixed capital formation was 1.4 per cent on average. In 1999 it was 13.8 per cent. (UNCTAD, 2001b, 316.)

others due to the weak availability and high cost of financing. The lack of profitable investment opportunities is the other side of the coin.

Figure 5.2 Growth of real GDP and population in Tanzania, %



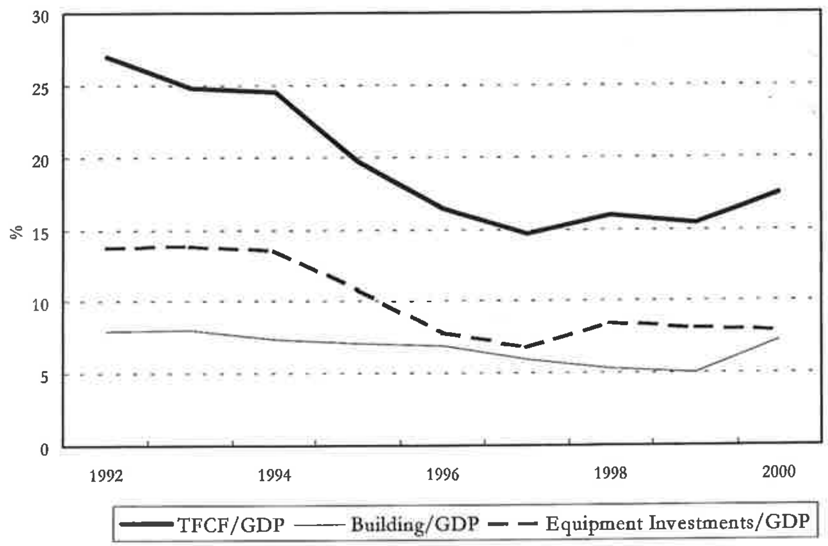
Source: National Bureau of Statistics.

In 2000 there was some recovery in investments bringing the investment rate up slightly to 17 per cent. For purposes of comparison, the world average investment rate was 23 per cent and the average in East Asia and Pacific was 31 per cent in 2000. (World Development Report 2002.) The investment rate in Tanzania is far too low for sustainable GDP growth.

The labour force grew in 1997-2000 at an annual rate of 2.9 per cent on average, i.e., at about the same pace as the population. There was a declining trend during this period; in 2000 the growth rate was 2.4 per cent. The severe HIV/AIDS situation has its own impact on the labour supply. Over half of the labour force was in the age group of 15-29 years. Women represent slightly more than half of the entire labour force. Unemployment, according to the

Tanzanian definition, was 16 per cent during the first part of 2000 (United Republic of Tanzania, 2001a, 79).[59] The rate was 36 per cent in urban areas and 9 per cent in rural areas. In addition to open unemployment, unregistered unemployment (underemployment) is high.

Figure 5.3 Investment ratios in Tanzania: total fixed capital formation TFCF/GDP, building investment/GDP and equipment investment/GDP, %



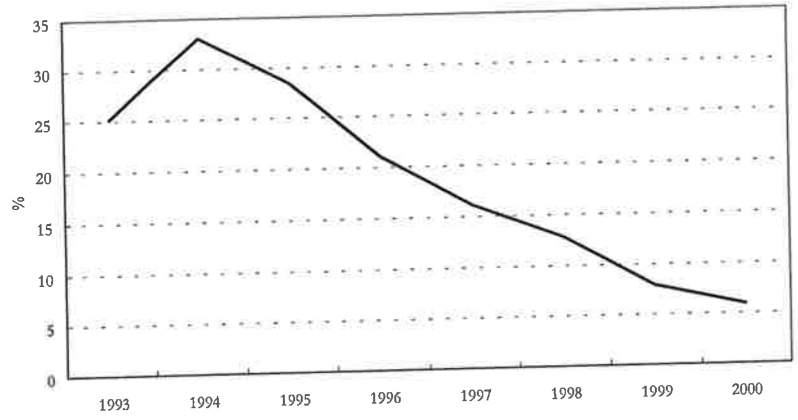
Source: National Bureau of Statistics.

Inflation has been decreasing substantially during the past years (Figure 5.4). In 2000 the National Consumer Price Index was only 5.9 per cent above the level of the previous year. The decline is mainly due to prudent fiscal and monetary policy measures implemented in the recent past, coupled with improved supplies of foodstuffs. Because of the relative closeness of the economy, price de-

[59] The definition for the year 2000 includes people who had jobs but unreliable ones, those who worked for less than 40 hours a week and those who were not employed at the time of the survey due to their inability of getting a job or lack of land for agriculture, and farmers who were not engaged in any agricultural activity during the season (United Republic of Tanzania, 2001a, pp. 79-80).

velopments reflect mainly the domestic situation. International developments affect prices mainly through energy prices. The weight of food in the index is 64.2 per cent. Clothing and footwear has a weight of 9.9 per cent, rents 4.9 per cent and transportation 4.1 per cent.

Figure 5.4 Inflation in Tanzania according to the National Consumer Price Index (NCPI), %

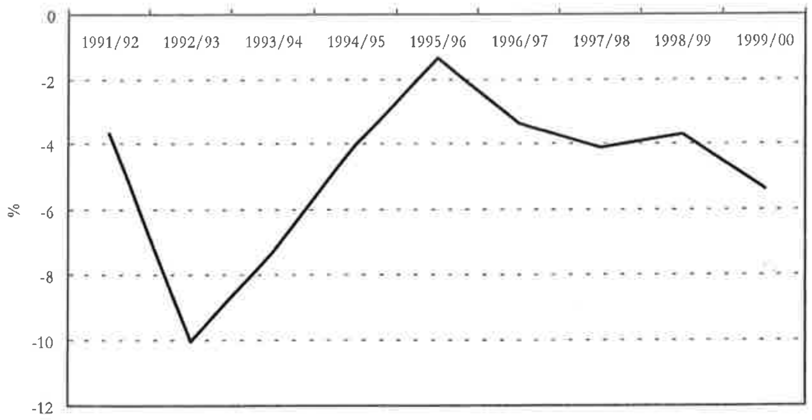


Source: National Bureau of Statistics.

During the fiscal years 1991/92-1999/2000 the central government deficit was 4.8 per cent of GDP on average (Figure 5.5). Foreign grant financing of the deficit was 2.6 per cent of GDP on average. With the grants, the deficit thus averaged 2.2 per cent of GDP.

The deficit has varied somewhat in the 1990s depending on the economic situation and on policy constellations. During recent years the deficit has been on a slightly increasing trend. On the other hand, the amount of foreign grant financing also increased to 3.9 per cent of GDP in the fiscal year 1999/2000.

Figure 5.5 Central government balance in relation to GDP in Tanzania, %[1]

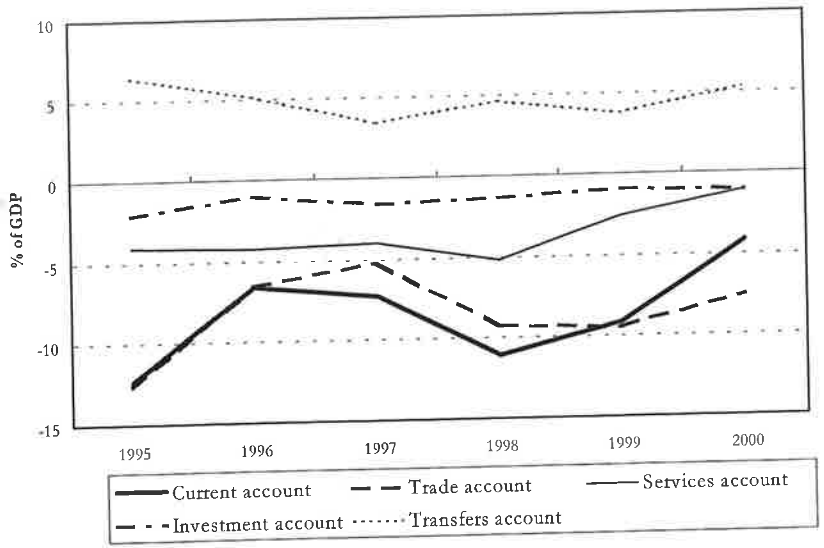


[1] The fiscal year in Tanzania is from the 1st of July to the end of June. In the figure the deficit of each budget year is expressed as a percentage of the GDP (in current market prices) of the year of the second half of the fiscal year.
Source: National Bureau of Statistics.

The deficit in the current account balance was 9.6 per cent on average in 1995-2000 in relation to GDP. The deficit had a declining trend. In 2000 it was 5.9 per cent. Excluding current official transfers the deficit was 13.3 per cent of GDP on average, and 9 per cent in 2000. (Figure 5.6.)

The exchange rate is currently floating. The rate is managed, when regarded as necessary, by interventions. The need arises often for seasonal reasons, because capital flows vary between seasons. Current account transactions are free. Capital transactions, instead, are controlled, except with respect to other East African Union countries (Kenya and Uganda). There are, however, also capital account transactions with other countries through FDI related operations, official development aid and foreign borrowing. The control concerns mainly capital outflows. There is a target to liberalise capital account transactions by 2003.

Figure 5.6 Current account in Tanzania, % of GDP



Source: Bank of Tanzania (2001).

The exchange rate depreciated drastically in the early 1990s. During the second part of the decade and during 2000 and 2001 the depreciation has been more modest. (See Figure 5.13.) In relation to the Euro, the exchange rate was in July 2001 about the same as in January 1999. It fluctuated, however, somewhat during this time.

The foreign net debt was USD 7,482 million in the end of June 2001. This is 85 per cent of the GDP of the year 2000. The debt is mainly taken by public authorities. This is a big burden for the central government, which has to direct about 20 per cent of total expenditure to debt servicing. (About the debt situation, see Section 5.8.)

5.4 Gross Domestic Product

Tanzania is one of the poorest countries in the world. The economy is heavily dependent on agriculture, which accounts for almost a half of GDP, provides more than half of merchandise exports, and employs 80 per cent of work force.

The Structure of GDP

Table 5.2 shows the composition of mainland Tanzania's GDP. There are two larger parts in the table, the monetary GDP and the non-monetary GDP. The former accounts for 71 per cent of the total and its share has declined a little during the 1990s. The share of the non-monetary sector has risen due to an increase in owner-occupied housing.

The share of agriculture (both monetary and non-monetary) is 45 per cent of total GDP. Crops account for almost 35 per cent and livestock almost 5 per cent of GDP. The share of agriculture has declined during the 1990s. In 1992 it was 48 per cent. Mostly this drop comes from the livestock production.

Manufacturing accounts for a little over 7 per cent of the GDP and construction is slightly over 5 per cent. The share of trade, restaurants and hotels has declined during the 1990s, but it still stands at over 12 per cent of the GDP.

Table 5.3 shows the composition of GDP in the smaller part of Tanzania, namely Zanzibar. Out of the 33 million inhabitants of Tanzania, slightly less than one million live in Zanzibar. The decline in the share of agriculture is the most essential feature in the development of the production structure in Zanzibar.

Table 5.2 GDP at factor cost by kind of economic activity at current prices, Mainland Tanzania, % share of total

Economic activity	1992	1994	1996	1998	2000
A: MONETARY GDP					
Agriculture	26.6	24.9	27.0	24.5	24.7
Crops	18.3	17.5	20.2	18.1	18.0
Livestock	4.5	3.7	3.3	3.0	3.1
Forestry and hunting	1.3	1.3	1.4	1.2	1.1
Fishing	2.5	2.4	2.1	2.3	2.4
Mining and quarrying	1.1	1.2	1.1	1.5	1.5
Manufacturing	8.2	7.4	7.4	7.5	7.5
Electricity and water supply	1.5	1.8	1.9	1.6	1.7
Electricity	1.4	1.7	1.7	1.4	1.5
Water	0.2	0.2	0.2	0.2	0.2
Construction	4.5	3.7	2.9	4.1	4.2
Trade, restaurants and hotels	15.8	15.0	14.3	12.4	12.4
Transport, and communication	5.2	6.2	5.6	4.9	4.9
Financial and business services	5.7	7.2	6.1	6.1	5.7
Finance and insurance	3.6	4.5	3.3	3.0	2.7
Real estate	1.7	2.4	2.5	2.9	2.7
Business services	0.3	0.3	0.3	0.2	0.3
Public administration and other services	9.2	9.6	8.7	10.9	10.3
Public administration	6.4	6.6	5.8	8.3	7.8
Education	1.1	1.3	1.2	1.1	1.1
Health	0.6	0.6	0.6	0.5	0.5
Other services	1.1	1.1	1.1	1.0	1.0
Less financial services indirectly measured	-4.5	-5.5	-4.0	-2.7	-2.3
Total Monetary GDP	73.3	71.6	71.0	70.7	70.6
B: NON-MONETARY GDP					
Agriculture	21.4	20.0	21.0	20.2	20.4
Crops	17.0	15.9	17.1	16.5	16.6
Livestock	2.2	1.8	1.6	1.4	1.5
Forestry and hunting	1.9	2.0	2.1	2.1	2.0
Fishing	0.3	0.3	0.2	0.3	0.3
Construction	0.9	0.9	0.9	0.9	0.9
Owner-occupied dwellings	4.4	7.4	7.0	8.2	8.1
Total non-monetary GDP	26.7	28.4	29.0	29.3	29.4
C: TOTAL GDP : (A+B)	100.0	100.0	100.0	100.0	100.0

Source: Bank of Tanzania.

Table 5.3 Zanzibar GDP at factor cost by industrial origin, at current prices, % share of total

Economic activity	1995	1996	1997	1998	1999	2000
Agriculture	40.9	40.4	39.7	36.9	38.1	36.4
Mining and quarrying	0.3	0.2	0.2	0.4	0.3	0.3
Manufacturing and handicraft	5.9	5.7	6.0	6.1	5.9	5.7
Electricity and water supply	1.5	1.3	1.2	1.3	1.8	1.5
Construction	6.5	5.4	4.9	3.6	3.2	3.9
Wholesale & retail trade, restaurants and hotel	19.8	20.7	19.8	19.9	21.0	20.0
Transport and communication	3.9	5.3	5.3	5.1	5.5	6.0
Finance and insurance	4.3	3.6	2.2	2.4	3.3	3.3
Public administration and other services	18.5	18.5	20.9	24.4	21.9	23.0
Less: imputed bank charges	-1.6	-1.1	-0.3	-0.1	-1.2	-0.1
GDP at factor cost	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bank of Tanzania.

In the late 1990s economic growth in Tanzania was higher than in the first part of the decade (see Figure 5.2). This is mainly due to high growth in mining, in construction and in private services (Table 5.4). In agriculture bad weather conditions reduced the output in some years, and the growth was lower than during the decade on average.

In mining substantial foreign investments have led to an expansion of production. The tourist sector has also experienced rapid growth. The number of tourists has increased from 261,595 in 1994 to 501,667 in 2000.[60] Earnings from tourism have quadrupled during this time. In manufacturing the average growth rate was 5.2 per cent, which was clearly more than during the first part of the decade, when there was a painful adjustment period, among others in the textile and clothing industry.

60 The number of foreign tourists in Tanzania has been about the same as that in Nepal.

Table 5.4 Gross domestic product by kind of economic activity, volume change, %

Economic activity	1996	1997	1998	1999	2000
Agriculture	3.9	2.4	1.9	4.1	3.4
Crops	4.2	2.3	1.8	4.5	2.9
Livestock	2.7	2.7	1.9	3.5	3.9
Forestry and hunting	2.7	2.7	1.2	2.4	4.8
Fishing	4.1	3.7	3.5	3.2	7.2
Mining and quarrying	9.6	17.1	27.4	9.1	13.9
Manufacturing	4.8	5.0	8.0	3.6	4.8
Electricity and water supply	11.1	2.2	5.5	3.9	5.0
Electricity	12.4	2.3	6.0	4.0	5.2
Water	1.6	1.7	1.8	3.0	3.4
Construction	7.6	8.2	9.9	8.7	8.4
Trade, restaurants and hotels	3.5	5.1	4.7	6.0	6.5
Transport, and communication	1.1	4.9	6.2	5.8	6.1
Financial and business services	0.4	7.7	5.6	4.1	4.7
Finance and insurance	-5.4	16.5	9.0	4.3	4.3
Real estate	3.5	3.3	3.4	4.0	4.9
Business services	6.0	1.2	6.0	4.2	5.5
Public administration and other services	1.6	3.2	2.7	3.5	3.6
Public administration	0.0	2.0	1.5	1.9	2.5
Education	3.8	3.7	6.6	3.6	5.6
Health	3.7	5.1	2.4	3.2	5.1
Other services	4.9	6.3	4.0	9.5	4.9
Less financial services indirectly measured	-10.0	23.5	8.6	3.4	1.4
Total GDP (factor cost)	4.2	3.3	4.0	4.7	4.9

Source: Bank of Tanzania.

Agriculture

Agriculture is the most important sector in the Tanzanian economy, with its 45 and 36 per cent shares in the GDP of the mainland and Zanzibar, correspondingly. In the Mainland almost 55 per cent of the agricultural output is produced in the monetary economy, and the remaining 45 per cent in the non-monetary economy, i.e. in subsistence farming. The agricultural sector consists of crops, livestock, fisheries, forestry and hunting. The sector is an important source for export earnings, more than half of merchandise trade originates in this sector (for exports, see Section 5.5). About 82 per cent of the employed working-age population is engaged in agriculture. Most of them work on smallholdings as self-employed or unpaid family workers.

The farming land is owned by the state, but the state rents it to farmers with long-term contracts. Farming is mainly small scale. The farms are usually between 0.9 and 3 hectares in size. In the production of important cash crops, especially of tea, there are large-scale farmers. About 70 per cent of Tanzania's crop area is cultivated by hand hoe, 20 per cent by ox plough and 10 per cent by tractor.

Crop production constitutes the largest part (77 per cent) of agricultural output in the Mainland. The most important food crops include maize, paddy, wheat and pulses. The main cash crops are coffee, cotton, tea, cashew nuts, tobacco, sisal and pyrethrum. Production varies considerably depending on weather conditions.

