



Regional Economic Integration

**Challenges for South Asia
during turbulent times**

Edited by

Saman Kelegama
Ratnakar Adhikari
Puspa Sharma
Paras Kharel



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Foreword

Motivated by the need for a sustainable platform for the exchange of knowledge, experiences and ideas among stakeholders to make the regional integration process in South Asia deliver substantial results on the ground, a group of think tanks in South Asia came together to organize the 1st South Asia Economic Summit (SAES) in 2008. Giving continuity to the forum, the 3rd SAES was held on 17–19 December 2010 in Kathmandu. The core theme of the 3rd SAES was “Regional economic integration, climate change and food security agenda for the Decade 2011–2020”. It was organized by South Asia Watch on Trade, Economics and Environment (SAWTEE) and South Asia Centre for Policy Studies (SACEPS) in partnership with the Asian Development Bank, the Commonwealth Secretariat, Oxfam Novib, the United Nations Development Programme and the United Nations Economic and Social Commission for Asia and the Pacific, and in collaboration with Centre for Policy Dialogue, Dhaka; Institute of Policy Studies of Sri Lanka, Colombo; and Research and Information System for Developing Countries, New Delhi.

The Summit covered a wide range of trade, socio-economic and climate change issues that are critical to enhancing and deepening regional cooperation in South Asia, including emerging economic outlook and policy challenges for South Asian economies; enhancing merchandise trade in South Asia; regional cooperation on climate change; services trade liberalization in South Asia; trade and climate change issues for South Asia; South Asian action plan on energy cooperation; food security agenda for South Asia; integration issues for South Asian least-developed countries; trade facilitation and integration in South Asia; labour migration issues for South Asia; and role of people’s representatives, the private sector and other civil society actors and agencies in strengthening regional cooperation. It was participated by policymakers, representatives of governments, political parties, the business community, international and intergovernmental organizations, development partners, civil society, academia and the media from all member countries of the South Asian Association for Regional Cooperation (SAARC).

This book is an outcome of the papers presented and the deliberations in the 3rd SAES. Due to various unforeseen glitches, the volume could not be published soon after the Summit as scheduled. However, we believe that the ideas generated in the Summit, which had the participation of a cross-section of stakeholders, have much to inform the re-

gional integration process in South Asia. While readers may find some of the facts and figures slightly dated because the articles were written in late 2010 or early 2011 and may also note that some important developments in the region have overtaken some of the points made in a few of them, we feel that the central ideas and arguments continue to remain relevant. Hence we have come up with this publication for wider dissemination of those ideas and arguments. Marking the silver jubilee of SAARC, the 16th SAARC Summit held in Thimphu, Bhutan in April 2010 saw leaders of the region acknowledging that progress had been extremely slow in almost all areas of regional cooperation in the 25 years of the body's existence. They pledged to make SAARC "truly action oriented". We hope that this volume will contribute towards that end.

We would like to express our sincere gratitude to all the partners for generously sponsoring the 3rd SAES. Thanks are also due to the collaborators for their continuous support. We would like to thank the individual authors and the editors for their contributions to the volume, and to all the participants of the 3rd SAES for making it a success.



Posh Raj Pandey, Ph.D.
Executive Chairman
SAWTEE

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Abbreviations and acronyms

ACV	Agreement on Customs Valuation
ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
AH	Asian Highway
ALI	Air Services Liberalization Index
APEC	Asia-Pacific Economic Cooperation
ASA	Air Services Agreement
ASEAN	Association of Southeast Asian Nations
ASYCUDA	Automated System for Customs Data
AWG-LCA	Ad Hoc Working Group on Long-Term Cooperative Action
BASA	Bilateral Air Services Agreement
BFTA	Bilateral free trade agreement
BIS	Bureau of Indian Standards
CASAC	Coalition for Action on South Asian Cooperation
CBDR	Common but differentiated responsibilities
CBEC	Central Board of Excise and Customs
CCC	Ceylon Chamber of Commerce
CDS	Centre for Development Studies
CEPA	Comprehensive Economic Partnership Agreement
CFL	Compact fluorescent light
CoE	Committee of Experts
COP	Conference of Parties
CPC	Central Product Classification
CPD	Centre for Policy Dialogue
CTE	Committee on Trade and Environment
CTESS	Committee on Trade and Environment Special Session
CTH	Change of tariff heading
DOTS	Direction of Trade Statistics
DSM	Dispute Settlement Mechanism
EGS	Environmental goods and services
EGs	Environmental goods
ES	Environmental services
EU	European Union
FDI	Foreign direct investment
AIFTA	ASEAN-India Free Trade Area
FDI	Foreign direct investment

