

Module-3

Trade Policy and Related Concepts

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Acronyms

CGE	Computable General Equilibrium
GDP	Gross Domestic Product
EBS	Export Bonus Scheme
ERS	Economic Recovery Programme
FDI	Foreign Direct Investment
FTA	Free Trade Area
LDCs	Least Developed Countries
IMF	International Monetary Fund
NRP	Nominal Rate of Protection
NTBs	Non-Tariff Barriers
OGL	Open General Licence
QRs	Quantitative Restrictions
SAARC	South Asian Association of Regional Cooperation
SAD	Special Additional Duty
SAM	Social Accounting Matrix
SAP	Structural Adjustment Programme
SROs	Statutory Regulatory Orders
WTO	World Trade Organisation

1.1 Bangladesh

After the independence in 1971, the evolution of trade policies in Bangladesh can be categorised into three major phases. The *first* phase covered the period 1972-1978, and was characterised by the pursuit of an import-substitution strategy through high tariffs, quantitative restrictions (QRs) on imports, import licensing and strict exchange control measures. These policies aimed to protect domestic industry as well as to raise revenue. The distorted incentive structure of the period, however, led to allocative and productive inefficiencies, strained the external sector, created anti-export bias, and consequently resulted in low growth of the economy.

The disappointing performance of the import-substituting trade regime prompted the policy makers to introduce reforms towards a free market economy and export led industrialisation although at a relatively slow rate during 1979-1990. This was the *second* phase. Trade reforms, launched in the 1980s, were aimed mainly at rationalising and reducing tariffs and other import taxes, and eliminating import prohibitions and QRs. Incentives were also introduced to boost exports and diversify the export base.

The *third* phase (1991 and onwards) has been characterised by a greater openness of the economy (rapid liberalisation) through accelerated trade liberalisation (by significant cut in the tariff rates and drastic elimination of QRs), financial and fiscal reforms, and privatisation. During the 1990s, Bangladesh also embarked on a liberal industrial and investment policy. The 1991 Industrial Policy, for example, targeted the expansion of export-oriented industries and employment creation through attracting foreign direct investment (FDI) and removing all barriers to make the industrial sector more efficient and internationally competitive.

1.2 Bhutan

Being landlocked having borders with India, China, and Sikkim, Bhutan can suitably trade through road only with India. Therefore, as a small economy, it has a free trade agreement (FTA) with India under which its exports to India are exempted from India's tariff and its imports from India are exempted from its tariff. However, it has high and a quite escalated tariff rates which are applied to imports rather than to the local production of import substitution firms. This indicates some protection against imports from India despite the FTA with India. It began to be more trade oriented from the late 1980s by liberalising its imports. However, it maintains quite a high of tariff rate.

1.3 India

India's trade policy in early stage can be characterised by highly inward-oriented industrialisation which, after three decades of independence, began to be outward looking. The trade policy evolution of India can be divided in three regimes. First, based on the Mahalanobis strategy of development, India entered into the era of ambitious industrialisation in 1950s (Chadha *et. al*, 1997). The emphasis was on import substitution, heavy industries and a central role for public sector. The characteristics of its external sectors were dominated by the

prevalence of export pessimism, a highly protectionist trade policy regime and regulation through quantitative controls on imports, and an exceptionally high tariff rates.

Second, liberalisation of India's trade policy regime began in the late 1970s some momentum of which was gained at the latter half of the 1980s. Particularly, several committees in the period 1977-1985 influenced Indian thinking on trade policy reform which emphasised on two major points: there was a need to develop a system which would make export less costly and more profitable; and there was a need to move away from a discretionary system of quantitative import controls to a system based on tariffs. With these points, in the long term fiscal policy, there was envision of eventual removal of import licensing from all imports, gradual removal of QRs along with expansion of Open General License (OGL) list of imports. However, with its views regarding trade policy, India remained to be a highly protected economy at the end of 1980s (World Bank 1989; cited in Chadha *et. al* 1997).

The third phase of rapid liberalisation commenced in July 1991 with the crisis in the external sector and the concurrent fiscal deficit. It was associated with correcting the overvaluation policy by a major devaluation of the rupee, introduction of major structural reforms in the industrial and trade policy regimes, productivity and international competitiveness of India's manufacturing sector. With the changes in trade policy involving abolishing import licensing (except for imports of consumer goods) as well as reductions in import duties, and the like, India has entered a new era with a more competitive industrial environment and gaining more efficiency.

1.4 Maldives

As a very small economy, Maldives remains also small in terms of trade orientation. It is noteworthy that Maldives remains to be less liberalised compared to other South Asian countries. Though some of the policies have been undertaken to liberalise its trade, it restricts its imports using import quotas. Between 1980 and 2003 its currency has been devalued by 70 percent.

1.5 Nepal

Nepal began its rapid trade liberalisation in the early 1980s. Among South Asian countries, Nepal liberalised trade most extensively in 1980s and 1990s. Albeit tariff was one of the instruments to liberalise trade, Nepal's tariff reform initiated in early 1990s. It has maintained quite a low level of tariff since early 1980s. Between 1989-90 and 2001-02, unweighted average customs duty fell from 39.8 percent to 13.7 percent. However, Nepal never used import licensing and other non-tariff measures to protect imports which helped it liberalise its trade most extensively in the region.

1.6 Pakistan

The inheritance of Pakistan, after independence in 1947, was a very poor industrial base and was a predominantly agricultural economy. However, Pakistan's trade policy can be characterised by a high degree of protectionist on the whole. The trade policy evolution of Pakistan can be divided in three regimes. The *pre-1972* period is characterised by a high degree of protection, *ad hoc* policies, and distortions on both imports and exports. There was a policy of import

substitution industrialisation, and an Export Bonus Scheme (EBS), which amounted to a multiple exchange rate system, was introduced to stimulate exports. The next period is found to have many changes in its trade policies that reflected the dissimilar approaches to economic development. This regime, however, can be characterised by a high degree of tariff and non-tariff protection.

The period 1988 and onwards has the specialty of Structural Adjustment Program (SAP). Under an agreement with the International Monetary Fund (IMF), SAP precipitated some reforms that promoted general liberalisation of the economy. There has been a trend towards greater liberalisation including some decreases in tariffs, export promotion through various measures including zero rate of duties for raw materials and intermediate goods predominantly used in the production of export and replacement of the uniform income tax rebate system with a graduated one, which encouraged over valued exports. Trade liberalisation in Pakistan has accelerated since 1991. In particular, import taxes have been reduced sharply, and Statutory Regulatory Orders (SROs) a major source of trade distortions - have been mostly withdrawn and non-tariff barriers (NTBs) have been largely dismantled. These measures were reinforced by greater capital account liberalisation and greater opening up to foreign investment as well as more liberal policies on the domestic front.

1.7 Sri Lanka

Among the South Asian economies, Sri Lanka is the first country to begin trade liberalisation. Its trade liberalisation story can be divided into four segments. Prior to late 1970s, Sri Lanka's policy makers thought of adopting an inward looking import substituting industrialisation, banning the import of a huge range of consumer goods in 1970 in order to be greater self sufficient. Understanding that this strategy was hindering development in the country, Sri Lanka began trade liberalisation policies in late 1970s. However, its economy 'opened up' gradually in 1977 through liberalised imports of a large number of non-agricultural commodities.

They decided to open the economy, abandoning many of the government controls established in the previous 20 years and 1977 was the first step in this regard that saw significant trade liberalisation, including reducing import tariffs and almost abandoning the use of import licensing and quotas, and financial sector liberalisation. It also included dismantling of foreign exchange controls and easing restrictions on foreign investment. The second stage of liberalisation started in 1989. A Tariff Commission was established to further rationalise the import tariff system towards two bands of 10 percent and 25 percent, and export duties were phased out completely. After 2002, Sri Lanka decided to liberalise trade more rapidly. It planned to implement a series of second generation reforms including factor market liberalisation which refers to land, labour, utility and financial sector liberalisation.

