INCLUSIVE TRADE AND INVESTMENT:
IMPACTS AT THE COUNTRY, SECTORAL AND COMMUNITY LEVELS

INTRODUCTION

To enrich this report, a number of country and sectoral studies have been conducted. The studies, which are presented below, along with some examples taken from the existing literature, illustrate challenges at the country or sectoral level that are not covered in the econometric work, but are important in providing a comprehensive understanding of who benefits from trade, investment, trade facilitation and other related policies in Asia and the Pacific and why.

The cases are organized by the specific aspect of international openness that they reflect, that is: trade integration; trade facilitation; foreign direct investment (FDI) and investment promotion; and development of responsible business practices. Each case is also paired with the indicators of inclusivity which were examined earlier (table 10.1). The concluding section offers a brief synthesis of the main lessons learnt from the presented cases and presents policy recommendations.
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Quick guide to cases of inclusive trade and investment in the Asia-Pacific region

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A. TRADE INTEGRATION AND PROMOTION

In this Report, it has been established that trade liberalization policies alone, despite increasing efficiency, do not necessarily produce benefits for all. To improve the chances of trade delivering inclusive growth, Governments need to craft a comprehensive strategy – combining trade policies with appropriate complementary measures. Policies should aim at helping all levels of society gain from increased trade. The benefits obtained through exports should be utilized for economic restructuring to further improve the economy’s resilience and efficiency (Lim, 2009). This does not imply that further trade liberalization has to be postponed until such additional measures are established. Instead, the pace of trade liberalization needs to be more carefully managed while complementary policies are more urgently pursued. This can generate a virtuous circle in which improved productivity and competitiveness would also foster new investment. With more investment and trade comes faster economic growth, which can lead to higher fiscal revenue for Governments. These in turn can be allocated to further enhancements in the complementary policies. The case studies provide illustrations of how these synergies could be exploited to enhance prosperity for all. They also demonstrate how easier access to regional and global markets can provide direct benefits to producers and consumers.

1. Trade integration reduced poverty but now the Lao people must battle inequality

The trade liberalization and growing international integration of the Lao People’s Democratic Republic has delivered economic growth, growing household incomes and poverty reduction. The benefits have been felt in both rural and urban areas. Trade has led to falling poverty by lowering the cost of living and raising real income. As a result of trade, consumers can access a wider choice of goods, and at lower prices. With better, cheaper inputs and better access to credit, farm productivity and returns to household enterprises have grown, raising household incomes. That, in combination with economic growth, increased the Government’s revenues and facilitated investment spending on infrastructure and social services. As a result, poverty has been declining rapidly, though with growing inequality. However, environmental impacts and the forced relocation caused by some large, land-exploitation projects have raised concerns over villagers’ livelihoods and food security.

Since the Lao People’s Democratic Republic joined ASEAN in 1997, a growing number of bilateral trade agreements for preferential market access have been signed to ease trade with trading partners. As the country was preparing for WTO accession (completed in February 2013) and the creation of the ASEAN Economic Community (AEC) in 2015, trade barriers were gradually dropped, including tariffs for many goods originated in ASEAN. Over this same period, trade as a percentage of GDP grew as the Lao People’s Democratic Republic gradually became more integrated with the world; poverty continued to decline steadily from 46% in 1993 to 27.6% by 2008. If this poverty reduction trend continues, the national poverty rate will have dropped to 19% by 2015 (see figure 10.1).

Poverty declined across all regions, but at a faster rate in urban areas. Poverty in the capital, Vientiane, fell at a faster rate than in the northern, central and southern regions of the country. While rates of absolute poverty fell over the 15-year period – 1992/93-2007/08 – inequality increased nationwide, with the exception of the southern region. The share of total household income spent on food also declined; while the share in 1992/3 was 64.3% it had fallen to 46.1% by 2007/8. On the other hand, spending on non-food items, essential for everyday living, increased.

The decline in the share of income spent on food was largely caused by a reduction in self-produced food. This was attributed to growing household cash income – as farm households transitioned from self-sufficient farming towards commercial farming. This was aided by more villages becoming connected with the market economy via greater access to roads, electricity and telecommunications. More affordable personal transportation units (motorcycles) and telecommunication units have become available and thus entering commercial agriculture is more feasible for villagers.

The population also benefitted from growing ownership of durable goods as household income rose and the prices of durable goods fell in real
Increasing trade openness and falling poverty, 1993-2015

FIGURE 10.1

Poverty trends and international trade in the Lao People’s Democratic Republic

Source: Southichack and Phonvisay (2013).

terms (figure 10.2). For example, the price of motorcycles dropped substantially after Chinese and Korean motorcycles entered the market at a price around half that charged by their Thai competitors.

The rates of ownership of durable goods (motorbikes, mobile phones, televisions, refrigerators and electric rice cookers) rose faster than in urban areas. This seems to suggest that real purchasing power of rural households was growing faster than that of the average urbanite. Price and household consumption expenditure analyses for 47 consumer goods and services all indicate that between 1997/98 and 2007/08 real consumption in rural areas grew at a higher rate than in urban area – though the sample size was small.

The Lao People’s Democratic Republic also benefited from improvements in its terms of trade. Global prices for its rice, meat, vegetables, coffee and traditional skirts improved while prices for imports of essential everyday goods fell. This particularly helped farmers and other producers. To some extent these benefits for households were offset by worsening terms of trade for other items such as gasoline, electricity, water, school fees, school uniforms and other clothing items.

FIGURE 10.2

Downward trends in real prices since 1996

Source: Southichack and Phonvisay (2013).
International trade has helped job creation in non-agricultural sectors to a limited extent. However, as economic growth has been largely driven by the capital-intensive resource sector, job creation outside the agricultural sector remains rudimentary. A recent labour survey revealed that the Lao labour force has a low level of educational attainment, with 48.7% having only primary school education. Only 7.2% of the labour force has technical school education and only 5.4% has at least college education. Thus, low educational attainment remains one of the most important barriers to many types of investments and, thus, to job creation outside of agriculture.

In addition, data suggest that agricultural productivity has increased, as trade allowed for greater availability of improved inputs and cheaper technology in agricultural production. This evidence is confirmed by the finding from the price-household expenditure ratio analysis which suggests that farmers’ real income has grown. More jobs in the non-agricultural sector have been created as it continued to expand, although the number was still very small compared to farm jobs. While most newly created non-agricultural jobs are located in urban areas, the possibility of internal migration allows the rural population to also benefit.

Government revenues and expenditures have grown over time in both real, total, and per capita amounts, especially since the mid-2000s. Since 2005, real per capita revenues from domestic sources have increased, as a result of the growing economy and international trade. This allowed the Government to expand infrastructural development and increase its spending on social services. However, a considerable proportion of government revenues (28.6%) and expenditures (19.2%) have been financed by import taxes (tariffs and excise tax on imported goods). A drastic drop in import taxes revenue could jeopardize efforts of poverty reduction, at least in the short run. However, rural and poor households would be made worse off from a reduction in import taxes only if it led to a cut in government spending on social services such as retirement benefits, primary education and healthcare.

Rural households could also be worse off, if trade liberalization led to a substantial increase in land-extensive or resource-based investments, which could result in land encroachment or destruction of natural forest and environmental degradation.

Rapid growth in investment, associated with FDI and stimulated by trade liberalization and international integration, has created a growing demand and competition for resources. Without the Government’s proper attention, villagers’ rights to livelihoods and security could be violated and, as a result, push the affected villagers towards greater hardship and deeper into poverty.

Policy actions are needed to enhance complementary policies and ensure that the benefits from trade continue to be widely shared. But as poverty is a complex, multidimensional problem, involving multiple factors that go far beyond the scope of responsibilities entrusted with the Ministry of Industry and Commerce, policy responses which go beyond the traditional realm of trade policy will also be needed. While the Ministry is capable of implementing certain policies that can contribute to poverty reduction, inter-ministry cooperation is necessary in order to adequately tackle poverty problems. Thus, while a focus is on trade related issues, policy recommendations made by the study go beyond those relevant for the Ministry’s direct responsibilities.

The following actions are recommended:

- Reduce trade costs associated with administrative barriers and technical barriers;
- Promote market competition;
- Prioritize infrastructure development;
- Strengthen and expand agricultural extension services;
- Improve general education quality and expand enrolment in technical (vocation) training schools;
- Enhance government regulation of activities based on exploitation of land and those with potential environmental impacts.

LESSONS

Overall, the trade liberalization and growing international integration of the Lao People’s Democratic Republic have been successful in achieving economic growth, lifting household incomes and reducing poverty. This has benefited both rural and urban areas and facilitated the introduction of farmers into commercial agriculture. Yet, low educational
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attainment remains one of the most important barriers to many types of investments and, thus, to job creation outside of agriculture. Of importance for continued poverty reduction are: the direction of government revenue spending; increasing educational attainment to facilitate job creation outside of agriculture; and appropriate governance of natural resource exploitation.

Exports of Sri Lanka have had duty-free access to the Indian market under the India–Sri Lanka Free Trade Agreement (ISLFTA) since 2003. ISLFTA has adopted a conventional approach to trade liberalization and included trade in goods but not liberalization of investment or services trade. The critics of the agreement claimed that focusing on goods only would limit the agreement’s potential for job creation. Instead they preferred a wider focus including promotion of trade in services and investment flows. Since the agreement has been under implementation for a decade, it is now possible to review its effects on employment and on other important aspects of inclusivity and development.

From the perspective of expanding bilateral trade, the agreement was very successful; in 2000 Sri Lanka’s exports to India were $58 million, less than one tenth of its imports from India totaling $600 million. In 2012 exports grew to $519 million and imports to $3.4 billion, therefore reducing the import-export ratio to 6 to 1. Over the same period, Sri Lanka also diversified its exports to India. While there has been a reduction in exports of major traditional export products, a variety of other products have gained market access and have contributed to a steady increase of exports to India.139

At the same time, in parallel with the expansion of trade under the trade agreement, new FDI flows were triggered in activities associated with rubber-based products, ceramics, electrical and electronic items, wood-based products, agricultural commodities and consumer durables. A study by UNCTAD (2003) tied these new investments, totaling $145 million in 37 different projects, to the existence of the bilateral free trade.

By 2012, India emerged as the fourth largest overall investor in Sri Lanka with investments of $160 million. According to the Board of Investment of Sri Lanka, India was the second largest foreign direct investor in Sri Lanka in 2011, with an investment of $147 million (out of a total inbound FDI of $1.057 billion).140 Notable recent Indian investment commitments are from: Shree Renuka Sugar to set up a sugar refining plant at Hambantota ($220 million); Dabur to set a fruit juice manufacturing plant ($20 million); Altair Project by South City, Kolkata for real estate development in Colombo ($400 million); and Krrish Square Project by Krrish Group for Mixed-development in Colombo ($460 million).

Moreover, the last few years have also witnessed an increasing trend of Sri Lankan investment into India. Significant examples include Brandix (about $1 billion to set up a Brandix India Apparel City spread over 1,000 acre land in Vishakapatnam), MAS holdings, John Keels, Hayleys, Aitken Spence (hotels), Ceylon Biscuits (Munchee brand), Carsons Cumberbatch (Carlsberg) and DRH Logistics International.

Indian investments in Sri Lanka, have mostly been in the labour intensive sectors of vegetable oil and fat, metals, ferrous metals, oilseeds, wood products and machinery equipment. These investments opened employment opportunities to local, mostly unskilled, people. Moreover, opportunities for increased employment at semi-skilled or skilled levels were also created. De Mel (2009) who studied the impacts of ISLFTA on employment estimated that as of the end of 2007, some 6,747 individuals gained employment as a result of Indian investment in 70 projects. De Mel also pointed out that most of these projects appear to be in areas of the services sector that were not explicitly covered by the free trade agreement, and therefore cannot be attributed to the agreement-led impacts. On the other hand, Kelegama and Karunaratne (2013) observed that within the first two years of the implementation of ISLFTA, several sectors experienced over 100% growth, including industries such as chemical product manufacturing, cement manufacturing,
and pearl harvesting. They stated that some 5,900 jobs were created as a result of Indian investment projects and in few cases these related to inter-company relocation of labour.

Despite the limited scope of the agreement which only liberalized trade in goods, bilateral investment flows also rose. Together with the expansion of trade, this helped to generate more employment and to contribute towards further integration of the two economies. Freer trade has not only directly facilitated the investments in the manufacturing sector, but also had spillover effects on the services sectors like telecommunications which provide greater opportunities for higher-skill employment. This was also recognized recently by the President of the Indo-Lanka Chamber of Commerce and Industry who stated that the FTA had been a win-win for both nations.

LESSONS

Even without explicit liberalization of services trade or for temporary movement of natural persons, FTA-driven investments can have a positive impact on local employment. The India-Sri Lanka FTA is a very good example how an expansion of trade flows may lead to positive spillover effects in inward investment and thereby induce job creation.

3. Promoting inclusive trade where it matters the most – at the community level

There have been several initiatives which aimed at promoting growth and inclusivity through trade, but few of them have seen similar success to the “One Village One Product” (OVOP) movement. Begun in Oita, Japan in the late 1970s, what started as a rural development programme intended to create employment at the village-level by promoting local products has now become a global model for trade promotion. Today, OVOP has been applied in dozens of countries. While each country applies its own adaption of the OVOP model, the main goals are the same – alleviating poverty, developing rural areas and creating employment at the community level through the promotion of locally produced products.

Thailand’s local version of OVOP – the One Tambon, One Village (OTOP) programme – is widely acknowledged as one of the most successful adaptions of the original movement. Since its initiation in 2001, OTOP has grown from a poverty alleviation programme to a more sophisticated SME promotion programme which now covers more than over 22,762 villages nationwide, with 37,840 OTOP producers and over 1.3 million members and employees. OTOP has been particularly successful in generating inclusive employment. Many of the programme beneficiaries have been housewives and older people, who now enjoy access to employment and are able to contribute to overall rising household earnings.