FSC	Free Sale Certificate
FSCs	Full service carriers
FTA	Free trade agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Co-operation Council
GDP	Gross domestic product
GEP	Group of Eminent Persons
GHGs	Greenhouse gases
GMS	Greater Mekong Sub Region
GOB	Government of Bangladesh
HS	Harmonized Commodity Description and Coding System
ICD	Inland container depot
ICT	Information and communications technology
IMF	International Monetary Fund
IMTP	Integrated Multi-modal Transport Policy
INR	Indian rupees
IPCC	Intergovernmental Panel on Climate Change
IPR	Intellectual property right
IPS	Institute of Policy Studies of Sri Lanka
ISFTA	India-Sri Lanka Free Trade Agreement
ISO	International Organization for Standardization
ITC	International Trade Centre
IWT	Inland water transport
JIT	Just-in-Time
L/C	Letter of credit
LCCs	Low-cost carriers
LCS	Land Customs Station
LDC	Least-developed country
LED	Light emitting diode
LIF	LDC Integration Fund
LOC	Line of credit
Mercosur	Southern Cone Common Market
MFA	Multi-fibre arrangement
MFN	Most-favoured-nation
MOP	Meeting of Parties
MPs	Members of Parliament
MRAs	Mutual recognition agreements
NAFTA	North American Free Trade Agreement
NAMA	Non-agriculture market access

NITDB	Nepal Inter-modal Transport Development Board
NLDCs	Non-LDCs
NSL	Notified Sensitive List
NTBs	Non-tariff barriers
OBR	Output-based rebate
OECD	Organisation for Economic Co-operation and Development
OSL	Operational Sensitive List
PPMs	Processes and production methods
PPP	Public-private partnership
PSI	Pre-shipment inspection
PSQCA	Pakistan Standards and Quality Control Authority
QUASAR	Quantitative Air Services Agreements Review
RCA	Revealed Comparative Advantage
RECA	Regional economic cooperation arrangement
RIS	Research and Information System for Developing Countries
RoO	Rules of origin
RTA	Regional trade agreement
S&DT	Special and differential treatment
SAARC	South Asian Association for Regional Cooperation
SACEPS	South Asia Centre for Policy Studies
SADB	South Asian Development Bank
SADs	Special additional duties
SAEU	South Asian Economic Union
SAFAS	SAARC Framework Agreement on Trade in Services
SAFTA	South Asian Free Trade Area
SAPTA	SAARC Preferential Trading Arrangement
SARSO	SAARC Regional Standardization Organization
SATIS	SAARC Agreement on Trade in Services
SAWTEE	South Asia Watch on Trade, Economics and Environment
SMC	SAFTA Ministerial Council
SMEs	Small and medium enterprises
SPS	Sanitary and phytosanitary
SRMTS	SAARC Regional Multi-modal Transport Study
TAR	Trans Asian Railway
TBT	Technical barriers to trade
TLP	Tariff liberalization programme
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TRQ	Tariff rate quota

TTMRA	Trans-Tasman Mutual Recognition Agreement
UAE	United Arab Emirates
UK	United Kingdom
UN	United Nations
UN/CEFACT	United Nations Centre for Trade Facilitation and Electronic Business
UNCTAD	United Nations Conference on Trade and Development
UNECE	United Nations Economic Commission for Europe
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
UNFCCC	United Nations Framework Convention on Climate Change
US	United States
VAT	Value added tax
VER	Voluntary export restraint
WALI	Weighted Air Services Liberalization Index
WITS	World Integrated Trade Solution
WTO	World Trade Organization

Chapter 1

Introduction

Saman Kelegama, Ratnakar Adhikari,
Puspa Sharma and Paras Kharel

The South Asian Association for Regional Cooperation (SAARC) has completed 27 years of its existence. Two of the objectives behind the establishment of SAARC are the acceleration of economic growth, social progress and cultural development in the region; and the promotion of active cooperation and mutual assistance in the economic, social, technical and scientific fields. The cooperation element was built-in to facilitate economic growth, social progress and the like in the region. In this context, a number of frameworks have been put in place by SAARC to support economic growth in individual countries via strengthening economic integration in the region.