Table 5.5 Production of major agricultural crops in Tanzania ('000 tons)

Crop	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01
FOOD CROPS								
Maize	2,159.0	2,567.0	2,638.0	1,831.0	2,685.0	2,452.0	2,128.0	2,240.0
Paddy	614.0	723.0	733.8	550.8	810.8	506.0	476.0	991.7
Wheat	59.0	75.0	61.0	78.0	112.0	82.0	32.0	118.0
Pulses	186.7	374.0	384.0	374.0	453.0	528.0	584.0	674.0
CASH CROPS								
Coffee	48.5	43.5	52.0	42.4	38.0	46.6	47.9	58.1
Cotton	48.4	44.5	84.2	84.5	69.9	39.0	35.0	41.4
Tea	22.4	24.8	24.3	24.0	26.2	21.9	24.8	26.7
Cashew nuts	46.5	63.4	82.0	63.0	93.2	103.3	121.2	98.6
Tobacco	24.0	18.3	28.0	35.4	52.0	38.0	31.8	24.8
Sisal	30.5	25.5	32.0	23.0	20.0	24.0	20.6	25.2
Pyrethrum	2.8	2.4	2.0	1.3	1.3	4.0	-	-

Source: Bank of Tanzania.

Livestock production is about 10 per cent of total agricultural output in the Mainland. In 2000 there were 16.4 million cattle, 1.7 million goats, 630,000 sheep, 27.9 million indigenous chickens and 1.2 million ducks in the country. These were owned by 1.6 million households. (United Republic of Tanzania, 2001a.)

Fishing comprises 6 per cent of agricultural output. It is important in Zanzibar, on the coast of the Mainland as well as on the great Lakes Victoria, Tanganyika and Nyasa.

Mining

Mining constituted 1.5 per cent of the GDP in the Mainland in 2000. It is projected to increase up to 10 per cent in 2025 in the Development Vision of the Tanzanian government (United Republic of Tanzania, 1999). Production of, for example, gold has already increased substantially during recent years. There are still important unused mineral resources and the potential for expansion is huge. Tanzania is well-endowed with minerals like gold, diamonds, gemstones, energy minerals (coal), iron ore, nickel, cobalt, platinum, and several industrial minerals. (Table 5.6.)

Table 5.6 Mineral production in Tanzania

Mineral	Unit	1994	1996	1998	2000
Diamonds	Carat	25,540	126,670	97,830	354,388
Gold	Kg	2,861	318	427	15,060
Gemstones	Kg	48,507	142,160	48,518	150,000
Salt	Ton	84,289	86,700	75,000	70,000
Phosphate	Ton	..	717	1,431	5,100
Limestone	000 Ton	1,740	1,200	1,181	1,500
Tin ore	Ton	9	..	..	..
Gypsum	Ton	53,000	55,430	59,066	60,000
Coal	Ton	45,027	52,000	45,073	79,184
Pozolana	Ton	...	..	..	..
Kaolin	Ton	541	1,332	..	..

Source: United Republic of Tanzania (2001a, 148) (originally Minerals Department).

Carat = 0.205 gms.

Until recently, virtually all mineral development was in the hands of the State Owned Mining Corporation (STAMICO). The liberalisation and privatisation of the sector has attracted an increasing number of large foreign mining companies into the country. The companies are mainly from South Africa, United States and Australia. In addition to large mining firms there are also small firms in the sector, although their share in the output is modest. Small-scale activities are concentrated in gemstone mining.

Foreign companies use sophisticated modern technologies, while small miners use labour intensive and low-level production technologies.

Processing of minerals occurs usually abroad. This is related to the logistics of the large foreign enterprises and to economies of scale. The largest potential for processing in Tanzania is in gold and diamonds as well as in small-scale processing of gemstones. Wider Tanzanian processing is promoted by the government by the legislation on export processing zones, where certain privileges are provided for companies. The plan to establish these kinds of zones has proceeded slowly. Currently there is only one export processing zone (in Zanzibar). There are, however, some in the Mainland under preparation.

Manufacturing

The share of manufacturing is about 7 per cent of GDP. In the low-income countries it is 18 per cent on average, and in the OECD countries about 25 per cent on average. The low share of manufacturing in Tanzania is largely due to the high share of agriculture. This reflects the level of development, but also the country's comparative advantage, which is concentrated on the use of land and other natural resources. Manufacturing employs about 150,000 people. This is one per cent of the total labour force, which is estimated to be about 16 million. The difference between the output and employment shares of manufacturing shows that productivity is superior in manufacturing when compared to the rest of the economy. Especially in the agricultural sector underemployment and inefficient use of labour are common.

The food industry is by far the most important sector of manufacturing (Table 5.7). Activity in this industry consists of processing of domestic agricultural products. Often the processing does not add significant value. The paper industry accounts for the second and the chemical industry for the third largest share of manufacturing. Within the chemical industry, petroleum refining is the most important subsector. Its share of manufacturing is 10 per cent. The corresponding share of rubber production is 4 per cent. Production of non-metallic products constitutes 12 per cent of the manufacturing output. This item includes the manufacture of cement, glass and glassware, pottery, etc.

Table 5.7 Estimates of output shares of different sectors of manufacturing, %

Sector	1996-2000
Food, beverages and tobacco	46.8
Textiles, apparel, leather, footwear	1.0
Timber, timber products, furniture	1.0
Paper, paper products, printing	16.8
Chemical products	15.1
Non-metallic products	11.8
Basic metal products	2.2
Machinery and transport equipment	5.2
Miscellaneous manufacturing	0.1
Manufacturing	100.0

Source: National Bureau of Statistics (United Republic of Tanzania, 2001a, 158).

Manufacturing and repair of machinery and transport equipment has a 5 per cent share of total manufacturing. This activity is mainly small scale and directed to the domestic market. The basic metal industry has a modest share of output. Processing of domestically mined metals is limited. Gold is mainly transported abroad for refining. Diamonds are partly cut in Tanzania.

Tanzania once had an important textile and clothing industry. The industry collapsed, however, during the privatisation and opening up process. The former state-owned textile industry was not competitive and efficient enough to survive in the face of free competition and falling import restrictions.

Because of its natural conditions, Tanzania has a comparative advantage in the food industry. Widening the agricultural production and increasing the degree of processing provide possibilities for the development of the sector.

The growth of the mining sector gives some possibilities for widening the basic metal industry and refining of non-metallic minerals. Currently the scale of production is regarded as too small for competitive processing of, for example, gold.

The textile and clothing industry might in principle belong to the group of industries, where Tanzania has a comparative advantage. It employs relatively cheap labour and domestic raw materials like cotton. Competition in this sector is, however, fierce globally. The sector has also diminished so much in size that large-scale investments and transfer of technology are required to restore it.

Tourism

Tourism is not mentioned as a separate sector in Table 5.2. It affects several branches like hotels, trade, transport, manufacturing, agriculture, etc. Tanzania's annual earnings from tourism were USD 739.1 million, i.e. 8.2 per cent of GDP, in 2000 (United Republic of Tanzania, 2001a, 130). On the other hand a substantial part of tourism expenditure has focused on imported inputs. Unfortunately there are no input-output studies about the multiplier effects of tourism.

In Nepal it is estimated that 62 per cent of tourist expenditure is focused on imported materials or services. Assuming that the figure is the same in Tanzania, a rough estimate of the contribution of tourism to GDP is about 3-4 per cent, as it is for Nepal, too. Even though the net effect is clearly smaller than the gross effect, a contribution of about this size is still important.

The potential for the development of tourism is substantial. The number of tourist targets can be increased and the stay of tourists can be lengthened. There are numerous under-utilised tourist attractions in different types of tourism (wildlife, trekking, beach, culture, etc.). The development of this sector requires, however, substantial investments in infrastructure. (Ministry of National Resources and Tourism, 1999.)

Other activities

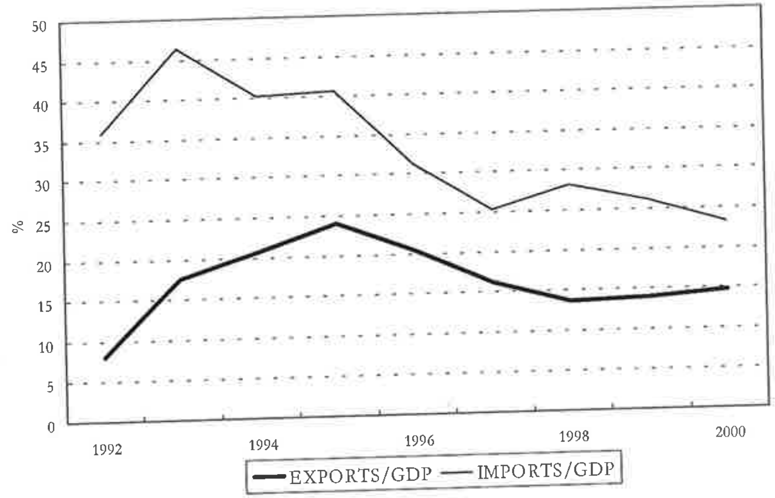
An important sector is trade, restaurants and hotels, the GDP share of which is about 12 per cent in the Mainland and 20 per cent in Zanzibar. The high share in Zanzibar reflects the importance of tourism and trade in Zanzibar. Public administration and other services account for 10 per cent of GDP in the Mainland and over 20 per cent in Zanzibar. Financial and business services have a share of about 6 per cent in the Mainland and of 3 per cent in Zanzibar. The share of construction is between 4 and 5 per cent in both parts of the country.

5.5 Foreign Trade

Importance of Foreign Trade

In Tanzania, the relation of exports of goods and services to GDP has recently been about 15 per cent (Figure 5.7). The world average has been about 22 per cent. In East Asia and Pacific the corresponding ratio was 39 per cent in 1999. (World Development Report 2000/2001.)

Figure 5.7 Exports and imports in relation to GDP, %[1]



[1] Exports and imports of goods and services in relation to GDP, in current prices.
Source: United Republic of Tanzania (2001a).

In Tanzania exports are shared about equally between goods and services (as in Nepal). The relatively high share of services reflects the importance of tourism and transport. When compared to the world average the share of exports to GDP is rather low. In developing countries, however, the large extent of subsistence farming tends to reduce this figure.

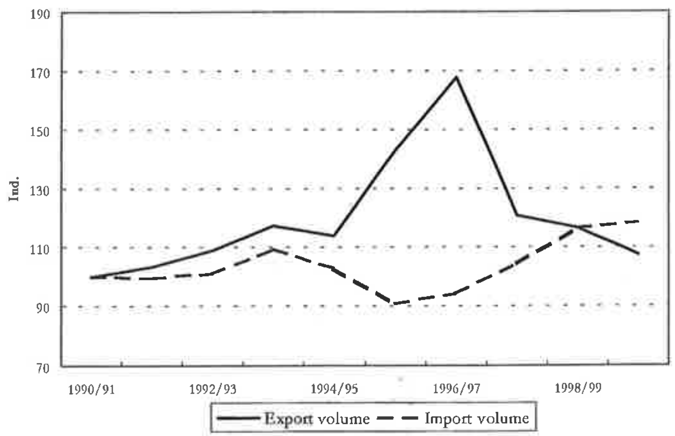
The exports-to-GDP share has fluctuated between years. This reflects developments in export volumes as well as in prices. For example, in 1994 and 1995 prices of coffee, cotton, sisal and tea were high, which was reflected in the value of exports. After this the prices declined. Additionally export volumes of cotton declined drastically.

Tanzania's balance of goods and services is in deficit, which is reflected in the higher share of imports. There has been a declining trend in the GDP share of imports, too. This is mainly due to modest price developments of industrial raw materials as well as due to more stringent economic policies, which have curbed the growth of domestic demand.

Structure and Development of Merchandise Trade

Export volumes developed modestly in the 1990s (Figure 5.8). The level of merchandise exports was only 7 per cent higher in 1999/2000 than in 1990/1991. They have also fluctuated considerably. Exports reached a peak in 1996/1997. After the mid 1990s exports of coffee, cotton, tobacco, cashew nuts and manufactured goods were all high. They dropped after this. Import volumes have been more stable. They were 18 per cent higher in 1999/2000 than in 1990/1991.

Figure 5.8 Development of Tanzania's merchandise foreign trade volumes, 1990/91=100 (base year 1992)



Source: International Monetary Fund (2000, 22) (data provided by the Tanzanian authorities and IMF staff estimates, fiscal years).

Agricultural products constitute more than half of Tanzania's merchandise exports. Previously the share was clearly greater, but recently mineral exports have increased their share in total merchandise exports. (Table 5.8.) The share of manufactured goods has however declined to less than a half of that in the early 1990s.

Table 5.8 Tanzania's most important merchandise export products, % shares

Product	1991	1993	1995	1997	1999	2000
Cotton	17.9	17.5	17.7	17.3	5.3	5.7
Coffee	21.8	21.8	20.8	15.8	14.0	12.7
Sisal	0.6	0.8	0.9	1.2	1.3	0.8
Tea	6.3	8.4	3.4	4.2	4.5	5.0
Tobacco	4.9	3.9	3.9	7.2	7.9	5.8
Cashew nuts	4.6	5.0	9.2	12.1	19.1	12.8
Petroleum products	1.8	3.1	1.6	0.9	0.1	0.1
Minerals	11.2	15.5	6.5	6.8	12.8	26.5
Manufactured products	16.3	11.9	16.1	14.7	5.9	6.5
Other	14.5	12.1	19.7	19.6	29.2	24.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bank of Tanzania.

The value of cotton exports has declined dramatically (Table 5.9). This is because of a decline in prices, but especially because of a decrease in export volumes (Table 5.8 and Figure 5.9). The demand for the Tanzanian type of medium fibre cotton has diminished in the world market.

Efforts have been undertaken to promote exports of non-traditional crops such as spices, horticultural items, and oilseeds. Currently these exports are, however, still modest.

Tanzania's foreign trade is not very concentrated at the 3-digit level of SITC classification (Table 5.10). The smaller the value of the index is, the less concentrated foreign trade is. According to these kinds of indices, Tanzania's foreign trade is less concentrated than Nepal's, where the value of the index varies between 0.37 and 0.55 for exports (see Chapter 4). This diversity is, however, somewhat misguiding, because even if diversified at the product level, Tanzanian exports are concentrated on agricultural and mineral products. The prices of these products fluctuate heavily and their demand is prone to significant demand and supply shocks.

Table 5.9 Tanzania's most important export products, TZS mill., in current prices

Product	1991	1993	1995	1997	1999	2000
Cotton	13,632	31,697	69,238	79,623	21,613	30,262
Coffee	16,554	39,428	81,168	72,744	56,973	67,058
Sisal	479	1,441	3,535	5,591	5,371	4,166
Tea	4,797	15,176	13,216	19,498	18,117	26,213
Tobacco	3,692	7,097	15,372	33,060	31,981	30,719
Cashew nuts	3,522	9,133	36,077	55,513	77,668	67,652
Petroleum products	1,370	5,632	6,215	4,337	404	79
Minerals	8,479	28,074	25,545	31,303	51,952	139,928
Manufactured products	12,420	21,625	63,043	67,717	24,193	34,370
Other	11,038	21,845	76,970	90,163	118,848	127,325
Total merchandise exports	75,981	181,148	390,378	459,549	407,118	527,774

Source: Bank of Tanzania.

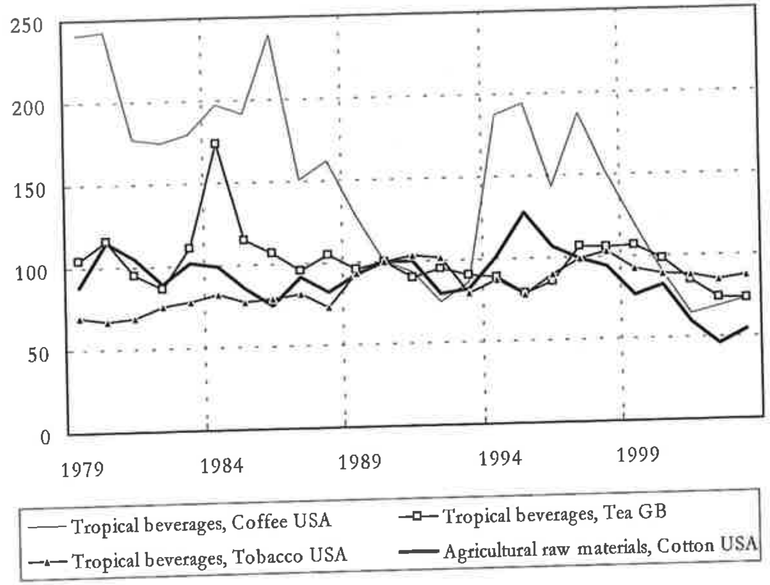
Table 5.10 Concentration indices[1] of exports and imports

	1995	1996	1997	1998	1999
Concentration index					
Exports	-	-	0.27	0.21	0.25
Imports	0.10	0.07	0.12	0.08	0.07
Number of commodities					
Exports	-	-	76	123	128
Imports	187	188	190	193	191

[1] Trade concentration index is a modified version of the Hirschmann index. It is calculated as a square root of the sum of the ratios (raised to the power of two) of each of the 239 products at the 3-digit SITC (Rev. 2) to total exports or imports. The result is then normalised by a square root of 1 over 239. The index varies between 0 and 1 (maximum concentration).
Source: UNCTAD (2001c).

Exports of coffee fluctuate depending on climate conditions. Through price developments they depend also on weather conditions of major coffee producers (Table 5.9 and Figure 5.9). The same applies to tea and tobacco.

Figure 5.9 Commodity prices, USD-basis (2002 and 2003 forecasts by AIECE), 1990=100



Sources: History: HWWA index data base (ETLA); forecast: AIECE (Association of European Conjuncture Institutes).

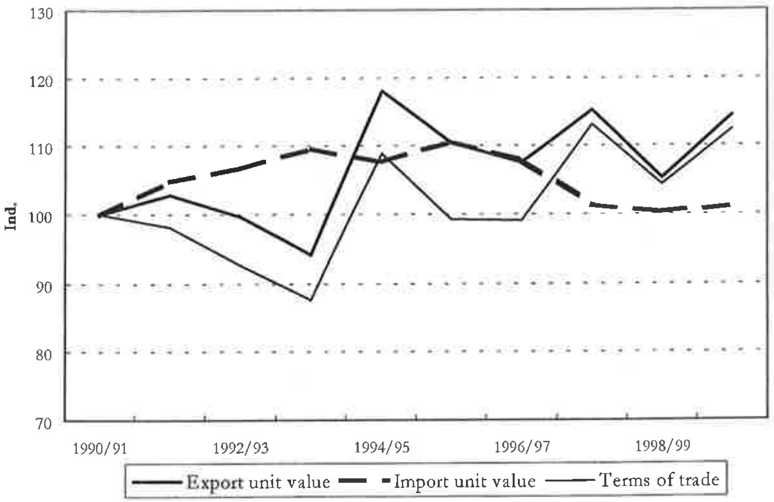
The volatility of prices of Tanzania's important export products is a clear problem for the country (Figure 5.10). In addition to agricultural products, mineral prices also fluctuate widely.