The programme has also contributed to increased productivity and higher quality products through its quality control efforts for exportable products. Locally made products are rated through “Product Champion” contests that have four main criteria. The criteria include: i) export potential through strong brand capacity; ii) stability and production sustainability and stability of quality; iii) levels of consumer satisfaction; and iv) the background of the product, particularly the use of locally available resources, knowledge and culture. The program has also created an OTOP logo to assist with consumer recognition, and a system of stars indicating the ranking in the Product Champion contests. Products granted more stars are able to receive superior financial support including bank loans, marketing loans, the provision of tools and machineries and enjoy enhanced export promotion benefits, including access to local and international exhibitions and fairs.

The results of the OTOP programme thus far have been impressive. According to the Government of Thailand, SMEs supported by OTOP account for 37% of GDP and 30% of total exports of Thailand (GPRD, 2013). OTOP product sales amount to 76 billion baht and are expected to top 100 million baht by 2015 when Thailand enters the ASEAN Economic Community (GPRD, 2013). The OTOP community and Thai SMEs have identified several measures which would improve the programme’s impact, including: enhanced access to financing instruments; improved access to modern technology, information and knowledge about key export markets; and support in meeting international product standards.
OVOP and its sister programmes such as OTOP are proof of how trade and investment can successfully promote inclusivity. Through these programmes, local communities have proven to be more than capable of taking part in international trade if they are given the opportunity to do so on their own terms and with their own products. These programmes also show that it is not necessarily trade and investment itself that creates inclusive development impacts - but rather it is the modalities of that trade and investment that does so. Clearly empowering whole communities to produce and export original products is one way of making trade inclusive.

LESSONS

OTOP has created a strong network of producers and therefore has the potential to assist poor and rural communities in many ways, including by enhancing market access, product recognition and promotion, business skills and access to capital.

B. TRADE FACILITATION MEASURES FOR INCLUSIVE DEVELOPMENT

A number of trade facilitating initiatives in the Asia-Pacific region resulted in gains for the poor. The cases selected show that trade facilitation contributes to inclusive development. The cases also show that interventions in supply chains at their early stages (e.g. production or post-production) deliver the maximum benefits from trade facilitation.

1. India’s e-choupal – generating “win-win” outcomes based on ICT and better logistics

Electronic choupal or e-choupal (Hindi for “meeting place”) is equipped with a computer and internet connectivity. It is run by an operator, who acts as the interface between the computer and the less literate farmers (who are unable to operate computers). The operator is a trained individual, who also works as an ITC salesperson, often a literate farmer from the village. E-choupal is an initiative by ITC India, a large company involved in commodity exports, food processing and retailing etc. It has retail outlets across the country. Their biggest export item is soybeans, sourced from rural India. E-choupal was first established in 2000. Since then ITC has established 4,500 e-choupals in 40,000 villages impacting about 4 million farmers.

North Indian rural markets are characterized by supply chains dominated by a number of intermediaries. Typically, the soybeans of a producer reach the local wholesale market (called Mandi) after passing through two intermediaries. The farm gate price is what the first intermediary quotes. The volume is weighed using traditional weighing machines, often generating inaccurate results disfavouring the farmer. The quality of the product deteriorates over the long-supply chain due to inefficient transportation systems and weak infrastructure.

ITC has established working relationships with meteorological departments and agricultural universities to develop information content for the computer systems used by the e-choupals. It also receives information from input supply companies on the price and availability of fertilizers and seeds. The computer is connected to a central server which contains ITC prices for agricultural products. It contains the “Mandi” prices too. Farmers can compare and negotiate their prices with ITC. The farmer also can get access to weather forecast, information on production practices and soil testing services, and can place order for fertilizers and other inputs. The internet connectivity allows farmers to submit any query to the operator, which the operator searches through ITC’s server or the internet.

The farmers could also sell their produce to ITC through the operator. They bring samples of their produce and the operator quotes a price. They can then compare the prices offered by other intermediaries through the internet. If agreeable, the farmers transport the produce to the ITC collection centre nearby and get paid by the operator within two hours. ITC uses modern equipment and weighing systems to ensure less spillage and correct reading of the volume. Transportation costs are reimbursed by ITC. Farmers reportedly prefer this system compared to traditional Mandi or auction systems.

The e-choupal model is primarily based on two aspects of trade facilitation: improved access to trade-related information and efficient logistics and transportation services. The initiative yields a “win-win” result for both ITC and the farmers. Both reduced their transaction costs. In the traditional system, material handling, labour payment at the Mandi and spillage used
to cost farmers about 3% of the value supplied. It is reported to be nil now. Farmers can have access to up to date weather information, better agricultural practices, price information and supply-demand data for their products. ITC also saves 3% of the value procured from less spillage, using modern equipment, and lower transport cost. A continuous and predictable supply of soybeans helps their business now that there is an influx of farmers into e-choupal. Farmers’ sales of their produce are now more organized, predictable and secured.

LESSONS

The e-choupal case shows how farmers can achieve economic gains from better post-production handling and improved access to information. The ICT-based solutions can also be used to build strong business linkages down the international supply chains. These linkages not only facilitate trade but integrate small producers into supply chains also. The improved services including access to market information and logistical facilities provide better alternatives to the farmers for supplying their products. Since ITC is supplying their products to domestic markets, it is natural that the quality improvements in their products could spill over to the domestic markets that ITC supplies to. In the long run, the knowledge gained could lead to higher long-term productivity.

2. Thayang Cooperative: facilitating linkages between farmers and the organic market with support from e-traceability

It is extremely difficult for individual farmers in developing countries to supply to international markets. It is no different for Thai farmers. They either sell their produce in local markets or supply to traders for sales in big cities as their products do not meet the criteria for export quality. This is also because appropriate production practices are not followed. They are not organized and so it is costly for them to export without any common platform. One company overcame all these issues – Thayang Agriculture Company Ltd.

Thayang is a leading exporter of organic bananas to Japan and also a supplier to the supermarkets of Thailand. It is a farmers’ cooperative, established in 1966, located in Petchburi Province in Thailand. The cooperative currently employs about 2,100 farmers and produces about 1,300 tons of chemical free bananas. Its primary client is a Japanese organization called TOHTO. It supplies to local supermarkets and retailers too. A simplistic value chain of Thayang is presented in figure 10.3.

Thayang farmers operate under a contract farming system. They receive information on production methods, input, credit and extensive support from the cooperative. Prices of bananas

FIGURE 10.3

Value chain for exporting organic banana
(Thayang Agriculture Co., Ltd)

Source: Keretho, 2012.
are fixed and higher than open market prices. In addition to this, Thayang has developed an electronic traceability system which allows Japanese consumers to trace back necessary information on origins and production.

Thayang has been supplying bananas to its counterpart in Japan since 1992. However, it did not have a traceability system and a farmer information management system until very recently. As a result, they did not receive ISO 9000 and ISO 14000 certification. However, now with help of Japanese buyers, it has implemented a barcode traceability system. As presented in figure 10.4, the traceability system at Thayang captures information at four stages: farm level, delivery at packing facility, packing and delivery (Otento (Thailand), n.d.).

The traceability system and good agricultural practice are central to Thayang’s operation. Farmers in the Thayang cooperative follow certain guidelines for producing bananas. They refrain from using chemical fertilizers or pesticides and use the land for banana production only. They maintain a record of their cultivation too. The information items include: the farmer’s name and code; the cultivation area; crop numbers; transplant dates; and the use or not of chemicals. They also record information on production techniques such as manure usage and any pest treatments (Otento (Thailand) Co., Ltd., n.d.). The cooperative plays a “quality control” role by inspecting the farm site, identifying bananas to harvest and transporting them back to cooperative premises. At the receiving facility, the receiving date, farm code, number of products, the workers’ details are recorded. The product specifications are checked against those demanded by the TOHTO or Japanese buyer. This database produces product labels containing data from the database. Then labels are printed and put on the bananas and boxes carrying them. After packing, the boxes are kept in a temperature controlled environment at 12.5 degree celsius. The bananas are then exported to Japan’s Agricultural Cooperative Corporation (WAGO). Delivery data including shipping dates and the number of cartons are then entered in the system. WAGO then let the bananas ripen and supply them to the TOHTO consumer cooperative.

A number of factors have been key to this success story. First, Thayang has been able to organize the farmers and reduce the transaction cost. Second, adoption of an e-traceability system helped retain the Japanese organic market. Third, farmers have been provided with appropriate technology, quality specifications, credit and technical service. Fourth, Thayang has maintained a strong control over the entire supply chain to ensure the quality of the products.

**FIGURE 10.4** Information recorded in Thayang’s Electronic Traceability System

Source: Adapted from Otento Thailand Co. Ltd. Presentation.
LESSONS

Successfully integrating agricultural producers into high-value international supply chains involves significant changes on how they organize and interact among themselves and with other actors in the supply chain. Cooperating with actors up in the value chain led to increased learning opportunities and technology transfer for the farmers. Enhanced and more transparent procedures through implementation of traceability systems have helped targeting health conscious consumers and access high-value export markets.

3. Dongfeng in China: revolutionizing a village through e-commerce

Dongfeng, located in China’s eastern province of Jiangsu, used to be a poor village as recently as ten years ago. Inhabited by about 5,000 people, villagers were dependent on traditional agriculture, mainly rearing pigs or producing vegetables in their farmlands. Now, many of them own online shops that sell furniture. Villagers use an online platform called taobao.com, which is China’s largest consumer to consumer e-commerce website for the domestic market. It offers a secure online payment system for traders.

A local village graduate called Sun Han is the hero of the case. Upon return from a city where Sun was working in a telecom company, he started his own online store selling home accessories in 2006. He started to take interest in small furniture, and employed a few villagers to begin making furniture. He immediately experienced good sales and experienced a ten-fold revenue increase in just a year. He started to educate other villagers on using the internet and e-commerce websites. The villagers started learning skills for making furniture. The furniture was relatively simple with few features. Nevertheless, demand was quite high and many villagers started their own online stores shortly after. An estimated 100 online stores were established by 2008. Slowly logistics service providers opened their offices in the village. Some entrepreneurs could not operate computers and were not able to transact online. They used handwriting recognizing software to type in computers. The farmers turned entrepreneurs started providing support services including furniture design and delivery. Up to the end of 2011, there were 1,200 online stores and more than 600 households were involved in furniture manufacturing. About 85% of the total furniture sales on taobao.com are now done by Dongfeng villagers. Total sales exceeded 300 million Chinese yuan ($49 million) in 2010. Average monthly profits for villagers are several thousand Chinese yuan. The furniture products are now supplied to Beijing, Shanghai, Guangzhou and exported to: Japan; New Zealand; Republic of Korea; Spain; Hong Kong, China; and other economies. Today, driven by the rise of the furniture industry, most of the villagers are engaged in the furniture business through online sales. This situation created opportunities for peripheral industries. As of 2010, there were six metal processing plants, two hardware accessories shops, seven computer stores and fifteen logistics service providers in the village (Jin, 2012).

A number of aspects were critical to the success of Dongfeng village. First, the adoption of e-commerce as a platform to trade by the villagers was crucial. Dongfeng residents were not exposed to the practice of e-commerce before Sun Han started his own business. Good Internet connectivity and a safe e-payment option also helped. The ease of entering online trading enabled villagers to quickly start their stores. Almost anyone could open a store on websites like taobao.com. Second, the market for furniture was correctly identified. This was combined with quick learning of new skills by the workers.

LESSONS

This case is perhaps one of few cases where traditional farmers have undergone a complete transformation and become entrepreneurs driven mainly by the adoption of modern information and communications technology and services. E-commerce enabled a remote village to connect with the national market and to conduct business and trade efficiently. The case highlights the fact that the availability of such technologies and services may not be enough and their benefits need to be demonstrated widely, including to those that may not be initially perceived as likely users; the economic gains of further adoption could be enormous.
4. Export processing zones in Sri Lanka and their impact on poverty reduction

In Sri Lanka, there are 12 economic zones including nine export processing zones (EPZs), two industrial parks and one export processing park. Until 2007, EPZs contributed to 38% of total exports. Since the establishment of the first EPZ, employment in these economic zones has increased significantly. In 2012, these economic zones employed more than 127,000 workers, a significant share of them being female.

A recent ESCAP-ARTNeT study analysed “the effectiveness of EPZs on poverty reduction and an analysis of these zones as a mechanism of trade facilitation” (Karunaratne and Abaysekara, 2013). In essence, this study examined the efficiency of the trade procedures in these zones and their socio-economic impact on their immediate surroundings. It also looked at the impact of the zones on employment generation, education, and working conditions in these areas.

The two largest EPZs which were the subject of the study are located in Katunayake and Biyagama around 50 km from Colombo. Enterprises operating inside EPZs are approved by the Board of Investment of Sri Lanka. The study found at least two aspects of trade facilitation that EPZ enterprises are enjoying access to compared with enterprises outside the zones in relation to importing and exporting. They are: (i) a reduction in necessary documentation and processes, (ii) a reduction of time taken.

The findings showed that customs and other procedures related to trading were simplified for enterprises inside EPZs. For example, enterprises are not required to visit customs offices in Colombo to submit a customs declaration; instead it can be done inside EPZs. Cargo can also be examined inside EPZs rather than in the port. Table 10.2 provides a comparative picture of the processes for the enterprises inside and outside EPZs.

EPZ enterprises require substantially fewer documents. For import declarations for example, only five types of documents are needed as opposed to nine types for non-EPZ enterprises. Time taken to complete export and import procedures for EPZ enterprises are almost half of those of outside EPZs. For example, submission of the customs declaration takes about four hours for enterprises inside EPZs whereas it could take up to ten hours for other enterprises.