The signing of the SAARC Preferential Trading Arrangement (SAPTA) in 1993 was a major first step forward in the direction of economic integration in South Asia. The realization of the need to move to higher levels of economic cooperation resulted in the signing of a Framework Agreement on South Asian Free Trade Area (SAFTA) in 2004, which became operational in 2006. At the 16th SAARC Summit held in Thimphu in April 2010, SAARC leaders signed the SAARC Agreement on Trade in Services (SATIS). The negotiation on regional services trade liberalization, based on the Agreement, has already commenced and very soon the “offer” and “request” list of all South Asian countries will be known to stakeholders.

Although frameworks are in place to facilitate economic integration in the region, the results achieved in SAARC are far from satisfactory. For instance, intra-regional merchandise trade, which is one of the most important indicators of the depth of regional economic cooperation, still hovers at around 5 percent of the total merchandise trade of South Asian countries. The liberalization of trade in services has been on the SAARC agenda since 2005, but progress on this is very slow.

Regional economic integration has, therefore, remained a challenge in South Asia compared to many other regional groupings. Numerous studies have attempted to highlight the reasons for the slow movement of economic integration, but new issues keep emerging and have further complicated the process. Of late, climate change has emerged as a serious threat to all countries of South Asia and it is going to add to the already precarious conditions of people, mostly the poor and vulnerable, living in the region for a number of reasons. It is going to have severe implications for the region's biodiversity on which mostly the poor and women depend for their survival. It is also going to adversely affect other areas of the economies. It has been predicted that climate change is going to worsen agriculture production and productivity in South Asia in such proportions that the region is going to face the greatest yield decline in almost all crops, thereby aggravating food insecurity.

These issues have a direct bearing on the livelihoods of a vast majority of people, mostly the poor and vulnerable farmers who constitute a majority of the region's population. Consequently, they could retard the minimal progress achieved in poverty reduction in the region. Such issues have to be taken into consideration when formulating the economic integration agenda for South Asia. Moreover, it is pertinent to have a new and fresh look at the challenges of regional economic integration in the South Asia region. This book attempts to highlight the challenges for regional economic integration in South Asia by examining the current shortcomings and future challenges.

The book is divided into six parts. Part 1 (Chapter 2) highlights the problems and opportunities of regional economic integration. Part 2 (Chapters 3–5) focuses on the impediments to goods and services liberalization while Part 3 (Chapters 6–8) examines the issues with regard to regional connectivity and trade facilitation. Part 4 (Chapters 9–10) analyses the financial inflows to South Asia in the form of remittances at a time of global turbulence and finances required for more effective integration of least-developed country (LDC) members of SAARC into the regional economic cooperation framework. Part 5 (Chapters 11–12) then discusses the role of the civil society and the private sector in expediting regional economic integration, and finally, Part 6 (Chapters 13–14) ex-

amines environmental goods and challenges related to climate change in the region.

In Chapter 2, titled "Changing face: The trials and fortunes of regional cooperation in South Asia", Saman Kelegama provides an assessment of the performance of SAARC and its efforts to promote regional cooperation in South Asia. By initially identifying how SAARC has not lived up to its expectations thus far, the author sets the tone for the chapter as he proceeds to identify how a potential still remains for the member states of the region to use regional initiatives under the purview of SAARC to their advantage and, accordingly, overcome their individual deficiencies that deter the achievement of their developmental goals. The author notes, however, that such a reality is conditional upon the ability or willingness of policy makers to recognize the obstacles that have hampered their efforts in the past, and learn from such mistakes to provide the necessary impetus that has thus far been lacking within the efforts of SAARC.

After recognizing the benefits of regional integration that are yet to be enjoyed within the South Asia region, the author proceeds to identify the obstacles that have hindered SAARC from achieving the desired transformation aspired within the Group of Eminent Persons (GEP) report. While an array of obstacles has been identified, each of which has hindered the efforts to achieve the desired level of regional cooperation, they can be collectively categorized as arising due to three overarching set-backs. First, there are obstacles that have arisen due to the geopolitical tensions present in the region, which has meant that there has been a lack of political commitment towards regional objectives. Second, obstacles have arisen due to the lack of domestic infrastructure within the region necessary to stimulate and support intra-regional trade flows. The third set-back is the lack of adequate channels being institutionalized to engage stakeholders (regional business and academic communities) other than government, within the decision-making processes of SAARC. SAARC processes tend to suffer from only being informed by the voices and positions of national governments, which themselves operate based on their own agenda.