Box 1: A Summary of South Asia's Trade Policy Evolution

	Protectionist Period	Period of Moderate Liberalisation	Period of Rapid Liberalisation
Bangladesh	1972-78: Characterised by the pursuit of an import-substitution strategy through QRs on imports, import licensing and strict exchange control measures.	1979-1990: Trade reforms, launched in the 1980s, were aimed mainly at rationalising and reducing tariffs and other import taxes, and eliminating import prohibitions and QRs. Incentives were also introduced to boost exports and diversify the export base.	1991 and onwards: Characterised by greater openness of the economy (rapid liberalisation) through accelerated trade liberalisation, financial and fiscal reforms, and privatisation.
India	Prior to late 1970s: Characterised by the prevalence of export pessimism, a highly protectionist trade policy regime and regulation through quantitative controls on imports, and an exceptionally high tariff rates.	Late 1970s-1991: Liberalisation of India's trade policy regime was begun in the late 1970s; some momentum of which was gained at the latter half of the 1980s. There was an envision of eventual removal of import licensing from all imports, gradual removal of quantitative restrictions along with expansion of Open General License (OGL) list of imports. However, India remained to be a highly protected economy at the end of 1980s (World Bank 1989).	1991-onwards: The rapid liberalisation was associated with correcting the overvaluation policy by a major devaluation of the rupee, introduction of major structural reforms in the industrial and trade policy regimes, abolishing import licensing (except for imports of consumer goods) as well as reductions in import duties.
Nepal	Until late 1970: Nepal adopted import substitution strategies. Domestic industries were protected through high barriers to trade.	From early 1980s to late early 1990s: Introduction of cash subsidy programme to promote exports in 1981. Also duty exemption on export commodities, special financial arrangement for production and export, simplification of licensing and customs procedures.	From early 1990s and onwards: The 1992 Trade Policy aimed for simplifying existing import licensing and control system, gradual replacement of QRs on imports with tariffs, simplify import procedures and documentation, and move towards a fully convertible Nepalese currency.
Pakistan	The <i>pre-1972</i> period: Characterised by a high degree of protection, ad hoc policies, and distortions on both imports and exports. There was a policy of import substitution industrialisation, and a	1972-1988: This period is found to have many changes in its trade policies, though the regime can be characterised by a high degree of tariff and non-tariff protection.	The period 1988 and onwards: Trade liberalisation in Pakistan has accelerated since 1991. In particular, import taxes have been reduced sharply, SROs - a major source of trade distortions - have been mostly

	Protectionist Period	Period of Moderate Liberalisation	Period of Rapid Liberalisation
	multiple exchange rate system.		withdrawn and NTBs have been largely dismantled. These measures were reinforced by greater capital account liberalisation and greater opening up to foreign investment as well as more liberal policies on the domestic front.
Sri Lanka	Prior to late 1970s: Characterised by inward looking import substituting industrialisation, banning on import of a huge range of consumer goods.	Late 1977-1989: Significant trade liberalisation, including reducing import tariffs and almost abandoning the use of import licensing and quotas, and financial sector liberalisation, including dismantling foreign exchange controls and easing restrictions on foreign investment.	1989 onwards: For the first time, and after 2002 for the second time characterised by rapid liberalisation. The second period encompasses factor market liberalisation that refers to labour, land, utilities, and financial sector reform.

2. Evolution of Trade Policy in Sub-Saharan Africa

To achieve several (and, sometimes, inconsistent) objectives, Sub-Saharan African (SSA) countries attempted to use trade policy and therefore the trade policy in this region evolved in the 1960s and 1970s. These decades, however, can be characterised as largely inward-oriented development strategy which actually failed to achieve any fruitful outcome. This inward-oriented policy not only failed to attain sustainable growth in desired manufacturing sector but it has also created a difficult legacy of massive inefficiency and heavy import dependence that needs to be overcome. To overcome the problem, therefore, trade liberalisation in this region began to be effective since the early 1980s and are, in many cases, still on-going and have achieved some significant results but much still remains to be done especially in terms of rationalising the trade regimes. It is important to note that most of Africa's recent trade liberalisation efforts have been based on SAPs supported by the World Bank.

2.1 Ghana

Ghana undertook reforms to correct the critical distortions contributing to the stagnation and decline of the economy in the 1970s. This period can be characterised by a plethora of trade control instruments: high tariffs, stringent QRs, export restrictions, foreign exchange restrictions, and a high black market premium. However, to increase efficiency, Ghana, facing more than a decade of unprecedented economic decline, launched an Economic Recovery Programme (ERP) in 1983. The ERP was to seek implementation of the prescriptions of the World Bank and the

IMF for structurally adjusting developing country economies. The programme was divided into two phases: 1983-86 covered the four years of first phase and the second phase started and continued till 1991. Liberalisation, however, was the target in the first phase aiming at rationalisation of exchange rate to stimulate export. Therefore, rapid trade liberalisation in Ghana took place in early 1980s. The reforms include trade and industrial policy measures that aimed to increase the dynamism and efficiency of the industrial sector. Three devaluations over three-year period and a steady reduction in the gap between the official and the parallel market rate were undertaken. Moreover, an auction market for foreign exchange was introduced in 1986, and the unification of the exchange rate was finally accomplished the following year. In case of QR, import licensing and prohibitions were terminated by 1989.

2.2 Uganda

After a civil war in 1985-86, Uganda undertook a broad range of trade liberalisation measures in 1987. Its scenario prior to this date was almost common that was held in Ghanaian economy (Rodrik, 1998). Initially, the reform focused on removing the extreme distortions in the market for foreign exchange. Following a devaluation in 1987, its currency was adjusted through 1989 and the parallel market premium declined steadily (Rodrik, 1998). On the export side, it abolished all export taxes from exports of coffee.

1.2.3 Mali

Mali in 1986 began its trade reforms. Its first step in this regard was elimination of export monopolies. This process was strengthened when Mali liberalised the quota and abolished import monopolies in 1988. Furthermore, all QRs and import licensing requirements were abolished in 1990 and import tariffs were reduced to a very low level in the following year.

Box 2: A Summary of Sub-Saharan African's Trade Policy Evolution

	Protectionist Period	Period of Moderate Liberalisation	Period of Rapid Liberalisation
SSA	1960s and 1970s: Characterised mostly by inward looking import substituting industrialisation. the trade regime in each country was characterised by a plethora of trade control instruments: high tariffs, stringent QRs, export restrictions, foreign exchange restrictions, and a high black market premium.	Early 1980s	Late 1980s and onwards
Ghana	Prior to 1983: This period can be characterised by a plethora of trade control instruments: high tariffs, stringent QRs, export restrictions, foreign exchange restrictions, and a high black market premium.		1983-onwards: Launched of an Economic Recovery Program (ERP) in 1983.

	Protectionist Period	Period of Moderate Liberalisation	Period of Rapid Liberalisation
Uganda	Prior to 1987: This period can be characterised by a plethora of trade control instruments: high tariffs, stringent QRs, export restrictions, foreign exchange restrictions, and a high black market premium.		1987-onwards: Initially, the reform focused on removing the extreme distortions in the market for foreign exchange. On the export side, it abolished all export taxes from exports of coffee.
Mali	Prior to 1986: Use of high restrictions on imports and existence of monopolies in exports.	1986-1988: Elimination of export monopolies.	1988-onwards: Mali has unilaterally carried out major liberalisation efforts under the SAP being implemented since 1988.

3. Trade Liberalisation Measures in South Asia

3.1 Bangladesh

Though Bangladesh has a large export-oriented garment industry began to grow in 1980s, most of the manufacturing industries supplying domestic market are still highly protected, i.e. the common is the tariff of 50 to 100 percent. While liberalisation started in 1980s, it slowed down in 1995. Though the customs tariffs were reduced, there were some opposite policies in still in place. For example, there were other varieties of protective import taxes which, by 2001, accounted for about one-third of customs collections of the country. Moreover, at the same time Bangladesh retained a number of QRs for trade reason and the government also reduced the basic maximum customs duty in two steps in two years in 2002-03 and 2003-04 budgets.