The study considered a number of factors to assess the impact on poverty reduction for the workers in the immediate surroundings of EPZs. In doing so, it considered job creation, wages, female workforce participation, working conditions and benefits, and indirect employment as some of the major indicators. The study reported mixed findings. The major positive impact was clearly direct job creation. More than 127,000 jobs in all the zones of Sri Lanka were created. What is noticeable is that most of these jobs went to low-skilled workers due to the nature of the jobs. Many jobs were occupied by workers coming from villages far from EPZs. As can be seen in figure 10.5, share of female workers in Sri Lankan EPZs is mostly higher than that of male workers. More than 60% of workers in Sri Lankan EPZs are female. This is quite a contrast to Sri Lanka’s entire workforce, of which, only 33% are female. However, when it comes to wages, mean averages for low-skilled workers in manufacturing units of EPZs were only 5% higher than the average across Sri Lanka’s entire manufacturing sector. One downside as found in the study is the high turnover rate for EPZ workers compared with non-EPZ workers. As reported by the workers, the reasons included “hectic work-schedules” and insufficient wages. This is quite surprising given the strict labour standards set by the Board of Investment of Sri Lanka, which stipulates working hours, overtime pay, and holidays. On the other hand, workers outside EPZs were receiving better work benefits including healthcare facilities, and on the job training, and were staying with their employers longer. As required by the Sri Lankan law for private sector employees, all workers received Employees’ Provident Fund and Employees’ Trust Fund.

LESSONS

EPZs, by facilitating trade and investment, led to the creation of jobs for low-skilled and female workers inside the zones, and the development of support services in the zone-surrounding areas. However, higher staff turnover rates in EPZs suggest that the overall working
conditions may not be as good inside as outside EPZs. To enhance inclusive outcomes of EPZ, special attention may be needed on enforcing appropriate labour laws in these zones. In the long term, however, facilitating trade and investment across the national territory rather than only in special zones should be pursued.

C. FOREIGN DIRECT INVESTMENT AND PROMOTION POLICIES

The potential benefits of FDI for households in host countries are derived from: the impacts it can have on supply capacity and job creation; the transfer of new technologies and skills; the

<table>
<thead>
<tr>
<th>Processes or activities</th>
<th>Enterprises outside EPZs</th>
<th>Enterprises inside EPZs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Line Ministry approval</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>Import License</td>
<td>Required</td>
<td>Not required</td>
</tr>
<tr>
<td>Payment terms</td>
<td>Limited to L/C, D/A, DP, or Advance (T/T, bank draft)</td>
<td>None-payment also by offshore 3rd party</td>
</tr>
<tr>
<td>Advanced payment limits</td>
<td>$10,000</td>
<td>No limit</td>
</tr>
<tr>
<td>No-foreign-exchange-basis imports</td>
<td>Maximum of $1,000 and no commercial quantities</td>
<td>No limit</td>
</tr>
<tr>
<td>Original documents</td>
<td>Received through bank</td>
<td>Received directly from shipper</td>
</tr>
<tr>
<td>Delivery order</td>
<td>Obtained from shipping agent</td>
<td>Obtained from shipping agent</td>
</tr>
<tr>
<td>Import declaration</td>
<td>Customs declaration submitted to Customs (Long Room)</td>
<td>Customs declaration submitted to BOI service center in Colombo or EPZs</td>
</tr>
<tr>
<td>Payment of duties and taxes</td>
<td>Bank of Ceylon near Long Room</td>
<td>Bank of Ceylon counter at BOI location</td>
</tr>
<tr>
<td>Determination of examination level</td>
<td>By Customs</td>
<td>By Customs</td>
</tr>
<tr>
<td>CBCU registration – sea cargo only</td>
<td>Not required</td>
<td>Required</td>
</tr>
<tr>
<td>Payment of SLPA charges</td>
<td>SLPA center at Port</td>
<td>SLPA counter at BOI office or at Port</td>
</tr>
<tr>
<td>Collect gate pass from SLPA</td>
<td>Delivery documents to SLPA</td>
<td>Delivery documents taken to SLPA</td>
</tr>
<tr>
<td>Cargo pickup</td>
<td>From port</td>
<td>From port</td>
</tr>
<tr>
<td>Cargo examination</td>
<td>Examination by Customs</td>
<td>Examination by Customs at Verification Unit, EPZs, or consignee location</td>
</tr>
<tr>
<td>Transport cargo to importer location</td>
<td>Only after examination – if required</td>
<td>Before examination - possible</td>
</tr>
</tbody>
</table>

**Source:** Taneja, Nisha, John Arnold, and Pallavi Kalita, 2011.
development of managerial know-how; access to finance; and access to new markets. Promotion and facilitation of FDI thus often forms a core part of the strategy employed by host countries to promote economic development. However, FDI can function as a mixed blessing: it can contribute capital and skills to developing countries but, unless properly regulated, it also carries the risk of transnational corporations (TNCs) abusing their market power.

Despite the growing trend towards more responsible business practices, there are incidences where the operations of companies – local or foreign-owned – have negatively affected the welfare of local communities because of abusive labour practices, indifference towards the environment, or a near-sighted focus on pursuit of profit. Recent tragedies in a number of factories operating in the least developed countries and as part of global supply chains have given rise to new criticism of the operations of TNCs in these countries. The tragedies have cast a shadow on the positive impact FDI can have on host economies. Notwithstanding those instances, under the right conditions and policy environment, FDI has the potential to contribute significantly to inclusive growth.

Studies have found that FDI inflows not only enhance productivity and exports of affiliates of TNCs, but can also positively influence sales and productivity of local suppliers to foreign plants. For instance, a 1% rise in FDI resulted in a 3% growth in productivity of input suppliers in Lithuania (Javorcik, 2004). It is thus also important for Governments to support building the capacity to absorb and adapt technology. For example, Singapore in collaboration with TNCs has set up various centres to adopt and adapt foreign technologies to local requirements. This can be done through pro-competitive regulations, education and promoting innovation.

Empirical evidence of the impact of FDI on host economies reveals that its impact depends on decisions made by the investor as well as the local context (Colen, Maertens and Swinnen, 2008). Investor decisions include the motives for investing, the mode of entry and the choice of investment destination. The local context is determined by government policies, rules and regulations, the level of human capital formation, governance and institutions.

Although FDI is not a panacea for development, it can help support inclusive growth when host governments, home governments, and TNCs...
adopt certain measures. The following examples describe these measures and illustrate how FDI can impact employment, productivity and skills, wages and non-wage working conditions. The last example describes what home governments can do to ensure that companies investing abroad support inclusive development in the host country.

1. Inclusive growth through foreign direct investment in the retail sector

Retail is one of the most controversial sectors in developing countries for FDI as it is typically dominated by small and medium-sized enterprises (SMEs) that provide the bulk of employment. It is argued that FDI would crowd out SMEs and would lead to unemployment. Singh (2011) cites studies which report employment losses in the value chain. For example, as compared with 18 jobs created by a street vendor, 10 by a traditional retailer and 8 by a shop vendor in Vietnam, a supermarket like Big C needed just 4 persons for the same volume of produce handled (Wiggerthale, 2007). A study also found that the spread of supermarkets led to a 14% reduction in the share of “mom and pop” stores in Thailand within four years of permission for FDI entry (Vander Stichele, van der Wal and Oldenzeil, 2006). It is thus argued that the use of modern technology by supermarkets prevents effective employment creation.

However, the evidence for job reduction as a result of FDI in retail is not conclusive. For instance, Mukherjee and Patel (2005), in a study of developing countries’ experiences with FDI in retail, found that FDI in general led to higher quality of employment and, as long as the economy was growing, no negative effect on employment could be found. Popli and Singh (2012), in evaluating the potential impact of India’s FDI liberalization policy in retail, found that at least 10 million jobs would be created within three years. They also observe that in Indonesia, even several years after the entry of supermarkets, 90% of fresh food and 70% of all food is still controlled by traditional retailers. In China, FDI in retailing rose sharply after China entered WTO but currently local retailers still dominate the Chinese market, competing successfully on the basis of superior knowledge of local culture and consumer demand and essential connections with local Government.

Moreover, FDI in retailing has positive effects on productivity, efficiency and international competitiveness of the retail sector in developing countries and links local farmers, suppliers and manufacturers to global supply chains. Chari and Raghavan (2012) note that the entry by large international retailers into the Indian market may help tackle inflation especially in food prices. Moreover, technical know-how from foreign firms can improve supply chain efficiency in India, in particular for agricultural produce. Better linkages between demand and supply have the potential to improve the price signals that farmers receive and also serve to enhance agricultural and other exports.

A similar trend is noted in Thailand after it liberalized FDI in the wake of the 1997 Asian financial crisis. It was argued that FDI breached the fragile competitive balance that existed in Thailand between traditional retailers and wholesalers, with unfair methods such as predatory pricing, exclusive dealing and resale price maintenance. Shannon (2009) ironically observes that the criticism from local retailers, suppliers and politicians was directed at the big hypermarkets rather than the smaller convenience stores such as 7-Eleven which have a potentially much larger impact on local grocery stores. In the meantime, Schipmann and Qaim (2011) observe many wet-markets in Thailand continue to operate in city centres alongside the foreign mega-stores without much apparent difficulty as they cater to different market segments. The biggest threat today is not posed by hypermarkets but the proliferation of convenience store chains such as 7-Eleven (Natrajan, 2012). While the lack of zoning laws undoubtedly contributed to the elimination of many local mom-and-pop stores, the influx of foreign retailers seems to have contributed to employment among suppliers as most of the sourcing by the big supermarkets is done from local producers. Therefore, it can be observed that FDI in retailing has contributed to employment on a rather large scale, including in the provinces though precise figures are difficult to obtain.

In addition, as observed by Meyer-Ohle (2010) in a study of large shopping malls in Japan and Singapore, Asian malls are very competitive as they play a strong role as leisure destinations. Thus, while there is evidence that foreign retailers have crowded out SMEs, in their absence local...
large retailers may have had the same effect. The consolidation and growth of large retailers reflects changes in global business models and consumer behaviour and are therefore part and parcel of the economic development and growth process. As Fels (2010) reports, from 1997 to 2007 more than 100,000 small shops were forced out of business by modern retail outlets. These social costs must be balanced against the benefits flowing from lower costs to consumers.

LESSONS

These cases show that the displacement of local retailers by superstores, foreign or national, does not always occur and that the evidence of job displacement as a result of entry of (foreign) supermarkets is not conclusive. However, the rise of indigenous large retail shopping complexes shows that domestic retailers can be very competitive. In this respect, the issue in assessing the impact of the retail industry on inclusive growth is not so much the influx of FDI but rather the issue of concentration and dominance by a few large firms, national or foreign. Therefore, countries have to watch for anti-competitive behaviour which would squeeze local suppliers, raise prices and reduce quality. The enforcement of proper competition and zoning laws and the aggressive promotion of responsible business practices backed by adequate legislation would be the right responses; however, given the speed of change, Governments may have difficulty to keep up with implementing appropriate legislation.

2. Malaysian ICT sector: using foreign direct investment to create employment and improve skills

In the 1970s, the state of Penang in Malaysia adopted an export-oriented strategy by plugging into the global economy via the electronics sector. The availability of an English-speaking workforce together with the Government’s tight control over labour organizations attracted foreign investors looking for cheap labour in the early 1970s while the establishment of free trade zones eased the operations of these TNCs and allowed for duty-free import of intermediate and capital goods. Over time, Penang has become one of the most developed industry clusters, and information and communications technology (ICT) the leading manufacturing sector in Malaysia.

FDI in both the ICT and electronics industries has been a key driver of growth and development in Malaysia. Earlier, employment creation was one of the motives for Malaysia to attract FDI; however, the attainment of near full employment in the country since the early 1990s implies that mere employment creation is no longer the aim for the FDI-led development strategy of Malaysia. Rather it is the technology from FDI and the need to create high technology skills through

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**BOX 10.1**

**Thriving retail sector of Thailand**

At roughly 300 stores per million people (similar to Malaysia and Singapore), compared to an average of 50 in Viet Nam or Indonesia, plus online shopping, the Thai multi-brand retail scenario is comparable to that in the United States or Western Europe. All its formats permeate the city: cash and carry (usually wholesale), hypermarkets, supermarkets, smaller “express” shops, the ubiquitous “Sevens” and their main competitor, Family Mart, that dot almost every Bangkok street. Big retail currently handles close to half the total value of a retail trade worth around 480 billion baht. Wet-markets and traditional grocery stores account for the other half, but with a relatively lower rate of growth, this share is projected to fall.

Given the lax legislative environment, the surge in FDI in retail met with resistance when anti-competitive behaviour was noted. It was argued that FDI breached the fragile competitive balance that existed in Thailand between traditional retailers and wholesalers, with unfair methods such as predatory pricing, exclusive dealing and resale price maintenance. However, as of today, a retail act, first drafted in 2007, remains a draft.

However, FDI in retail is no longer a contentious domestic issue. Local capital proved no pushover: in the past decade they have wrested a big share of the pie and the sector is clearly oligopolistic in character. They were strong enough to drive out French giant Carrefour in 2010. In fact, in preparation for the ASEAN Economic Community, the focus is on outward FDI in other ASEAN countries and also India.

**Source:** Natrajan (2012)
technology transfer that is urgently needed, especially as Malaysia aspires to become a high-income economy by 2020. In order to attract FDI from leading information technology (IT) TNCs in the world, the Malaysian Government has offered tax incentives, invested in infrastructure such as fibre optic network and imported skilled foreign knowledge and IT workers.

The role of foreign companies in creating employment opportunities in the Malaysian ICT sector has been significant. Foreign firms have tended to employ more workers than local firms. Over the period 2000-2008 foreign firms operating in the ICT sector employed on average over 900 workers per company whereas the corresponding number for local companies was slightly below 300. This difference may be due to differences in scale, however the fact remains that foreign firms on average employed over a quarter of a million people per year during 2000-2008 compared to slightly above a 100,000 jobs employed by local companies in the ICT sector.

Overall, the Malaysian ICT industry employs more female than male workers. Female workers are often tasked with unskilled jobs and over the period 2000-2008 on average accounted for 60% of the unskilled workforce hired in foreign firms, and 56% of the workforce in local firms. While the share of skilled female workers still remains low, it has been increasing in recent years. In both foreign and local firms, male workers have a higher proportion of the skilled jobs.