The author notes that this is easier said than done and that the magnitude of reform required could initially benefit from an acceptance of the environment which it faces and the need, therefore, to adapt to the prevailing reality. He further argues that if such an acceptance can be achieved, the capacity of SAARC to fulfil its aspirations outlined in the GEP report is strengthened due to the evolving nature of the region, which is reflected foremost in the change in attitude of India towards regional cooperation, due largely to its fear of China's increasing pres-

ence within the region. Although an array of opportunities (such as spill-over effects generated from India becoming a services hub) exists to revitalize the regional cooperation movement, the author notes that it is essential for the region to incorporate commitments that its member states can satisfy and accommodate.

Chapter 3 is on “Pruning India’s sensitive list under SAFTA”, by Nisha Taneja, Saon Ray, Neetika Kaushal and Devjit Roy Chowdhury. The inability of SAFTA and its predecessor to enhance the levels of intra-regional trade in South Asia is a predicament that has continually challenged the efforts of regional policy makers. When one assesses the root cause of this problem, a contributing factor that has been noted is the effect of the sensitive lists maintained by the member states, and how they act as a stumbling block to intra-regional trade.

Although there is a rationale behind the need to use sensitive lists in a preferential or free trade agreement, the reality is that the manner in selecting the items that are included in these lists by countries such as India has undermined the capacity of the trading arrangement to achieve its purported effectiveness. In accordance with the overarching purpose of sensitive lists and the asymmetric responsibility to liberalize imports that is expected of a dominant economy within a region, the chapter argues for the need to prune the size of India’s sensitive lists to a level that reflects strictly the inclusion of items that are justifiable on grounds of food security, revenue purposes and infant industry protection.

To support this argument, the chapter presents and applies a five-step policy tool based on a revealed comparative advantage approach to illustrate how the items included in India’s sensitive lists under the India-Sri Lanka Free Trade Agreement for Sri Lanka and SAFTA for Bangladesh and Pakistan can be limited to items in which India is not competitive as well as items that are crucial for food security and revenue purposes. Interestingly, the findings from the application of this policy tool to India’s sensitive lists for Sri Lanka, Bangladesh and Pakistan indicate a drastic reduction in the number of items, and hence the possibility to undertake an asymmetric responsibility by India in liberalizing imports. (The editors note that at the 17th SAARC Summit in the Maldives, India reduced its sensitive list for all SAARC LDCs, retaining only 25 items).

In Chapter 4, titled “Non-tariff barriers in South Asia: Nature, implications and measures to address the challenges”, Mustafizur Rahman argues that the sustained application of an excessive level of non-tariff barriers (NTBs) by the member states of SAFTA remains as a key factor contributing to the inability of the regional trade agreement to boost intra-regional trade in South Asia. While an array of arguments ex-

ists to support the necessity of NTBs under environmental, health and safety grounds, the adoption of such measures on a discretionary basis by countries within the region has become a common occurrence and, therefore, a pitfall that impedes the ability to achieve trade expansion for participating member states through SAFTA. By highlighting the findings from a survey of NTBs reported by SAARC member states to the Committee of Experts, the author reports that the NTBs most imposed in trade among SAARC countries relate to sanitary and phytosanitary measures and technical barriers to trade, quotas, anti-dumping measures, licence requirements, countervailing duties, documentation procedures and SAFTA certification.

In addition to such NTBs, factors such as the lack of physical, industrial and communication infrastructures are also found to create additional NTBs that restrict trade, as these factors are found to have a negative effect on market access and trade flows. By encompassing the experiences of other similar regional arrangements in dealing with such NTBs, the author notes that the region can learn from such experiences and thereby effectively resolve the current NTB-related issues, which are undermining the objectives of SAFTA. To this end, he concludes by suggesting a broad range of policy and institutional initiatives that fall under the purview of trade facilitating measures which must be undertaken at the regional level, if the excessive application of NTBs by member countries is to be overcome.

In Chapter 5, "Services trade in South Asia: Contours of liberalization and modalities in SAFTA", Rajan Sudesh Ratna begins by providing an illustrative account of the liberalization experience related to trade in services, currently planned in South Asia under the purview of SAARC. The author then highlights the importance of the sector to the region, although he recognizes that the goal of achieving greater regional prosperity and development through deeper regional integration is dependent upon the ability of the member states to make a concerted effort to liberalize trade in services. Although a cautionary note is also provided regarding the necessary prerequisites and modalities through which the liberalization of trade in services can be effectively achieved, the author proceeds to acknowledge and praise the current efforts in the region that have led to the signing of SATIS by SAARC member states. The regional approach to liberalizing trade in services has furthermore been considered a viable alternative to the multilateral approach as it allows member states to minimize the risks that could arise under the multilateral approach.