With increases in the other protective import tariffs that more than offset this liberalisation such as in 2004, measured on its average unweighted protective import taxes, Bangladesh was found to be the most protected country in South Asia (World Bank 2004). Table 1 exhibits the extent of the integration of Bangladesh economy with the world economy. Figure in Box 3 shows the trend in average applied tariff rates for the period 1997-2005. Moreover, the figures in the Box 4 show the trend in the ratio of export to gross domestic product (GDP), of import to GDP and of trade to GDP for each of the South Asian economies for the period 1971-2002

Table 1: Openness Indicators of Bangladesh

Series/Year	1971	1975	1980	1985	1990	1995	2000	2003	2005
Export GDP ratio (%)	6.29	2.9	5.5	5.55	6.12	10.87	13.98	14.21	
Import GDP ratio (%)	10.73	8.1	17.88	13.23	13.53	17.34	19.23	20.04	
Trade GDP ratio (%)	17.02	11	23.38	18.78	19.65	28.21	33.21	34.25	
Tariff				81	94	26	21.2	18.8	16

Source: World development indicator (WDI) (2004), The World Bank website.

3.2 Bhutan

In the early 1980s, Bhutan began to undertake different liberalisation measures. In 1980, its integration into the world trade, indicated by the ratio of trade to GDP, was 49.19 percent of GDP which radically increased to 62.53 in 1985 (see Table 2). By 1995, this was 80.73 percent of GDP and at that year its average applied tariff rate was 17.5 percent which was 15.4 percent in 2000. Figures in Box 3 and Box 4 show the trend in average applied tariff rate and these three ratios. It is important to note that Bhutan has not QRs.

Table 2: Openness Indicators of Bhutan

Series/Year	1971	1975	1980	1985	1990	1995	2000	2002	2005
Export GDP ratio (%)	-	-	13.06	15.37	28.26	36.88	25.95	21.84	
Import GDP ratio (%)	-	-	36.13	47.16	32.29	41.63	54.78	42.75	
Trade GDP ratio (%)	-	-	49.19	62.53	60.55	78.51	80.73	64.59	
Tariff						17.5	15.4		22.2

Source: World development indicator (WDI) (2004), The World Bank website.

3.4 India

In case of NTBs, under the comprehensive import licensing system, there were restrictions on import of many goods in India before 1980. However, during 1991-92 reforms, restrictions on imports of raw materials and manufactured intermediate goods were removed whereas the case for industrial products remained to be restricted for imports. In 1998, on the basis of complaints from the South Asian Association of Regional Cooperation (SAARC) countries in this regard, India exempted the restrictions for SAARC countries and with the pressures from WTO it was bound to free about 715 tariff lines by 2001. During the 1991-92 reform, India also reduced tariffs from almost prohibitive level (almost 130 percent) to much lower levels (33 percent) in 1997-98. In 2004-05, there was a large reduction in tariffs for most of the industrial goods by abolition of the Special Additional Duty (SAD)¹.

The final cut was implemented to 15 percent in 2005-06 and to 12.5 percent in 2006-07 (World Bank, 2006). The scenario for tariff barrier on agricultural products is not same as the case for industrial goods as they were in 2005-06, almost three times the level of non-agricultural tariffs (40 percent). Figure in Box 1 shows the trend in average applied tariff rate in India for the period 1990-2005. Anti-dumping is another source of protection which has frequently been used by India. Its anti-dumping policy affects 29 countries and 167 products and India has been found to be the most active user of anti-dumping by the late 1990s and early 2000s. Table 3 shows the India's integration into the world trade by using showing three ratios; ratio of export to GDP, of import to GDP, and of trade to GDP. Moreover, the figures in the Box 4 show the trend in the ratio of export to GDP, the ratio of import to GDP and the ratio of trade to GDP for each of the South Asian economies for the period 1971-2002.

¹ Special additional duty: prior to its abolition, four percent of the assessable value of an import plus Customs duty plus additional duty (World Bank 2004).

Table 3: Openness Indicators of India

Series/Year	1970	1975	1980	1985	1990	1995	2000	2002	2005
Export GDP ratio (%)	3.61	5.95	6.28	5.38	7.15	11.0	13.89	14.48	
Import GDP ratio (%)	4.5	7.0	9.46	7.83	8.56	12.20	14.65	16.0	
Trade GDP ratio (%)	8.11	12.95	15.74	13.21	15.71	23.20	28.54	30.48	
Tariff	-	-	74.3	100	81.8	41.0	32.7	28.3	16

Source: World development indicator (WDI) (2004), The World Bank website.

3.5 Maldives

Maldives remained to be one of the most closed economy, may be due to its geographical reason. Its integration to world trade, indicated by the ratio of trade to GDP, was only 7.61 percent in 1980 which was only 16.99 percent in 1995 and 15.13 percent in 2003, respectively (see Table 4).

Table 4: Openness Indicators of Maldives

Series/Year	1970	1975	1980	1985	1990	1995	2000	2003
Export GDP ratio (%)	-	-	1.82	1.81	2.45	9.27	8.95	8.52
Import GDP ratio (%)	-	-	5.79	3.77	6.40	7.72	7.16	6.61
Trade GDP ratio (%)	-	-	7.61	5.58	8.85	16.99	16.11	15.13

Source: World development indicator (WDI) (2004), The World Bank website.

3.6 Nepal

Nepal's integration to world trade was not high in 1980 though its average tariff rate was low. Figure in Box 3 shows the trend in average applied tariff rate of Nepal. In 1980, the ratio of trade to GDP was only 30.27 percent whereas the average applied tariff rate was 22 percent. In 1990, these figures were 32.19 percent and 22.6 percent, respectively, almost no change in a decade (see Table 5). However, by 2003, those figures were 45.43 and 14.8 percent, respectively, implying some liberalisation measures to be in effect. Figures in Box 4 show the trend of these ratios.

Table 5: Openness Indicators of Nepal

Series/Year	1970	1975	1980	1985	1990	1995	2000	2003	2005
Export GDP ratio (%)	4.9	8.9	11.54	11.53	10.53	24.97	23.28	16.65	
Import GDP ratio (%)	8.3	13.37	18.73	20.0	21.66	34.52	32.43	28.78	
Trade GDP ratio (%)	13.2	22.27	30.27	31.53	32.19	59.49	55.71	45.43	
Tariff	-	-	22	21	22.6	11.0	14.2	14.8	14.7

Source: World development indicator (WDI) (2004), The World Bank website.

3.7 Pakistan

Starting in 1980s, trade liberalisation in Pakistan continued slowly until serious interruptions in 1996-97 when commenced a new, comprehensive trade liberalisation programme and continued until 2002-03. At that measure, the general maximum customs duty was reduced to 25 percent

though the actual protection rates remained a bit higher than customs duties. The government has largely completed an ambitious and politically sensitive programme of comprehensive liberalisation of trade and other policies that affect its agricultural sector *vis-à-vis* India, Bangladesh and Sri Lanka, where there are strong protectionist elements in agricultural policies.

One factor influencing trade policy liberalisation in Pakistan is the recognition of the large volumes of illegal imports via Afghanistan and from India that high protection has encouraged (The World Bank 2004). Table 6 shows the extent of openness of the Pakistan economy to the world trade and figure in Box 3 portrays the trend of average applied tariff rate in Pakistan for period 1982-2005. Moreover, the figures in the Box 4 show the trend in the ratio of export to GDP, of import to GDP and of trade to GDP for each of the South Asian economies for the period 1971-2002

Table 6: Openness Indicators of Pakistan

Series/Year	1970	1975	1980	1985	1990	1995	2000	2003	2005
Export GDP ratio (%)	7.77	10.85	12.49	10.42	15.54	16.71	16.35	20.48	-
Import GDP ratio (%)	14.67	22.39	24.1	22.81	23.37	19.42	17.96	20.36	-
Trade GDP ratio (%)	22.44	33.24	36.59	33.23	38.91	36.13	34.31	40.84	-
Tariff	-	-	78	77	64.8	50.1	23.6	16.8	14.3

Source: World development indicator (WDI) (2004), The World Bank website.

3.8 Sri Lanka

Sri Lanka's trade and its industrial sector are dominated by its export-oriented garment industry and its textile sector. Despite the addition of a surcharge to customs duties, industrial tariffs have been low, and in 1997 all textile tariffs were abolished and since then the textile industry has been operating under free-trade conditions – both in supplying garment exporters and the domestic market. However, there is significant protection of some manufacturing industries, and also considerable intervention and protection of some major agricultural import substitution crops, especially rice, potatoes, onions and chilies. Sri Lanka's early trade liberalisation and the appreciation of its currency in relation to the Indian Rupee led to a large and growing trade deficit with India, and in the hope of correcting this deficit, Sri Lanka entered into an FTA with India which became operative in March 2000.