In the early 1990s, export prices declined in dollar terms and accordingly the terms of trade deteriorated. In the late 1990s the terms of trade improved due to higher export prices and declining import prices.

Tanzania's most important export countries in 2000 were the United Kingdom (22 per cent of total exports), India (15 per cent), Germany (10 per cent), the Netherlands (10 per cent), Japan (5 per cent) and Kenya (4.8 per cent). The share of South Africa was 2 per cent in 2000. (Table 5.11.)

The shares of the UK, India and the Netherlands have clearly increased, whereas those of Germany, Japan and Belgium have declined.

Figure 5.10 **Export unit value, import unit value and terms of trade in Tanzania, in dollar terms 1990/91=100 (base year 1992)**



Source: International Monetary Fund (2000, 22) (data provided by the Tanzanian authorities and IMF staff estimates, fiscal years).

Table 5.11 **Tanzania's most important export countries, % of total merchandise exports**

Country	1992	1993	1994	1995	1996	1997	1998	1999	2000
United Kingdom	8.6	7.8	6.0	5.9	5.2	5.0	10.1	17.0	22.0
India	8.2	8.9	10.2	8.5	9.3	8.9	19.5	20.6	14.8
Germany	12.9	11.9	10.6	10.6	9.5	9.0	8.3	6.4	9.9
Netherlands	5.7	5.1	4.8	6.0	5.6	5.3	7.7	5.7	9.9
Japan	8.1	9.2	9.4	9.6	8.4	8.0	7.7	8.0	5.1
Kenya	2.2	1.8	1.9	1.8	1.8	1.7	4.4	3.8	4.8
Ireland	0.2	0.4	0.6	0.1	0.3	0.2	3.4	2.6	3.5
Belgium	9.1	2.8	3.3	1.5	1.1	1.1	4.4	3.1	2.8
United States	2.9	2.9	3.1	3.5	3.0	2.8	2.2	3.3	2.3
Singapore	3.1	2.0	2.7	2.2	2.0	1.9	1.9	4.5	1.0
Indonesia	3.5	3.6	1.9	2.8	2.7	2.5	1.0	1.7	0.7

Source: Bank of Tanzania.

Tanzania's most important export products into the OECD countries are coffee, fish, tobacco, as well as sugar, molasses and honey, which together accounted for 74 per cent of Tanzania's exports to the UK, Germany, Japan, the Netherlands and Belgium in 1998 (Table 5.12).

Gold is mainly exported to Europe, diamonds to the London market, copper to Japan, and gemstones to Asia, Europe and the USA.

Table 5.12 **Tanzania's most important export products to the UK, Germany, Japan, the Netherlands and Belgium, USD 1000, and their share in total exports to these countries, %**

Product (SITC)	1993	1994	1995	1996	1997	1998
071 Coffee and coffee substitutes	68,151	70,286	100,846	91,914	90,917	92,113
Share, %	41.0	36.7	41.0	37.9	34.5	34.5
034 Fish, fresh, chilled or frozen	837	3,042	18,187	27,814	36,374	55,758
Share, %	0.5	1.6	7.4	11.5	13.8	20.9
121 Tobacco, unmanufactured; tobacco refuse	17,725	15,846	19,658	30,176	44,659	35,297
Share, %	10.7	8.3	8.0	12.4	16.9	13.2
061 Sugar, molasses and honey	7,257	7,894	8,334	8,764	10,119	14,135
Share, %	4.4	4.1	3.4	3.6	3.8	5.3
222 Oil seeds and oleaginous fruits	4,894	4,359	9,877	13,507	10,368	7,980
Share, %	2.9	2.3	4.0	5.6	3.9	3.0
292 Crude vegetable materials, n.e.s.	2,704	4,401	5,671	6,038	6,865	7,360
Share, %	1.6	2.3	2.3	2.5	2.6	2.8
Total	166,293	191,660	246,156	242,604	263,483	266,707

Source: OECD.

Although important for Tanzania, the shares of these products in the imports of the five OECD countries are small. The highest shares are in coffee, tobacco and cotton. In 1998 the shares were 1.7 per cent, 1.4 per cent and 1.1 per cent, correspondingly. (Table 5.13.) The low shares mean that Tanzania does not have important market power in these products.

Table 5.13 Tanzania's share in the imports of certain products by the UK, Germany, Japan, the Netherlands and Belgium, %

Product (SITC)	1993	1994	1995	1996	1997	1998
071 Coffee and coffee substitutes	2.25	1.53	1.63	1.89	1.57	1.72
121 Tobacco, unmanufactured; tobacco refuse	0.76	0.64	0.81	1.20	1.74	1.39
265 Vegetable textile fibres, not spun; waste of them	0.35	0.49	0.88	0.93	0.89	1.14
074 Tea and mate	1.21	0.68	0.46	0.60	0.78	0.76
034 Fish, fresh, chilled or frozen	0.01	0.03	0.18	0.28	0.38	0.64
061 Sugar, molasses and honey	0.28	0.26	0.23	0.25	0.31	0.44
689 Miscellaneous non-ferrous base metals for metallurgy	0.14	0.25	0.25	0.03	0.04	0.26
Total	0.016	0.017	0.018	0.017	0.019	0.019

Source: OECD.

Tanzania exports for example cement, plastic, wood, canvas products, fish and cooking oil to its neighbouring countries

The most important import item for Tanzania is consumer goods. Their share of all merchandise imports was 37 per cent in 2000. Of that 12 percentage points was food stuffs and the rest was other consumer goods. The share of machinery was 19 per cent and the share of transport equipment 15 per cent. The share of industrial materials was 11 per cent.

South Africa is the most important import country (Table 5.14). The main reasons for this are the close geographic location and the importance of the country in FDI, especially in the mining and tourism sectors. The mining sector imports machinery and transport equipment needed in the sector. South African -owned hotels in turn are tempted to favour goods from that country.

The western countries and Japan are important sources for machinery and high-tech imports. Kenya's high import share is explained by the close geographic location as well as by Kenyan and other foreign investments in the country. Australia has expertise in the mining machinery. India and China are sources of consumer goods and intermediate products. The United Arab Emirates and Saudi Arabia are suppliers of mineral fuels.

Table 5.14 Tanzania's most important import countries, % of all merchandise imports

Country	1995	1996	1997	1998	1999	2000
South Africa	6.1	5.2	7.3	8.3	10.5	11.5
Japan	7.0	5.5	5.6	8.3	11.0	9.3
United Kingdom	9.4	9.2	9.3	7.8	7.9	7.0
Australia	0.1	0.1	0.1	1.8	5.0	6.2
Kenya	8.9	11.6	7.2	6.7	5.8	6.1
India	4.6	7.7	5.9	5.4	5.8	5.8
China	4.8	4.6	4.7	3.1	3.6	4.5
USA	4.3	3.6	4.0	5.2	6.1	3.9
United Arab Emirates	6.1	6.5	7.1	3.8	3.1	3.7
Saudi Arabia	0.7	3.5	2.0	2.1	1.7	3.6
Germany	3.4	3.2	3.8	4.9	3.8	3.4

Source: Bank of Tanzania.

The import shares of South Africa, Australia and Japan have been growing during the past 5 years. In the cases of South Africa and Australia this reflects increased imports of mining machinery, reinforced by the FDI of these countries' mining firms in Tanzania.

Merchandise imports are about twice as large as exports. The trade account is thus negative.

Structure and Development of Trade in Services

The share of services in total exports is about the same as that of merchandise exports. Tourism is the most important item in service exports. The second largest item is transport services or 'other business services', depending on the year. (Table 5.15.) Transport services include, in addition to activity related to Tanzania's own foreign trade, also transit trade from and to the neighbouring countries. Tanzania is an important transit country for Uganda, Democratic Republic of Congo, Zambia, Malawi and North Mozambique.

Annual fluctuations are large. This is explained by true volatility in tourism and in transport services. The data collection and classification problems are, however, another source of volatility.

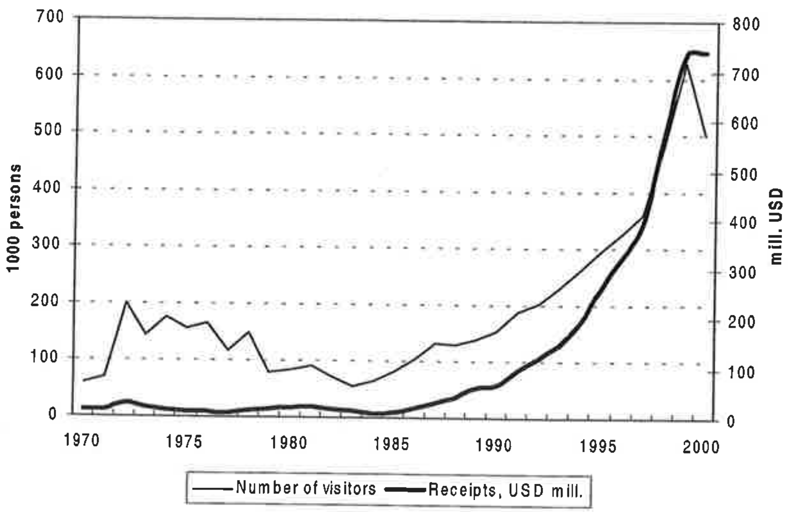
Table 5.15 Exports of services, % of total services

Sector	1992	1993	1994	1995	1996	1997	1998	1999	2000
Transport	..	4.5	1.6	0.3	11.5	12.0	10.9	8.4	8.8
Travel	41.2	42.1	43.8	86.1	77.8	68.7	71.9	71.8	56.7
Other business	58.9	51.0	52.6	7.6	2.9	3.8	3.2	3.2	14.7
Government services	..	2.2	1.9	2.8	1.0	5.0	3.8	3.8	7.8

Source: UNCTAD (2001c).

The number of foreign visitors was 501,669 in 2000. There was a decline from the figure of 627,325 recorded in 1999. In terms of tourism receipts there was, however, some increase in 2000. (Figure 5.11.) The number of visitors fluctuates partly because of volatility in the visits of people from the neighbouring countries.

Figure 5.11 Number of tourists (1000 persons) and tourist income (mill. USD) in Tanzania



Source: Ministry of Natural Resources and Tourism (2001).

According to the number of international visitors, the African (especially the East African) countries form the largest group. In 2000 there were 210,000 African visitors in Tanzania. From Europe there were 154,000, from North America 42,900 and from East Asia and Pacific 38,300 visitors. Kenya, the UK, the USA and South Africa are the most important origin countries of visitors. (Ibid.)

By purpose of visit 'holiday' accentuated for 339,596 visitors in 2000, business for 130,201, transit for 10,956 and other for 20,916 persons. (Ibid.)

In the imports of services, travel and transport are the most important items. Financial and insurance services and 'other business services' have the third largest share, the ranking depending on the year.

Imports of services have been somewhat greater than exports. The balance of services has been slightly negative during all of 1995-2000.

Foreign Trade Regime

Tanzania is a founding member of the WTO. This membership determines a lot of the country's foreign trade regime. The WTO framework guarantees harmonised trade practices and often low tariffs for many industrial products. In the case of textile and clothing, trade is, however, limited by the Multifibre Agreement (MFA). It limits exports to certain quotas, which are allocated country wise. In the case of agricultural products, market access is also limited. This concerns especially non-tropical products. The WTO has a plan to widen its scope in the case of services and to improve the safeguard of intellectual property rights.

In principle, Tanzania has accepted the WTO rules in a praiseworthy manner. In the application of them it has, however, suffered from the typical problems of least developed countries. Its scarce technical and financial resources have limited the utilisation of the WTO and reduced active participation in its work. As an LDC, Tanzania benefits from the special and differential treatment afforded to developing countries in the form of exceptions or delayed implementation of certain provisions. In the future negotiations Tanzania's main interest is in the liberalisation of trade in agricultural products. Otherwise it opposes the incorporation of new issues in the negotiations, and stresses the need to make the existing agreement work better.

As a developing country Tanzania enjoys preferential trade treatment by the industrial countries. The GSP (Generalised System of Preferences) systems of various countries provide lower tariffs and less non-tariff barriers to developing countries, especially to LDCs. The GSP systems have, however, had rather limited success in promoting the exports of the LDCs. One reason for this is the general reduction of tariffs, whereby the margins for the LDCs have diminished. The rules of origin and other administrative requirements have also been so complex that the LDCs have had difficulties satisfying them. Additionally, the GSP benefits have often been tied to certain amounts of imports (see for example Sharer, 2001).

With the EU Tanzania has, together with 76 other African, Caribbean and Pacific (ACP) countries, as a continuation of the Lomé convention, the so-called Cotonou agreement. The agreement was signed on June 23rd, 2000 in Cotonou, Benin. In addition to trade the agreement covers several forms of aid and co-operation between the EU and ACP countries. The agreement covers the years 2000-2020, but it will be divided in four phases of five years each.

The EU has decided to allow duty and quota free market access to all products except arms for the 49 countries which the United Nations defines as the world's least developed nations (LDCs). The agreement was put into practice the 5th of March 2001. For sugar, rice and bananas, however, there are transition periods. In the case of Tanzania the treatment of sugar is relevant, because it is an important export product. UNCTAD (2001a, 39) has estimated that the 'Everything But Arms' (EBA) programme increases Tanzania's exports by about 6 per cent from the baseline. Tanzania is among the largest beneficiaries. This is because the EBA program liberalises especially imports of agricultural products. The greatest gains are expected in the exports of paddy rice, processed rice, cereals and sugar.

Duties on sugar will be reduced by 20 per cent on 1 July 2006, by 50 per cent on 1 July 2007 and by 80 per cent on 1 July 2008 and eliminated at the latest by 1 July 2009. However, to compensate for the delay in liberalisation for these products, the EU will offer immediate and real market access to the LDCs through the creation of duty-free quotas for sugar and rice, based initially on the best figures for LDC exports during the 1990s, plus 15 per cent. These will increase by 15 per cent each year during the interim period. The gradualism is motivated by the time needed in the EU to adjust to

the new situation in the framework of the Common Agricultural Policy. (Commission of European Communities, 2001.)

A recent agreement, which is potentially important for Tanzania, especially for the textile and clothing sector, is the African Growth and Opportunity Act (AGOA) of the United States. It was signed by President Clinton in May 2000. The aim of the act is 'to provide reforming African countries with the most liberal access to the U.S. market available to any country or region with which the United States does not have a Free Trade Agreement. It supports U.S. business by encouraging reform of Africa's economic and commercial regimes, which will build stronger markets and more effective partners for U.S. firms.' (U.S. Department of Commerce, 2001; UNCTAD, 2001a.) It gives the Sub-Saharan African countries a preferential treatment with respect to other countries. Until now the opportunities of the Treaty have not, however, been utilised in Tanzania (Guardian (Tanzanian), November 20, 2001).

From a trade policy point of view the most important African organisations for Tanzania are the East African Community (EAC) and the Southern African Development Community (SADC).

Tanzania, Kenya and Uganda have a very ambitious plan in the context of the East African Community (EAC). The community was founded in November 1999. Rwanda and Burundi will obviously be members rather soon. The final aim is to form an economic and political union. Trade liberalisation is among the most immediate targets. The countries plan to implement a common external tariff by 2004. A background for the integration is the geography and the countries' common colonial history as well as the role of swahili as the widely used language in this area. Also political democracy (currently) and production structures in the countries have many similarities.

Trade liberalisation is the central aim of the Southern African Development Community (SADC), too. This community has also more far-reaching targets in the economic and political field. The SADC is, however, a more heterogeneous community than the EAC, for which reason the ultimate targets can easily prove to be too ambitious.

Tanzania practically abolished export licensing in 1993. Export taxes are collected in the case of raw gemstones. Exports of processed products are tax-free.

According to COMESA (2001) there are practically no import related non-tariff barriers (NTB). There are, however, some exceptions. Import licenses are required on goods deemed to be sensitive for health or security reasons. An import license is required for livestock, meat and edible offal, live trees and other plants, edible fruit, nuts, vegetables, roots and tubers. (U.S. Government, 2001.) Physical barriers relating to infrastructure and efficiency of customs will take some time to be eliminated. Imports to Tanzania above USD 5,000 are subject to pre-shipment inspection for quality, quantity and price verification.

Tanzania has cut import tax rates by more than a half during the liberalisation process (Table 5.16). The average tariff of 16 per cent is still higher than the average of 12 per cent in the rest of the world, and especially higher than the 5 per cent of the industrial world. It is also higher than the 11 per cent average of the LDCs. In South Africa the average customs tariff was 8.5 per cent, and in Kenya 18 per cent in 1999. (See Chapter 3.)

Table 5.16 Average customs tariff in Tanzania, unweighted average, %

	1992	1993	1993	1995	1996	1997	1998	1999
Import tariff	33.0	27.5	27.5	24.5	24.4	21.8	21.6	16.1

Source: World Bank.

Tanzania grants at least Most Favoured Nation (MFN) treatment to its trading partners. Since July 1999 Tanzania has used a five-tier structure for import tariff rates:

1) zero per cent;
2) 0-5 per cent for raw materials, replacement parts, and capital goods;
3) 5-10 per cent for semiprocessed inputs and spare parts (except spare parts for motor vehicles;
4) 15-20 per cent for fully processed inputs and motor vehicles spare parts;
5) 20-25 per cent for consumer goods. (U.S. Government, 2001.)

The simple average of the applied import duties is now 16.1 per cent. The average tariff for finished goods is 18.3 per cent, and the average rate for primary and semiprocessed goods is 13.3 per cent. (Ibid.)

Trade in services is largely liberalised. In the tourism sector, however, only Tanzanian nationals are allowed to have travel agent licences. Foreigners can still be co-owners in joint ventures in this field. (Ibid.)

Government procurement regulations require that all purchases over USD 5,000 must be made via open tender. Domestic bidders are, however, given a 7.5 per cent price preference in the final choice. Current account transactions are fully liberalised. There are capital account restrictions. They are consistent to the IMF instructions on developing countries. (Ibid.)

Tanzania is member of several organisations in the area of intellectual property rights protection, among others of the World Intellectual Property Organisation (WIPO) and the International Union of the Protection of Industrial Property (Paris Union). In practice copyright holders have, however, been unable to defend their rights due to the lack of well-defined property rights laws and inadequate law enforcement. (Ibid.)