This being said, there are numerous unique challenges in the region which have to be managed if SATIS is to effectively deliver the liberal-

ization of trade in services and facilitate the overall vision of building a South Asian community. In this regard, the findings of some key studies conducted on the topic of liberalizing intra-regional trade in services illustrate how these challenges could be alleviated if policy makers are willing to adhere to such recommendations, as those findings illustrate the scope that exists within the region to facilitate trade creation via deeper regional integration.

Chapter 6 is on “Air services liberalization in South Asia” by Anushka Wijesinha. After establishing the dynamic nature of the relationship between air connectivity and regional economic integration, the author shows the need to address the lack of air connectivity within the region by identifying factors that are inhibiting air connectivity in South Asia. Accordingly, he suggests policy measures that could lead to greater air connectivity, which simultaneously also facilitates greater economic integration in the region.

After identifying the positive gains that are achievable for the wider economy through the liberalization of the air services sector, the author initiates his analysis of the factors that currently inhibit air connectivity in the region. In so doing, he recognizes the limitations that arise through Air Services Agreements (ASAs) themselves, which are implemented to provide the regulatory framework for the sector globally. The author notes that South Asian ASAs in particular are even more restrictive than average ASAs that operate globally, which themselves are known to be relatively restrictive.

The author then proceeds to identify a further set of factors inhibiting air connectivity in the region that extend beyond the hampering effect of the pertinent ASAs in the region. A primary factor that the author deduces from his consultations with industry stakeholders is how a lack of commercial viability to increase air connectivity within the region due to low level of demand for flights, except for the case of India, affects trade in air services. A host of technical factors such as code sharing issues, operational costs, visa bottlenecks, geographic issues and route-specific issues has further been identified as contributing towards the current low level of intra-regional air connectivity. To mitigate the specific challenge posed by code-sharing restrictions, the liberalization of restrictions on code sharing in ASAs has been identified as a viable policy option. This would allow the region to overcome the current impediment caused by the reluctance of certain national airlines (Sri Lankan Airlines) to enter into arrangements with other national airlines (Biman Bangladesh Airlines and Nepal Airlines) for certain routes on the grounds that their quality and safety records are not up to the mark.

According to the author, the achievement of air connectivity through the liberalization of the sector will be met with a set of supplementary challenges (the entry of low-cost carriers, infrastructural inadequacies and undue political interference in the processes) that are likely to manifest as more progress is achieved. In light of such challenges, he advocates the need to stay on track and not be deterred by such developments as he emphasizes how the liberalization of air services can spur a virtuous cycle of increased dynamism that can facilitate the attainment of overarching regional goals which encompass national interests as well. In recognition of the lack of experience within the region, he provides a word of advice by stipulating how the region can learn from the phased manner in which air services liberalization has been achieved in other regional arrangements such as the Association of Southeast Asian Nations (ASEAN) and the European Union (EU).

In Chapter 7, titled “Improving transport connectivity in South Asia”, M. Rahmatullah suggests that the fragmented nature of the transport network (system) and the high logistical costs in South Asia (13 percent to 14 percent of the commodity value) compared to that in the United States (8 percent of the commodity value) are significant drawbacks that have impinged upon other advancements made to increase intra-regional trade. Thus, improving intra-regional trade flows will be dependent on improving overland transport connectivity among SAARC countries. The chapter calls for the need to prioritize projects that target transport connectivity shortcomings within the region to facilitate trade and investment.

In respect of the steps taken to ensure transport connectivity in the region, the chapter recognizes the two regional projects initiated by the United Nations Economic and Social Commission for Asia and the Pacific—the Asian Highway (AH) and the Trans Asian Railway (TAR)—as pioneering efforts in the region. The contributions made by the SAARC Regional Multi-modal Transport Study (SRMTS) and the Joint Communiqué between Bangladesh and India, in particular, are identified as fundamental steps that have been taken in the right direction to achieve a long-lasting cooperation in transport connectivity in the northeastern sub-region of South Asia.

The author takes the transport fragmentation in Northeast India as a case study to illustrate his arguments and proposes the policy framework required to improve connectivity. He shows that the necessary steps that need to be undertaken for the key agreements in the Joint Communiqué to materialize indicate how transport connectivity within the region is a multi-faceted phenomenon. It not only requires a collective (regional) mindset but also supporting measures such as transit

agreements to ensure that additional human made trade costs do not arise.

