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South Asia

Towards a Viable Free Trade Area

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In the last one and a half decades since the idea of economic cooperation was first mooted in South Asia, intra-regional trade has barely increased. It still languishes at less than 5 percent of the region's total foreign trade (Table 1). Due to the sluggish pace of trade liberalization based on regional agreements—beginning with the SAARC Preferential Trading Arrangement (SAPTA) in 1993, which was replaced in 2004 by the Agreement on South Asian Free Trade Area (SAFTA)—there has been a proliferation of bilateral trade agreements (BTAs) among the Member States of the South Asian Association for Regional Cooperation (SAARC). Intra-SAARC import trade mainly takes the form of imports from India to Bangladesh, Nepal and Sri Lanka, while only Nepal is significantly dependent on intra-regional exports (Tables 2 and 3). Nepal and Sri Lanka already have BTAs with India; there is also a BTA between Pakistan and Sri Lanka.

The progress made by BTAs, together with the emergence of the trans-regional Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation Free Trade Area (BIMSTEC FTA) Framework Agreement—which includes five of the seven SAFTA Members —casts doubt over the relevance of SAFTA. Hence, in order to have a positive impact, SAFTA needs to yield trade opportunities in new areas, rather than just reducing barriers to existing traded items. The efficacy of SAFTA is also undermined by factors within, such as the slow pace of its tariff liberalization programme (TLP), the huge size of sensitive lists, the prevalence of non-tariff barriers (NTBs), the exclusion of services and investment, high transaction costs, and the ever-present uncertainty resulting from Indo-Pak trade relations, particularly the non-application of most-favoured-nation (MFN) status for Indian products by Pakistan. This Briefing Paper examines some of these issues and suggests measures to make SAFTA a viable FTA.

Tariff liberalization programme

A major criticism of the SAFTA Agreement, which came into force in 2006, is the slow pace of its TLP. TLP, under which tariffs have to be slashed to 0–5 percent, has been phased in over a 10-year period for least-developed country (LDC) Members and a seven-year period for non-LDC ones (eight years for Sri Lanka). The SAFTA Agreement will have to be fully implemented by India and Pakistan in 2013, by Sri Lanka in 2014 and by the LDCs (Bangladesh, Bhutan, the Maldives and Nepal) in 2016. SAFTA also allows Members that wish to move faster to do so without having to wait for other Members to catch up.

The urgency for SAFTA to assert its relevance is particularly pressing due to the proliferation of free trade agreements (FTAs) in the region. The India-Sri Lanka Free Trade Agreement (ISFTA) will be fully in place by 2008 and the Pakistan-Sri Lanka Free Trade Agreement (PSFTA) by 2010. Moreover, the BIMSTEC FTA Framework Agreement is running parallel to SAFTA, with five SAFTA Members also part of the trans-regional FTA, which goes beyond SAFTA to include investment and trade in services, and also contains a provision for fast-track liberalization. In particular, India's increasing involvement in trade agreements, both bilateral and trans-regional, is likely to result in preference erosion for other SAFTA Members. Therefore, a reconsideration of the pace of its TLP is essential for SAFTA to be of relevance.

It must, however, be noted that if liberalization is too rapid, Members, particularly the LDCs, will not have sufficient time to mitigate the adjustment costs. While an FTA would ideally strike a balance between the two conflicting objectives of rapid liberalization and mitigating adjustment costs, the problem faced by SAFTA is that it is joining the race too late. Nonetheless, SAFTA could potentially strike a balance by identifying certain products of particular trade interest within the region (items that are heavily traded or those identified to have trade potential), and fast-tracking the liberalization of these key products. Similar measures have been adopted by the Association of Southeast Asian Nations (ASEAN) and BIMSTEC. Furthermore, SAARC countries could explore other methods of mitigating adjustment costs, without resorting to delaying liberalization. These include: improving the fluidity of labour markets to make it easier for