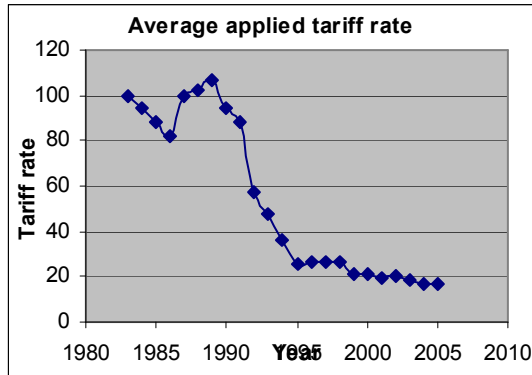
Although Sri Lankan exports to India have increased quite rapidly since then up to 2002-03 they were still very small, and the bilateral trade deficit with India had increased substantially. The official measure of openness, the trade-GDP ratio was 78.12 percent in 2003 implying a large trade orientation of Sri Lanka (see Table 7). Tariff is the major trade policy instrument and in 2005 estimated average applied tariff rate was 10.8 percent. The figure in Box 3 shows the trend in average applied tariff rate of Sri Lanka for the period 1990-2005 and the Table 7 shows the extent of Sri Lanka's integration to the world trade. Moreover, the figures in the Box 4 show the trend in the ratio of export to GDP, of import to GDP and of trade to GDP for each of the South Asian economies for the period 1971-2002.

Table 7: Openness Indicators of Sri Lanka

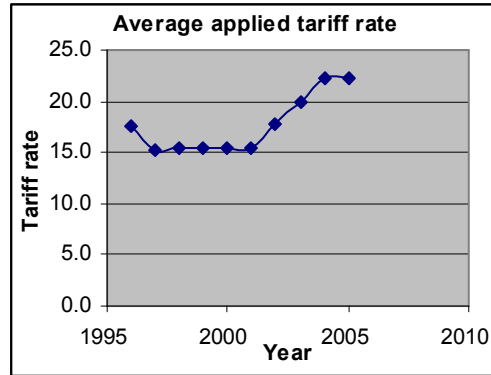
Series/Year	1970	1975	1980	1985	1990	1995	2000	2003	2005
Export GDP ratio (%)	25.45	27.49	32.22	26.40	29.21	35.60	39.02	35.77	
Import GDP ratio (%)	28.60	34.96	54.80	38.40	38.02	46.03	49.62	42.35	
Trade GDP ratio (%)	54.05	60.45	87.02	64.80	67.23	81.63	88.64	78.12	
Tariff			45	31	28.3	20	9.3	8.7	10.8

Source: World development indicator (WDI) (2004), The World Bank website.

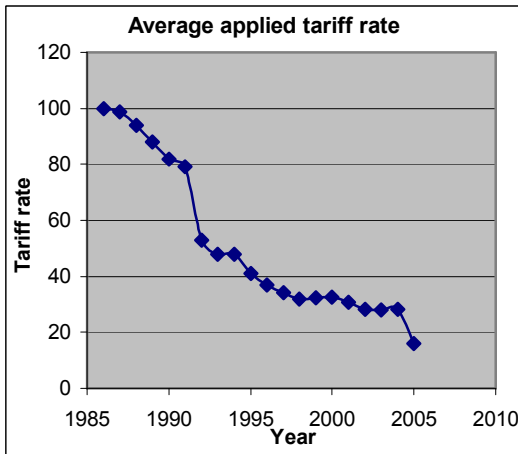
Box 3: Trend in Average Applied Tariff Rate in South Asian Countries



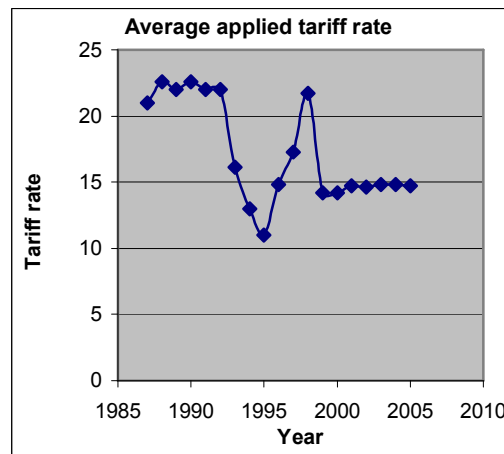
Bangladesh



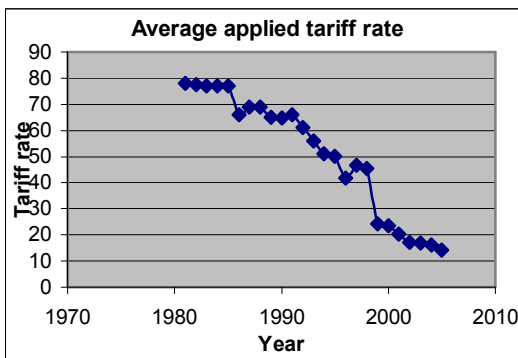
Bhutan



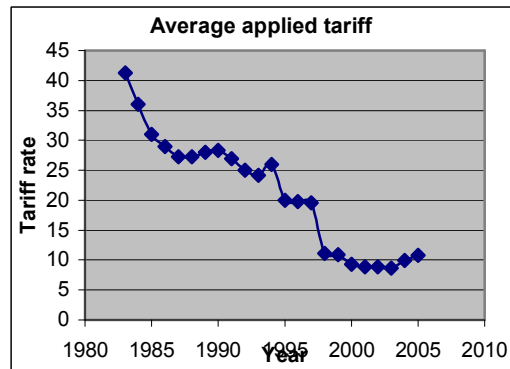
India



Nepal



Pakistan



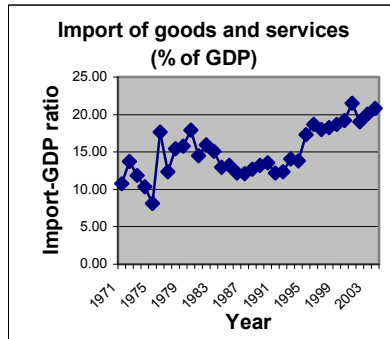
Sri Lanka

Source: World Bank website

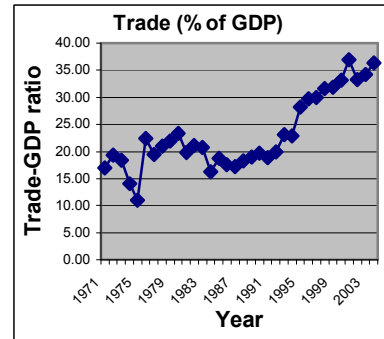
Box 4: The Export-GDP Ratio, Import-GDP Ratio and Trade-GDP Ratio in South Asian Countries