The author categorizes the benefits of cooperation to achieve transport connectivity under i) benefits accrued to users (e.g., transport efficiency in terms of time and costs, productivity gains, dynamic benefits such as employment creation and poverty reduction); and ii) benefits accrued to transit facility providers (e.g., transport charges, port charges, border crossing charges, toll charges, transit fee earnings). These benefits provide the necessary incentives for national governments within the region to honour their commitments, prioritize projects and take necessary actions to address the outstanding problems. The author concludes by highlighting how the natural resources sector in Northeast India could be tapped into, thereby leading to trade creation.

Chapter 8 is on “Role of government regulations in trade facilitation: Case of Nepal”, by Pushpa Raj Rajkarnikar. The author initially postulates the importance of trade facilitation within the overall processes of trade reform by depicting how trade facilitation enhances trade competitiveness through the reduction of transaction costs that are incurred in international trade transactions. Referring to transaction costs, the author notes that such costs, which can be classified as direct (administrative, transportation, communication) and indirect (opportunity costs), arise within international trading procedures and act as a debilitating factor on the ability to perform international trading activities effectively and efficiently. To understand where these transaction costs arise, the author incorporates the International Trade Transaction Model developed by the United Nations Centre for Trade Facilitation and Electronic Business to illustrate the various procedures that are recognized as constituting an international trade transaction. In this regard, the author recognizes that government regulations have an ability of influencing either positively or negatively i) commercial procedures; ii) transport procedures; iii) regulatory procedures; and iv) finance procedures.

Therefore, the goals of trade facilitation are innately related to the act of reducing the inhibiting effects that are created by the direct and indirect costs. These costs exist within the varying procedures that collectively constitute an international trade transaction. What the author postulates, therefore, is that an array of government regulations can be found to influence those procedures. These regulations generate undue trading costs which hinder the potential ability of enhancing trading levels if they are not properly implemented to stimulate the free trade agenda. These areas of government regulations can be listed as i) trade control regulation; ii) customs regulation; iii) technical regulation; iv) product-specific regulation; and v) sectoral regulation. By undertaking

a case study of Nepal, the author illustrates the shortcomings that exist in the current efforts made by the Government of Nepal.

Although the policy initiatives undertaken (such as customs reform, transport connectivity reforms, use of information and communication technology to facilitate knowledge dissemination for all stakeholders involved in trading activities) by the Government of Nepal to improve the state of trade facilitation within the country correspond with the recommendations noted in the chapter, the tangible gains achieved in this regard have been negligible, if not non-existent. This predicament is explained by the negligible improvement in the days to export and import, and limited improvement in the cost of export and import, despite the measures having been “supposedly” implemented.

In Chapter 9, titled “The financial crisis in the Gulf and its impact on South Asian migration and remittances”, S. Irudaya Rajan and D. Narayana begin by postulating what a number of large-scale migration surveys conducted after the global financial crisis of 2008 had anticipated. There was fear of a large-scale retrenchment of expatriate labourers originating from South Asia in the Gulf region and a significant loss of inward remittances to South Asia. To consider the validity of such claims, the authors investigate three main areas of interest which can be summarized as: i) how has the crisis affected the demand for South Asian migrant workers in the Gulf countries?; ii) what strategies did the emigrants adopt to cope with their situation at their place of work (country of destination) and what is the likely impact of the crisis on the home country in terms of decline in remittances, if any?; and iii) did countries in South Asia see large-scale return emigration and find a decline in the outflow of emigrant labour to Gulf countries as well as inward remittances from them?

Using the findings of two surveys, the authors come out with a contrary conclusion as the overall loss of jobs for South Asian emigrants owing to the crisis is estimated at less than 5 percent. Therefore, a significant reduction in the demand for South Asian migrant workers owing to the crisis is not established. A segment of the emigrant workforce from South Asia who did lose their jobs, however, chose to remain in the Gulf countries and find further employment opportunities, may be even at a lower wage rate. Hence, the fact that they would accept any job at a lower wage and send home some remittance to repay their loans was a contingency strategy that they adopted to manage the implications of the crisis. The fact that 178,000 South Asian emigrants decided to remain in the Gulf out of the total 264,000 South Asian emigrants who lost their jobs indicates that South Asian countries did not experience large-scale return emigration. As a matter of fact, approximately 9.5 million South

Asian emigrants continued to reside in the Gulf region even after the 2008 crisis.

The authors, however, observe that there were other factors at play which prevented remittances to South Asia from declining. They are: i) the debts incurred in the migration process obliged them to stay; ii) the anticipated large-scale return emigration did not happen; iii) the initial drop in the outflow of emigrants did not significantly impact the stock of South Asian emigrants in the Gulf; iv) the appreciation of the US dollar vis-à-vis South Asian currencies; v) the continuous rise in oil prices generating more income in the Gulf; and vi) the reverse migration of the crisis-led return emigrants back to the Gulf.