Table 1 Intra-SAARC trade (2004)

	Intra-SAARC trade (US$ million)	World trade of SAARC countries (US$ million)	Share of intra-SAARC trade in world trade of SAARC countries (%)
1980	1,210	37,885	3.2
1985	1,054	44,041	2.4
1990	1,584	65,041	2.4
1995	4,228	104,159	4.1
2000	5,884	141,978	4.1
2004	11,342	232,155	4.8

Note: Data from IMF, Direction of Trade Statistics, various issues.
Source: Weerakoon and Tennakoon (2006)

Table 2 Intra-SAARC import trade (in %)

	Bangladesh	India	Maldives	Nepal	Pakistan	Sri Lanka
Bangladesh		0.1	0.0	0.3	0.3	0.1
India	15.5		10.2	42.0	2.5	18.1
Maldives	0.0	0.0		0.0	0.0	0.3
Nepal	0.0	0.3	0.0		0.0	0.0
Pakistan	1.1	0.1	0.3	0.2		1.4
Sri Lanka	0.1	0.3	10.6	0.0	0.3	
Total	16.7	0.8	21.1	42.4	3.1	25.9

Note: Data from IMF, Direction of Trade Statistics, Yearbook 2005.
Source: Weerakoon and Tennakoon (2006)

Table 3 Intra-SAARC export trade (in %)

	Bangladesh	India	Maldives	Nepal	Pakistan	Sri Lanka
Bangladesh		2.3	0.0	0.3	1.5	0.2
India	1.0		0.4	39.2	1.2	6.8
Maldives	0.0	0.1		0.0	0.0	1.1
Nepal	0.1	1.0	0.0		0.0	0.0
Pakistan	0.6	0.6	0.0	0.5		0.7
Sri Lanka	0.2	1.9	12.3	0.0	1.0	
Total	1.8	5.8	12.7	40.0	3.7	8.8

Note: Data from IMF, Direction of Trade Statistics, Yearbook 2005.
Source: Weerakoon and Tennakoon (2006)

workers to switch between industries, ensuring that temporary safety nets are provided for workers in industries that are likely to suffer due to trade liberalization, and providing specific training to workers to prevent long-term unemployment in these industries.

Sensitive lists

The size of the sensitive lists adopted in SAFTA is another matter of concern. A sensitive list of 20 percent of Harmonized Commodity Description and Coding System (HS) 6-digit tariff lines has been retained for non-LDC Members (Weerakoon and Tennakoon 2006), and a close approximation of that for LDC Members. This allows several key trading items to be placed on the list for exemption from TLP. The size of the sensitive lists in SAFTA is, in general, greater than those of bilateral FTAs in the region (Table 4). Under ISFTA, for example, only 13 percent of Sri Lankan exports to India fall in the sensitive list, while under SAFTA, nearly 42 percent of Sri Lankan exports to India are exempt from TLP.

All in all, almost 53 percent of total imports in South Asia are subject to sensitive lists (Table 5). The LDCs have placed between 64 percent and 74 percent of the total value of their imports from South Asia under sensitive lists. Likewise, 47 percent of Sri Lankan exports and 57 percent of Indian and Maldivian exports are restricted by the sensitive lists of fellow SAARC Members, allowing little scope for improved market access through SAFTA (Weerakoon and Tennakoon 2006).

This problem has been successfully addressed in other regional trade agreements. In ASEAN, for instance, sensitive lists are phased out in five equal installments. SAFTA may not go to the extent of completely removing the sensitive lists, but should incorporate a mechanism that stipulates a binding commitment to pruning the same. As things stand now, the SAFTA Agreement only mandates a review of sensitive lists every four years without any binding commitments on the reduction of the extent of protection.

Given the size of sensitive lists in SAFTA, the four-year period of review is too long, and since there is no binding commitment involved, the 'review clause' lacks teeth. Until there is a mechanism to downsize the sensitive lists, the impact of SAFTA will be limited and it will lose its relevance in a region where other less restrictive trade agreements are prevalent.