All in all, over the period 2000-2007 foreign establishments in the ICT sector have been important in terms of their contribution to value added, employment, and exports of the industry. While both local and foreign firms have increased their share of skilled workers, labour productivity of foreign firms has remained higher than their local counterparts. This might be due to the outsourcing of lower value added production from foreign to local firms. Significantly, foreign firms utilize more Malaysian skilled workers than local firms. This may be attributed to their relatively higher wages and salaries and a tight labour market for local talents. While the ICT sector has increased employment opportunities for women both in foreign and local firms, as noted above, they are employed mainly in unskilled jobs. Women are also paid less than their male counterparts in both skilled and unskilled work.

Over the period 2000-2007 foreign companies in the ICT sector have also increased their share of value added as a percentage of total value added in the sector, whereas the share of local companies has declined. In 2000, foreign firms accounted for 73% of value added in the ICT sector; in 2007 their share had risen to 79%. Local companies have struggled to match the levels of value added of foreign companies. One of the reasons for this is that they lack absorptive capacity to upgrade manufacturing activities from low to high value added activities. Due to lack of proper skills among the local population, local companies have not been able to fully benefit from knowledge or technology spillovers from foreign companies.

The Government of Malaysia has made efforts to improve the level of human capital in the country. For example, the Penang Skills Development Centre (PSDC) was created in 1989 to address the problem of mismatch between the skills industry needed and the skills the local workers had. The Centre offers a great example of how to create linkages between TNCs, SMEs, the Government and the academia. The Centre provides training to SMEs in areas ranging from business skills to learning how to use the latest technology and links them with TNCs through coaching and mentoring programmes. By 2002, the Centre had trained over 75,000 workers. The Government has been active in providing the physical infrastructure to enable the programme and academia has been involved in providing training materials and teacher training. One of the reasons for why the Centre has been so successful is that training has been relevant and tailored to meet the needs of companies and the economy. In addition, SMEs have been partnered with TNCs after careful matching of business philosophies, needs and capabilities (UNCTAD, 2000; Ruffing, 2006). The success of the Centre shows that Malaysia has taken steps in the right direction; however, more similar efforts are required to transform Malaysia into a high value added economy. More attention could also be directed towards the training and skills upgrade of female workers, who seem to be stuck in low-skilled and low-paying positions. In order to ensure an inclusive outcome, the Malaysian Government needs to make sure that both training and job opportunities are provided equally to male and female workers.
LESSONS

The key policy lesson highlighted by the example of Malaysia is the critical need for developing countries to focus on human capital development in order to gain from the presence of TNCs in the country. While a lot of attention is paid in developing countries on creating the appropriate investment conditions to attract FDI, less attention has been paid on enhancing the absorptive capacities of their economies. The education system in the host country must be well equipped to supply the kind of human capital that is needed by TNCs and for industrial upgrading. Equally important is to ensure that all members of society have opportunities to improve their skill level.

3.  Foreign direct investment and wages in China – an evolving landscape

The tremendous economic growth experienced by China over the past three decades has been largely driven by FDI. China is the developing world’s largest recipient of FDI, attracting $121 billion in 2012. Over the years, TNCs relocated production and sourced inputs from China, drawn in part by a stable system and plentiful workforce, but especially by low wages. Today, partly as a result of tremendous economic success of China, this picture is changing: wages are climbing, and the desire for a more skilled workforce is increasing. FDI, though still higher than in any other developing country, fell by 2.3% in 2012 compared to the previous year.

What is prompting these shifts? In an effort to lessen turnover and address worker discontent, both TNCs and the Government have been increasing wages. HSBC estimates that Chinese manufacturing wages rose about 20% per year between 2005 and 2011; in 2011 the Chinese Government raised the minimum wage by an average of 20% across 13 provinces. Accenture Consulting examined the wage levels specifically in three of the most important manufacturing industries in China: footwear (Nike, Adidas, Puma), heavy machinery (Caterpillar, John Deere, Terex), and personal computers (Hewlett Packard, Dell, Apple, Lenovo). For all three industries the average hourly wage has risen over the past years. Figure 10.6 shows how the average real wage has developed in Bangladesh, China, India, Indonesia, Thailand and Viet Nam since 2005. Whereas most countries have experienced moderate growth in average real wages, or even a decline as in India, average real wages have surged in China.

Wages in China are rising for three reasons: (1) a shortage of skilled workers in eastern China, where the majority of FDI-driven manufacturing still takes place; (2) increasing experience and educational levels of the workforce; and (3) government legal and regulatory measures to increase wage rates, embodied, for instance, in the Labour Contract Law of 2008. In essence, a combination of rising education and FDI has led to increases in Chinese worker productivity. Together with a public policy of supporting higher incomes, these effects have translated into rising wages. This public policy has meant that the Government has allowed increasing labour organization, collective bargaining, and strikes, even though independent unions are still banned in China (factory unions are either part of the Government-run All-China Federation of Trade Unions or organized by employers).

These trends reflect China’s aim to move up the value-added chain to increasingly skilled and technology-oriented production activities. The middle class is growing, and with it the standard of living of millions of people. FDI flowing to China is increasingly oriented to the domestic market consumption, as opposed to being oriented to exports as before. At the same time, these trends also represent an opportunity for other countries in Asia. South-East Asian countries, which received only 2.7% of global FDI in 2002 following the 1997 Asian financial crisis, currently receive 8.2% of global FDI, almost on par with China’s 9%. Firms are increasingly directing new or redirecting existing FDI from China to countries with relatively more attractive wage rates, such as Cambodia, India, Indonesia, Thailand, or Viet Nam.

The experience of China provides a very useful example for how a country is managing the process of economic evolution, combining FDI attraction, education, and regulation to achieve its domestic social goals.
4. Can foreign direct investment help Thailand to absorb a higher minimum wage?\(^{151}\)

After several decades of minimum wages being outpaced by inflation, the Thai Government recently raised the minimum wage to 300 baht (approximately $10) per day. Given that 30-40% of Thai businesses are labour-intensive, some economists expect that higher wages will be a blow to FDI in Thailand over the next few years.

The fear is that Thailand’s international and regional competitiveness will be adversely impacted by increased labour costs. Foreign investors may consider relocating to other countries, such as Indonesia and Viet Nam. This would also induce Thai businesses to employ greater numbers of informal and migrant workers, who are expected to arrive from neighbouring countries in even greater numbers, particularly Cambodia and Myanmar, where the daily minimum wage is $2.03 and 58 cents, respectively.

In contrast, other economists believe that the minimum wage will improve Thailand’s chances of competing with other regional economies in attracting new FDI. The rationale is that a higher minimum wage will require firms to increase productivity to stay competitive, thereby moving Thailand’s economy up the value chain. This would require increasing training and technology adoption, and thus help Thailand escape the notorious middle-income trap. The higher minimum wage may also push Thai workers to raise their own skill levels in preparation for increased labour competition as a result of influx of migrant workers. According to a recent Economic and Social Survey of Asia and Pacific (ESCAP, 2013b), the minimum wage increase in Thailand may boost GDP growth by 0.7% and add 0.6 of a percentage point to employment growth by 2015, so long as it is accompanied by appropriate adjustment policies and measures.

The Government of Thailand expects that increased income for workers will boost domestic consumption, which will provide a strong incentive for foreign investors to increase FDI to tap into growing Thai disposable income. As firms attempt to satisfy this growing consumption demand, this may in turn foster productivity gains and innovation, and in turn lead to further economic growth.

\(^{151}\) Asia-Pacific Trade and Investment Report 2013
Finally, when TNCs make decisions between FDI market destinations, they take into account a multitude of factors, including but not limited to labour regulations and labour conditions in addition to labour costs. Implementation of the recent minimum wage hike is a signal to the international community that Thailand is serious about economic modernization and industrial transformation, moving away from unskilled labour industries to more value-added activities. This should attract TNCs that aim to source and produce goods and services further along the economic value chain. The real impact of this minimum wage increase remains to be seen, but these represent some of the mechanisms whereby the increase can help Thailand achieve investment and growth that is sustainable and inclusive.

5. Improving non-wage labour conditions in the garment industry: Bangladesh and Cambodia

Bangladesh and Cambodia provide interesting contrasts in their approaches to the structure and regulation of FDI in the garment industry. In Bangladesh, investment in the garment industry is mostly from domestic sources, with TNCs purchasing the final products. In contrast, investment in the garment industry in Cambodia is mostly from FDI. By comparing these two countries, one can derive insights on the impact of FDI in a domestic economy that could be useful to other countries where the production of garments also play an important economic role.

**Bangladesh**

Bangladesh is the world’s second-leading garment exporter after China, with garments comprising 79% of the economy’s $24.3 billion of exports. Bangladesh has more than 5,000 garment factories, employing almost 4 million workers. The industry has helped raise the living standards of millions of people, driving growth at nearly 6% annually. It has provided steady employment for many rural migrants, particularly women, who earn more than they would have in traditional rural activities. In doing so, the industry has given women an independent source of income, empowering them as economic agents. The growth of the Bangladeshi garment industry has therefore decreased poverty and empowered traditionally disenfranchised populations (Razzaque and Eusuf 2007).

Nevertheless, the garment industry has been plagued over the past couple of years by concerns over safety, loss of life and angry protests over rock-bottom wages. In 2013, Rana Plaza, an eight-story commercial building, collapsed in Dhaka, resulting in the death of 1,127 people. This and other disasters have attracted international attention to labour conditions in Bangladesh, bringing pledges from government officials and many global companies to tighten safety standards. The Government of the United States cut the country’s GSP duty-free trade privilege, and the European Union has threatened to do the same if Bangladeshi authorities do not ensure that factories across the country comply with international labour standards. This could exert pressure as 40% of the country’s garment exports go to the United States market and 60% to the European Union market. The European Union has offered assistance to the Bangladeshi authorities to help meet these standards. The Government of the United States also exerted pressure on their apparel importers to actively contribute to improving the work safety and labour climate in Bangladesh.

The host country has a key role to play in helping to make such investment inclusive. The Government of Bangladesh shut down three factories of the Nassa Group (manufacturer for WalMart and Sears) and recommended that the owner of Rana Plaza, along with the owners of the five garment factories housed in the building, be charged with “culpable homicide” for allegedly forcing employees to return to work the previous day. The Government of Bangladesh also announced it would raise the minimum wage for garment workers and issued a new labour law that makes it easier for workers to organize by removing the previous requirement that factory owners approve formation of a union. However, ILO has stated the new law falls short of providing labour freedom of association, as it stipulates that workers can only form a union if 30% of employees approve in advance (Agence France Presse, 2013).

TNCs are playing a key role in making their investment decisions lead to more inclusive development. Nearly 90 firms from Australia, Europe and the United States, including Carrefour, H&M, Gap, Walmart, Target and Tesco, have signed agreements to improve conditions in garment factories in Bangladesh.
The agreements require setting up safety standards and inspections in factories with which these firms do business in Bangladesh. These inspection results would then be used for remedial steps where there are safety issues.

Cambodia

Just as in Bangladesh, the garment industry in Cambodia is critical for the country’s growth, employment and foreign exchange earnings. According to IMF (2013), garments accounted for 75% of the country’s total exports of $5.22 billion in 2011. The garments industry generates 9.2% of total gross value added (UNCTAD, 2013a or 2013b) and employs up to half a million workers, with 500 garment and shoe factories.

FDI into Cambodia has increased from an estimated $520 million in 2009 to $1.5 billion in 2012 (IMF, 2013). Investors are attracted by significant investment incentives to investors offered by the Government of Cambodia. UNCTAD (2013a or 2013b) estimates that from 2007 to 2011 about 90% of investment in the garment industry was as a result of FDI.

The real effect on Cambodian workers in the garment industry, however, is mixed. On the one hand, garment industry jobs pay some of the highest salaries across manufacturing sectors in Cambodia, although these salaries remain amongst the lowest in the region overall. Over the period 2001-2011, the annual average salary of garment workers rose by 65%, allowing them to support their families in rural areas. In addition, over 90% of employees are women, thereby providing employment opportunities and revenue to a traditionally disadvantaged segment of the population. The International Finance Corporation estimates that the garment industry in Cambodia helps alleviate poverty in nearly 10% of the population (UNCTAD, 2013a or 2013b).

On the other hand, there has been a recent spate of strikes protesting difficult working conditions. The Cambodian Labour Ministry’s Department of Vocational Training announced that approximately 1,686 workers in garment and shoe factories fainted in 2012 due mainly to overwork, poor health, and exposure to chemical substances. Strikes by the country’s more than 300,000 garment workers nearly quadrupled in 2012 to 134, according to the Garment Manufacturers Association of Cambodia. Most existing factories are running at full capacity, with a shortage of skilled workers, causing employees to press their demands for better wages and working conditions. In addition, the collapse of a concrete roof at a Nike shoe factory in Cambodia in May 2013 has reinforced pressure on suppliers to the world’s big shoe brands to raise wages and improve working conditions.

There exists a framework to monitor and report on conditions in the garment industry. The “Better Factories Cambodia (BFC)” programme of ILO is established as a factory auditing body to monitor Cambodia’s improvements in labour rights and conditions in factories. The cost of compliance with the programme has meant that production costs are higher and hence factories need to raise productivity in order to stay competitive in the export market. This requires potentially more training, better technology, and moving up the value chain. At the same time, better working conditions could also enhance efficiency in production. It is still too early to tell whether these effects will continue to play out in this way. But preliminary research by Fukunishi and Yamagata (2013) suggests that the increase of labour costs due to BFC played a role in inducing productivity growth. OECD and others (2013) concludes that “the case of the Cambodian garment industry suggests the possibility that social upgrading catalysed economic upgrading, although this relationship is still unclear.”

LESSONS

While both countries had a similar starting point, different government policies, private sector programmes, and consumer awareness have led investment in the garment industry to have very different developmental implications in each country. The lesson learned is that it is very difficult for a country, by itself, to adopt the measures necessary to guide investment towards inclusive outcomes. Rather, there has to be partnership between all actors. International organizations, business groups, civil society and other stakeholders can together create conditions whereby investment translates into sustainable, dynamic and inclusive growth. This example of two countries therefore shows that the host government, home government and
private sector all need to take measures that help investment be more inclusive.