Since its implementation in July 1998, the Value-Added Tax (VAT) has remained at the flat rate of 20 per cent. Exports are not subject to VAT. Imports of food, health items (e.g., pharmaceuticals), educational supplies, water, and transport and financial services are also zero-rated. There are VAT exemptions for foreign investors in sectors preferred high by the government (for example in mining), see Chapter 5.6. An excise tax is levied on domestic and imported petroleum, alcoholic and non-alcoholic beverages, and tobacco products. (Ibid.)

5.6 Foreign Direct Investment

Structure and Development of FDI

The stock of inward foreign direct investment (FDI) was 11 per cent in relation to GDP in Tanzania in 1999. In all developing countries the corresponding figure was 28 per cent and in Africa 21 per cent. In Nepal it was 2 per cent (see Chapter 3). In Tanzania the FDI stock is thus relatively small, but not among the smallest.

It has grown crucially in the 1990s due to the policy of liberalisation and opening up. (Table 5.17.) Between 1995 and 2000 the flow of FDI has increased by 28 per cent, from USD 150.9 million to USD 192.8 million (Bank of Tanzania).

Table 5.17 Inward foreign direct investment in Tanzania and in selected countries, % of GDP

Country	1980	1985	1990	1995	1999
Tanzania	0.9	1.3	2.2	7.0	11.2
Uganda	-	0.2	0.1	4.7	15.8
Kenya	5.5	7.8	7.9	8.1	8.2
Africa	4.6	7.4	11.1	18.2	21.0
Least developed countries	2.8	4.3	5.0	9.5	14.2
Developing countries	10.2	14.1	13.4	15.6	28.0
Developed countries	4.7	6.1	8.4	9.2	14.5
World	6.0	7.8	9.2	10.3	17.3

Source: UNCTAD (2001b), 325-337.

In Tanzania the FDI flows were 13.8 per cent of gross fixed capital formation in 1999. It was the same figure as in the developing countries on average. In the LDCs the share was 7.9 per cent. The world average was 16.3 per cent and the developed country average was 17.0 per cent. In Nepal the share was only 1.2 per cent in 1998. Foreign direct investment is thus important for capital formation in Tanzania, but it is lagging behind when compared to the world average. (UNCTAD, 2001b, 321-324.) There is also a risk that growth in FDI flows will decelerate when the large investments in the mining sector have been completed.

The year 1992 was a turning point for the liberalisation and privatisation process in Tanzania. The same year was crucial for foreign direct investment, too. The number of restructured and privatised state-owned enterprises reached 333, or 84 per cent of the total 395 by December 2000. Several of the remaining 62 state-owned enterprises were at some stage of the privatisation process. Many of the privatised enterprises moved to foreign ownership. The energy sector and public utilities (post, railways, etc.) are waiting for privatisation. There are, however, differing opinions about the pace and extent of it.

There are no data available on the sizes of foreign investments according to branches of manufacturing industry. Instead, there exist data on the number of projects. These are presented in Table 5.18.

Table 5.18 Summary of registered investment projects in Tanzania from 1990 to September 2001

Sector	Total number of projects	New projects	Foreign projects	Joint ventures	Total employment	Total investment, mill. TSH
Agriculture and livestock	135	76	38	61	47,266	318,581
Natural resources	105	83	25	34	24,903	349,326
Tourism	256	193	49	87	22,761	314,217
Manufacturing	824	612	164	234	119,181	1,337,169
Petroleum and mining services	87	76	17	41	9,911	455,890
Construction	110	91	27	30	10,836	1,188,639
Transportation	95	66	15	37	7,344	158,809
Services	105	83	24	38	13,786	143,217
Computer sector	8	7	2	4	148	6,625
Financial institutions	32	28	13	13	1,335	349,707
Telecommunication	19	15	3	11	1,753	1,206,237
Energy	1	1	-	1	90	97,800
Human resources	10	5	2	2	610	43,334
Total registered investments	1,787	1,336	379	593	259,924	5,969,551

Source: Tanzania Investment Centre.

Measured by the number of projects between 1990 and September 2001, about 54 per cent of the registered projects were foreign or joint venture projects. Most of the foreign projects were implemented in manufacturing. The food and beverage industry has attracted FDI for example in the processing of sugar, tea and coffee, and in the beer industry. Tourism and agriculture received the second and third positions. In the tourist sector many big hotels are owned by foreigners. In agriculture foreign investments are located in big cash crop entities (tea, tobacco, sugar, sisal, coffee, flowers).

Investors in the agricultural sector are mainly from SADC countries.

Only some mining projects are registered in the table because most investments in this sector are not realised through the Tanzania Investment Centre. Only some of the service investments in this sector are recorded. Even though not recorded properly above, mining is an important sector for foreign investment.

In the case of mining the foreign firms have leased the mines from the government. They pay the government a sum corresponding to the value of 3 per cent of the net output in the case of gold mines, and 5 per cent in the case of diamonds. Additionally they pay the normal taxes. Investments in mining have often been criticised for having a small employment content. As a counter argument it has been mentioned that the sector pays an important contribution to the government, which then uses the money for the sake of the people. Additionally the mines employ people indirectly in the surroundings, and they organise education, health care and other infrastructure in the mine areas.

Measured by the value of investments, the United Kingdom is the most important origin country for FDI to Tanzania (Table 5.19). British investors have been active in various sectors. U.S. investors have also invested in different fields. Mining is one of the most important sectors, and big U.S. mining companies are active in Tanzania.

South Africans have been active in mining, in the hotel industry, in the telecom sector (Vodafone), in the foodstuff and beverage industry, and in domestic trade. Kenya, as one of the neighbouring countries, also has investments in several fields in Tanzania. The projects are usually smaller than those of UK, U.S. or South African origin. When looking at the statistics, one must bear in mind that some projects are recorded as South African or Kenyan, because the investment is done by a local daughter company of an international firm. The Canadians are involved mostly in gold mining activities.

Many banks in Tanzania are foreign-owned. The largest are Stanbank (South-African), Standard Chartered (British), Barclays (British), and Citibank (U.S.). The entry of foreign banks has intensified competition in the financial market and increased the efficiency of the sector.

Table 5.19 Most important countries of origin for FDI to Tanzania, accumulation up to June 2000, value (bill. TSh) and number of projects

Country	Value of projects, bill. TSH	Number of projects
United Kingdom	325	255
United States	194	59
South Africa	142	42
Kenya	109	92
China	90	47
Canada	87	54
Germany	47	54
Netherlands	43	41
Italy	38	50
India	32	60

Source: Tanzania Investment Centre.

Policy towards FDI

Foreign direct investment has had an important role in the Tanzanian economic and development policy since the early 1990s. It is regarded as a channel for capital, human resources and technology. Tanzania is short of all these.

Domestic saving is scarce because of the low standard of living and because of the large subsistence sector. The banking sector is not very efficient, either.

There are 17 commercial banks in operation in Tanzania. Nine of them are foreign owned, 6 are joint ventures and 5 are local. There are 11 non-bank financial institutions and 12 other financial institutions. The former dominant national bank NBC was reorganised and divided into two parts: 1) a privatised commercial bank and 2) a grass root bank (Rural Community Bank), which gives credit on favourable conditions in rural areas.

Lack of collateral is often a problem for domestic credit. Land is owned by the state but leased to farmers. Leasing agreements can be used as a collateral, but the value of these is low, and the leasing system is unsettled. Another problem is the scarcity of banking networks in rural areas.

Tanzania has a specific investment promotion policy, which was approved by the government in October 1996. The practice is in

Tanzania, as in many other countries, less ideal than the principles. The policy concerns domestic as well as foreign investments. The main aim is to create supportive conditions for investments. The policy underlines the following ultimate targets (United Republic of Tanzania, 2001b):

1) maximum utilisation of domestic capacity,
2) maximum promotion of exports of goods and services to enhance the development of a dynamic and competitive export sector,
3) the encouragement of inflows of external resources to complement national efforts,
4) encouragement and facilitation of the adoption of new technologies in activities that especially have a direct bearing on productivity, quality and increased competitiveness,
5) enhancement of a transparent legal framework that facilitates the promotion and protection of investments,
6) deregulation of the investment approval process,
7) re-defining the role of the private sector and putting it into a more central role,
8) creating a balance between administrative controls and market forces as a mean for allocating resources,
9) re-emphasis on political pluralism to enhance democracy,
10) rededication of the nation's adherence to Rule of Law.

A specific body, the 'Tanzania Investment Centre (TIC)', has been established for the administration of all investment-related questions. It is a 'full-service house' with tasks related to investment information, advice, registration and certification. Its function is 'to promote, co-ordinate, and facilitate investment into Tanzania...All government departments and agencies are required by law to co-operate fully with TIC in facilitating investors'. (United Republic of Tanzania, 2001b.)

There is no investment licensing. An investor is, however, required to qualify for 'a Certificate of Incentives' at Tanzania Investment Centre. Investments in Tanzania are guaranteed against nationalisation and expropriation. Tanzania is a member of the International Centre for Settlement of Investment Dispute and of the Multilateral Investment Guarantee Agency (MIGA). If negotiations between the government and the investors are not enough, the disputes will be set for the judgement of the above-mentioned bodies. Tanzania has bilateral investment and double-taxation agreements with several countries. (Ibid.)

Regulations allow 'unconditional transferability through any authorised bank in freely convertible currency of net profits, repayment of foreign loans, royalties, fees, charges in respect of foreign technology, remittance of proceeds and payment of emoluments and other benefits to foreign employees working in Tanzania' (ibid). There are no restrictions in enterprises entering into technology transfers. Agreement for transfer of technology must, however, be registered at TIC as soon as it is concluded. Foreign-owned enterprises can obtain credit from domestic institutions up to the limits established by the Bank of Tanzania. (Ibid.)

In attracting foreign investment to Tanzania, two preferred categories of sectors are determined:

1) **lead sectors**, which include mining, infrastructure (e.g. road construction, bridges, airports, generation of electricity, telecommunication, water services, back-up services to mining and the like) and export processing zones (currently only one operating),
2) **priority sectors**, which include agriculture including livestock, aviation, commercial buildings, commercial development and micro-finance banks, export processing, geographical special development areas, human resources development, manufacturing, natural resources (including fishing), rehabilitation and expansion, radio and TV broadcasting, tourism and tour operations.

In both categories the corporation tax is 30 per cent, except in export processing zones, where it is zero. The sales tax on capital goods is zero in both categories. The most distinct difference is in the case of custom duty on capital goods: for lead sectors it is zero and for priority sectors 5 per cent. This difference shows that the Tanzanian government has put much emphasis on attracting foreign capital to the mining sector. This has been seen as a large FDI inflow to the sector. The corporate income tax is 30 per cent for domestic as well as for foreign firms. The capital gains tax has been abolished. The highest marginal income tax rate is 35 per cent.

In the context of every Certificate of Incentives a firm gets an initial automatic immigration quota of up to five persons during the start-up period. Additional experts are allowed upon presentation of request to the Executive Director of the TIC. There are no limits to immigration quotas with respect to any investment in the mining and petroleum sectors provided the investors submit a justification for foreign experts required. (Ibid.)

As a member of the International Monetary Fund (IMF) and the World Bank, Tanzania is under the supervision of these organs. Conditionality in the lending policy of these institutions contributes to macroeconomic stability.

Factors Attracting FDI to Tanzania

In addition to special investment promotion measures, there are natural **attractions for FDI** in Tanzania. These include: political stability, liberalisation and privatisation of the economy, liberalised foreign exchange controls related to FDI, relative macroeconomic stability, collaborative and weak labour unions, flexible wages, abundant mineral resources, large stock of arable land, excellent geographic location in the East African region and many kinds of tourist attractions.

Tanzania is politically a more stable country than many other African countries. It is also relatively safe in terms of criminality, etc. The liberalisation and privatisation process has gone far. FDI is welcomed to the country. There are anyway some tasks left in the liberalisation process. The macro-economy is currently rather stable. The public deficit and inflation are at a tolerable level, taking into account the LDC status of the country.

Labour unions are collaborative, partly perhaps as a heritage from the previous state-controlled unions. The unions are weak. The unionisation rate among workers is 50 per cent (Trade Unions Congress of Tanzania). The large working-age population also hampers excessive wage demands. Wages are negotiated at the firm level, which allows for firm-specific contracts.

Abundant mineral resources are the main factor attracting FDI into the mining sector. The area of arable land is large and there are unused possibilities. The climate is favourable for the plantation of many kinds of farming products. Drought is, however, often a problem.

The geographic location of the country is favourable. Ship transportation from Tanzanian ports is convenient to different parts of the world.

For investments in the tourist sector Tanzania has many attractions. Many of them are still waiting to be utilised. There is potential for growth in all kinds of forms of tourism. These include nature, wildlife, trekking, beach and culture tourism.

There are also several **disadvantages for FDI**. These include: shortages in the quality and coverage of education; low starting level in manufacturing (related to low practical skills); poor infrastructure; corruption and public sector bureaucracy; low domestic demand (poverty problem, small middle class); high indebtedness of the country; severe HIV/AIDS situation; comparatively high electricity, transportation and telecommunication costs; relatively high import tariffs; difficult process of discharging employees (becoming easier by new labour laws); low social security (can lead to a degeneration of the labour force); rather high local taxation and often double taxation; drought is often a problem in agriculture; people are not very entrepreneurial (subcontracting, other linkages); poor commercial culture (failure to abide by agreements); the Tanzanian economy is rather unknown in the world (has a vague image).

Problems with education concern primary, secondary, higher and vocational education. There are currently 3 million children, who have reached school age, but are not at school (Tanzania Teacher's Union). There are not enough classes and/or teachers. Teachers are not often highly educated. The gross enrolment ratio in primary education was 77.6 per cent in 2000 (Ministry of Education and Culture, 2001, 9). Also secondary and vocational education faces quantity and quality problems. Only about 8.5 per cent of the labour force has post-primary education or training (United Republic of Tanzania, 2001b).

The share of manufacturing is just 7-8 per cent of GDP. This means that the starting level in this sector is low. The labour force does not have the required skills, and the working culture is underdeveloped. A big part of the labour force lives in rural areas.

Infrastructure in various fields like in transportation, telecommunication, energy, health care and education is poor especially in rural areas. There are only some growth areas, where the infrastructure is satisfactory. Foreign investors often have to invest in the general infrastructure, too. This is the case for example in the mining sector.

Corruption is a problem in Tanzania, too. This concerns the so-called grand as well as petty corruption. Petty corruption is usually regarded as the bigger problem. There are people at all levels, who want to have their own share of the 'cake'. This increases costs and harms competition. Also bureaucratic administrative practices create additional costs and delay business operations.

Low domestic demand, which is related to the large subsistence sector, to poverty and to a small middle-class, discourages investors, whose aim is to service the domestic market. Low demand potential is combined with the poor transportation and telecommunication infrastructure, which additionally tends to decrease sales in the country.

The high indebtedness of Tanzania means that the debt service payments take an important part of the government budget. It also tends to increase taxes. The high indebtedness means that this problem will stay for a long period of time, what is a disincentive for FDI.

The severe HIV/AIDS situation in Tanzania is a disincentive for foreign investment, because it aggravates the shortage of skilled labour. It is also a risk for the employers, because the investment put in working skills often is in vain. The effects of the HIV problem are reinforced by the psychological fears related to the disease.

The price of electricity is often regarded as high in Tanzania. This is due to the shortage of power plants, to inefficiency in energy production, to drought, which has often harmed water energy production, and due to long transfer distances. Tanzania has suffered from drought in 1990, 1992, 1994, 1997 and 2000. Transportation is expensive because of long distances and the wide rural areas. Telecommunication is also expensive.

Import tariffs, which provide high levels of protection for value-added goods, increase costs especially in manufacturing. Tariffs increase input costs of those industries, which have to source inputs outside the country.

Discharging labour has until now been rather difficult. The new labour law will, however, make it easier.

Another kind of a labour market problem is the lack of social benefits in the country. On the one hand, it forces people to actively apply for a job, and it decreases wage demands. On the other hand, however, it increases the poverty problem, which has negative effects on the current and future quality of the labour force.

The value-added tax in Tanzania is 20 per cent, whereas in Kenya it is 18 per cent and in Uganda 16 per cent (Confederation of Tanzania Industries). Import duties are also somewhat higher. This makes Tanzania slightly less attractive in relation to those countries. The industrialists prefer a widening of the tax base instead of a high tax rate. There is also a lot of duplication in taxation. Local taxation is regarded as a problem in Tanzania, because the rules concerning it are vague. This gives the local authorities the possibility for discretion in the determination of taxes. The extent of capital and personal income taxation is usually regarded as proper.

The commercial culture has been a problem in Tanzania. Contracts between business parties have often been left unfulfilled. This situation has been improved through the new Commercial Code.

A problem for Tanzania, as for many other African countries, is the poor image of the country. The international public often cannot differentiate between African countries. For them there is only one Africa. Rational investors often are more informed. But the problem also affects them through the prejudices of the potential foreign customers.

All in all, Tanzania has several attractions for FDI. This has been materialised especially in the mining and tourism sectors. The country, however, still needs new investments in the traditional sectors, but especially in manufacturing and in agriculture. In attracting more FDI, improvements in the infrastructure, in education and in the working and business culture are of crucial importance.

5.7 Other Forms of Globalisation of Firms

In addition to foreign direct investment, foreign firms participate in globalisation at the production level through for example: a) joint ventures with minor foreign equity, b) the supply of technology or trademarks through licensing agreements, c) production sharing agreements, d) international subcontracting, and e) contracts on franchising. (See Chapter 2.)

Table 5.18 shows that **joint ventures** are used rather extensively in international production co-operation. Between 1990 and September 2001 the number of established joint ventures was 593 whereas the number of FDI projects was 379. The numbers of joint ventures include, however, projects where the Tanzanians do not necessarily have a majority ownership. Additionally the size of the joint venture projects is usually smaller than that of fully foreign-owned projects (for example in the mining sector).

Most joint ventures exist in the manufacturing sector, where there are 234 firms. They are common also in tourism (87) and in agriculture (61).

In some cases the explanation for joint ventures is in the legislation, which prohibits fully foreign-owned enterprises. This is the case in travel agency services. In some cases joint ventures have arisen as a result of the privatisation process, related to the efforts to attract capital. Also privately owned firms have needed capital in the growth process. Other motives include transfer of technology and business know-how. On the side of foreign investors a joint venture is preferable sometimes because of the local knowledge in consumption habits, language, logistics, etc. Joint ventures are also an easier way of entering the market than establishing a new foreign-owned firm.

Licensing agreements are used in the import of technology and of trademarks. It is utilised for example in the production of beverages.