Table 4 Sensitive lists* in South Asia

	SAFTA	ISFTA	PSFTA
Bangladesh	1,254		
Bhutan	157		
India	884	419	
Maldives	671		
Nepal	1,310		
Pakistan	1,183		540
Sri Lanka	1,065	1,180	697

* Number of tariff lines
Source: Weerakoon and Tennakoon (2006)

Table 5 Trade restriction under SAFTA

	Value of imports from from SAARC subject to sensitive lists (%)	Value of exports to SAARC subject to sensitive lists (%)
Bangladesh	65.0	22.0
India	38.4	56.5
Maldives	74.5	57.6
Nepal	64.0	46.4
Pakistan	17.2	34.0
Sri Lanka	51.7	47.0
Total	52.9	

Note: Calculated using World Integrated Trade Solution (WITS) data.
Source: Weerakoon and Tennakoon (2006)

Non-tariff barriers

Tariffs have been falling the world over due to unilateral, bilateral and multilateral liberalization of trade over the last three decades. As a result, the emphasis of protection has shifted from tariff to non-tariff measures. NTBs are relatively high in South Asia. However, SAFTA fails to deal with NTBs effectively. Though the SAFTA Agreement requires Members to notify the Committee of Experts (CoE) of any NTBs and para-tariff measures, the CoE can only recommend their removal and this recommendation does not entail a binding commitment.

A wide range of World Trade Organization (WTO)-consistent NTBs are still in place in India. These include tariff rate quotas (TRQs) on 14 tariff lines[1] (HS 8-digit level), import restrictions and licensing, and limited port availability. In ISFTA, for example, tea and garment exports from Sri Lanka to India can only be cleared at specified ports. Similarly, the customs entry points along India's land borders with Bangladesh, Nepal, Bhutan and Pakistan cannot be used to clear items on the sensitive list—sanitary and phytosanitary (SPS) measures taken by India that are said to deviate from international standards.[2]

Pakistan has low NTBs, but it does apply technical and safety regulations under WTO rules on goods trade. In Bangladesh, there is a significant application of para-tariffs (e.g., industrial development surcharges and supplementary duties), to the extent that 38 percent of the average protection is due to para-tariffs. Bangladesh continues to maintain quantitative restrictions on eggs, poultry and salt, for which the government has obtained waivers from the WTO. Sri Lanka bans the import of tea and spices on the grounds that low quality imports, if mixed with Sri Lankan products, reduce the quality of exports and thus affect their marketability. Some of these NTBs, such as certain items of security, health and cultural interest, are genuine. However, a majority of them are simply protectionist measures. If SAFTA fails to phase out NTBs within a stipulated timeframe, tariff liberalization will have little positive impact.

Transaction costs

South Asia is plagued with huge transaction costs that deter trade and reduce business opportunities in the region. These transaction costs include excessive documentation[3], high service charges at ports, high transport costs due to weak infrastructure, time wastage at customs due to non-cooperation, lack of harmonization and unpredictability. Article VIII of the SAFTA Agreement attempts to address these issues such that participating countries agree to consider "the adoption of trade facilitation and other measures to support and complement SAFTA for mutual benefit". The measures suggested include customs simplification, cooperation and harmonization, standards harmonization, simplification of import procedures, transit requirements facilitation, development of transport and communication infrastructure, promotion of investment and fair competition, and macroeconomic consultation.

It is arguably too ambitious to attempt to tackle all of these issues simultaneously, and a sequential approach is advisable given the large investments required for trade facilitation measures. It would be prudent to identify a few areas where cooperation is relatively easy and the benefits are large and tangible in the short to medium term. These areas should be vigorously explored by creating binding commitments as well as granting special and differential treatment to the LDC Members, which should also receive technical assistance from both the non-LDC Members and international organizations that work in related areas, e.g., the United Nations Conference on Trade and Development (UNCTAD) and the World Customs Organization (WCO).