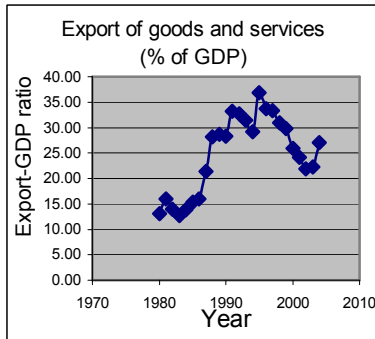
Bangladesh



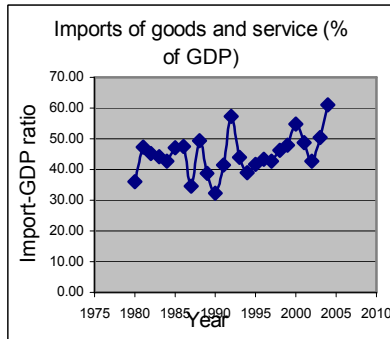
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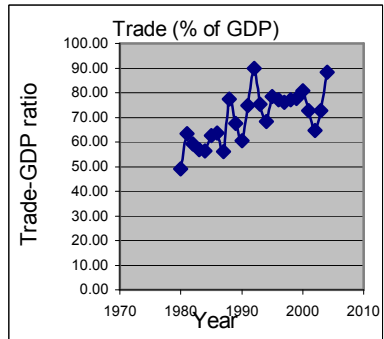
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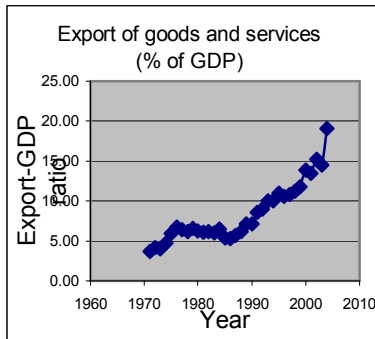
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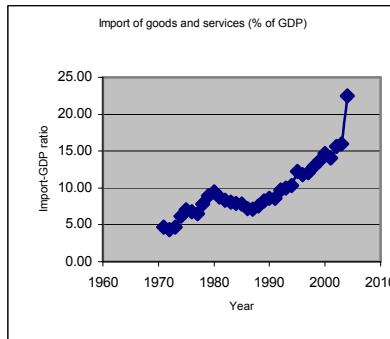
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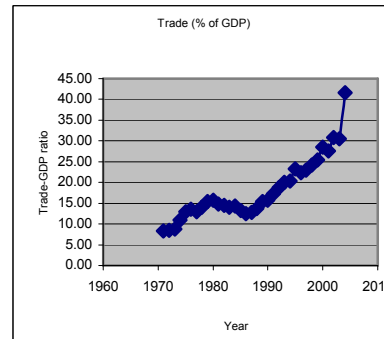
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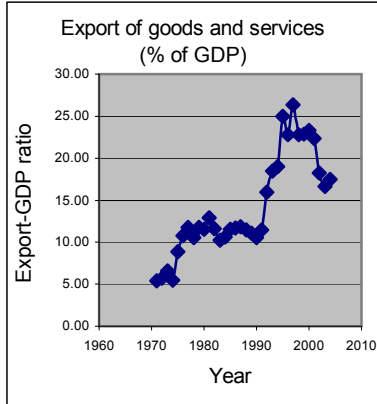
India



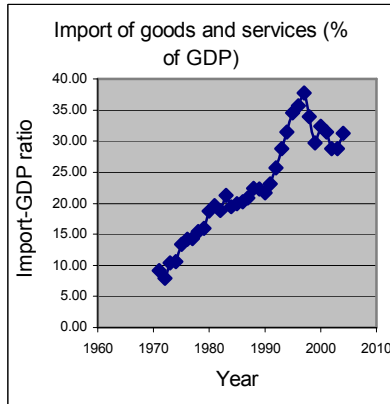
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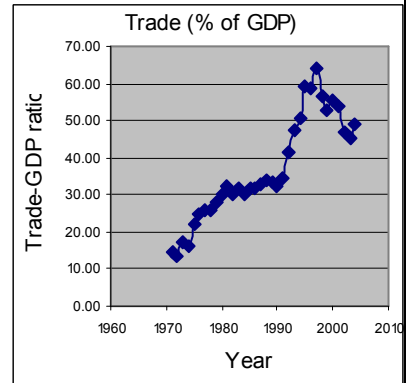
India



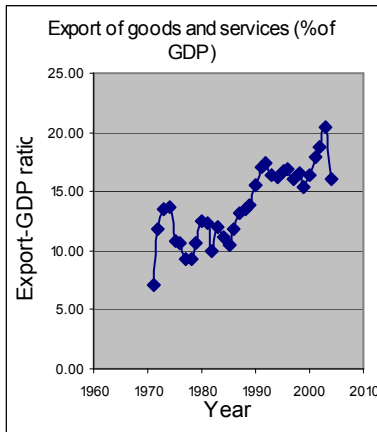
Nepal



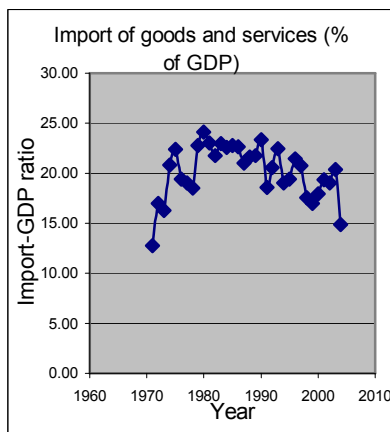
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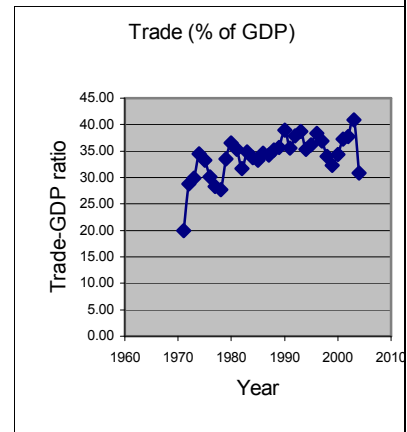
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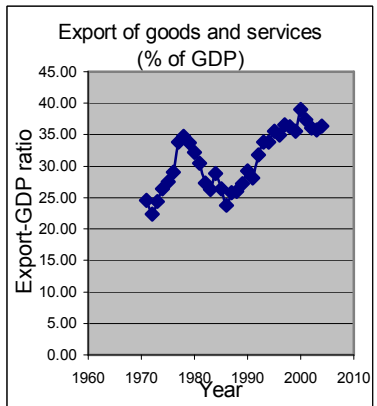
Pakistan



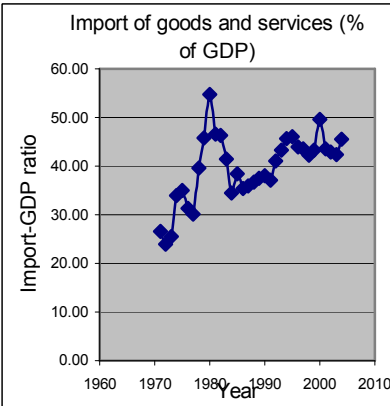
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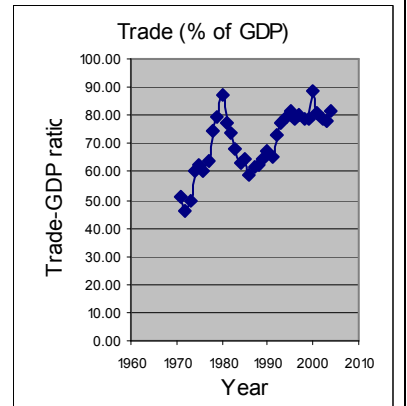
Pakistan



Sri Lanka



Sri Lanka



Sri Lanka

Source: World Development Indicator (2004)

4. Trade Liberalisation Measures in Sub Saharan Africa

Though the SSA countries began trade liberalisation in early 1980s, this region still continues to be one of the world's most protectionist regions. Under the Uruguay Round, developed countries agreed to cut their bound tariffs by almost 40 percent. Tariffs in SSA countries, however, remained higher than what was in the rest of the world, getting benefits of a misconceived policy of special treatment for the LDCs and their concomitant exception from some of the World Trade Organisation (WTO) Rules. Average applied tariff rate of the region fall from 22.1 percent in 1983 to 17.7 percent in 2003, which is the largest, in average, among the world's second highest, and next to South Asia. It is important to note that though South Asia has the highest average applied tariff as a region whole, its rate of reducing tariff is much higher (70 percent) than that of the SSA in the period 1983-2003 (Tupy, 2005).

It is noteworthy that inter-regional trade of African (including SSA countries) includes only 10 percent of their total exports where as the figures for the same category of Western Europe and North America are 68 and 40 percent, respectively. This low figure of inter-regional trade in African economies is due to protectionist policies in the region which again obviates that SSA is one of the most protectionist regions in the world.

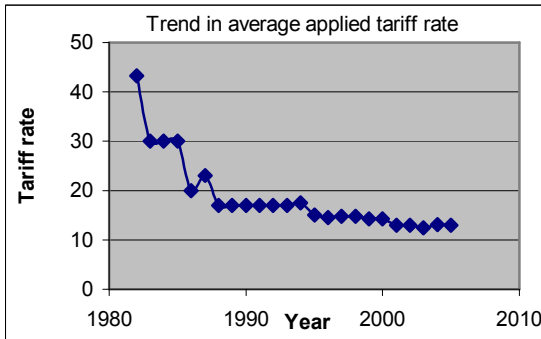
4.1 Ghana

In Ghana, trade liberalisation measures were started to be undertaken in the early 1980. Ghana liberalised its foreign exchange market by introducing an auction market for foreign exchange market in 1986. In case of QRs, import licensing and prohibitions were terminated in 1989. There were several rounds of tariff reforms aiming at rationalising the tariff structure and at making up for some of the protection lost through the reform of the QRs. However, the range of tariffs and their dispersion have been greatly reduced (Rodrik, 1998). In 1982, Ghana's tariff rate was 43.3 percent which was 17 percent in 1990 and 13 percent in 2005. Figures in Box 5 shows the trend in the average applied tariff rate of Ghana. Moreover, figures in Box 6 show the trend in the ratio of export to GDP, import to GDP and of trade to GDP.