There is rather little **subcontracting** to foreign firms in Tanzania. There is some in the tea sector, where Tanzanians subcontract to Dutch firms. This activity has a clear growth potential.

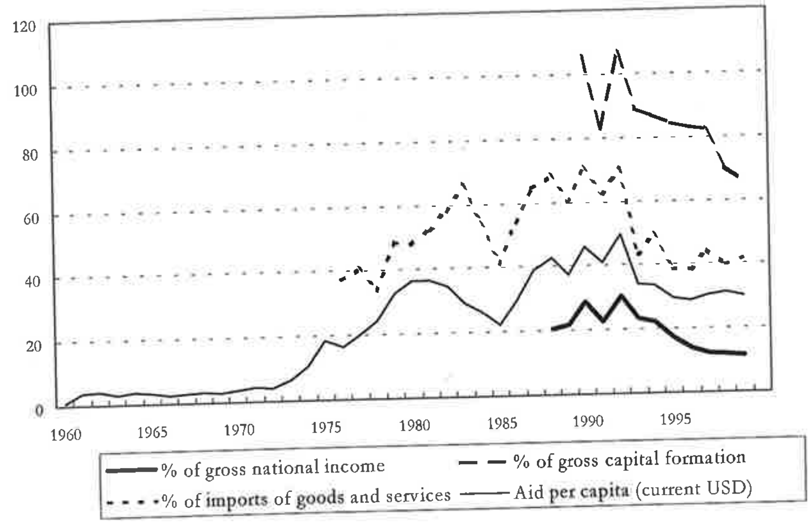
Franchising is used to some extent in the hotel business.

All in all the 'other forms' of globalisation are not very important in Tanzania. They are concentrated in smaller businesses than the FDI. They have, however, an important growth potential.

5.8 Foreign Aid and International Indebtedness

Tanzania receives substantial amounts of foreign aid. In 1999, foreign aid was 11 per cent of gross national income, 66 per cent of gross capital formation, and 41 per cent of total imports (Figure 5.12). It is important for the central government budget, too. In the budget year 1999/2000 about one-third of total expenditure and 94 per cent of development expenditure was financed from foreign funds (United Republic of Tanzania, 2001a, 63).

Figure 5.12 **Foreign aid in Tanzania**



Source: World Bank: World Development Indicators 2001.

Foreign aid must be regarded as a form of globalisation, too. It is based on the international responsibilities of foreign governments and civil societies. It redistributes national resources internationally and seeks to reduce poverty and contribute positively in the development process.

The development assistance is realised in the form of grants and concessional loans to Tanzania. It includes financial, technical and material assistance. The key development partners are the EU and its several member countries, the USA, China, Japan and Norway. Additionally Tanzania gets assistance from international organisations. These include the UN and its sub-organisations, the World Bank's International Development Association (IDA), the International Monetary Fund (IMF) and the African Development Bank (ADP). Moreover, several national and international non-governmental organisations give assistance to Tanzania. Bilateral official development aid to Tanzania has usually been about twice as large as multilateral aid (Table 5.20).

In the case of other official flows, where the aid component is below 25 per cent, the flows are often negative because of amortisation payments of the debt (ibid.).

Foreign aid, especially in the case of bilateral assistance, was previously very much donor driven. Recently the policy has been changed so that the priorities are determined more than before together with the Tanzanian government. The donors support different sectors. In addition to a better say of the Tanzanians concerning preferences, the aim of the new system is to make the administration of the aid more efficient, to co-ordinate the aid of different donors better, and to create a critical mass to each sector. This does not mean giving an open cheque to the government, as the donors still monitor the use of their funds.

Foreign borrowing is another way of getting foreign resources for the development of the country. Many developing countries, including Tanzania, have however borrowed too much. This has happened as a result of unrealistic growth assumptions, of unanticipated external shocks (like abrupt changes in raw material prices) and of the lending policies of the financial institutions. Long-term debt has declined in relation to the GDP. In 1990 it was 120 per cent of GDP, in 1999 it had declined to 67 per cent of GDP (Table 5.21). It is still at an unsustainable level, and debt service takes a fifth of export revenues. There has, however, been clear success in diminishing the debt.

Table 5.20 Official development assistance (ODA) and other official flows (OOF) to Tanzania, USD mill. and % of aid received by all developing countries

ODA/OOF	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
OFFICIAL DEVELOPMENT ASSISTANCE										
ODA, net USD mill.	1,173	1,080	1,338	950	965	877	877	944	1,000	990
- % of LDCs	2.1	1.8	2.3	1.7	1.6	1.5	1.6	2.0	2.0	2.0
Bilateral, USD mill.	844	764	816	650	570	587	605	569	769	613
- % of LDCs	2.3	1.9	2.0	1.7	1.4	1.5	1.7	1.8	2.2	1.6
Multilateral, USD mill.	326	318	525	300	389	286	274	373	228	376
- % of LDCs	2.5	2.0	3.1	1.9	2.1	1.6	1.7	2.5	1.6	2.9
OTHER OFFICIAL FLOWS										
OOF, net USD mill.	-0	-38	-25	2	-28	-32	-51	23	-5	-12
- % of LDCs	0.0	-0.3	-0.2	0.0	-0.2	-0.3	-0.5	0.1	-0.0	-0.0
Bilateral, USD mill.	28	4	8	40	8	-9	-30	35	11	-5
- % of LDCs	0.4	0.1	0.1	0.6	0.1	-0.1	-0.5	0.5	0.1	-0.0
Multilateral, USD mill.	-28	-42	-33	-38	-36	-23	-21	-12	-16	-7
- % of LDCs	-0.3	-0.6	-0.9	-0.6	-1.2	-0.7	-0.6	-0.1	-0.1	-0.1

ODA includes loans administered with the main objective of promoting the economic development and welfare of developing countries. They have a grant element of 25 per cent or more and are therefore 'concessional'. OOF includes loans with a target other than economic development and welfare of the aid recipient. They have a grant element of less than 25 per cent and are therefore 'non-concessional'. The grant element reflects the financial terms of the transaction, i.e. the interest rate, maturity (interval to final repayment) and grace period (interval to the first repayment of capital).

Source: UNCTAD (2001c).

Table 5.21 External long-term debt and debt service of Tanzania

	1991	1992	1993	1994	1995	1996	1997	1998	1999
Debt outstanding (mill. USD)	4,806	4,963	4,816	5,073	5,324	5,546	5,775	5,839	5,881
Debt outstanding (% of GDP)	100.7	112.4	117.6	116.4	103.8	87.0	76.2	68.4	67.4
Debt service (mill. USD)	192	190	186	156	260	268	205	254	..
Debt service (% of exports)	38.1	33.0	24.3	16.6	20.6	19.5	16.9	22.2	..

Source: UNCTAD.

When short-term debt is taken into account, the total foreign debt is somewhat larger than the figures presented above show. The total disbursed foreign debt was USD 6,312.2 million at the end of June 2001. This is about 76 per cent of the GDP of year 2000. (Table 5.22.) The net present value of the total debt in relation to exports of goods and services was 396 per cent in 1999 (see Chapter 3).

The most important purpose of the use of foreign debt is balance of payments support. This kind of financing is available from the IMF. Other important uses of external funding are transport and communication, agriculture, and energy and mining. At the end of June 2001 the central government accounted for 92.6 per cent of the total external debt. The rest of the public sector and the private sector accounted for 2.7 and 4.7 per cent, respectively. (Bank of Tanzania, 2001, 11.)

Tanzania participates in the Paris club negotiation process, where foreign debts of developing countries have been relieved. Until June 2001, debts worth USD 103.7 million have been consolidated, USD 93.6 million cancelled and USD 10.1 million rescheduled (ibid.). Tanzania has also participated in the debt buyback operations on the basis of grants given by the World Bank from the Debt Reduction Facility to Tanzania.

Table 5.22 Tanzania's disbursed external debt according to use of funds, mill. USD[1]

	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01
Balance of payments support	1,688.9	1,524.7	1,493.1	1,512.2	1,648.1	1,524.2
Transport and telecommunication	1,291.5	1,339.9	1,306.5	1,337.8	1,067.4	1,021.4
Agriculture	967.0	950.4	913.9	963.8	1,040.2	990.9
Energy and mining	721.9	745.8	791.6	821.8	869.0	824.3
Industries	609.3	567.6	527.7	504.4	430.0	413.8
Social welfare and education	245.1	257.4	276.7	292.7	426.5	332.0
Finance and insurance	192.1	184.8	167.3	215.5	122.8	131.2
Tourism	92.7	92.4	77.2	80.2	84.1	82.0
Others	814.7	937.2	881.7	851.9	850.2	992.7
Total disbursed outstanding foreign debt	6,623.3	6,600.3	6,435.8	6,580.3	6,538.3	6,312.2

[1]End of fiscal year, cumulative.
Source: Bank of Tanzania (2001), 81.

Tanzania is one of the countries, where the so-called Heavily Indebted Poor Countries (HIPC) debt-relief program is applied. As a result of this initiative the net present value (NPV) of debt will be reduced by some 54 per cent. The NPV of the debt-to-export ratio is estimated to fall below the 150 per cent target level of the HIPC program before 2020. Debt service payments will be cut by 47 per cent over time. (International Monetary Fund, 2001a.)

The HIPC initiative requires from Tanzania continuing progress in implementing sound macroeconomic and structural policies, and success in implementing its Poverty Strategy Paper (PRSP). The PRSP has been prepared as a result of wide public discussions in accordance to the broad guidelines of the IMF and the World Bank.

5.9 Effects of Globalisation on Tanzania's Macroeconomic Policies

Globalisation limits the room for manoeuvring in economic policy. Sound macro-economic policies are an important attraction factor for foreign direct investments and for all business activity. It means that the economic environment should be stable, i.e. inflation, current account and public finances are under control.

Inflation deteriorates competitiveness, distorts relative prices, and makes economic planning and budgeting difficult. Current account problems lead rather quickly to high interest rates, exchange rate instability and to a depreciation of the currency. High deficits and indebtedness of the government mean that corrective measures must be implemented sooner or later. This means tax increases and cuts in public expenditure. Economic agents anticipate these kinds of actions, which has an effect on their behaviour already before the measures are taken. High foreign debt has similar effects. It must be paid back some day. The amortisation process will be difficult especially if the debt is used inefficiently, i.e. not in a way that increases the export production potential.

In Tanzania inflation is currently about 5 per cent, which is a tolerable level, taking into account the country's status as an LDC. The central government deficit of about 5 per cent of GDP is high internationally, but here again it is a rather good figure for an LDC. Developing countries have infrastructure needs, which tend to increase the deficit. The current-account deficit was in 2000 about 6 per cent of GDP. It has declined clearly from the average of 1995-2000, when it was almost 10 per cent. (See Chapter 5.3.) The indebtedness of the country must be regarded as a disincentive for foreign as well as for domestic investors, because it means future restraint in the economy.

Tanzania has a floating exchange rate. A floating rate regime tends to insulate the economy from goods demand shocks. Inflation discipline is not necessarily as tight, however, as in the case of a fixed exchange rate.

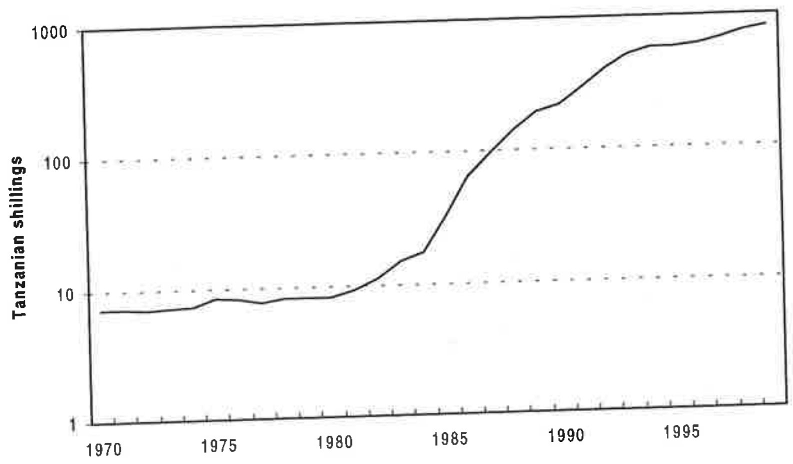
Tanzania's current account transactions are liberalised. The capital account transactions are controlled. This means that changes in the exchange rate can, to some extent, be controlled. This can diminish pressures against abrupt changes in the exchange rate in times of uncertainty. There are, however, a lot of current account transactions, by which economic agents can speculate if the exchange rate is regarded to be at an inappropriate level.

Inside the East African Union, i.e. between Tanzania, Kenya and Uganda, even capital transactions are free. This means that financial markets between these countries are in principle rather integrated. Capital flows between these countries are, however, not especially large or intense. The floating exchange rate also gives Tanzania

some freedom in monetary policy. The Bank of Tanzania intervenes in the foreign exchange market mainly to smoothen seasonal variations that arise due to the uneven timing of export revenues. The currencies of Kenya and Uganda float, too.

The exchange rate has lately been much more stable than in 1985-1995, when it depreciated strongly (Figure 5.13). Even though the shilling has slightly depreciated with respect to the dollar, it has recently been rather stable in relation to the euro. The shilling-euro real exchange rate has appreciated clearly since 1995.

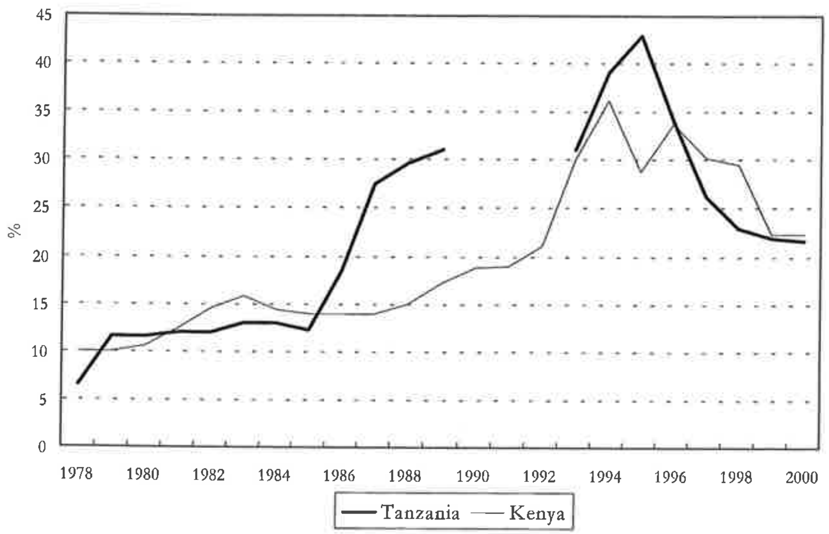
Figure 5.13 **US dollar in Tanzanian shillings, log scale (increase in the curve means depreciation of the shilling)** [1]



[1] Annual average dollar rate.
Source: International Monetary Fund (2001b).

Lending rates between Tanzania and Kenya diverged substantially in the second half of the 1980s. Lately they have behaved similarly, although interest rate levels can still differ substantially. In 1999 and 2000, however, they converged. (Figure 5.14.) The rate was in both countries slightly above 20 per cent. In Tanzania the discount rate was 15.4 per cent on average (Bank of Tanzania, 2001, 63). Consumer prices increased by 5.9 per cent during the same time period, which means that the real interest rate was very high. The high discount rate reflects a rather tight monetary policy and, obviously, high inflation expectations. The high interest rate margin between the discount and lending rates in turn reflects the risk considerations of the financing institutions, the low savings rate of the Tanzanians and inefficiencies of the financial market. Lack of collateral often increases the risk of lending.

Figure 5.14 Lending rates in Tanzania and in Kenya, %



Observations for the years 1990-1992 are missing for Tanzania (due to the transformation process of the economy).
Source: International Monetary Fund (2001b).

Recently lower inflation has led to a decline in the discount rate. In June 2001 it was 9.8 per cent. Consumer price inflation was at that time 5.1 per cent.

Macroeconomic integration between the East African countries will deepen in the coming years, if the integration plans are to be realised. The aim is to fix the bilateral exchange rates in some years. This would mean harmonisation of interest rates between Tanzania, Kenya, Uganda, and the possible new members Rwanda and Burundi. There is a plan for a deep integration in the larger South African area (SADC), but this is a much more difficult process than integrating the rather homogenous East African area. Even in the

case of East Africa, especially differences in politics can delay the process.

5.10 Effects of Globalisation in Tanzania: Benefits, Costs and Challenges

In the case of Tanzania, the concept 'globalisation' must be interpreted widely. In this study it means the country's participation in the international division of labour and integration of the economy into the world economy. The emphasis is thus on the economic aspects of globalisation. This concept includes the international operations of the Tanzanians as well as the activities of foreigners in the country.

The economy has a large non-monetary (subsistence farming) sector. About 30 per cent of GDP is produced in the non-monetary sector. And 82 per cent of the employment is in agriculture, partly in the monetary and partly in the non-monetary sectors. Many individuals work in both sectors. The large non-monetary sector means almost by definition that the economy as a whole cannot be very globalised.

It is, however, important to relate the extent of globalisation separately to the monetary sector, too. When we narrow the denominator, it has a wider importance.

The government of Tanzania has since the early 1990s been in favour of a liberal, privatised and open economy. This is a strategic position, which brings benefits but also costs, especially during the transition period. The logic behind the choice is more or less the fact that the standard of living can ultimately be increased only by participating in the international division of labour. Theoretically, this is shown already by standard foreign trade theory. There are also several empirical studies, which show that 'open' economies have performed better than 'closed' economies (see for example Sachs and Warner, 1995).

The world had already changed in the early 1990s in such a way that international firms had gained an important position in the world economy. This trend has continued since then. More and more firms are owned by people from several countries. They sell, buy and produce internationally, and there is an increasing proclivity to divide the production of different phases in different countries. The internationalisation process has thus progressed more deeply at the production level.

The above mentioned was the general background for the choice of the government. But there were specifically Tanzanian reasons behind it, too. Politically the collapse of the Soviet Union and of the Eastern European socialist countries decreased the attractiveness of centrally planned economic solutions. Tanzania's own experience of a state-led economy had not been encouraging, either. Even though the social achievements of the Nyerere regime were respected, the economic achievements were regarded as unsatisfactory. The shortage of national capital and know-how were concrete reasons for the liberalisation of foreign direct investment. Relying only on domestic resources would have delayed the utilisation of Tanzania's economic resources.