Possible starting points include the simplification and harmonization of customs operations. In fact, SAARC has had a Standing Group on Customs Cooperation since 1996. Beyond this, it will be beneficial to adopt a 'fast-track' approach allowing SAARC goods to pass through customs more rapidly. This could be achieved by reducing the requirement for documentation, licences, etc., for SAARC products. Furthermore, SAARC products could be exempted from non-tariff customs charges (e.g., port and airport levy and Export Development Board (EDB) fees in Sri Lanka). SAFTA could also have a requirement of increased transparency of customs data, including tariffs, document requirements and other data, which would simplify export and import procedures. SAFTA should make dissemination of such data mandatory for all Members (SACEPS 2006).

Standard harmonization will also boost intra-regional trade. Some groundwork is in place due to the existence of the SAARC Standing Group on Standards, Quality Control and Measurements since May 1998. Divergences in standards prevent free movement of goods across borders. Along with common standards it is important to harmonize testing, import inspections, product certification and system certification.

A useful first step would be to identify the main items of intra-regional trade within SAARC that are adversely affected by the lack of a common standard. Harmonization could begin with the standards of these products and then move on in a progressive manner until complete harmonization is achieved.

Intra- and inter-country transportation costs among SAARC Member States are a major transaction cost due to poor quality of transport infrastructure as well as delays associated with crossing borders and transit. Bangladesh, Bhutan, India and Nepal have transit requirements for goods trade among them. Nepal and India already have a treaty of transit in operation. SAFTA can follow such a model, adopting bilateral transit agreements for each of the countries requiring such facilities. There is also a case for cooperation on joint infrastructure projects, particularly with regard to road and rail connectivity, in which two or more partner countries stand to benefit from improved transport infrastructure.

Trade in services

The exclusion of trade in services from the SAFTA Agreement is unfortunate, given that services contribute 49 percent of South Asian gross domestic product and are the fastest growing form of trade in the world.[4] Trade in services in South Asia has been rather limited, both due to the failure to grasp opportunities (barring India) and due to the regulations in this sector. The cultural and linguistic ties, and geographic proximity among countries in South Asia make it easier for trade in services to take place. Furthermore, countries with similar levels of development, like those in South Asia, are likely to find it easier to make the compromises required for negotiating agreements on trade in services.

It is encouraging to note that a study has been commissioned by the SAARC Secretariat to assess the potential for the inclusion of trade in services in the SAFTA Agreement. It would be prudent to first identify the complementarities in services trade and then liberalize these areas on a priority basis. The variety of technical capabilities the region possesses provides much scope for benefiting from the liberalization of services such as telecommunications and information technology, tourism, health, education and other professional services.

A dynamic services sector has many positive spill-over effects for other sectors; this is particularly true of services sectors like finance, telecommunications and transport. The liberalization of regulations in areas such as air services, for example, will be crucial for improving connectivity in the region and reducing transaction costs. There is also much scope to gain from regional cooperation in certain sectors such as tourism. If governments and the private sector in the respective countries cooperate, attractive packages with simplified administrative procedures can be developed to boost tourism—for instance, religious tourism (e.g., Buddhism: Bodh Gaya in India, Lumbini in Nepal, Taxila in Pakistan and several ancient temples in Sri Lanka), and the beaches of Southern India, Sri Lanka and the Maldives.