Chapter 10 is on “LDC Integration Fund in South Asia” by Ratna-kar Adhikari. When commenting on the performance of SAFTA, the regional economic cooperation arrangement (RECA) of South Asia, numerous academics tend to focus on the ineffectiveness of the RECA by illustrating how the arrangement has failed to boost intra-regional trade since its inception. If one considers this as a surface-level problem, the analysis undertaken by Adhikari in this chapter can be considered as dwelling on the root causes of the problem. He recognizes how the overarching problem lies in the inability of the RECA to facilitate an equitable benefit-sharing arrangement, as LDCs are finding themselves and their trading interests marginalized within the regional context. Although the author does give recognition to the fact that there could be natural asymmetries in the benefits attainable for member states of any RECA, he argues that without taking measures to ensure that benefits can be equitably shared by all the participating member states, the sustainability of the RECA cannot be ensured.

The author shows how South Asian LDCs are excessively dependent on regional trade in terms of both exports and imports. The problem is primarily occurring due to their export interests being marginalized at the regional level. He notes that this is a problem of severe magnitude as the increasing dependence of LDCs on regional trade for their imports is causing their trade deficits to widen vis-à-vis their regional trading partners as they are unable to increase their exports to the region. By recognizing the existence of a sense of asymmetry in the distribution of benefits between the LDCs and developing countries of the region, he argues that there is need for regional policy makers to take measures to correct this asymmetry. This would help the LDCs of the region to realize their development potential and thereby also determine the sustainability of SAFTA in future.

The author highlights how other more successful RECA's such as the EU, the Southern Cone Common Market (Mercosur) and the ASEAN

Free Trade Area have been guided by the philosophical underpinning of “regional public good.” This concept views regional economic cooperation as a regional public good and thereby ensures that the benefits accrued are shared more or less equitably by all the participating members. In this context, the author calls for the rebirth of the proposal developed by the Coalition for Action on South Asian Cooperation that had made a plea for the “creation of a reasonably large sized fund” for the development of LDCs’ infrastructure, human resources, export production and diversification of export capacity, and calls upon South Asian policy makers to create an LDC Integration Fund. That would help SAARC LDCs enhance their capacity to better integrate themselves into the regional trade mainstream.

In Chapter 11, “Roles of peoples’ representatives and non-state actors in strengthening regional cooperation”, Nihal Rodrigo argues that the current inability to overcome the diminishing returns of the regional integration efforts under the purview of SAARC is linked to the underlying lack of commitment to the regional agenda and the absence of initiatives at the domestic level to achieve regional objectives. The author goes on to state that the ability of the region to achieve its desired goals in the future is, therefore, dependent on the degree to which the regional initiatives undertaken can effectively secure the constructive engagement of the people in the region. This consequently also ensures a greater level of commitment being achieved towards the regional objectives themselves. In this regard, the author underscores the need for regional cooperation efforts to take into consideration the multiple interests and perspectives of various stakeholders – corporate sector representatives, professional organizations, academic groups and civil societies – that can benefit from or are affected by the regional initiatives.

The author, however, recognizes that the importance of this notion is beginning to surface within the deliberations that take place under the officially recognized bodies of SAARC. The draft Charter of Democracy, for example, that is awaiting adoption/ratification, is considered a signal of how there is an increasing acceptance of the value of facilitating broad-based participation of the people in the governance processes. Regional economic cooperation initiatives are found to receive a greater level of commitment at the domestic level due to the sense of ownership and responsibility that arises from increased involvement of local stakeholders in the regional processes. Similarly, the engagement of all peoples is found to mitigate the various other debilitating effects on regional cooperation.

With hindsight, the author’s argument or prescription is certainly supportable as the greater engagement of the people being secured

within the regional processes could have meant, for example, the mitigation of numerous deadlocks that prevent the attainment of regional cooperation in a more efficient and effective manner. One such point of reference would be the prolonging of the implementation of SAFTA, which was significantly influenced by the breakdown of political relations between the two major economies of the region—India and Pakistan. This being said, the importance of his findings as a policy prescription cannot be understated as the regional cooperation process in South Asia stands to derive significant benefits from the suggested greater engagement of people.