6. When abroad, abide by domestic standards: firms from the United States in overseas markets

The United States has instituted strict requirements on its companies investing in Myanmar to ensure that, as the country re-engages with the international community, FDI promotes instead of hinders its development process. Effective 1 July 2013, United States firms investing more than $500,000 in Myanmar, or any amount in oil and gas, will have to report on how they ensure the rights of workers and provide protection for the environment. Firms also need to report on any payment over $10,000 to agencies or officials, any contact with Myanmar’s military, arrangements with private security companies, and the details of any purchase of land or real property. The business community, represented by the United States Chamber of Commerce, has complained that no other country is instituting similar obligations on its firms and that smaller firms will be especially at a disadvantage to compete since the costs of reporting will be relatively large comparative to their scale of operations. Even for larger firms the Chamber of Commerce views these requirements as putting firms at a competitive disadvantage relative to European and Asian firms, that have been rushing headfirst into this newly opening market.

Though firms from the United States have complained that they are at a competitive disadvantage because of different regulatory standards, these standards are an important step to ensure that investment in a newly opening market serves the interest of all stakeholders. In the short term, there may be additional costs to reporting, or in some cases loss of business to competitors that are willing to engage in unscrupulous activities. However, experience with instituting similar standards in the past has shown that businesses adapt and fold these requirements in their business models. They then find alternative ways to be competitive and in doing so help advance developmental outcomes.

A comparable experience can be seen from the Foreign Corrupt Practices Act of the United States. This act prohibits United States firms to give bribes as part of their business operations. In some cases this puts United States businesses at a disadvantage compared to firms from other countries that receive no sanction if they bribe officials. However, the fact that bribery is off the table for United States firms means this cost of doing business is nullified, and foreign officials and firms know they cannot pressure firms in this way. Dealings are more straightforward, and counterparts often prefer to engage in deals where things are clear and above board, rather than uncertain and surreptitious. After all, there is always a cost due to uncertainty and bribery leads to more uncertainty, not less: the payment that is sufficient today may no longer be sufficient tomorrow. Coupled with transparency provisions and independent reviews of government contracts, these measures can be sufficient to create a business climate that fosters development for all rather than enrichment for some.

Governments and officials seeking to improve the conditions of their citizens rather than simply their own are therefore likely to seek business partners operating under standards such as those imposed upon United States firms. Many see Myanmar as a test case for how a newly opening economy can choose to partner with firms that are abiding by certain corporate social responsibility instruments, so that investment leads to inclusive development, rather than the imbalanced and uneven development that has marked some other economic openings.

D. EXAMPLES OF RESPONSIBLE BUSINESS PRACTICES

As discussed earlier, businesses can contribute to inclusive development through their actions. More and more companies are adopting inclusive business models and implementing responsible business practices that have a tangible impact on economic and social development. Companies adhering to responsible business practices also ensure that they are implementing principles of good governance related to human rights, labour, environment, and anti-corruption in core business activities. As responsible business practices include focus on non-discrimination and community involvement, such practices can increase opportunities for low-income or socially-disadvantaged groups to be involved in
the value chain of companies’ core business as suppliers, distributors, retailers, or customers. The following case studies exemplify how companies in the tourism sector can support the education of local people, provide opportunities for career development and help alleviate poverty. A study also looks at how a new way of organizing business has affected the welfare of cocoa farmers in Vanuatu. The final example describes how ESCAP is working to raise awareness about opportunities to include persons with disabilities in business activities.

1. **Soria Moria Boutique Hotel, Cambodia**

The Soria Moria Boutique Hotel was founded in 2007 by a Norwegian couple. It is located in Cambodia in the town of Siem Reap. In 2012, the hotel employed 35 full-time employees, as well as 30 drivers and guides, all of them locals. What makes the Soria Moria Boutique Hotel unique is that, in 2011, it became the first majority employee-owned hotel in Cambodia as all hotel employees turned into business partners and owners. By giving the local hotel employees responsibility over the future of the hotel, the business truly empowered parts of the local population.

The hotel is also highly active in skills development of the local population and is exemplary in fostering employee upward mobility. The hotel supports a local non-governmental organization, Sala Bai, which offers free hotel skills training to about 100 young people annually. Participants in the training programme receive assistance in finding training and work placement in local hotels, including Soria Moria. Furthermore, in order to enhance employment possibilities of disadvantaged local youth, the hotel initiated the Employee Elevator programme. As part of the programme the hotel provides paid trainee positions to disadvantaged youth. In addition to the traineeship, the professional development of the participants is supported throughout their careers to ensure their upward mobility.

A good illustration of upward mobility of employees in the Soria Moria Boutique Hotel is the General Manager, Sam Sokha, who started as a dishwasher in the first business the hotel’s owners set up in Cambodia. With the support of the Soria Moria Higher Education Programme, which was established in 2007, she completed a degree in tourism management and a further Master’s Degree in business administration. The Programme funds scholarships for local community members to attend university. Finance for the Programme comes from donations from guests and profits of the hotel. In 2012, the Soria Moria Higher Education Programme supported 12 university students. The fact that employees are the owners of the hotel and that they are offered ample opportunities for upward career mobility has led to increased employee motivation, which has also benefitted the business.

2. **Nihiwatu resort, Indonesia**

The founders of the luxury resort Nihiwatu, who originate from the United States, founded the Sumba Foundation in 2000 in order to bring social benefits to the local population. Through the Sumba Foundation, the Nihiwatu resort (located on the remote Indonesian island of Sumba) has been able to use income from the resort for the implementation of local poverty alleviation measures. The Sumba Foundation focuses on social development in the areas of health, education and employment creation. By 2010, efforts of the Sumba Foundation had helped to decrease malaria infection rates by 85%. In addition, by building wells for several communities on the island, the Foundation has been instrumental in providing clean water to more than 14,800 people. As part of its efforts to enhance education opportunities, the Foundation has supported 14 local schools and funded scholarships for outstanding students who also have received job offers from the resort.

In order to actively provide employment opportunities for the local population, in 2010 the Sumba Foundation supported five organic farms which sold their products to Nihiwatu. Moreover, the Foundation supported a local bio-diesel project allowing the local members of the project to sell the fuel they generate to the resort. The project also engaged 120 Sumbanese families to produce coconuts to make the fuel. In the same year the resort also directly employed 210 persons, 95% of which were local Sumbanese.

The local engagement of the Nihiwatu resort provides a strong argument that the tourism business and social development projects can be mutually reinforcing. By 2010, holidaying dentists have helped to treat 1,300 villagers, enabling tourists to be part of the resort’s social
development efforts and to enrich their travelling experience. In addition, the resort’s guests support the efforts of the Sumba Foundation by donating money. Many of the resort’s guests return every year for vacation in order to see how their donations have benefited the local population. Therefore, the case of Nihiwatu shows that being socially responsible enriches the products tourist companies offer their customers and make the business sustainable as it creates a bond between the business and customers and improves customer loyalty.

3. Cooperatives improve export performance and life for cocoa farmers on Malekula, Vanuatu

The cocoa bean is one of the most important export goods of the Pacific islands. This case study presents the export challenges cocoa farmers face on the Pacific island of Malekula in the South Pacific islands of Vanuatu and describe how these challenges were successfully addressed with the establishment of a farmer’s association. The association allowed the farmers to be more productive and to earn a considerably bigger share of export revenues, along with improving access to education and health services.

The Cocoa Growers Association (CGA) was initiated by a project named POPACA, funded by France and the European Union, that lasted from 2001 to 2006. It established over 25 cooperatives for cocoa bean production on the island of Malekula in the South Pacific islands of Vanuatu. The project built steel drum dryers for the 25 cooperatives to improve the quality of dried cocoa beans. Of the 25 cooperatives initiated by POPACA, community leaders of 19 cooperatives took ownership of the project and the communities still thrive today.

CGA acts as an umbrella organization for the cooperatives and provides many services to the cocoa farmers of Malekula. The CGA provides access to cocoa seedlings, training on management and bookkeeping in the local language, provides advance payment and credit for the cooperatives and provides world market information. CGA, functioning as a non-profit organization, effectively eliminates the middleman in cocoa export by buying the cooperatives’ beans to export for a higher price than middlemen offer. The higher price nearly doubled the income for cocoa producers. Higher income was associated with the ability to pay school fees for children and increased investment in tools, communications and transportation. Over 1,500 people benefit from the improved access to export the high quality cocoa beans.

The main challenges farmers faced in cocoa production as a stable means of income before the project were extremely low prices, low quality dried cocoa beans, lack of buyer options, lack of access to credit and unpredictable buying periods. CGA acted to address these issues and has successfully been able to tackle some of them over the past six years. CGA has a revolving credit fund to provide advances to the cooperatives, and pay farmers “at the gate”, when they need it the most. CGA provides regular trainings on how to improve the quality of beans and enhance the cooperatives’ management operations by saving and investing funds for tool and equipment upgrades. CGA acts as a constant support for the farmers and is a stable local institution for farmers to buy high quality seedlings, learn about world market prices, receive trainings on better farm and business management and receive higher prices for their improved cocoa beans.

Notwithstanding obvious successes, one has to mention remaining weaknesses of CGA that could be addressed in the future. Foremost is the failure to promote gender equity. Though CGA provided access to the market for cocoa growers, this access was limited, at least at the management levels, to males. Additionally, the lack of strategic planning that exists will be a central pain point for CGA until resolved, and opportunities to strengthen this skill set must be provided for other similar associations. Also, the pursuit of organic certification must be considered as future organizations are designed to ensure that the highest level of economic benefit is derived. Finally, production issues (e.g. the age of the cocoa trees, low yield levels, and others) will need to be improved as CGA moves forward and in any future iterations of this type of organization.

LESSONS

_CGA has proven to be an effective organizational model delivering inclusive outcomes through_
exports because it addresses a well-established and well-known agricultural activity, and delivers a larger percentage of the final value of the product to its producers by cutting out predatory middlemen, establishing volume, and improving product quality. The CGA approach could be used in various other countries, especially when producers in various sectors struggle to break the cycle of low education/effect, low quality, and a low rate of return.

4. ESCAP-Sasakawa Award for disability-inclusive business practices in the Asia-Pacific region

In 2013, ESCAP, the Nippon Foundation and the Asia-Pacific Development Center on Disability launched the ESCAP-Sasakawa Award for disability-inclusive business in the Asia-Pacific region. This initiative aims to raise awareness of opportunities for inclusion of persons with disabilities in business activities as part of the Asian and Pacific Decade of Persons with Disabilities, 2013-2022. The Award aims to recognize three kinds of enterprises that demonstrate excellence and innovation in the delivery of disability-inclusive business practices: (a) a disability-inclusive multinational enterprise; (b) a disability-inclusive national or subnational enterprise; and (c) a disability-inclusive entrepreneurial business. All winners will receive recognition for their work, while the winner of the entrepreneurial category will additionally receive a cash prize ranging from $50,000 to $100,000 depending on the budget proposal of the suggested disability project the entrepreneurial business put forward.

Disability-inclusive businesses integrate persons with disabilities across most or all of the value chain in their business model. This involves developing and implementing new ways of expanding the impact on people with disabilities. Such an approach potentially involves a wide range of participants, both inside and outside the company including: senior management, supervisors, human resources personnel, product designers, suppliers, contractors, retail staff, building managers, marketers, and advertising agencies.

Disability-inclusive products and services are tailored specifically towards persons with disabilities — whether as customers, clients, employees or business partners. Products include ramps, lifts and other assistive devices. Services include retail site accessibility, specialized audio-visual services and interpersonal customer services. Institutional elements include workplace policies and human resource procedures, such as recruitment, selection and appointment, career guidance and development, and retention/return to work. Disability-inclusive products and services can also be “universally designed” in that they are designed from the perspective of catering to the needs of both persons with and without disabilities, such as drinking water from bottles marked with Braille. All these elements can give employers maximum access to the widest possible talent pool, and therefore make it more likely that investment is at once inclusive and also leads to dynamic and sustainable growth.

E. SECTORAL CASE STUDIES

As there are no one-size-fits-all solutions to enhancing inclusive trade and investment, it is important to acknowledge the differences not only between countries but also between sectors. Although all efforts to support development and improve the welfare of people are encouraged, some measures have proven to be more relevant than others in various sectors. Whereas the strengthening of the legal framework and the implementation of international standards, guidelines and initiatives have shown to be effective in the natural resources sector, investments in productivity are essential in the agriculture and manufacturing sectors. An example from India illustrates how promoting services trade through the removal of trade barriers together with targeted pro-poor policies and investments in education are necessary to ensure inclusive outcomes. The final example highlights the need to improve countries’ absorptive capacity in order to fully benefit from technology transfer and other potential benefits brought by trade and investment.

1. Inclusive development of natural resources sectors

Natural resources sectors such as mining, oil, gas, hydro, and forestry plantations are
attractive investments for resource-seeking multinational and state enterprises. The Asian and Pacific region produces well over a quarter of the world’s crude oil and natural gas, 70% of the world’s coal, sizeable percentages of other metals and minerals, and nearly a third of all energy produced from hydropower. It is also the world export leader of intensive plantation commodities such as timber, rubber and palm oil. Natural resource exploitation is often highly dependent on FDI, and the coal, oil and natural gas sectors are major destinations for FDI in the region, with developing countries such as Myanmar, Viet Nam, Indonesia, Turkmenistan and Uzbekistan being especially dependent on these investments.

Natural resource investments have the potential to bring about significant economic growth and development. However, corruption and poor fiscal management have often led to greater inequality. While natural resource investments generally have large potential to bring in foreign exchange earnings (through FDI and trade) and increase government revenue (through royalties, taxes and/or production sharing agreements), these benefits generally appear more at the macroeconomic level rather than the local level, in particular since employment impacts from such sectors are generally relatively low. As for related risks, natural resource investments have a poor record for human rights abuses and causing social ills through displacement and disruptions to the environment. Issues such as involuntary resettlement and the use of violence against community members to defend corporate assets are among the worst of these, yet health and safety and violations of labour rights remain an issue. The activities of these industries also often put pressure on the environment and on biodiversity, in particular in relation to water and deforestation. Due to the large amounts of capital involved in these investments, governance challenges such as corruption also present a clear challenge.