In terms of approach to services liberalization, SAARC would be best served by following a positive-list approach and adopting a 'spirit' similar to that of the Indo-Lanka Comprehensive Economic Partnership Agreement (CEPA)—that is, a progressive, sequential liberalization, bearing in mind the vast asymmetries within the region, mainly with regard to the LDCs. Like the Indo-Lanka CEPA, SAFTA should also attempt to liberalize the least contentious services sectors first to build confidence. It could focus on a few agreed priority areas such as tourism, air services and higher education to begin with. There are many lessons to be learnt from other international agreements on trade in services. ASEAN's common sub-sector approach, for instance, provides incentives to countries to schedule sub-sectors which would be of trade interest for the region. In this approach, if four Members have made a commitment in a sub-sector, all the Members must make an MFN offer in the sub-sector. However, if SAFTA is to use this approach, at least four Members, including two LDCs, will have to schedule a sub-sector before all other Members make an MFN commitment in that sub-sector.

Several issues need to be addressed to make liberalization of services a success. Since data and analyses of trade in services are very limited in South Asia, it is essential that this is improved in order to enable negotiators and stakeholders to make the best commitments in the interest of their respective countries. Regulatory capacity is also weak in the region, especially in terms of ensuring standards of service supply and adherence to rules. It is important to address this issue through greater cooperation between the regulatory bodies within the region and also learning from regulatory bodies in other countries that have entered into agreements on trade in services. There are also significant asymmetries in existing standards, and hence the qualifications of many services suppliers will not be recognized by fellow Members. Mutual recognition agreements (MRAs) will be required to harmonize standards in the region.

Conclusion

The cultural and linguistic affinities and geographical proximity among SAARC Member States indicate substantial potential for successful regional economic integration. Beyond the increase in intra-regional trade, there is potential for attracting foreign direct investment into different Members, both from other Members and from third parties wishing to take advantage of greater market access. Efficiency-seeking industrial restructuring has already begun in South Asia to a small extent: in ISFTA, several Indian firms have set up businesses in Sri Lanka to export back to India, taking advantage of the liberal trading environment. In more advanced regional integration schemes, this phenomenon has been more significant. In the European Union (EU), there was a significant restructuring according to comparative advantage, which resulted in specialization and greater productivity. There will also be significant benefits to consumers if an FTA is successfully implemented—availability of a greater variety of products, lower prices and other benefits of increased competition among suppliers. There could potentially be a significant impact on poverty alleviation if trade results in greater job opportunities as producers have greater access to markets. Last but not least, stronger economic ties could have positive political spill-overs. In such a situation, the economic cost of a breakdown in relations would make countries more likely to pursue a cordial diplomatic resolution of disputes.

Given the current situation in SAFTA , it is essential that a strong enabling environment is nurtured. Infrastructure needs to be improved both within and between countries, to reduce prohibitive transaction costs as well as to provide access to markets. Supply-side capacities also need to be improved in order to take advantage of the increased demand that will result from a larger market. While liberalization of trade in services is quite on the cards, more steps should be taken to ease the barriers to investment in the region. Though a late starter, SAFTA has the potential to provide significant benefits to the population of South Asia. In this context, it is important that SAFTA is far reaching and has greater depth, while taking into account the asymmetries in the region and maintaining sensitivity to the position of its LDC Members. ■

Notes

1 Though not all of these are filled.

2 WTO (2007).

3 It was estimated that Indian exporters need to obtain 258 signatures and 118 copies of the required documents such as registration for income and sales tax, bills of entry, export and shipping bills, licences for importing negative-listed goods, inspection certificates for second-hand goods and pre-shipment inspection certificates.

4 Between 1990 and 2002, global trade in services grew by 155 percent, compared with a growth of 97 percent in manufacturing and 40 percent in agriculture (Chanda 2005).

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SAWTEE
SOUTH ASIA WATCH ON TRADE, ECONOMICS & ENVIRONMENT

South Asia Watch on Trade, Economics & Environment (SAWTEE) is a regional network that operates through its secretariat in Kathmandu and 11 member institutions from five South Asian countries, namely Bangladesh, India, Nepal, Pakistan and Sri Lanka. The overall objective of SAWTEE is to build the capacity of concerned stakeholders in South Asia in the context of liberalization and globalization.

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