Liberalisation of the foreign trade regime and membership in the WTO have meant new possibilities for exports. The development of exports in the 1990s was, however, disappointing. GDP per capita has accordingly grown slowly.

Trade in industrial products has been largely liberalised. Tanzania's agricultural exports still face import restrictions and high duties. Imports are not, however, very restrictive in the case of tropical products, which are the main product group exported by Tanzania. Restrictions can, to some extent, limit the growth of exports of new products that are typically produced in temperate climate, such as meat and dairy products. Strict health norms are additionally an obstacle for exports of some foodstuffs. As an LDC Tanzania enjoys, however, preferential (GSP) treatment in the developed countries.

The 'Everything But Arms' (EBA) initiative of the EU and the AGOA agreement of the USA also improve the export possibilities of Tanzanian products to the developed countries. It would be of great importance for Tanzania and for other LDCs, if the EBA proposal of the EU were adopted by other developed countries, too. It could also be tied to the WTO process (Sharer, 2001).

The regional integration of African countries, for example in the framework of EAC and SADC, can help the countries in gaining more bargaining power in the international negotiations. It will also increase the allocation of resources inside the area. Regional integration is not, however, a substitute for world-wide liberalisation

and integration. Regional integration requires broad-based external liberalisation of the union and a common external tariff. Otherwise it will lead to a harmful trade diversion and will lead to more expensive imports. (See Sharer, 2001, 16.)

Liberalisation of foreign trade has created also problems. These were felt especially in the textile and clothing industry. Tanzania had, in the early 1990s, rather extensive production in this branch. The formerly state-owned firms were not, however, efficient enough to survive after the privatisation and opening up process. The firms were also very indebted. When imports were liberalised the domestic firms lost the domestic market. Formerly textiles constituted as much as 18 per cent of total merchandise exports, now their share is about one per cent. There are now some successful firms in the branch. Production of some special textiles like canvas is still thriving.

The policy of import liberalisation has been criticised in Tanzania. This concerns textiles, but also other consumer goods. It is said that a slower liberalisation could have saved these sectors. In addition to the Tanzanian government also international organisations, including the IMF, are criticised for demanding a too hasty liberalisation.

In addition to the import liberalisation, also a change in the quality requirements of textile users have affected the outcome. Tanzania produces a medium long fibre cotton quality, whereas the use has shifted to the short fibre cotton. Use of the domestic raw material is thus not such an advantage as before. Relatively low labour costs, however, would still be an advantage for Tanzanian textile and clothing production. The production capacity and know-how in this branch has been brought down and a resurgence in this area would require new capital, production know-how and possibly special political measures.

Foreign capital has been used extensively in the mining, manufacturing, tourism and the agricultural sectors. There are foreign investments in the retail trade sector, too. Foreign investment is regarded widely as a positive thing as such. The government tries to attract more FDI to the country. In this respect the attraction factors presented in Chapter 5.6 should be strengthened and the disadvantages minimised.

Foreign-owned firms are mainly criticised for having too weak linkages to the rest of the economy. The mining firms are capital intensive and they are criticised for employing too few Tanzanians. Taking into account the indirect effects through rents and taxes to the government, and the infrastructure investments made by the firms, the picture is perhaps not that dark.

Foreign-owned firms also often use foreign inputs in their production. In some cases this is related to the brand of the product (like in the case of hotel services). Often this is, however, related to the quality or availability of domestic inputs. In this respect, improvements in quality, transport infrastructure and in the marketing of the domestic inputs would help. This will not happen without investments in physical and human capital.

A problem in Tanzania is that products are usually exported unprocessed. Attracting foreign capital in the processing of domestic materials would be important. This concerns processing of minerals, agricultural products and possibly textiles. The agriculture and foodstuff industries are regarded as sectors, in which Tanzania has a strong comparative advantage. The same concerns the mining sector, where there still are many unused possibilities.

Tanzanian exports are not very concentrated when we look at concentration indices built using disaggregated data. The bulk of exports is however in the agricultural and mining sectors, where price fluctuations are large. This problem cannot be avoided fully in a country like Tanzania, but diversifying exports further by finding new export products and by increasing the level of processing would diminish the effects of price shocks. There is potential for new products in the manufacturing sector, but also in, for example, horticultural products.

There are rather many joint ventures in Tanzania. Increasing this form of co-operation can still contribute positively to enhancing linkages to the rest of the Tanzanian economy.

Subcontracting is a rather rare phenomenon in Tanzania. This can also provide more possibilities to integrate the Tanzanian economy to export production. The same applies to other forms of globalisation of firms.

In the labour unions the globalisation process is seen as a fact of life. It creates new working possibilities and often the foreign-

owned firms pay a better wage than the domestic firms. The privatisation process has, however, increased uncertainty in the firms and institutions, where this has already been done, and in those, which are to be privatised. Jobs are not as secure as before. The labour unions see the privatisation and changes related to it as a challenge. The effect of foreign labour market practises through foreign-owned firms is also seen as a potential problem.

Internationalisation and globalisation strengthen the tendency towards larger units and towards more efficiency in production. This means that many traditional jobs will disappear. This has already happened and it will continue. The logic of the process is, however, that it creates more new jobs than it eliminates. In some cases it can be useful to slow down the process to help firms with realistic possibilities to become profitable in the near future to survive. On the other hand, supporting unprofitable firms distorts the market and delays the necessary adjustment process. International agreements also set limits for the means of supporting firms.

Because of the low standard of living in the country, Tanzania cannot afford much social security. Those who have lost a job get a small once-and-for-all unemployment compensation. Otherwise people have to cope with the adjustment by themselves or with the help of their families.

Internationalisation is a market solution for the development problem. It is currently an unavoidable process. It creates new jobs, but it also destroys old ones. It modernises the society according to the international experience. Coping with this process is a problem for individuals, the government, non-governmental organisations, but also for the international donors.

The developed countries can diminish immediate poverty by providing development assistance and by implementing debt relief measures. But they also must help in building the physical and intellectual infrastructure, which is needed for strengthening the production basis of the country. It is crucial that the developed countries continue opening their markets for developing country exports.

The role of the Tanzanian government is naturally essential in increasing the benefits of globalisation. Even though a lot of measures have already been taken, there are still tasks ahead. These include the continuation of the liberalisation and privatisation process, practising sound macroeconomic policies, improving the infrastructure and education, reducing poverty, promoting good governance, eliminating corruption, increasing transparency of the administrative process, making the tax system more efficient, and increasing the efficiency of the financial system.

6 A COMPARISON AND EVALUATION OF THE EFFECTS OF GLOBALISATION

6.1 Some Comparisons

Basic Indicators

Nepal and Tanzania have several similarities, but also differences. According to population they are broadly of similar size, representing medium-sized countries. Nepal has 23 million and Tanzania 33 million inhabitants. The geographic area of Tanzania is more than six times that of Nepal. Tanzania has a long coast and good sea transport connections, whereas Nepal is a landlocked country. The countries have, however, several geographic similarities. They belong to the most mountainous countries in the world. Nepal has its Mount Everest and Anna Purna, Tanzania in turn is famous for its Kilimanjaro. Both countries are popular destinations for trekking and nature tourists.

The population density of Nepal is much higher than that of Tanzania. Both countries, however, have difficult internal transport connections. In Tanzania the share of urban population is 32 per cent and in Nepal just 14 per cent. In both countries the share of rural population is high.

Nepal and Tanzania are both least developed countries (LDCs). According to GDP per capita in Purchasing Power Parity (PPP) terms Nepal is the 176th and Tanzania the 206th country in the world. According to the Atlas methodology of the World Bank, the ranking changes in favour of Tanzania, which is the 187th, whereas Nepal's ranking is the 195th. The countries are thus among the poorest countries in the world. Technologically, their rankings depend on the measure. The density of personal computers is about the same, 2.7 in Nepal and 2.4 in Tanzania per 1,000 people. Telephone mainlines are more rare in Tanzania, where there are 4.5

mainlines per 1,000 people. In Nepal this figure is 11.3. Electricity production per person is somewhat higher in Tanzania than in Nepal. In both countries, it is, however, less than a fourth of that in Vietnam. (See Chapter 3.) In both countries the availability of electricity in rural areas is very poor. Frequent power cuts occur even in capital cities.

Both countries' income distribution is similar: the Gini index was 36.7 in 1996-97 in Nepal, and 38.2 in 1993 in Tanzania.[61] In Vietnam the income distribution is similar to that in Nepal and Tanzania. In Nicaragua and Mozambique it is more unequal. The Gini index has been about 60 in Nicaragua and about 40 in Mozambique. According to this indicator, income distribution has been clearly more unequal in Nepal and Tanzania than in Finland, where the value of the index was 25.6 in 1991. (World Development Report, 2002, 235.)

Poverty indicators of the countries are not easily comparable. By using the '1 US dollar per day' (in PPP terms) criterion Nepal seems to have relatively more poor people. In Nepal the share of poor people was 37.7 per cent in 1995, whereas in Tanzania it was 19.9 per cent in 1993. Life expectancy is lower in Tanzania because of the severe AIDS problem. Also the child mortality rate is more than a third higher in Tanzania, partly due to the AIDS problem.

Illiteracy among adults (above 15 years) was 15 per cent in Tanzania and 60 per cent in Nepal in 1999 (ibid., 233). Among young people (between 15 and 24 years), the illiteracy rate was 41.5 per cent in Nepal and 9.4 per cent in Tanzania. Tanzania seems to have a better general basic education even today.

Economic Performance and Structure

GDP per capita grew 2.4 per cent per annum on average in 1990-2000 in Nepal and just 0.3 per cent in Tanzania. The growth of the population was slightly higher in Tanzania, but the main reason for the difference is that annual GDP growth was 4.8 per cent on average in Nepal and 3.1 per cent in Tanzania. (World Development Report, 2002.) The economic performance of Nepal has not been good, either, and poverty has increased. The GDP growth targets

[61] The higher the index is, the more unequal the income distribution is. About the methodology, see for example World Development Report, 2002, 246.

of both countries are about 7 per cent per year. Rates of this magnitude would mean a clear progress in the development and a reduction in poverty. For example in Vietnam the average annual GDP growth rate was 7.9 per cent in 1990-2000.

A crucial reason for the worse performance of Tanzania lies in the poor export performance of the country. In 1999/2000 merchandise export volume was just 7 per cent higher than in 1990/1991 (see Chapter 5.5). This was due to the sensitivity of the traditional export products to changes in world demand and in the competitive environment, and specifically due to the decline in the textile and clothing exports.

Nepal's exports, especially to its neighbouring India, have grown very rapidly during the 1990s thanks to the free-trade agreement between the two countries. This has had a favourable effect on Nepal's GDP growth rate and also on FDI inflows into the country.

The poor export performance in Tanzania has been reflected in a low investment ratio, which stood at only 17 per cent in 2000. In Nepal it was 21 per cent. The high indebtedness of Tanzania has additionally affected the investment rate through a tight economic policy. Recent foreign investments in the mining sector give some hope for a higher growth in exports, but additional measures are needed. These include an increase in the processing rate of products and further diversification in exports.

Nepal has its problems, too. Recently the prospects of the textile and clothing industry have weakened by enhanced competition from more efficient producers (China and India). Also the termination of the Multi-Fibre Agreement by 2005 and the AGOA agreement will weaken Nepal's relative position in the textile and clothing market. Additionally, the political instability of the country harms all economic activity.

In terms of macroeconomic stability both countries have had progress. Inflation, government finances and the current account are at a tolerable level. In Tanzania foreign debt is a bigger problem than in Nepal.

In both countries agriculture is the most important sector. About 80 per cent of the population work in this sector. The share of agricultural output was 39 per cent in Nepal and 45 per cent in Tanzania in 2000. A large share of the agricultural output is subsistence farming. In Tanzania agricultural products are, however, important export products. More than half of merchandise exports are agricultural products. Also Nepal exports agricultural products (to India) but its comparative advantage is not as clear in the agricultural sector as in Tanzania.

The share of industrial output was 15 per cent of GDP in Tanzania and 20 per cent in Nepal. The share of manufacturing output is about 10 per cent in Nepal and about 7.5 per cent in Tanzania. In 1999 manufactured goods accounted for 69 per cent of Nepal's and 16 per cent of Tanzania's merchandise exports. (World Development Report, 2002, 239). Mining is an important export sector in Tanzania. Its share in GDP was 1.5 per cent in 2000, but the share of manufacturing exports was 27 per cent.

Extent of Globalisation

Liberalisation and privatisation are preconditions for market-based globalisation. According to the Heritage Foundation, Nepal and Tanzania have the same aggregate ranking in terms of economic freedom (describing among other things the degree of liberalisation) (see Table 3.9). They share the 108th position out of 155 countries. Vietnam, Bangladesh and India have less, and Mozambique and Kenya more economic freedom. All these countries are characterised as 'mostly not free'. Out of 4 classes, this is the third one, the fourth one being 'repressed'.

Nepal and Tanzania have both a lot to do in the areas of trade, property rights, regulation and the black market. In trade the low ranking in terms of freedom reflects high import tariffs. Poor success in terms of property rights describes the extent of piratism and the lack of control mechanisms in terms of property rights. Lack of success in terms of the black market is seen for example in smuggling, which is extensive in both countries. Corruption is a problem in both countries.

Nepal has a better ranking than Tanzania in trade, fiscal burden, government intervention, and monetary policy. Tanzania in turn has had more success in the areas of foreign investment, banking, and black market. In terms of wages and prices, property rights and regulation the index values are the same.

Both countries thus still have a long way to go with their liberalisation and privatisation process. Success in this area affects the FDI flows directed to the countries and the extent of domestic private

entrepreneurship. The process of liberalisation is, however, advancing, and the countries' governments are committed to it. In Nepal the Maoist guerrilla movement creates uncertainty in this respect. Political support for the Maoists is, however, small.

In terms of foreign trade, Nepal is a more globalised country than Tanzania. The share of exports of goods and services in GDP was 23 in Nepal and 15 per cent in Tanzania in 2000. The growth of exports has also been relatively high in Nepal. The number of foreign tourists has been about the same in both countries. The share of tourism income in total exports was 28 per cent in Tanzania in 1999 and 11 per cent in Nepal. This reflects the relatively smaller total exports in Tanzania.

Average import tariffs are slightly higher in Nepal than in Tanzania. They are both clearly higher than in the LDCs on average. Tanzania is a member of the WTO, whereas Nepal is just applying for membership.

Foreign direct investments are clearly smaller in Nepal than in Tanzania. The share of the FDI stock in GDP was 11 per cent in Tanzania and only 2 per cent in Nepal in 2000. The shares of FDI in gross fixed capital formation have also been clearly higher in Tanzania. In 1998 it was 12.8 per cent in Tanzania and 1.2 per cent in Nepal.

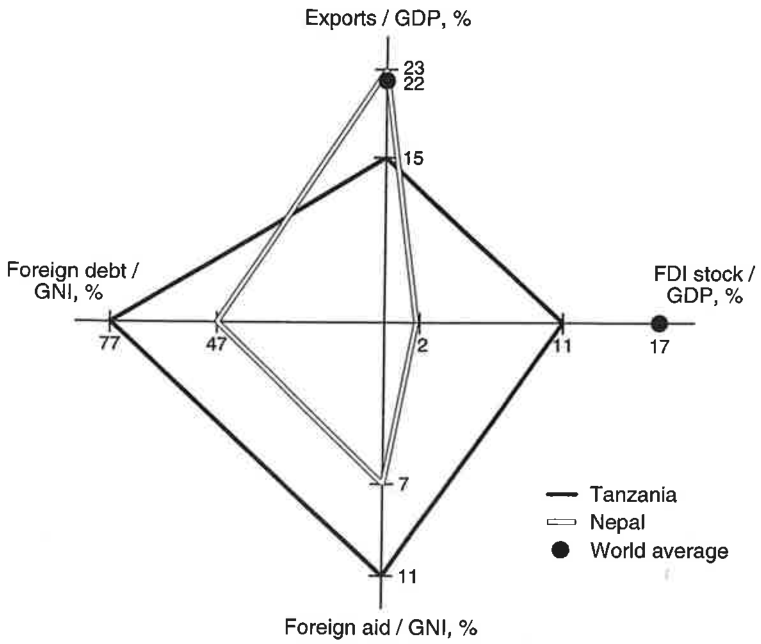
Migration is important for Nepal. In 1999 the remittances received from Nepalese workers from abroad were 13 per cent of exports of goods and services and 3 per cent of GDP (see Chapter 4.) From Tanzania there is no public data on remittances, but their extent is small. Both countries host a large number of foreign refugees.

Both countries receive a lot of foreign aid. In 1999 its share of gross national income was 11.0 per cent in Tanzania and 6.7 per cent in Nepal.

Tanzania is more indebted than Nepal. In the former country the present value of the debt was 53 per cent of GNI in 1999. In Nepal, the corresponding figure was 32 per cent. (World Development Report, 2000/2001, 239.) Tanzania participates in the Heavily Indebted Poor Countries (HIPC) debt relief program of the IMF and the World Bank.

Indebtedness limits the room for manoeuvring in macroeconomic policy, especially in Tanzania. This is seen among others in the conditions set by the international lending institutions. In terms of monetary policy, Nepal in turn has more limitations due to the pegged exchange rate with respect to its most important trading partner India. In fact India determines the monetary policy of Nepal. In Tanzania the floating exchange rate and lack of a big neighbour gives more freedom in monetary policy. This freedom concerns short-term policy options. In the long term, the need of macroeconomic stability requires similar discipline in the policies.

Figure 6.1 Extent of globalisation in Nepal and Tanzania



Exports/GDP and Foreign debt/GNI are from year 2000, the rest of the data dates from year 1999.

The extent of globalisation of both countries is not very high. The foreign trade-to-GDP ratio in Nepal is about at the world average, but in Tanzania clearly below that. In terms of FDI the stock is even in Tanzania clearly below the world average of 17 per cent of GDP. The flow in relation to total investment has, however, recently been about the same as in the world on average. This reflects the increased importance of FDI in Tanzania. In Nepal foreign direct investments are very low internationally compared. (Figure 6.1.) The importance of remittances received from people working abroad is large in Nepal, but not in Tanzania.

6.2 Challenges of Nepal and Tanzania in the Globalisation Process

Even though Nepal and Tanzania are not yet very globalised, their economic strategy is based on the benefits of the international division of labour. Both countries have liberalised their economies since the early 1990s to benefit more from the open sector and to attract FDI into the country. The process is underway, but not finished yet.