More responsible business practices are necessary to avoid these problems and bring about poverty reduction and social development at the local level. Businesses and policymakers share the responsibility of ensuring these responsible business practices take place.

On the policy front, the main challenges are to maximize economic benefits at both national and local levels while ensuring that the environment and human rights are well protected. In order to do this, Governments must do a number of things. First, they have to establish strong national legal and regulatory frameworks governing natural resource use. This involves ensuring investment and mining laws are sound, transparent and incentivize the right kind of investments. Second, comprehensive social and environmental regulations as well as their enforcement are determining factors. In essence, government policies are a major factor in encouraging businesses to appropriately and adequately address the environmental and social impacts of their operations.

Countries must also manage incoming resources and their own government revenues strategically. Participatory processes throughout the entire project cycle, as well as other mechanisms to enhance transparency and accountability are essential to ensuring the benefits of natural resource wealth are shared.

Meanwhile, businesses have the essential role of adopting and implementing international standards of responsible business practice to help them avoid negative impacts from their operations. A number of international standards, guidelines and initiatives have emerged to help businesses do so. These include voluntary principles-based initiatives such as the Global Compact and Guiding Principles on Human Rights; standards such as the OECD Guidelines for Multinational Enterprises, ISO 26000, International Financial Corporation (IFC) Performance Standards, and initiatives to increase transparency such as the Global Reporting Initiative (GRI). In addition to these instruments, a number of additional initiatives focus on the natural resources industries specifically, including Publish What You Pay and the Extractive Industry Transparency Initiative, certification systems, such as the Roundtable on Sustainable Palm Oil (RSPO) and Kimberly Process, and industry associations, such as The Global Oil and Gas Industry Association for Environmental and Social Issues (IPIECA) and International Council on Mining and Minerals (ICMM).

While enforcement mechanisms are still weak or non-existent for many of these instruments, what such instruments do achieve is to set clear expectations for business and provide a wealth of
implementation guidance. Such expectations are most effective with the biggest, most globalized and most visible companies, in particular in cases where companies feel pressure and scrutiny from financial stakeholders, host governments or home governments. However, many of the smaller, lesser-known TNCs fall through the cracks, facilitated in part by Asian financial institutions that are less concerned about these issues.

Ensuring inclusive investments in the natural resources sector thus requires policymakers to put in place a regulatory system and competent institutions to ensure that laws and regulations related to such areas as mining, environment and social laws follow international best practice, and their implementation is ensured. It is also important to ensure that revenues from the sector are used wisely and transparently, and that the proceeds not only benefit the country at large but also the communities impacted by the natural resource exploration.

Furthermore, businesses in the sector should be held accountable to international standards of responsible business practices. This includes ensuring that local communities are consulted and involved throughout the entire project cycle, through transparent and fair negotiations, and that grievance mechanisms are put in place to address the concerns of communities and workers. Finally, production linkages to local communities and companies should be facilitated, so that more value added is generated locally.

LESSONS

The revision of laws regarding the exploitation of natural resources may successfully lead to improved environmental requirements, increase local participation by giving local communities some approval authority, improve control and enforcement by Government in issuing licences. Auditing and accountability have also been improved. At the same time, a

BOX 10.2

Regulatory reform in Mongolia

Over the last few years, Mongolia was one of the fastest growing economies in the world, to a large extent because of investments in mining. The largest of these is the Oyo Tolgoi copper-gold mine, with a total projected investment of more than $10 billion. In 2009, the Government of Mongolia, Rio Tinto, and Ivanhoe Mines signed the Oyu Tolgoi Investment Agreement. It also specified that new laws passed subsequent to signing the agreement would not apply to Oyu Tolgoi.

After the signing of the agreement, formal complaints were filed by a civil society organization about the quality of the environmental impact assessment and water study for this project. It questioned the potential impact on quality and availability of water, wildlife and biodiversity in the area, and therefore on the pastures on which the country’s traditional nomadic population depend.7

Following this, the issuance and processing of new mining and exploration licences was suspended in 2010, and a working group was established to undertake revisions of the Mining Law. This ongoing revision is expected to introduce stricter environmental requirements (in particular relating to mine closures and rehabilitation), increased local participation by giving local communities some approval authority, improved control and enforcement by the Government in issuing licences, greater requirements for local development and local sourcing although points of contention still revolve around license classifications, and increased role for the Government as well as local community participation more broadly.

The revision procedure bears several things worth noting. The Presidential Office announced that it is relying more on national experts compared to previous revisions and the Government has increased its lawmaking capacity as well as accumulated experience dealing with foreign and domestic investors. In doing so, it has studied the practices of other resource-based economies. The process has been more inclusive and efforts have been made to avoid politicizing the revisions. The first public hearing took place on 18 January 2013. In efforts to address public concerns about mining, the working group has engaged civil society activists, local governments, government agencies and various professional organizations.8
At the same time, Mongolia is also seeking to offer greater assurances to foreign investors by making changes to the Investment Law. The revisions will make investments subject to regulation rather than bilateral deals. This is intended to provide greater clarity and stability to investors by making investments subject to, but also protected by, legislation that can only be amended by a two thirds parliamentary majority and whereby future changes will not affect the rules for investments made today.\(^c\)

Other changes include a more restrictive water usage law (2009) which prohibits minerals exploration in water basins and forested areas and cancelled over 200 mining and exploration licences for operations deemed too close to water basins and forests.\(^d\) Some efforts also target corruption through transparency. Since 2007, the Independent Authority Against Corruption has been operational. The Freedom of Information Law (2011) enables the public to seek information from government institutions and authorities about their activities, human resources, budget, finance and procurement of goods and services with state funds.\(^e\) The Conflict of Interest Law (2012) is intended to prevent conflicts of interest arising between the official duties and private interests of those in public service roles, and to regulate and monitor conflicts of interest in order to ensure that public service activities accord with the public interest and that transparency and faith in public services is maintained.\(^f\)

Mongolia is also an active participant of the Extractive Industries Transparency Initiative (EITI). It has filed reports yearly since 2006 and was declared an EITI compliant country in 2010. The process seems to be helping. In the first year, the reconciliation committee found a final discrepancy of $83.08 million (against total corporate claims of payments totally $430.83 million), while for 2011, the final discrepancy was down to $59,000. The accountants and auditors responsible for completing the report had a number of recommendations for improvement.\(^g\)

None of these measures is perfect and criticism/scepticism exists around all of them. Still, they are steps in the right direction.

\(^{a}\) www.miningwatch.ca/fr/node/6454. Overall (2013)
\(^{b}\) www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=40552&tx_ttnews%5Bbac kPid%5D=7&cHash=a6544697c99685d5ab7140449758672e. Overall (2013)
\(^{c}\) www.reuters.com/article/2013/03/27/mongolia-mining-idUSL3N0CH0J220130327. Overall (2013)
\(^{d}\) www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=40552&tx_ttnews %5BbackPid%5D=7&cHash=a6544697c99685d5ab7140449758672e. Overall (2013)
\(^{e}\) www.ifex.org/mongolia/2011/06/22/foi_law/.
\(^{g}\) www.eiti.org/files/Mongolia-2011-EIT Overall (2013)
Rice is a pillar of the Thai agricultural economy, with 55% of the country’s arable land occupied in rice production, making it the fifth largest cultivator in the world (IRRI, n.d.). However, after years of being the world’s top exporter of rice, the amount of the crop shipped from Viet Nam and India exceeded that of Thailand in 2012. Many credit the drop to the Government’s rice pledging scheme. The enactment of a government rice pledging scheme increased the price of paddy rice purchased by the Government to a higher rate than the market price. These controversial policies were first initiated in early 2000s; since this time the policies have been somewhat revised and reinstated. The current Government has allocated 405 billion baht, approximately $13 billion, in government funds allocated for the 2013 rice pledging scheme (Finch, 2012).

What the rice pledging scheme allows the Government of Thailand to do is act as a middleman: as a rice buyer. However, rice is a sensitive good, in which quality and grade depend on processing of raw rice (ensuring that rice grain sizes do not get mixed), and ensuring appropriate moisture content and storage. Therefore, the Government of Thailand outsources this task to over 600 mills across the nation (the country maintains more than 30,000 mills nationwide). Locations are set up nationally in which farmers can bring their rice product, and the government purchaser will register farmers and offer the farmer a purchasing price based on the rice quality. Ministry officials interviewed as part of this study stated that due to the fact that rice farmers maintain little market negotiating power, the scheme is designed to improve farmer livelihoods through allowing farmers to sell their rice product, and the government purchaser will register farmers and offer the farmer a purchasing price based on the rice quality. Ministry officials interviewed as part of this study stated that due to the fact that rice farmers maintain little market negotiating power, the scheme is designed to improve farmer livelihoods through allowing farmers to sell their rice product at a higher price. A ministry official from the Rice Bureau under the Ministry of Commerce stated that: “...after one-year of implementation of the scheme, it has been seen that the farmers have earned more money...improving their living standard and purchasing power”. Conversely, the representative also stated that the policy has not enhanced Thailand’s rice trade as seen by the country losing its number one exporter status last year (figure 10.7).

The rice exports of Thailand have increased significantly over the last two decades. Investment in infrastructure especially roads and distribution networks made exporting easier. Likewise, international product marketing enhanced consumer demand. Additionally, Thailand’s significant investment between the 1960s and 1980s, in agricultural development, improved irrigation systems, research and development, and technology resulted in improved crop yields, allowing for production to steadily increase along with demand. By 2008, Thailand exported approximately 10 million tons of rice, which made up about 33% of the world’s rice trade (IRRI, n.d.). This is a drastic change from production in the past, where Thai farmers grew rice mostly to meet household consumption demands, rather than supplying the global market.

This transition and Thailand’s integration into the global market, has increased producer income over the past few decades as well (figure 10.8). As seen in the example of Thailand, increased production, consumption, improved technology and ease of export are all components which have led to an inclusive market and opportunities for improved livelihoods. However, it should also be noted that significant market exposure, as well as government interventions, can cause price volatility. An example of this can be seen during the 2008 rice crisis, which significantly increased producer profit margins (Morris, 2013). However, despite the positive impacts for producers seen in 2008, there is also the potential for negative effects on farmer income generation if the global price experiences a sharp decline.

Uncertain production and consumption trends are potential risk factors for global prices. While, increased rice consumption both internally and internationally have been seen, according to ADB, it is projected that: “rice consumption is expected to continue rising, though at a lagged pace. However, production is projected to grow at a faster clip than in the previous decade, primarily due to rising yield. The rising surplus will lead to the sustained growth of exports and accumulation of stocks” (ADB, 2012). Both sustained growth in exports and accumulations of stocks contribute to greater food security for rice dependent countries, however this can have a negative effect on rice prices internationally, creating a downward trend in prices due to the increased global supply.

Currently, however, increased producer prices and profit margins have continuously improved since 2000. While increased wages also indicate
improved livelihoods and inclusion, equal access to increased wages/income at the field level are also, more generally, key aspects of an inclusive market. Farmer income received from rice production is based on rice quality. Lack of farmer bargaining power to negotiate with buyers (exporters, merchants, millers, etc.), is particularly due to the high level of organization among distributor/exporters and the quality standards in place. Therefore, from the production side, a farmer’s access to a high wage is based on his/her ability to produce high quality rice and effectively manage production costs, which is an agricultural risk experienced across the rice sector, however this risk is disproportionately detrimental to small and medium holder farmers who lack access to the resources and safety nets which are often more accessible by large scale producers.

Overall, despite some limitations, over the past two decades significant improvements within the rice market, in terms of quality, production, export and price, have been observed. Additionally, small and medium holder farmers have improved their living standards through

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**FIGURE 10.7**

Trends in rice exports of Thailand

Millions of United States dollars

*Source:* Calculated by authors based on export data from United Nations COMTRADE, from WITS database.

**FIGURE 10.8**

Export quantity of Thai rice

United States dollar/tonne

*Source:* Calculated by the authors based on FAOSTAT data.
improved income generation and access to resources/infrastructure. However, challenges still persist, particularly for small holder farmers who produce less and generate lower total income. Therefore, policy recommendations have been made in order to further enhance the rice trade and inclusive aspects of the rice sector of Thailand.

Policy recommendations:

1. The current Government policy is not a long-term solution. It is therefore suggested that the problem be tackled at its root cause; meaning in tandem with the Government’s short-term policies, long-term sustainable policy implementation measures should be explored in order to improve farmer livelihoods in a more comprehensive manner. Officials interviewed as part of this study stated that the policies must also focus on building farmers’ capacities to achieve more sustainable outcomes. This can be specifically achieved through conducting trainings on new technologies and market innovations, farming techniques, basic agricultural financial management/business management skills, and environmentally protective practices. This would allow farmers to improve their rice’s quality, quantity, productivity and income. Additionally, the use of newly developed rice breads and mechanisms can economize the cost of production and can make the price more competitive in the market.

2. Government rice stockpiles have surged to record highs of 18.2 million metric tons in 2013, compared to 5.4 million tons between 2008 and 2010, due to export reductions caused by the Government’s rice pledging scheme (Javier, 2013). In order to assist Thailand in regaining its number one exporter status, as well as assist Thai exporters to remain competitive in the market, current policies must be assessed in terms of sustainability and effective use of government funds. Furthermore, policy planning in order to identify a sustainable industry direction should be established. A first step in this direction, as recommended by a policy official at the Royal Thai Consulate General’s Office – Economics Department, New York, can be the incorporation of an agricultural development plan into the national agenda. If undertaken, stakeholders on all levels should be consulted and play a participatory role in the planning process, this includes small and medium holder farmers.

3. Increased government spending on research, in developing new rice breads, improved irrigation systems and technologies can significantly impact productivity, export and improve farmers’ livelihoods. Furthermore, rice policy should focus on quality control and value-added components to increase marketability.

a. Particular attention should be given to research and development in high-yielding rice varieties and varieties which are more resistant to climate change (i.e. flood and drought tolerant varieties).

b. Further improved and developed irrigation systems will assist farmers in managing appropriate water levels for rice cultivation and in some cases allow for harvest twice a year.

c. It is important to patent and trademark Thai Rice breads to protect Thailand’s intellectual property and rights in the market.