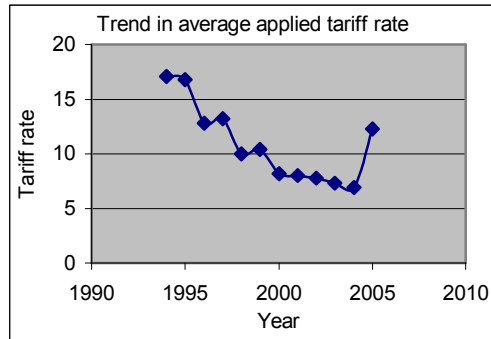
4.2 Uganda

In Uganda, devaluation of domestic currency had been adjusted periodically in 1987 through 1989. Tariff reforms were taken at several rounds. On export side, however, it removed the monopoly of coffee marketing and abolished all export taxes. In 1986, it had average applied tariff of about 30 percent which was about 7 percent by 2004. Figures in Box 5 show the trend in average applied tariff rate of Uganda. Moreover, figures in Box 6 show the trend in the ratio of export to GDP, import to GDP and of trade to GDP.

Box 5: Trend in Average Applied Tariff Rate in Ghana and Uganda



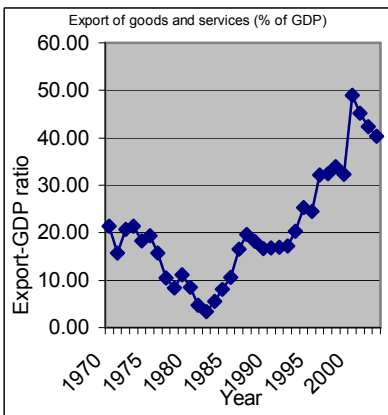
Ghana



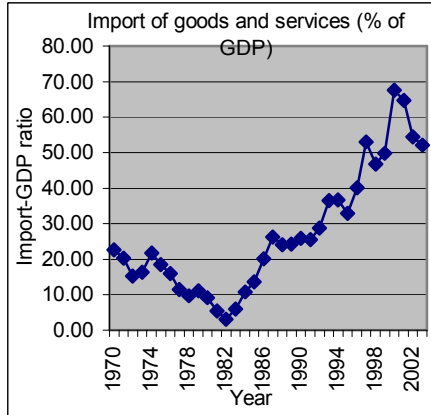
Uganda

Data Source: World Bank website.

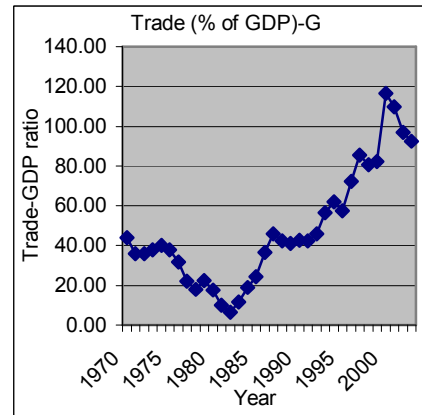
Box 6: The Export-GDP Ratio, Import-GDP Ratio and Trade-GDP Ratio in Ghana and Uganda



Ghana



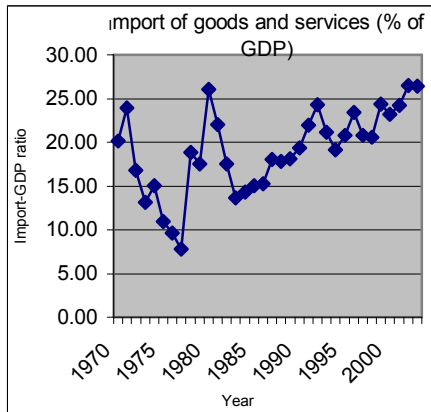
Ghana



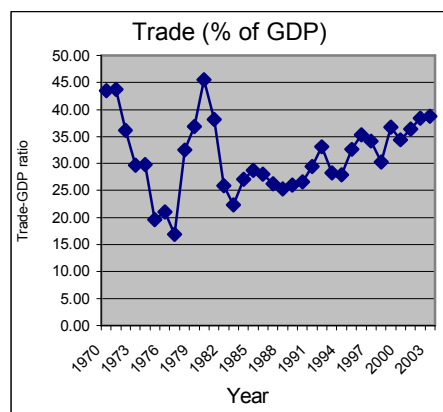
Ghana



Uganda



Uganda



Uganda

Source: World Development Indicator (2004).

5. Trade and Growth: Key Theoretical Proposition

There are competing theories on the contentious issue of trade and economic growth. There have also been a large number of empirical studies trying to test those theories under different context. The key schools of thought are: Static ‘Gains from Trade’ Theories; Structural Pessimism – ‘Trade as an Engine of Impoverishment’; the New-Orthodoxy – Revival of ‘Trade as an Engine of Growth’; ‘New-trade Theories’; and ‘Endogenous Growth Theories’.

5.1 Static ‘Gains from Trade’ Theories

Among the schools of thoughts regarding the debate on trade and growth is the *Static Gains from Trade*. On the basis of the fact that trade is beneficial for the trading countries, there are three dominant theories: the theory of comparative advantage; the Heckscher-Ohlin-Samuelson theorem; and the theory of vent for surplus. Ricardian theory of comparative advantage is the most influential theory. At the heart of this theory is the difference in factor productivities between countries. International trade diverge the countries’ specialisations in consumption and production as the countries have different factor productivity. And this theory argues that country with having a comparative advantage in any commodity will export that commodity. The Heckscher-Ohlin-Samuelson theorem is the extension of the classical theory of comparative advantage. This theorem reasons that countries have different factor endowments and different factor intensities across goods. Therefore, the country abundant in any factor will, according to this theory, export commodities intensive to that factor.

Since the low income countries are labour abundant, this theory implies that they will export the commodities intensive to labour. Finally, the theory of vent for surplus (Myint, 1958) considers the trade as the opportunity to utilise the under-utilised factors of production. The basic idea of this is that in the low income countries factors are under-utilised and trade with other countries creates this type of opportunity. This brings income to unemployed factors of production. The implication of this theory is that if the developing countries export the products of factors that would otherwise not be employed can gain from trade.

5.2 Structural Pessimism: ‘Trade as an Engine of Impoverishment’

The ‘Structuralist’ theories on trade developed during 1950s and 1960s. Among the variants of these theories (Prebisch, 1950; Singer, 1950; Nurkse, 1962; Vernon, 1966) the most influential one is the Prebisch-Singer view on international trade. According to this theory, the world is divided into two parts – the centre and the periphery – where the industrialised countries are at the ‘centre’ and the developing countries are ‘periphery’. This theory sees the trade as the engine of impoverishment in the periphery countries and as a source of enrichment of the rich countries. The basis of this argument is that the low income countries export income inelastic primary products and with the per capita income rise in the rich countries lowers the demand for these primary products thereby causing the poor countries to be impoverished. Prebisch (1950), examining the British net barter terms of trade of the period 1870-1930, came to a conclusion of declining terms of trade which are hurting the poor countries.

At the heart of this theory are four propositions: terms of trade; export instability; pervasive infant industries; and misdistribution of gains from trade (Greenaway and Milner, 1993; cited in Raihan, 2007). Supporting the ‘infant industry argument’, the structuralists argue that with protection the infant industry will be mature to utilise economies of scale so that output can be produced at minimum unit cost. This school of thought is also concerned over the ‘maldistribution’ of gains from trade at the world scale. Moreover, assuming that there exists a substantial technological gap between developed and developing countries, structuralists extend their theory by ‘product cycle theory’ which states that the gains from trade are mostly appropriated by the developed countries. The theory of market failure is the microeconomic foundation of the structuralists’ argument.