In both countries there are several tasks and challenges, which should be emphasised. The most important ones are listed below:

1) Improving political stability (civil war in Nepal);
2) Lowering birth rates;
3) Fighting against poverty and diseases (especially AIDS in Tanzania);
4) Continuing liberalisation of the economies;
5) Improving administrative practices and diminishing corruption;
6) Improving the energy, transport and communication infrastructure;
7) Improving education (primary, secondary, high and vocational);
8) Support for research and development;
9) Liberalising foreign trade further;
10) Increasing the degree of processing in production and diversifying the foreign trade;

11) Deepening regional integration;
12) Attracting more FDI and deepening the linkages of foreign investors with the rest of the economy;
13) Improving the efficiency of the financial system;
14) Better responsiveness of the economy and society to structural change;
15) Improving the social safety nets and other policies to counteract the negative effects of globalisation;
16) Continuing the stability oriented macroeconomic policies;
17) Improving the social status of women in both countries and of Dalits in Nepal.

Political stability is currently rather good in Tanzania, especially in relation to other developing countries. In Nepal, however, political instability is an acute problem for all economic development, not only from the point of view of globalisation.

Fighting poverty and AIDS is a precondition for the survival of whole nations. Poverty and AIDS are a severe risk for economic development especially in Sub-Saharan Africa. In this respect support from the international community is needed.

Continuing liberalisation and privatisation is a precondition for further FDI and for domestic investments. This concerns especially sectors, which by their nature produce marketable goods, i.e. where no essential externalities exist (no public goods).

Administration is often too bureaucratic and slow. Better and more efficient practices and the elimination of corruption would increase the efficiency of the whole economy and attract FDI.

Poor energy, transport and communication infrastructure is one of the key obstacles for economic development. It also limits FDI inflows. As a land-locked country Nepal has a special need to improve its foreign transports. Both countries have a very poor domestic transport infrastructure. Also communication is poor and expensive.

Primary, secondary and high education as well as vocational training are all key elements for economic development. In the short run poor education is a bottleneck for investment. In the long run, it limits the innovativeness and productivity of people.

Domestic innovations could also be enhanced by supporting research and development. This can be done through direct public support or by supporting private R&D activity.

Liberalisation is needed in the export market as well as in the import sector. Developed countries should continue liberalisation of their imports. The 'Everything But Arms' initiative of the EU should be followed by other developed countries.

Import tariffs are still high in Nepal and Tanzania. The slow pace in cutting tariffs has been motivated by the aim to protect domestic high-value-added production. Reducing the tariffs would, however, give more room for firms, which have to source input deliveries outside the country. This kind of outsourcing is an essential element in modern production processes. Lower tariffs for imports also help in the transfer of technology. In some well specified cases temporarily higher tariffs and transition periods can be used on the basis of the so-called infant industry argument.

In the WTO negotiations developed countries should not require a too ambitious agenda with respect to labour and environmental standards. The developing countries would have big difficulties in fulfilling them in the short run. Standards in these areas can also easily be used as barriers to trade. Labour and environmental standards are important in the longer run, but probably they can be promoted better in other organisations than the WTO, and by giving guidance and support in these respects. Nepal should become a member of the WTO.

Nepal and Tanzania have both a vulnerable structure of exports. In Nepal the product structure of exports is concentrated. On the other hand it mostly exports manufactured goods. In Tanzania exports are concentrated in agricultural and mining products, where price fluctuations are very pronounced. Both countries have a need to increase the value-added and quality of their products and they need to find new kinds of export products. In Tanzania, the export performance has been poor in the 1990s. In Nepal, the current situation is perhaps even more worrisome, due to the political instability, which affects especially tourism, but also manufacturing industry. Also the AGOA agreement and the end of the Multi-Fibre Agreement by 2005 are risks for Nepal's clothing exports.

Nepal and Tanzania are both involved in regional economic integration processes. Regional integration can be a good tool in lowering the overall tariff level. A common market is an attraction for FDI in the case of firms, which want to locate different activities in different countries. Regional integration is, however, not a substitute for global liberalisation. For example, Nepal's regional integration is mainly with India, whose markets remain very sheltered from global competition. The markets of the developed countries are important for Nepal and Tanzania, and the liberalisation of trade cannot work unilaterally. Institutions built for regional integration can also be a tool in defending the interests of the LDCs in global trade negotiations.

Foreign direct investment is already rather high in Tanzania. Nepal is, however, underdeveloped in this respect. In Nepal there is a clear need to increase efforts in attracting foreign capital. In both countries the linkages of foreign-owned firms to the rest of the economy should be strengthened.

The financial systems do not function well in either country. In Nepal, the liberalisation process is not yet finished. In Nepal the amount of domestic credit is relatively higher than in Tanzania. In 2000 domestic credit provided by the banking sector was 43.5 per cent of GDP in Nepal, but only 11.7 per cent of GDP in Tanzania (World Development Report, 2002, 239). In Tanzania there is an urgent need to improve the availability of credit and decrease its price. One way is to improve conditions to use land as collateral. Ultimately this is the easiest, when land is privately owned, but also longer-term leasing contracts would help. Good and profitable investment objects are the other side of the coin. All factors improving competitiveness and innovativeness will help in this respect.

A big problem in the developing countries in general is the low responsiveness of the economy to factors of structural change. In an economy where economic changes are fast, slow responsiveness gives social problems more time to arise. Developing countries have a large subsistence farming sector, which is bound to become smaller. This process should be more or less managed to avoid social problems. Many things mentioned above are reasons for the slow responsiveness. These include high birth rates, poor education, transport and communication infrastructure, housing and other problems in urban areas, etc. The strategy of the structural change should be a question of co-ordination for different authorities.

Even though the responsiveness of the economy could be improved, fast changes in the economy unavoidably create social problems. Globalisation hastens the turnover of firms and speeds economic changes in general. Social safety nets are needed in order to maintain the skills of the employees and to avoid social unrest. The same concerns, for example, environmental policy. The poor economic situation of the countries, however, makes these improvements difficult.

Macroeconomic stability is a good aim for any country. A developing country can very well be a net-borrower from abroad. This is a natural thing during the development process. But indebtedness has its limits. Borrowing should be monitored carefully to avoid over-indebtedness. In Nepal, the debt situation is still satisfactory, even if the level of debt has risen steadily. In Tanzania, however, domestic and international measures are needed to cut the debt to a sustainable level.

Nepal and Tanzania have decided to participate in the globalising international economy. This decision means liberalisation and privatisation of the economy. It also requires conducting sound macroeconomic policies. Globalisation limits the room for manoeuvring in economic policy. The countries, however, get something in return. They get a more efficient domestic economy and foreign economic and technological resources. This in turn is a prerequisite in the fight against poverty.

Globalisation does not necessarily mean losing national political objectives and preferences. As a precondition for free trade and foreign direct investments, developed countries or firms should not require developing countries to do much more than follow the general rules of free trade, conduct sound economic and administrative practices, and respect basic human rights.

YHTEENVETO

Globalisaatio on nykyisin hyvin ajankohtainen keskustelunaihe sekä kehittyneissä teollisuusmaissa että kehitysmaissa. Teollisuusmaiden osalta globalisaatiota koskeva keskustelu on suhteellisen pragmaattista, mutta kehitysmaiden tapauksessa siihen liittyy enemmän poliittisia ja sosiaalisia näkemyseroja.

Tässä tutkimuksessa analysoidaan kehitysmaiden taloudellista globalisaatiota. Raportin pääsisältö koostuu Nepalin ja Tansanian tarkemmista analyyseista.

Aluksi tarkastelemme globalisaation käsitettä, sen historiaa ja vaikutuksia kehitysmaihin yleensä. Sen jälkeen esitämme eräitä empiirisiä indikaattoreita taloudellisesta globalisaatiosta Suomen pitkäaikaisissa kehitysyhteistyökumppaneissa Nepalissa, Tansaniassa, Mosambikissa, Etiopiassa ja Vietnamissa sekä eräissä muissa kehitysmaissa. Tämän jälkeen tutkimus keskittyy globalisaatioon kahdessa maassa, Nepalissa ja Tansaniassa. Näitä maita tutkitaan perusteellisesti tutkimuksen alussa esitetyn viitekehyksen puitteissa.

Taloudellinen globalisaatio kehitysmaiden näkökulmasta

Globalisaatio on tässä tutkimuksessa määritelty kansallisvaltioiden rajojen yli ulottuvaksi taloudelliseksi toiminnaksi seuraavilla alueilla: 1) tavaroiden ja palvelusten ulkomaankauppa, 2) suorat sijoitukset, 3) muut yritysten väliset yhteistyön muodot, 4) kansainvälinen siirtolaisuus, 5) ulkomainen otto- ja antolainaus, 6) ulkomainen apu ja 7) makrotaloudellinen integraatio. Laaja ulkomaankauppa on välttämätön, mutta ei riittävä ehto globalisaatiolle. Se vaatii myös muiden ylikansallisten taloudellisten yhteistyömuotojen olemassaoloa. Kuljetus- ja muun kommunikaatioteknologian kehittyminen on oleellisesti voimistanut globalisaatiota kaikilla sen osa-alueilla.

Nykyään vain osa kehitysmaista osallistuu laajasti globalisaatioon. Näihin maihin kuuluvat muiden muassa Kiina, Indonesia ja Brasilia. Globalisaatioon osallistuvien maiden väestö on noin 3 miljardia. Pitkälti globalisaatioprosessin ulkopuolella olevien maiden väestö on noin 2 miljardia henkeä. Nämä maat ovat enemmän tai vähemmän marginalisoituneet.

Useimmat kehitysmaat haluavat globalisoitua. Ne haluavat lisätä ulkomaankauppaansa, tulla Maailman kauppajärjestön (WTO) jäseniksi ja saada enemmän ulkomaisia sijoituksia. Tämä pyrkimys liittyy 1980- ja etenkin 1990-luvulla alkaneisiin demokratisoitumis-, liberalisaatio- ja yksityistämisprosesseihin. Neuvostoliitossa ja Itä-Euroopassa vallinneen sosialismin romahdus osaltaan nopeutti tätä prosessia. Globalisaatiopyrkimyksistä huolimatta kehitysmaiden näkemykset globalisaation sisällöstä ja sen ehdoista kuitenkin poikkeavat osittain siitä, miten ne nähdään kehittyneissä teollisuusmaissa.

Taloudellista vapautta kuvaavat indikaattorit osoittavat, että vaikka erityisesti Itä-Afrikan maat ovat tulleet aiempaa vapaammiksi, sielläkin tämä kehitys on vielä kesken. Etelä-Aasian maat ovat vähemmän vapaita kuin Itä-Afrikan maat. Sekä Nepalissa että Tansaniassa kauppa, omaisuuden suoja, säätely sekä musta tai harmaa talous ovat ongelmallisia alueita taloudellisen vapauden näkökulmasta. Nepalissa suorat sijoitukset ja rahoitussektori on vielä lisättävä näihin ongelma-alueisiin.

Lähtien niistä perusvalinnoista, jotka monissa kehitysmaissa on tehty markkinatalouden toteuttamisen suhteen, katsomme että taloudellinen globalisaatio on hyödyllinen kehitysmaille. Se luo kuitenkin myös ongelmia, joita täytyy pyrkiä vähentämään sopivin poliittisin toimin.

Kehitysmaat hyötyvät ulkomaankaupan kautta tapahtuvasta kansainvälisestä työnjaosta. Yksi globaalitalouden keskeisistä trendeistä on ollut ulkomaankauppaa rajoittavien ja tuotantorakennetta vääristävien tullien alentaminen. Tullit ovat vielä nykyisin korkeammat kehitysmaissa kuin kehittyneissä teollisuusmaissa. Tullien ohella kauppaa rajoittavat erilaiset muut kaupan esteet kuten maiden taloudellinen tuki omalle maataloudelleen.

WTO on tärkein kanava monenkeskisille kauppajärjestelyille. Monilla kehitysmailla on lisäksi alueellisia kauppajärjestelyjä. Nämä edistävät kauppaa tietyllä maantieteellisellä alueella. Samalla nämä järjestelyt altistavat alueen yrityksiä kilpailulle, mikä auttaa niitä kohtaamaan maailmanlaajuisen kilpailun. Lyhyellä ja keskipitkällä aikavälillä taloudelliset uudelleenjärjestelyt aiheuttavat sopeutumiskustannuksia. Esimerkiksi ns. monikuitusopimuksen (MFA) lakkaaminen vuoteen 2005 mennessä muuttaa tekstiilien ja vaatteiden kaupan sopimuspohjaa, mikä vaikuttaa muun muassa Nepaliin ja Tansaniaan.

Suorat ulkomaiset sijoitukset tuovat kehitysmaille taloudellisia resursseja ja teknistä tietämystä, jota ne kipeästi tarvitsevat pyrkiessään ratkaisemaan köyhyysongelmansa. Se, missä määrin kehitysmaat hyötyvät suorista sijoituksista, riippuu niistä taloudellisista vuorovaikutussuhteista, joita ulkomaalaisomistuksessa olevilla yrityksillä on muuhun talouteen. Näiden suhteiden laajuus ja muoto riippuvat muun muassa investointien muodosta ja toimialasta sekä niiden pituudesta.

Globalisaatio toteutuu nykyään yhä enemmän tuotannon ja yritysten tasolla. Tuotanto on usein hajautunut niin, että eri tuotantovaiheet suoritetaan eri maissa. Tällainen tuotannon ja yritysten globalisaatio toteutuu suorien sijoitusten, mutta myös muiden taloudellisten yhteistyömuotojen kautta. Näitä ovat vähemmistöosakkuuteen pohjautuvat yhteisyritykset, teknologian tai tuotemerkkien siirto lisenssisopimusten pohjalta, kansainvälinen alihankinta ja franchising-sopimukset.

Kansainvälinen siirtolaisuus on keino reagoida työvoiman tarjonnan ja kysynnän suhteellisiin eroihin. Kehitysmailla on runsaasti työvoimaa suhteessa pääomavarantoonsa. Joissakin kehittyneissä maissa taas tilanne on päinvastainen. Ulkomailla työskentelevien työntekijöiden kotiinsa lähettämät palkkarahat ovat merkittävä ulkomaanvaluutan lähde eräissä kehitysmaissa. Kehittyneissä teollisuusmaissa siirtolaisuutta rajoitetaan ja säädellään tarkasti.

Ulkomainen otto- ja antolainaus sekä ulkomaanapu ovat tärkeitä ulkomaisten rahoitusresurssien lähteitä kehitysmaille. Monet kehitysmaat ovat nykyisin ylivelkaantuneita ja kansainväliset ponnistukset velkojen uudelleenjärjestelemiseksi ovat meneillään. Ulkomaanapu on alentunut tuntuvasti suhteessa maailman BKT:hen.

Globalisaatio merkitsee myös makrotalouksien ja talouspolitiikan integroitumista. Vapaa pääoman liikkuvuus johtaa kansallisen rahapolitiikan itsenäisyyden kaventumiseen, jos valuuttakurssi on enemmän tai vähemmän kiinteä. Kelluva kurssi antaa jonkin verran tilaa kansalliselle rahapolitiikalle lyhyellä aikavälillä. Pääoman liikkuvuus ei ole useissa kehitysmaissa vielä täysin vapaata, mikä osaltaan lisää kansallisen rahapolitiikan pelivaraa. Kehitysmaiden velkaantuneisuus johtaa kansallisen finanssipoliittisen itsenäisyyden kaventumiseen, kun julkisten menojen kasvua täytyy rajoittaa, jotta rahoittajien usko velkojen takaisinmaksuun säilyisi.

Nepal

Nepal on avautunut huomattavasti viimeksi kuluneiden muutaman vuosikymmenen aikana ja erityisesti 1990-luvulla. Maasta tuli monipuoluedemokratia vuonna 1990. Liberalisaation ja yksityistämisen seurauksena ulkomaankaupan osuus bruttokansantuotteesta on kohonnut. Samalla BKT henkeä kohti on noussut vain noin kaksi ja puoli prosenttia vuodessa nopean väestönkasvun vuoksi. Köyhyys ja tulojen epätasaisuus ovat lisääntyneet.

Yksi tärkeistä tekijöistä on vuoden 1996 vapaakaupan takaava kauppasopimus Intian kanssa. Sen seurauksena Nepalin ja Intian välinen kauppa on lisääntynyt huomattavasti. Ilman ulkomaankaupan voimakasta kasvua Nepalin henkeä kohti laskettu bruttokansantuote olisi kehittynyt toteutunutta selvästi heikommin. Vapaakaupan lisäksi Nepal ja Intia ovat vuodesta 1950 lähtien taanneet toistensa kansalaisille samat asumis- ja omistusoikeudet sekä oikeuden osallistua kaupankäyntiin ja liikkumisvapauden kuin oman maansa kansalaisille.

Kauppasopimus umpeutui vuoden 2001 lopussa ja sen jatkaminen osoittautui vaikeaksi Intian vastalauseiden vuoksi. Lopulta uusi sopimus kuitenkin solmittiin ja se astui voimaan maaliskuussa 2002. Tällä kertaa tietyille tärkeille nepalilaisille vientituotteille (vihannesöljy, akryylilanka, kuparituotteet, sinkkioksidit) Intiaan asetettiin kuitenkin kiintiöt. Kauppasopimuksen jatkaminen on erittäin hyvä asia Nepalin kannalta, mutta kiintiöt hidastavat kasvua kyseisillä toimialoilla.

Vuodet 2001 ja 2002 ovat olleet vaikeita Nepalille ja maan globalisoituminen ja taloudellinen kehitys ovat hidastuneet. Maailmantalouden taantumalla, Yhdysvaltain antamilla kauppahelpotuksilla Saharan eteläpuoleisille maille sekä Nepalin sisällissodan eskaloitumisella on ollut hyvin negatiivinen vaikutus Nepalin ulkomaankauppaan, investointeihin sekä talouskasvuun yleensä. Nepalin vienti teollisuusmaihin koostuu käytännössä yksinomaan vaatteista ja matoista. Vaatevientiä uhkaa monikuitusopimuksen päättyminen vuoteen 2005 mennessä. Nepalin viennin rakennetta teollisuusmaihin pitäisikin monipuolistaa.

Kokonaisuutena Nepalin viennin rakenne on kuitenkin monipuolistunut 1990-luvun aikana, sillä muuta vientiä monipuolisempi vienti Intiaan on kasvanut hyvin voimakkaasti. Intian voidaan odottaa tulevan vielä nykyistäkin tärkeämmäksi kauppakumppaniksi tulevaisuudessa, jos maiden välinen kauppa säilyy (ainakin enimmäkseen) vapaana. Nepalin viennissä on 1990-luvun aikana tapahtunut rakenteellinen muutos pois elintarvikkeista ja raaka-aineista kohti valmistettuja tuotteita. Vaikka Nepal vie edelleen maataloustuotteita, lähinnä Intiaan, siitä on tullut näiden tuotteiden nettotuoja.