3. Regional production networks, manufacturing and inclusive growth in the Philippines

Regional economic integration in East and South-East Asia has been characterized as initially a market-driven process of increased trade and FDI inflows, and subsequently a formal process of arrangements to liberalize trade and integrate economic activities through free trade agreements (FTAs) among East and South-East Asian countries (Balboa and Medalla, 2011). This has led to more intensified regional production networks involving many regional countries, including the Philippines. Set against the backdrop of continuing economic integration in the region, it seems that economic growth in the Philippines has not been as inclusive as in the other countries: manifested in the increase in the magnitude of poverty.

The challenge is to increase demand for the labour services of the poor while pursuing integration into production networks. It appears that the manufacturing sector provides employment opportunities for the poor and also offers relatively higher wages compared to agriculture, which is currently the major
employer of the poor. However, expected high-productivity employment opportunities from the manufacturing sector were not fully realized due to some bottlenecks in the sector. This partly explains the persistence of poverty in the Philippines. To promote inclusive growth and reduce poverty, the manufacturing sector has to be made more competitive and, at the same time, productivity in the agriculture sector (the major employer of the poor) has to be increased.

The Philippine manufacturing sector has been stagnant for years due to bottlenecks such as low investment, poor infrastructure and weak logistics. The country’s investment rate (both public and private) has been falling in recent years and has been comparatively lower than those of its neighbours. The low investment rate can be attributed to poor infrastructure, high vulnerability to macroeconomic and political risks, the weak financial system, poor logistics and high energy costs. As a result, industrial upgrading, and thus labour productivity growth, are being hampered. These have negative implications for labour demand thereby decelerating the creation of good-paying jobs in skilled-labour manufacturing industries. At the same time, the quality of human capital in the country can partly explain the low investment rate and low labour absorption in manufacturing subsectors (Intal, Borromeo and Largoza 2010). Some of the low-skilled labour-intensive manufacturing industries such as garments and textiles that can potentially absorb large number of less-educated workers are not big players in the manufacturing sector. As a consequence, the manufacturing sector as a whole was not able to absorb a greater number of less-educated workers, who are generally the poor, and therefore failed to contribute much to poverty reduction.

Meanwhile, regional economic integration has affected the agriculture sector through tariff reductions on certain agricultural and fishery products, as stipulated in a number of FTAs. While these subsectors absorb the majority of the less-educated workers, they tend to offer very low wages. In fact, wages of the less-educated workers in the agriculture sector are among the lowest (around PHP137 in 2009 while PHP147 in 2011, on average). Thus, high absorption of less-educated workers, who are generally the poor, in the agriculture sector provides another explanation of the non-inclusivity of economic growth and thus the persistence of poverty in the country.

According to Intal, Borromeo and Largoza (2010), regional production networks have been central to regional economic integration in East Asia during the past two decades. Consequently, there has been further extension of integration through Regional Comprehensive Economic Partnership negotiations and other agreements. Thus, it is expected that production networks in East and South-East Asia will further deepen and widen in the years to come.

What could be done so that further integration of the Philippines into regional production networks benefits more of the country’s poor? To achieve more inclusive growth and reduced poverty, it is important to attack the problem from both the demand and supply sides. Demand for less-educated workers needs to be increased to absorb the significant number of less-educated poor workers. Regional economic integration that leads to regional production networks resulting in a more dynamic manufacturing sector can be one source of that increased demand. At the same time, investments have to be made to increase the access of the poor to quality education so that they can take advantage of employment opportunities which are not available to most of the poor right now.

The study has shown that the manufacturing sector absorbs “less-educated workers” and pays them higher wages than in other sectors. If the manufacturing sector can grow faster, this can provide employment opportunities for less-educated poor workers. It is imperative to address constraints in the manufacturing sector so that it can absorb a greater number of the poor and lift them out of poverty. Aldaba and Aldaba (2010) highlighted some concrete suggestions on how the manufacturing sector can be revived and become more competitive. Alongside adopting an industrial policy that aims to develop local firms, it is suggested that the Government must also carry out measures that would improve the investment climate in the country and increase the participation of local firms in higher segments of the industry value chain. Some of the recommended policies in the aforementioned paper are as follows: (i) human resource development and training; (ii) industrial and technology upgrading, or development of technological capabilities and
specialized skills of firms; (iii) finance support programmes for SMEs; (iv) improved linkages between local firms (including SMEs) and TNCs through information exchange; (v) promotion of subcontracting and outsourcing activities; (vi) improvement of infrastructure and logistics through policies aimed at lowering power and communication costs, provision of sufficient port systems, travel time reduction, and offering of travel and shipment options; (vii) improvement of overall investment climate by addressing low institutional quality, corruption and inefficient bureaucracy; and, (viii) capacity building and adequate funding for the Competitiveness and Linkages Programme of the Department of Trade and Industry and Board of Investments.

However, the manufacturing sector employs only 8.3% of total workers, of which 23% are less-educated. This translates to around 1 million less-educated workers in the manufacturing sector. Assuming an annual growth rate of 5% or higher, the manufacturing sector can only absorb a small proportion of the less-educated workers. It is thus not likely that the manufacturing sector can quickly absorb all the excess labour in the agriculture sector, where 74% of chronically poor workers are currently employed. If the Government aims to reduce poverty more quickly, it is equally important to also increase productivity in the agriculture sector.

Moreover, it is also important that the quality of labour being supplied by the poor be enhanced so that more employment opportunities would be opened to them. At the same time, improving labour quality would have long-term positive impact on technical, skill-intensive manufacturing firms that participate in regional production networks, such as electronics, machineries, chemicals, and high-technology agro-industry (World Bank, 2010). In fact, the 2010 Philippines Skills Report noted that manufacturing firms with a higher proportion of skilled workers, or those with at least some high school education, tend to be more competitive. Hence, programmes aimed at improving human capital are very timely and relevant.

4. Services trade growth in India: implications for poverty and inequality

Trade in services has gained more importance in recent years as advances in technology have permitted new means of providing services across borders. While there is little doubt that services trade is an essential ingredient in economic growth and sustainable development, it is widely accepted that it can only make such positive contribution if appropriately liberalized across countries. A well-crafted reform process facilitates services trade and generates higher economic and social welfare, more particularly in developing countries where services is the largest single occupational category.

Global services trade has risen substantially over the last two decades; growth has been higher than that for trade in goods in the past decade. Developing economies and China and India in particular, have witnessed even faster growth rates in services trade. India has seen a gradual structural shift towards the services sector over the past decades, with services comprising a growing share of GDP and employment. Today, the services sector in India represents an essential component of the competitive, knowledge-based economy, accounting for 56.5% of GDP in 2012-13. India’s services export currently constitutes about 35% of the country’s total export. India’s share of world commercial services exports increased from 1.08% in 2000 to 3.23% in 2012 (see table 10.3). Taken together, China and India contribute to over 7% of global commercial services exports and about 10% of world commercial services imports. While commercial services exports grew much faster in India than that of China during 2000 and 2012, China’s prowess in merchandise export generates huge services imports, almost double than that of India. Yet, a large part of services sector, both in India and China, is untapped and rarely exposed to the international market.

The services sector has been the major source of economic growth in recent years in India. India’s emerging services trade sectors are no longer traditional sectors such as transport, travel and tourism. Technology is also redefining the way social services are provided with a potential to enhance the effectiveness and efficiency of public and private social service delivery. Services now provide the bulk of employment for the skilled and unskilled workforce, both in the organized and unorganized sectors. In contrast, financial services as well as information and communication technology services, which currently dominate the services exports basket of India, offer employment only to the skilled
workforce. Therefore, the most challenging task is how to balance this structural shift in order to minimise the short-term maladies of globalization. Removal of barriers to services trade through liberalization and complementary policy reforms, can lead to both sectoral and economy-wide improvements in performance and generate pro-poor growth.

India has also done extremely well in IT and the IT-enabled services sector, including business process outsourcing activities. This sector has revealed a strong comparative advantage and significant foreign demand growth. This explains India’s interests in Modes 1 and 4 of the General Agreement on Trade in Services negotiations. However, the growth of IT and IT-enabled services are concentrated in select urban centres, and are biased to high and medium skill labour. India’s growth (and inward investment) brings new technology in the economy. The adoption of new technology furthers the wage divide, particularly between the skilled and unskilled, in the short run. As a result, while the IT and IT-enabled services sector can assist in poverty reduction, it can also increase inequality within urban areas as well as inequality between urban and rural regions.

Econometric evidence appears to strengthen the existing linkage between trade and poverty. India has been relatively successful in delivering pro-poor growth in the past few decades. Although the impact of services exports on poverty and inequality appears to have been marginal, the empirical estimations do not raise any doubt that poverty reduction has benefited from services exports. Higher income from services exports has been helping India to deliver successful pro-poor growth.

Although poverty has responded effectively to growth and services exports over time, the same does not hold true in the case of inequality; the knowledge and skill-intensive nature of services exports favour the skilled workforce more than the unskilled workforce. Hence, the growth of services exports has alleviated poverty through the expansion of income, although it has not been particularly effective in reducing [urban] income inequality. It must be added that although the econometric results do not conclusively show the role of services exports in rising urban inequality, they do point out that some of infrastructural variables (e.g. personal computers or telephone lines) have selectively benefited the urban workforce. Nonetheless, infrastructure related to services exports (mainly software and business process outsourcing) exports, currency depreciation, and reduced tariffs on trade have been instrumental in enhancing India’s services exports. Therefore, services trade has surely helped in the reduction of poverty in India but at the same time has increased urban inequality as well as inequality between urban and rural areas.

As India continues to expand its services sector, both for domestic consumption and international trade, the challenge facing industry and the Government is rising inequality. Therefore, the key message is that services trade may tend to

**TABLE 10.3**

<table>
<thead>
<tr>
<th></th>
<th>Export 2000</th>
<th>Export 2012</th>
<th>Export CAGR**</th>
<th>Import 2000</th>
<th>Import 2012</th>
<th>Import CAGR**</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(US$ billion)</td>
<td>(%)</td>
<td></td>
<td>(US$ billion)</td>
<td>(%)</td>
<td></td>
</tr>
<tr>
<td>World</td>
<td>1491.00</td>
<td>4349.90</td>
<td>9.33</td>
<td>1463.80</td>
<td>4152.30</td>
<td>9.08</td>
</tr>
<tr>
<td>China</td>
<td>30.15</td>
<td>190.44</td>
<td>16.60</td>
<td>35.86</td>
<td>280.16</td>
<td>18.69</td>
</tr>
<tr>
<td>Share of China in world (%)</td>
<td>2.02</td>
<td>4.38</td>
<td></td>
<td>2.45</td>
<td>6.75</td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>16.03</td>
<td>140.71</td>
<td>19.84</td>
<td>18.03</td>
<td>127.48</td>
<td>17.24</td>
</tr>
<tr>
<td>Share of India in world (%)</td>
<td>1.08</td>
<td>3.23</td>
<td></td>
<td>1.29</td>
<td>3.07</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Services Trade Gateway, WTO. Accessed October 2013.*
aggravate inequalities in the absence of policies and programmes for guaranteeing “inclusive” economic growth. By effective pro-poor targeting, the Government can make services exports better for the poor, and reduce the divide between them and the richer segments of society. There are a number of ways this can be done with important policy implications for India. We recommend that the Government of India build capacity to maximize the country’s endowments of skilled IT labour. A greater role for the private sector in ICT training and development would increase the supply of skilled manpower. Evidently, most of the growth in inequality between the highest and lowest earners is due to poor educational performance of the unskilled. The Government has to improve the quality of education, from primary to higher education.

5. Technology transfer and inclusive growth

Foreign companies have an incentive to transfer technology to domestic companies if it allows them to receive higher-quality inputs at a lower price from domestic companies within an environment of proper intellectual property rights protection. In order to avoid being overly dependent only on one supplier, foreign companies may disseminate technology to more than one domestic company. According to Moran (2011), foreign companies have in some cases found it beneficial to assist local companies in meeting the specific quality criteria of the foreign company and to become reliable suppliers. This type of support has extended to component suppliers as well as supporting industries. The assistance from foreign companies has often come in the form of setting up production lines, helping in the formulation of management strategies, assisting in financial planning and quality control as well as facilitating companies’ access to export markets.

The agriculture sector, which in many least developed countries still is the most important economic sector, provides a good example of potential positive effects of FDI on technology transfer. Synergies between FDI in agriculture and inclusive growth arise when foreign investors provide local farmers with what they need the most: financial capital, modern technology, management expertise and business know-how (FAO, 2013). By helping farmers in developing countries in these fields, FDI can contribute to inclusive growth as farmers, and especially small farmers, often belong to socially-disadvantaged groups. In addition, FDI in agriculture of developing countries is particularly important for inclusive growth where local farmers lack access to information, supply chains, domestic and international markets, and state-of-the-art technology as well as managerial skills (Stamm and others, 2006). Box 10.3 provides an example of how a partnership between a TNC and local small farmers in India has promoted technology and skills transfer as well as inclusive growth.

Empirical studies have yet to reach a consensus about the impact of technology transfer on productivity. Studies often use different definitions of productivity or technology and make different assumptions regarding, for example, plant size or factor intensity (Lipsey and Sjoholm, 2004). Therefore, empirical studies of technology transfer and the impact of FDI on host country productivity have often yielded varying results. For example, Javorcik (2004) shows that a positive link exists between foreign company presence and the productivity of workers. In her study on firm-level data from Lithuania, Javorcik (2004) finds that productivity spreads from foreign companies to local companies through backward linkages, especially in cases where there is joint foreign and domestic ownership of the company as these companies are more likely to source domestically. This view is challenged by Kohpaiboon (2009), who has studied vertical and horizontal spillovers in Thailand. Kohpaiboon finds that no spillovers from backward or forward linkages can be found in the Thai manufacturing sector. Instead, he discovers that horizontal technology transfers take place under a liberal trade policy regime. In addition, export-oriented companies tend to be more productive than domestic market-oriented ones. Kohpaiboon concludes that in order for host economies to fully benefit from productivity increases resulting from foreign company presence, they must also pay attention to liberalizing trade policy.