5.3 The New-Orthodoxy: Revival of ‘Trade as an Engine of Growth’

This school of thought emerged during the late 1970s and early 1980s. Factors that contributed to the reconsideration of ‘trade as an engine of growth’ are: i) the emergence of the so called ‘new-classical counter-revolution’ in the mid-1970s at both the academic and policy levels; (ii) the increasing dissatisfaction among the developing countries regarding their inward looking trade regimes; (iii) the conditionalities attached to aid and loans under the SAP of the IMF and the World Bank; and (iv) the remarkable export and growth performance of the East-Asian economies (Love, 2001; cited in Raihan, 1997).

This school of thought emphasised the importance of the comparative advantage and free trade to attain overall efficiency at both the domestic and global level. They argued that the promotion of export would generate several benefits including higher export productivity. It labels the import substituting industrialisation as inefficient and growth inhibiting. Thus, this school thinks that to enhance growth, developing countries should remove barriers to trade. Several policy prescriptions also emerged from their arguments: bringing policy neutrality between exports and imports; ‘getting prices right’, including exchange rates; removing price controls; reducing public expenditure; privatisation and deregulation of public enterprises; encouraging foreign investment; and controlling domestic monetary expansion (Love, 2001; cited in Raihan, 2007).

5.4 ‘New-trade Theories’ and ‘Endogenous Growth Theories’

The school of ‘new trade theories’ emphasised on issues such as learning, scale, market structure, externalities, and institutional influences on trade performance (Brander and Spencer, 1985; Krugman, 1986; Rodrik, 1988; cited in Raihan, 2007). It takes importantly the existence of some ‘strategic’ sector in the economy. The ‘endogenous growth theories’ carry many of the views of the ‘new trade theories’.

Box 7: Key Propositions of Theories on Trade and Growth

<p style="text-align: center;">Static ‘Gains from Trade’ Theories</p> <ul style="list-style-type: none"> • Based on the fact that trade is beneficial for the trading countries. • Three dominant theories: the theory of comparative advantage, the Heckscher-Ohlin-Samuelson theorem, and the theory of vent for surplus. • Ricardian theory of comparative advantage, the most influential one: At the heart of this theory is the difference in factor productivities between countries • The Heckscher-Ohlin-Samuelson theorem: the country with abundant in specific factor will export commodities intensive to that specific factor. Since the low income countries are labour abundant, this theory implies that they will export the commodities intensive to labour. • The theory of vent for surplus: It considers the trade as the opportunity to utilise the under-utilised factors of production. The basic idea under this is that in the low income countries factors are under-utilised and trade with other countries creates this type of opportunity. This brings income to unemployed factors of production. 	<p style="text-align: center;">Structural Pessimism: ‘Trade as an Engine of Impoverishment’</p> <ul style="list-style-type: none"> • The ‘Structuralist’ theories on trade developed during 1950s and 1960s. • The most influential theory, among the variants of these theories, is the Prebisch-Singer view on international trade. • This theory sees the trade as the engine of impoverishment in the periphery (developing) countries and as a source of enrichment of the rich countries. • The basis of this argument is that the low income countries export income inelastic primary products and with the per capita income rise in the rich countries lowers the demand for these primary products thereby causing the poor countries to be impoverished. • Four propositions are at the heart of this theory: terms of trade, export instability, pervasive infant industries, and misdistribution of gains from trade (Greenaway and Milner, 1993; cited in Raihan, 2007). • The structuralists support the ‘infant industry argument’. • They also are concerned over ‘maldistribution’ of gains from trade.
<p style="text-align: center;">The New-Orthodoxy: Revival of ‘trade as an engine of growth’</p> <ul style="list-style-type: none"> • This school of thought emerged during the late 1970s and early 1980s • Factors that contributed to the reconsideration of ‘trade as an engine of growth’ are: i) the emergence of the so called ‘new-classical counter-revolution’ in the mid-1970s at both the academic and policy levels; (ii) the increasing dissatisfaction among the developing countries regarding their inward looking trade regimes; (iii) the conditionalities attached to aid and loans under the SAP of the IMF and the World Bank; and (iv) the remarkable export and growth performance of the East-Asian economies (Love, 2001; cited in Raihan, 1997). • This school of thought emphasised the importance of the comparative advantage and free trade to attain overall efficiency at both the domestic and global level. They argued that the promotion of export would generate several benefits including higher export productivity. It labels the import substituting industrialisation as inefficient and growth inhibiting. 	<p style="text-align: center;">‘New-trade Theories’ and ‘Endogenous Growth Theories’</p> <ul style="list-style-type: none"> • The school of ‘new trade theories’ emphasised on issues such as learning, scale, market structure, externalities, and institutional influences on trade performance (Brander and Spencer, 1985; Krugman, 1986; Rodrik, 1988; cited in Raihan, 2007). • It takes importantly the existence of some ‘strategic’ sector in the economy. • The ‘endogenous growth theories’ carry many of the views of the ‘new trade theories’.

6. Summaries of Some Empirical Studies on Trade and Growth

6.1 Cross Country Econometric Studies

Box 8: Cross Country Economic Studies

Study	Methodology, Findings and Limitations
Dollar (1992)	<ul style="list-style-type: none"> • This study constructs two separate indices to capture the degree of outward-orientation: an index of real exchange rate distortion and an index of real exchange rate variability. • It regresses these two indices on per capita GDP growth for the period 1976-85 for 95 developing countries. • Finding is that there is statistically significant relationship between growth and outward orientation. • This study has also limitation such as Dollar's two indices of outward orientation are inappropriate and misleading (Rodrik and Rodriguez, 2001).
Sach and Warner (1995)	<ul style="list-style-type: none"> • Used a zero-one dummy variable to capture the 'openness' of any country. The dummy takes the value of zero if the economy was closed and according to any of the criterion, including: (i) it had average tariff rate higher than 40 percent; (ii) its NTBs covered on average more than 40 percent of imports; (iii) it had a socialist economic system; (iv) it had a state monopoly of major exports and finally; (v) its black market premium exceeded 20 percent during either of the 1970s and 1980s decades. • Findings: the 'openness' dummy has a high robust coefficient implying that the openness has high degree of impact of economic growth. Their argument in this regard is that the direct effects of trade liberalisation are increased competition, specialisation, and reduced rent seeking – which are important contributory factors for economic growth. • Limitations: Strength of the 'openness' dummy.
Edwards (1992)	<ul style="list-style-type: none"> • Used a cross country data set of 30 developing countries for the period 1970-1982. • Theoretical model of the study states that in a small country, capital accumulation, labour force growth and the technological gap between the country in question and advanced nations have positive impact on the steady state growth rate of aggregate output, whereas the degree of trade distortions is negatively related to the growth. • Used two basic sets of trade policy indicators: 'openness' indicators (the way in which trade policy restricts imports) and 'intervention' indicators (the extent to which trade policy distorts trade, either positively or negatively) • Findings: country with more open trade regime, controlling for other factors, have faster growth. • Limitations include: (i) for most of variables Edwards used an average for the 12 years, but for only trade policy indicators he used data only for the year 1982; and (ii) standard control variables, such as initial income, education, regional dummies, which raises skepticism over the regression results have not been applied in none of the regression models.
Dollar and Kraay (2001)	<ul style="list-style-type: none"> • The earlier studies on the relationship between trade and growth shortcomings regarding econometric estimates such as measurement error of the variables, omitted variable bias, and endogeneity problem.

Study	Methodology, Findings and Limitations
	<ul style="list-style-type: none"> • The trade policy indicators that are used in empirical literature are not particularly good. • For this, decade-over-decade <i>changes</i> in the volume of trade has been used as an imperfect proxy for <i>changes</i> in trade policy which, at least, is not dependent on the geographical proximity. Period dummy has also been taken to control for shocks which is common in all countries such as shocks or reductions in transport costs. • Data set that spans 100 countries. • The finding is that changes in growth rates are highly correlated with changes in trade volumes, controlling for lagged growth and addressing a variety of econometric difficulties. • This methodology is different from that of much of the existing empirical literature that relates growth to cross-country difference in trade volumes which reflect countries' geographical characteristics, such as their proximity of major markets, their size, or whether they are landlocked. • As a result this type of evidence tells little about the effects of trade policy on growth, and it may even reflect the effects of geography on growth through other channels. • However, using the variable decade-over-decade in the volume of trade as an imperfect proxy for changes in trade policy ensures that the results are not driven by geography, nor by any other country characteristics that affect both growth and trade volume, but changes a little over time, i.e. institutional quality.