Intiasta tulleet suorat investoinnit ovat vaikuttaneet positiivisesti Nepalin kauppaan Intian kanssa. Intian osuus kaikista suorista investoinneista Nepaliin on 36 prosenttia. Yhdysvaltojen osuus on 17 prosenttia ja Kiinan osuus 11 prosenttia. Toimialoittain tarkasteltuna 43 prosenttia suorista investoinneista on suuntautunut teollisuuteen, 21 prosenttia turismiin, 21 prosenttia muihin palveluihin ja 14 prosenttia energiasektoriin. Nepalilla on potentiaalia turismissa ja vesivoiman tuotannossa. Lisäksi vapaakauppa Intian kanssa luo mahdollisuuden tuottaa hyödykkeitä Intian markkinoille. Yhteenlaskettu suorien investointien kanta Nepalissa on kuitenkin hyvin pieni, vain kaksi prosenttia bruttokansantuotteesta. Toimenpiteitä suorien investointien edistämiseksi tulisi jatkaa.

Tekijät, jotka jarruttavat suoria investointeja ovat samat, jotka jarruttavat Nepalin talouskasvua yleensä. Ensinnäkin Nepalin fyysinen ja sosiaalinen infrastruktuuri on puutteellinen. Tiet, sillat ja telekommunikaatio ovat huonossa kunnossa. Ammattitaitoisesta ja koulutetusta työvoimasta on pulaa. Luku- ja kirjoitustaidottomuus on edelleen yleistä myös nuorten aikuisten joukossa, vaikka koulujärjestelmä on kehittynyt huomattavasti viimeisinä vuosikymmeninä. Näiden seurauksena syntyvyys on liian korkea, sosiaalinen stagnaatio ja köyhyys hallitsevat ja viennin kilpailukyky on alhainen. Tuottavuus on alhainen sekä maataloudessa että teollisuudessa. Tuottavuuden ja tuotteiden laadun nostaminen on erittäin tärkeää kilpailukyvyn parantamiseksi.

Lisäksi korruptio on levinnyt laajalle. Se johtaa huonoon hallintokulttuuriin, läpinäkymättömyyteen ja vastuuvelvollisuuden puuttumiseen yritysmaailmassa, politiikassa ja oikeuslaitoksessa. Edelleen Nepalin mahdollisesti pitkäksikin venyvä sisällissota on hyvin haitallinen. Sodan juuret ovat maan syvässä köyhyydessä. Sisällissodalla on hyvin kielteinen vaikutus turismille, josta saadut valuuttatulot ovat tärkeitä ja auttavat osittain tasapainottamaan Nepalin suurta tavarakaupan alijäämää. Sisällissota vaikuttaa kielteisesti myös valtion rahoitustilanteeseen turvallisuusmenojen kasvun ja verotulojen laskun kautta.

Nepal on hakemassa jäsenyyttä Maailman kauppajärjestössä WTO:ssa. Muun muassa lainsäädäntöä täytyy jonkin verran muuttaa ennen kuin maa voi liittyä WTO:hon, mutta emme näe jäsenyydelle vaihtoehtoja. Nepalin molemmat naapurimaat, Intia ja Kiina ovat WTO:n jäseniä. Lisäksi tarvittavat lainsäädännölliset muutokset ovat itsessäänkin tärkeitä.

Monet nepalilaiset työskentelevät ulkomailla, lähinnä Intiassa. Ulkomailla työskentelevät nepalilaiset lähettävät vuosittain valuuttatuloja takaisin Nepaliin määrän, joka vastaa noin kolmea prosenttia bruttokansantuotteesta. Tämä vastaa suunnilleen turismin osuutta Nepalin bruttokansantuotteesta.

Ulkomainen apu on tärkeää Nepalille. Vuonna 1999 apu vastasi 43 prosenttia keskushallinnon menoista, seitsemää prosenttia bruttokansantulosta ja 34 prosenttia bruttopääomanmuodostuksesta. Apu oli 15 Yhdysvaltain dollaria henkeä kohti vuodessa eli kolme kertaa enemmän kuin Nepalin koko suorien investointien kanta. Silti suhteessa kansantalouteen apu on pienentynyt noin puoleen vuoden 1989 huipustaan.

Nepal luetaan kohtuullisen vähän velkaantuneeksi alhaisen tulotason maaksi. Vuonna 2001 velan osuus oli noin 47 prosenttia bruttokansantuotteesta. Velanhoitomenot olivat noin neljä prosenttia viennistä. Velkaantuminen on kuitenkin kasvanut pitkällä aikavälillä.

Vaihtotaseeseen liittyvät pääomanliikkeet ovat olleet vapaita Nepalissa vuodesta 1993, mistä lähtien Nepalin rupia on ollut yksipuolisesti kytketty Intian valuuttaan. Nepalin rahapolitiikka seuraa siksi Intian rahapolitiikkaa. Maiden valuuttojen välinen reaalinen vaihtokurssi on pysynyt vakaana 1990-luvulla.

Tansania

Tansania sijaitsee Itä-Afrikassa Intian valtameren rannalla. Maa koostuu mannermaasta (Tanganjika) ja Sansibarin saariryhmästä. Tansania on maantieteellisesti laaja maa. Se on suunnilleen yhtä suuri kuin Saksa ja Ranska yhdessä. Maalla on useita kohteita luonto- ja kulttuurituristeille. Ilmasto vaihtelee rannikon trooppisesta ylänköjen lauhkeaan vyöhykkeeseen. Väestö on noin 33 miljoonaa.

Tansania on yksi maailman köyhimmistä maista. YK:n inhimillisen kehityksen indikaattorilla mitattuna Tansania oli 140. kaikkiaan 162 maasta vuonna 2001. Kansallisen määritelmän mukaan 48.4 prosenttia väestöstä kärsi vuonna 2000 'perustarvikkeiden köyhyydestä' ja 26.6 prosenttia 'elintarvikkeiden köyhyydestä'.

Tansania harjoitti niin kutsuttua afrikkalaista sosialismia 1960-luvulta 1990-luvun alkupuolelle. Yksipuoluejärjestelmä lakkautettiin muodollisesti 1. heinäkuuta 1992. Johtava CCM-puolue kuitenkin dominoi yhä poliittista elämää. Loka-marraskuussa 2000 pidetyissä vaaleissa se voitti 244 kaikkiaan 274 parlamenttipaikasta.

Poliittiseen liberalisointiin liittyy taloudellinen liberalisointi. Talouden vapauttaminen ja yksityistäminen alkoivat jo vuonna 1992, mutta tämä toiminta on ollut aktiivisinta vuoden 1995 jälkeen.

Tansanian kokonaistaloudellinen kehitys oli 1990-luvulla melko epätyydyttävää. Vuosina 1989-2000 kokonaistuotanto (BKT) kasvoi keskimäärin 3.3 prosenttia vuodessa. Koska väestö kasvoi 2.9 prosenttia, BKT henkeä kohti kohosi vain 0.4 prosenttia. Tämä johtui erityisesti heikosta vientikehityksestä. Tavaraviennin määrä oli budjettivuonna 1999/2000 vain 7 prosenttia suurempi kuin 1990/1991. Huono vientikehitys heijastui investointiasteeseen. Se laski selvästi 1990-luvulla ja oli vuonna 2000 vain 17 prosenttia. Maailman keskiarvo oli 22 prosenttia.

Tansanian kansallisen määritelmän mukaan työttömyysaste oli 16 prosenttia vuoden 2000 ensimmäisellä puoliskolla. Piilotyöttömyys on kuitenkin suuri. Inflaatio on laskenut vuoden 1994 yli 30 prosentista noin viiteen prosenttiin vuonna 2000. Tämä lasku johtuu suurelta osin vakauteen tähdänneestä talouspolitiikasta. Julkisen talouden ja vaihtotaseen vajeet ovat nykyisin siedettävällä tasolla. Julkinen velka on yhä kestämättömän suuri.

Tansaniassa on suuri rahatalouden ulkopuolinen sektori. Manner-maalla se on noin 30 prosenttia BKT:stä. Tämä sektori koostuu pääasiassa omavaraisuuteen perustuvasta maataloudesta. Monetaarisen ja ei-monetaarisen maatalouden osuus koko BKT:stä on noin 45 prosenttia. Tämä osuus on alentunut hieman 1990-luvulla. Tehdasteollisuuden osuus on hieman yli 7 prosenttia ja rakentamisen 5 prosenttia BKT:stä. Kaivostoiminnan tuotanto on 1.5 prosenttia kokonaistuotannosta. Kaupan sekä ravintola- ja hotellitoiminnan osuus BKT:stä on yhteensä 12 prosenttia.

Globalisaatio ei ole kovin pitkällä Tansaniassa ulkomaankaupan osalta. Tavaroiden ja palvelusten viennin osuus BKT:stä oli noin 15 prosenttia vuonna 2000. Tuonnin vastaava osuus oli 24 prosenttia. Molemmat osuudet alenivat vuoden 1995 jälkeen. Viennissä lasku aiheutui heikosta vientimäärän kehityksestä. Tekstiili- ja vaatetusteollisuuden vienti suorastaan romahti sektorin liberalisoinnin jälkeen. Aiemmin valtion omistamat yritykset eivät olleet riittävän kannattavia säilyäkseen. Myös puuvillan vienti laski tuntuvasti ulkomaisten asiakkaiden laatuvaatimuksissa tapahtuneiden muutosten seurauksena. Vienti- ja tuontihinnat pysyivät 1990-luvun lopulla ja 2000-luvun alussa keskimäärin viime vuosikymmenen puolivälin tasolla.

Yli puolet tavaraviennistä koostuu maataloustuotteista. Kaivannaistuotteiden osuus oli 26 prosenttia ja teollisuustuotteiden osuus 6.5 prosenttia vuonna 2000. Kaupan keskittyneisyyttä mittaavien indeksien mukaan viennin hyödykerakenne ei ole läheskään niin keskittynyt kuin Nepalissa. Tämä johtuu runsaasta tavaroiden lukumäärästä. Hintaherkkien maatalous- ja kaivannaistuotteiden suuri osuus antaa kuitenkin syyn kohottaa viennin jalostusastetta ja hajauttaa viennin hyödykekoostumusta edelleen.

Tuontitulleja on alennettu Tansaniassa alle puoleen 1990-luvun alun tasosta. Nykyinen 16.1 prosentin keskimääräinen tulli on yhä korkea vähiten kehittyneiden maiden 11 prosentin keskiarvoon tai teollisuusmaiden 4 prosentin keskiarvoon verrattuna. Tansania on Maailman kauppajärjestön (WTO), Itä-Afrikan yhteisön (EAC) ja Eteläisen Afrikan kehitysyhteisön (SADC) jäsen. EAC ja SADC pyrkivät molemmat vapaakauppaan alueellaan. EAC:ssä tavoite lienee lähempänä.

Palvelujen osuus koko viennistä on noin puolet. Matkustus ja kuljetus ovat tärkeimmät erät. Matkustuksen osuus on noin puolet palveluviennistä.

Tansanialla on suhteellinen etu maataloustuotteissa, kaivannaistuotteissa ja turismissa. Suhteellisen halpa työvoima ja hyvä maantieteellinen sijainti ovat houkutuksia myös työvoimaintensiiviselle tehdasteollisuudelle. Tämä sektori on maassa kuitenkin alikehittynyt.

Viime aikoina Tansania on houkutellut maahan runsaasti ulkomaisia sijoituksia. Suorien sijoitusten varannon osuus BKT:stä oli 11 prosenttia vuona 1999. Tämä on alle vähiten kehittyneiden maiden 14 prosentin keskiarvon. Sijoitusvirta on kuitenkin ollut viime aikoina suuri. Se on keskittynyt kaivosteollisuuteen. Suoria sijoituksia suuntautuu myös muille toimialoille. Vuonna 1999 suorien sijoitusten virta oli melkein 14 prosenttia maan kokonaisinvestoinneista. Kaikissa vähiten kehittyneissä maissa tämä osuus oli keskimäärin 8 prosenttia. Tärkeimpiä sijoitusten lähteitä ovat olleet Iso-Britannia, Yhdysvallat, Etelä-Afrikka ja Kenia. Investointeja houkutellaan maahan tarjoamalla ulkomaisille yrityksille edullisia investointi- ja tuotantoehtoja.

Tansania on riippuvainen kehitysavusta. Vuonna 1999 avun osuus oli 11 prosenttia bruttokansantulosta, 66 prosenttia bruttopääomanmuodostuksesta ja 41 prosenttia tuonnista. Budjettivuonna 1999/2000 noin kolmannes kaikista budjetin menoista ja 94 prosenttia sen kehitysmenoista rahoitettiin ulkomaisista lähteistä.

Tansanian koko ulkomaanvelka oli noin 76 prosenttia BKT:stä kesäkuussa 2001. Maa osallistuu Kansainvälisen valuuttarahaston (IMF) ja Maailmanpankin velkojen uudelleenjärjestelyohjelmaan, ns. HIPC (Heavily Indebted Poor Countries)-ohjelmaan.

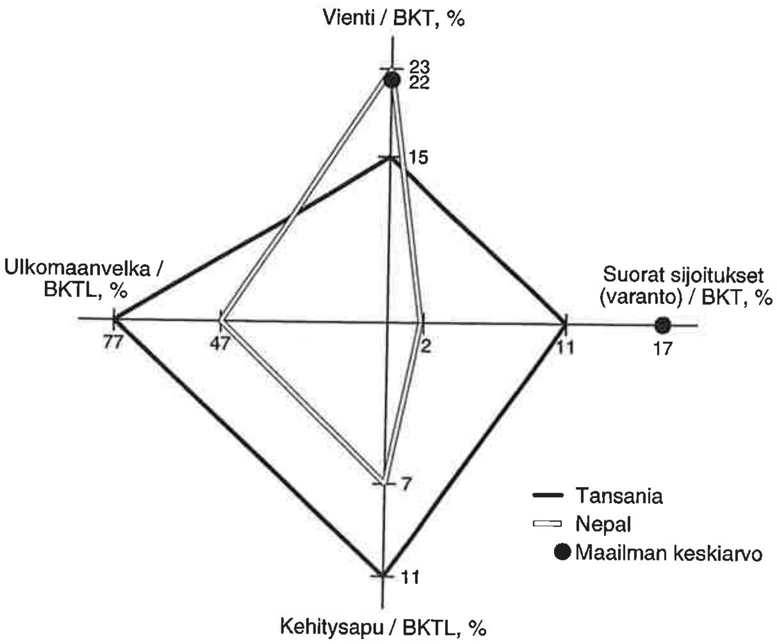
Velkaantuneisuus rajoittaa finanssipolitiikan liikkumavaraa. Tansanialla on kelluva valuuttakurssi, joka antaa jonkin verran rahapoliittista itsenäisyyttä lyhyellä aikavälillä. Pääomataseeseen liittyvien pääomanliikkeiden rajoitukset lisäävät tätä vielä hieman. Vaihtotaseeseen liittyvät pääomanliikkeet ovat kuitenkin vapaat.

Globalisaation laajuus ja sen haasteet

Nepalissa ja Tansaniassa globalisaation aste ei ole kovin korkea. Ulkomaankaupan osuus BKT:stä on Nepalissa sunnilleen maailman keskitasoa, mutta Tansaniassa selvästi sen alle. Suorat sijoitukset ovat kansainvälisesti verrattuna vähäisiä Nepalissa. Myös Tansaniassa niiden varanto (11 prosenttia BKT:stä) alittaa selvästi maailman keskiarvon (17 prosenttia BKT:stä). Suorien sijoitusten virta suhteessa kokonaisinvestointeihin on kuitenkin ollut viime aikoina Tansaniassa suunnilleen sama kuin koko maailmassa keskimäärin. Tämä heijastaa suorien sijoitusten tärkeyttä maassa. Ulkomailla työskentelevien työntekijöiden palkkatulojen kotiutuksilla on suuri merkitys Nepalissa, mutta ei Tansaniassa.

Vaikka Nepal ja Tansania eivät vielä ole kovin globalisoituneita, niiden taloudellinen strategia perustuu kansainvälisen työnjaon hyödyntämiseen. Molemmat maat ovat liberalisoineet talouksiaan 1990-luvun alusta lähtien hyötyäkseen enemmän avoimesta sektorista ja houkutellakseen suoria sijoituksia. Tämä prosessi on meneillään, mutta vielä kesken.

Kuvio **Taloudellisen globalisaation laajuus Nepalissa ja Tansaniassa**



Vienti/BKT vuodelta 2000 ja ulkomaanvelka/BKTL vuodelta 2001, muut vuodelta 1999.

Molemmilla mailla on globalisoitumisprosessissaan useita tehtäviä ja haasteita. Tärkeimpiä niistä ovat:

1) Poliittisen vakauden lisääminen (Nepalissa on sisällissota);

2) Syntyvyyden alentaminen;
3) Köyhyyden ja tautien vastainen taistelu (Tansaniassa on vakava AIDS-ongelma);
4) Taloudellisen liberalisoinnin jatkaminen;
5) Hallintokäytäntöjen parantaminen ja korruption vähentäminen;
6) Energia-, liikenne- ja kommunikaatioinfrastruktuurin kohentaminen;
7) Koulutuksen tehostaminen (perus-, keski- ja korkean asteen sekä ammattikoulutuksen);
8) Tutkimuksen ja tuotekehityksen tukeminen;
9) Ulkomaankaupan vapauttamisen jatkaminen;
10) Jalostusasteen nosto tuotannossa ja ulkomaankaupan monipuolistaminen;
11) Alueellisen integraation syventäminen;
12) Maihin suuntautuvien suorien sijoitusten lisääminen ja niiden ja muun talouden välisten vuorovaikutussuhteiden vahvistaminen;
13) Rahoitusjärjestelmän tehokkuuden parantaminen;
14) Talouden ja yhteiskunnan parempi reagointikyky rakenteellisiin muutoksiin;
15) Sosiaalisten turvaverkkojen ja globalisaation haittavaikutuksia vähentävien poliittisten toimenpiteiden vahvistaminen;
16) Vakautta edistävän talouspolitiikan jatkaminen;
17) Naisten aseman kohentaminen molemmissa maissa ja dalitien aseman parantaminen Nepalissa.

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