In general, there are several channels through which technology transfer can take place (see table 10.4). Technology can be transferred through demonstration or imitation, labour mobility, exports, competition or backward and forward linkages with local companies (Crespo and Fontoura, 2007; also Blalock and Gertler, 2008). We will look at each of these channels in turn. First, adopting new technology may be expensive for local companies, especially if there is uncertainty about the benefits of the
technology. If a foreign company demonstrates that the technology can be successfully used in the market, the risks of acquiring the technology are reduced for the domestic company. Second, labour mobility contributes to technology transfer when local companies hire workers who have previously worked for foreign companies and who can then apply their knowledge of technologies in their work at the local firm. It is important to note, however, that foreign companies tend to pay higher wages than domestic companies which can discourage labour mobility from foreign firms to domestic firms. Third, entering export markets can be costly for host country firms as it requires the establishment of distribution networks and infrastructures and knowledge of foreign markets. By following the examples of foreign companies, or possibly collaborating with them, domestic companies can reduce the costs of entering those markets. Fourth, increased competition in the domestic market can act as an incentive for domestic companies to use existing resources more efficiently or adopt new technologies. The downside of increased competition is that local companies may lose market share to foreign companies and therefore may not be able to operate on an efficient scale.

Finally, local companies may become suppliers to foreign companies through backward linkages, if the foreign company sources input from the local company. In this case, the foreign company, in order to ensure a certain level of quality, may provide technology support to the local supplier to allow the supplier to reach required quality levels. It is also possible, that local companies create backward linkages with foreign companies and source inputs from them. The possible benefits would arise from gaining access to higher quality or cheaper inputs. However, higher quality inputs may lead to an increase in the price of the end product, which could hurt the sales of the domestic firm. (Crespo and Fountora, 2007)

Irsova and Havranek (2012), Lipsey and Sjoholm (2004) as well as Crespo and Fontoura (2007) have listed some of the potential factors that determine when and how transfers, especially horizontal transfers, take place. First, the size of the technology gap between domestic and foreign firms determines whether transfers are possible in the first place. If the gap is very large domestic firms might be unable to make use of the new technologies provided by foreign firms; if it is too narrow, foreign firms might not provide anything new to domestic firms. Second, while domestic companies, which have previously had experience with foreign technologies (for example through international trade), are often more receptive to foreign capital, they may also have less to learn from foreign firms as a result. Third, foreign investors with sophisticated technologies may be hesitant about investing in countries with low levels of intellectual property rights protection. Also, if protection levels are very high, domestic firms might have trouble in absorbing the technologies of foreign firms. Fourth, domestic companies often have easier access to technology of only partly foreign-owned

Box 10.3

Nestlé is assisting farmers to develop their skills and upgrade technology

The case of the involvement of Nestlé in Moga in North-East India is an example of good practice in forming partnerships between TNCs and small farmers in developing countries. Skill development and technology upgrading have been at the heart of the partnership. The company established refrigerated milk collection points to enable small farmers to sell their fresh milk close to their farms. These refrigerated milk collection points also enable local farmers to establish contacts with veterinarians, agronomists and trainers. In monthly training sessions, small farmers are trained on how to improve their animals’ health, cultivate environmentally sustainable fodder as well as manage their farms better. As a result of Nestlé’s involvement in Moga, the number of local farmers who supply Nestlé with milk rose from 180 in 1962 to 75,000 in 2006. Nestlé has substantially helped to provide employment opportunities and improve standards of living of the local population. Furthermore, the educational activities of Nestlé in Moga provided the company with a stable, local supply-chain base it so much depends on for its activities.

companies. Therefore, a high prevalence of joint ventures may facilitate technology transfers provided the local partner in a joint venture adds value to the venture.\textsuperscript{162} Finally, a highly educated labour force would be in a better position to adopt new technologies than a low-skilled workforce.

The extent to which a host country can benefit from new technologies brought by foreign companies depends on the absorptive capacity of the country. Absorptive capacity refers to the ability to make use of and apply knowledge received from others [Crespo and Fontoura, 2007]. Above we touched upon the determinants of technology transfer, which already hint at the ways in which host governments can facilitate technology transfer in the local economy and ensure that the outcome is inclusive.

Labour mobility both between foreign and domestic companies and between different geographic locations can work as a channel to spread new technologies to local companies throughout the host country. Governments can facilitate labour mobility between foreign and local companies by offering opportunities for local workers to upgrade their skills to match with those required by foreign firms. Encouraging local workers who have previously worked for foreign companies to start their own firms can be an effective way to facilitate technology transfer to the domestic economy. The Government can promote this by supporting entrepreneurship and providing SME development assistance. This would also serve to facilitate the formation of backward or forward linkages between foreign and domestic companies. Additionally, making sure that workers are also geographically mobile would help to spread new technologies evenly across the country.

Trade liberalization also plays a crucial role in facilitating technology transfer. Companies that have been exposed to foreign technologies in the past usually tend to be more able to absorb new ones in the future. Integrating into the regional and global economy through trade agreements is important, but linkages can also be forged through business-level efforts. For example, investment promotion agencies or boards of investment can work to create linkages between their foreign counterparts and bring foreign and local companies closer together.

The absorptive capacity of local companies is also largely determined by the research and development capacity of the firm and the level of education among the employees [Lipsey and Sjoholm, 2004 and Suyanto and Bloch, 2009]. For example, Xu (2000) finds that in order for technology transfer to result in productivity growth, the host country needs to reach a certain level of human capital development.

\begin{table}
\centering
\caption{Channels of technology transfer}
\begin{tabular}{|l|l|}
\hline
Channels & Benefits for local companies \\
\hline
Demonstration/imitation & Risks of adopting new technology are reduced as foreign company demonstrates how to successfully use the technology \\
\hline
Labour mobility & Local companies hire workers, who have previously worked for foreign companies, and benefit from their higher level of skills \\
\hline
Exports & Reduced costs for entering export market by collaborating with foreign companies to establish distribution networks of other export infrastructure \\
\hline
Competition & Gives an incentive to use existing resources more efficiently \\
\hline
Backward/forward linkages & Becoming suppliers to foreign companies or gaining access to cheaper or higher quality inputs \\
\hline
\end{tabular}
\end{table}
As countries develop, it becomes increasingly important to differentiate between increases in productivity and increases in innovation. Productivity captures improvements in efficiency: one can do more with the same amount, or do the same amount with less. Innovation, by contrast, is the quality of inventing new products or production processes. And in today’s world innovation and creating recognizable brands for products provide a competitive edge that is crucial for companies to thrive. Both productivity and innovation may be important for inclusive investment and economic development, but productivity more so in the short term and innovation more so in the medium and longer term. FDI generally leads to increases in productivity, depending on the absorptive capacity of the economy, as described above. While FDI generally would have positive impacts on innovation, some scholars have argued that FDI may actually hinder the development of technological capabilities among local firms and, hence, the long-term growth prospects of local economies (Jin, García and Salomon, 2013). This could take place through several mechanisms: (a) foreign firms might attract and pay for higher-skilled labour, leaving domestic firms short on talent, which is a key ingredient to innovation; (b) FDI can also reduce the expected returns to local entrepreneurship, so that the best would-be entrepreneurs prefer to take employment with foreign firms instead of founding new enterprises; (c) foreign firms could relegate local firms to less innovative, less profitable market niches, parts of the economy where the local firms do not face competition from the better capitalized, managed, and experienced foreign firms. For all these reasons, measures should be adopted to ensure that FDI leads to both increases in productivity and increases in innovation. And in both cases, public policies should work to translate this increase in productivity and innovation to increases in the real wages of workers.

CONCLUSION

The case studies reveal some important lessons and insights. More broadly, the following conclusions and policy recommendations, many of them closely interlinked, can be formulated as derived from the case studies but also incorporating the analysis of previous chapters in this part of the Report.

1. Increased openness under the right conditions can contribute to economic growth, employment generation and poverty reduction. However, additional government policies are required to ensure that the growth is truly inclusive. This includes policies to prevent unsustainable income inequalities and help all groups of society, in particular vulnerable groups, actively participate in, and benefit from, trade and investment processes. Amongst other things, targeted and higher public expenditures are required to develop supply-side capacity in particular in the areas of infrastructure and education, including of women.

2. The contribution of preferential trade liberalization to economic growth is greater if the coverage is broad and commitments sufficiently deep. Inclusive impacts will depend on net trade creation and employment effects. These are rarely fully known prior to implementation. However, a priori impact analysis based on economic data and modeling can help guide policymakers in putting in place supplementary measures, for example, trade adjustment programmes. Other complementary policies that should be considered include: minimum wages; education and life-long learning; social safety nets; unemployment benefits; and improved access to ICT and credit.

3. The development of domestic SMEs is crucial for creating jobs among the poorer segments of society. Governments can help this process by promoting entrepreneurship and reducing risk by facilitating access to finance, skills, business development services, appropriate technologies and market information and helping SMEs to forge effective linkages with larger and foreign enterprises which dominate regional and global value chains and production networks.

4. Duty- and quota-free imports of goods from the least developed countries can help these countries generate income from trade. This income is needed to improve these countries’ overall supply-side capacity and competitiveness. In addition, the Aid-for-Trade initiative should be used to complement locally available resources to strengthen inclusive trade and investment by steering the use of Aid-for-Trade funds towards trade expansion that generates jobs and income for poor people.
5. In that context, improvement of trade facilitation measures is a tested way for building inclusive trade-led growth. In particular, the proper application and utilization of modern ICT and Internet-based solutions such as traceability systems and e-commerce, help build supply-side capacity of many vulnerable groups, in particular farmers. These can be relatively cheap and quick and facilitate vulnerable groups’ access to market information and customers, thereby helping them to meet international quality standards and integrate more effectively into regional and global supply chains. Therefore, Governments should establish the required ICT infrastructure in rural and other relatively remote areas on a priority basis.

6. EPZs can play an important part in generating employment and income, in particular for women, though Governments need to ensure that such zones do not undermine internationally acceptable labour conditions and wages as part of FDI incentive packages. In addition, as employment in such zones is usually low-skilled, EPZs should strive towards attracting higher value-added industries and related services in the longer run. For this purpose, training and education of the labour force, in particular women, should be a priority. Further policies need to be put in place to allow better spillovers from the best practices followed in EPZs to the rest of national economy.

7. FDI has been proved to play an important role in the overall development process including by enhancing economic growth but this contribution is not automatic. By developing the overall investment and business climate, including strengthening the legal framework and infrastructure and aligning the national education system with the skills requirements of foreign investors, Governments can make FDI work for all.

8. FDI can lead to technology transfer leading, in turn, to enhanced productivity, in particular in the agricultural sector under specific conditions and when effective linkages are forged between foreign investors and local suppliers and farms. Among the required conditions are local absorptive capacity, a healthy level of competition, labour mobility, a minimum level of intellectual property rights protection, and the willingness of foreign companies to forge effective linkages with local companies thereby facilitating the access of local companies to technologies and export markets and related services and logistics.

9. The adoption and implementation of proper (i.e. internationally recognized) labour conditions and paying visible attention to wider social concerns and issues are becoming increasingly important determinants of individual companies’ competitiveness and the competitiveness of supply chains. As a result, businesses need to switch from practicing a charity-based perception of corporate social responsibility to the adoption of international principles of responsible business conduct and corporate sustainability.

10. FDI source countries can contribute to inclusive development in host countries by holding their companies investing abroad to stringent moral, inclusive and sustainability standards which make them liable to prosecution and/or risk customer backlash at home if those standards are violated. In this regard, the development of strong consumer groups in home and host countries are very important.

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**ONLINE DATABASES**


**ENDNOTES**

135 Some of which are published as TID working papers available from www.unescap.org/tid


139 According to Ministry of Commerce of Sri Lanka those declining traditional exports refer to vegetable oil, primary copper, margarine, marbles and pepper, while new exports include insulated wires and cables, poultry feeds, pneumatic tires, ceramics, apparel, furniture, air conditioners and coolers, measuring and checking instruments, glass bottles, processes meat products, medium density fiber boards, rubber gloves, thermal papers, tiles, boilers and machinery parts, iron and steel articles, panel boards and enclosures, sacks and bags, etc. (see http://goo.gl/JQWTKN, accessed 7 October 2013).

140 High Commission of India (2013). India’s important investments to Sri Lanka are in the areas of petroleum retail, hospitals, telecom, vanaspati, copper and other metal industries, real estate, telecommunication, hospitality and tourism, banking and financial services, IT and food processing (tea and fruit juices). Indian business organizations such as Indian Oil Corporation, Tata, Bharti Airtel, Piramal Glass, LIC, Ashok Leyland, L&T and Taj Hotels are present in Sri Lanka.

141 Based on Bowonder, Gupta and Sing (2005), FAO (2013), Bhatnagar and others (2003) and references therein.


143 The case has been prepared based on Chanadee and others (2011), and various presentations made in workshops, including Keretho (2012) and Pratumsa (2013).

144 The case has been prepared based on various authors, including Chinese Academy of Social Sciences (2010), Chen, Li and Zhao (2009).

145 The case has been prepared based on Karunaratne and Abaysekara (2013) and sources therein.

146 ESCAP (2013a) and Natrajan (2012).

147 Based on Tham and Kam (2013).

148 Examples of FDI incentives include tax holidays of up to nine years, exemption from import duty on machinery and equipment, free repatriation of profits, and special depreciation allowances to encourage reinvestment of earnings.


152 Joint ventures have mixed track records. Often, countries starting to open up to FDI are reluctant to grant 100% foreign ownership and insist on joint ventures. In many cases, however, the domestic joint venture partner is not up to the task, leading to frustration and often termination of the venture. As a result, various countries amended their foreign investment laws to allow for an increased number of sectors allowing wholly-foreign-owned enterprises.