6.2 Single-Country Econometric Studies

Box 9: Single-Country Economic Studies (Bangladesh)

Study	Methodology, Findings and Limitations
Begum and Shamsuddin (1998)	<ul style="list-style-type: none"> • Estimates the effect of growth of exports on economic growth for Bangladesh for the period 1961-1992. • Finding: Through increasing in total factor productivity, the growth of exports has a significant and positive impact of economic growth. • Limitation: this study follows a weak methodology as it considers only the short run impact of export growth.
Razzaque <i>et. al</i> (2003a)	<ul style="list-style-type: none"> • Estimates the effect of growth of exports on economic growth for Bangladesh for the period 1980-2000. • Finding: Contrary to Begum and Shamsuddin (1998), this study, while estimating long run impact of export growth on economic growth, finds no evidence of this type of relationship in the context of Bangladesh economy.
Razzaque <i>et. al</i> (2003b)	<ul style="list-style-type: none"> • Investigates the impact of trade liberalisation on economic growth in the context of Bangladesh. • Applies three measures of trade liberalisation; Trade-GDP ratio, ratio of imports of consumer goods to GDP, and implicit nominal tariff rate. • The investigation claims that there is no statistically significant association

Study	Methodology, Findings and Limitations
	between indicators of trade liberalisation and economic growth. Moreover, the study also does not find any evidence of impact of the measures of trade liberalisation on total factor productivity growth, contrary to the findings of Begum and Shamsuddin (1998) cited above.
Raihan (2007)	<ul style="list-style-type: none"> • Uses data for the manufacturing industries in Bangladesh and investigates the impact of trade liberalisation on the growth of manufacturing value-added. • The study finds no evidence of positive impacts of trade liberalisation. • On the contrary, the study finds negative impact of import penetration on the value-added growth in the manufacturing industries in Bangladesh.

6.3 Sub-Saharan Africa

Box 10: Single-Country Economic Studies (SSA Region)

Study	Methodology, Findings and Limitations
Onafowora and Owoye (1998)	<ul style="list-style-type: none"> • Explore the trade-growth nexus for 12 SSA countries. • Use the export/GDP ratio and a time dummy variable for trade liberalisation in their growth equation. • Findings: the regression results claim that the first indicator is statistically significant with a positive sign for six countries, a negative sign for two countries and insignificant for the rest four countries. The latter dummy, moreover, has come out to be statistically significant with a positive sign for five countries, with a negative sign for two countries, and statistically insignificant for the rest five countries.

6.4 Studies Based on CGE Models

Box 11: Studies Based on CGE Models

Study	Methodology, Findings and Limitations
Khondker (1996)	<ul style="list-style-type: none"> • To examine the impacts of tariff liberalisation under different policy scenario, this study uses the 1988-89 Social Accounting Matrix (SAM) for Bangladesh and develops competitive and non-competitive variants of static Computable General Equilibrium (CGE) models. • Findings: the investigation claims that the trade liberalisation has different impact on different sectors. Moreover, its impact also varies depending on the model structure, whether competitive model or non-competitive model. • For the competitive and constant returns to scale variant of model, tariff liberalisation causes to shift resources from heavily protected sector to less protected sector. • For imperfect competition market variant model, heavily protected manufacturing sector has come out to be main beneficiaries due to tariff liberalisation.
Arndt <i>et. al</i> (2002)	<ul style="list-style-type: none"> • Through a number of simulations relating to trade policy reform, look at the opportunities and challenges in the agricultural and garments sectors in Bangladesh. • These simulations illustrate the importance of trade policy and the links between Bangladesh and the world economy as far as the impacts

Study	Methodology, Findings and Limitations
	of the reforms in agricultural and garment sectors are concerned.
Khondker and Raihan (2004)	<ul style="list-style-type: none"> • This study examines the impact of different policy reforms in Bangladesh in a general equilibrium framework. • Finding: full trade liberalisation generates negative implications for the macro-economy as well as for the welfare and poverty status of households.
Pradhan and Amarendra (2006)	<ul style="list-style-type: none"> • A 28 sector, 3-factor and 9-household group CGE model of India is constructed to analyse the impacts of tariff and NTBs on the welfare and poverty of socio-economic household groups. • Findings: A general cut in tariffs leads to a decrease in overall welfare and reduction in poverty favoring urban households more. On the other hand, quota reductions on agriculture and food products result in a gain in welfare and a bigger reduction of poverty, with rural households doing better than urban households.

7. Anti Export Bias

If any policy results in declining trade, especially export, with other country (ies) then that policy is anti-export bias. To find whether any policy is anti-export bias or not, there is a B index developed by Bhagwati (1978) and Kruger (1978). It is important to note that the B index of anti-export bias is probably the best single summary indicator of the impact of trade policies on incentives because it measures the combined effects of various trade policies on the relative prices between importable and exportable goods and, hence, on the overall implicit taxation of tradable activities. This measure of anti-trade bias can be computed using the following expression.

$$B = \frac{E_m(1 + t + n + PR)}{E_x(1 + s - t_I + r)}$$

Where E_m and E_x are nominal exchange rates applied on imports (m) or exports (x); t is the average import duty, n is any additional differential domestic taxation of imports, PR is the differential between the domestic and border prices of importable commodities subject to QRs or import monopolies, s is any export subsidy ($s > 0$) or export tax ($s < 0$), t_I is the taxes and duties on inputs used in production of exportable goods (that is, the tax rate on inputs multiplied by the share of that input in total production costs), and r is any import duty rebate granted to producers of exportable goods.

The B index may be expressed in terms of either output prices or value added. In either case, if B is higher than one, as is usually the case, the index indicates the degree to which commercial policies favour import-substitution relative to exporting. If the B index is equal to one, then on average commercial policies are neutral between import-competing and exporting. And, if B

should turn out to be less than one, then the trade regime is partial to exporting rather than to import-competing activities.

8. Nominal vs. Effective Rate of Protection

8.1 Nominal Protection

The nominal rate of protection (NRP) on any good is the proportional difference between its domestic and international price arising from the trade policies in question. These policies can include import tariffs, export taxes, QRs (licensing requirements, prohibitions, rules of origin, local purchase requirements, etc.) and other ‘incentives’ such as subsidies and tax rebates. If the only relevant trade policy were a 20 percent import tariff, the NRP would be 20 percent – the proportional difference between the *cif* import price and landed price (and therefore of closely competitive locally produced goods) in the domestic market. With a more complex set of trade policy measures the NRP is an estimate of the equivalent ad valorem tariff that would lead to the same difference between domestic and international prices as prevails under the policies in question.

The NRP, therefore, is a measure of the total price-raising (or reducing) effects of trade policies on a tradable good being examined. The relationship between the domestic price and the world price of any good, and the derivation of NRP from this, can be expressed algebraically as:

$$P_d = P_w (1 + t + d + e) \quad [1]$$

$$\text{NRP} = (P_d - P_w) / P_w \times 100 \quad [2]$$

Where,

P_d and P_w are the domestic and world price, respectively, t and d are the *ad valorem* equivalents of taxes and duties on imports of the good, and e is the net *ad valorem* tariff equivalent of other non-tax, non-tariff trade restrictions. However, there are several practical problems in measuring the nominal rate of protection such as official versus applied rate, *ad valorem* versus specific rates, *ad valorem* equivalents of other measures etc.

8.2 Effective Protection

The effective rate of protection measures the net protective effect on producers of any product due to the structure of protection on both its inputs and its outputs. The intuition behind effective protection pre-dates the work of Corden and others. Following Corden (1971), the ERP can be defined as follows:

$$\text{ERP}_j = (t_j - a_{ij}t_i)/(1 - a_{ij})$$

Where,

ERP_j = effective rate of protection for activity j , t_j = nominal rate of tariff on activity j

a_{ij} = share of activity i in cost of activity j at free trade prices, t_i = nominal tariff on activity i .

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