Chapter 12 is on “Private sector in South Asia: Stumbling blocks or building blocks to regional integration?” by Anura Ekanayake. Even though the importance of increasing intra-regional trade through regional economic integration has become increasingly apparent over the years, efforts that have been made to achieve such an outcome in the region have continuously been marred by a range of factors. These include such issues as tariff barriers, NTBs, high trade costs and geopolitical tensions which work against the agenda of regional economic integration. To understand why policy makers are unable to overcome such factors even when a vast body of evidence exists in support of the potential gains that are achievable through trade liberalization, the author questions if the problems arise due to the role played by the private sector and their influence on the negotiating positions of national governments in trade policy negotiations.

The author initiates his analysis by noting how trade liberalization, through regional economic integration, entails a set of costs to certain sectors of the economy as liberalization proceeds to restructure and alter the dynamics of markets (creating winners and losers). The lack of protection and increased competition tends to flush out uncompetitive firms within certain sectors. He notes that the resistance to trade liberalization, particularly from import-competing sectors, is a natural phenomenon that arises as the parties that stand to lose from trade liberalization are likely to invest more heavily in lobbying efforts as a means of preserving their interests. This being said, the author notes that it would be a misconception to consider the role of the private sector as being limited to only voicing the concerns of parties that stand to lose from trade liberalization.

In this regard, he recognizes the importance of firms that stand to gain from liberalization mobilizing to counterbalance the conservative pressures of import-competing industries. Such an initiative would help in communicating to the wider economy the benefits that are attainable for the overall economy in the long run which may not be as visible

in the short run when compared to the costs that arise through trade liberalization.

Accordingly, he postulates that the actions/behaviour of the private sector in South Asia embody stumbling blocks if they hinder the promotion of regionalism, and building blocks if they facilitate such efforts. He cites the signing of the Indo-Lanka Comprehensive Economic Partnership Agreement being prevented due to the protests by some sections of the business community. The author indicates that the current actions/behaviour of the Sri Lankan private sector can be perceived as hindering the achievement of greater regional economic integration and, therefore, constituting a stumbling block. The arguments presented by this sector, according to the author, have been based on a high degree of misinformation, misinterpretation and baseless speculation. He concludes, however, by identifying how trade chambers can play a role in making the private sector a building block instead of a stumbling block to regional economic integration efforts. In this regard, the author notes that it is necessary for trade chambers to take a national interest-based position but also try to mitigate any adverse effects on or adjustment costs of specific sectors or firms.

In Chapter 13, titled "Trade and climate change: South Asian agenda at the UNFCCC and the WTO", Nitya Nanda begins by outlining the severity of climate change and its implications for the prevailing social, economic and environmental conditions across all regions of the world as debated among academics and policy makers alike. The author then goes on to discuss the context of South Asia where the ramifications of climate change have been further heightened due to the dependence of local communities on climate-sensitive sectors such as agriculture and fisheries for their livelihoods. The centrality of such sectors to the export baskets of South Asian countries makes it urgent to take measures to overcome the impacts of climate change, not least because the region's macroeconomic and trade performance are clearly dependent upon its ability to sustain growth of such sectors.

Although there is a clear convergence of opinion between developed and developing countries on the need to respond to the global problem, achieving an agreement on the nature of the required approach to combat climate change at the multilateral level has surprisingly proven cumbersome. By illustrating the contrasting positions of developed and developing countries at the United Nations Framework Convention on Climate Change and the World Trade Organization (WTO), the author stresses the need for both groups of countries to understand each other's underlying interests and accompanying expectations, if progress is to be achieved at the multilateral level. The author supports this argument by

illustrating how the relative importance of climate change mitigation and adaptation varies across the two groups. Accordingly, any measure that is adopted to address climate change mitigation *per se* would fail in achieving commitments from developing countries as it fails to address their developmental interests which are represented by way of climate change adaptation considerations.

Chapter 14 is on “WTO negotiations on environmental goods and services: South Asia’s interests” by Fahmida Khatun. The importance of the topic to South Asia is highlighted by the numerous issues faced by the region as well as the fact that a large proportion of the communities in the region depend on the prevailing conditions of the environment for their livelihoods.

The inadequacy of the efforts made to address such concerns has, however, meant that there is continuous pressure exerted at the level of the multilateral trading regime to provide further leeway for environmental considerations. This is evidenced within the ongoing Doha Round of trade talks. Paragraph 31(iii) of the Doha Ministerial Declaration specifically asserts the need to conduct negotiations on “reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services”.

For South Asian policy makers, their ability to continuously reap the benefits of trade liberalization and thereby increase trade volumes would be dependent on the extent to which the Doha Round encompasses their trading interests associated with the liberalization of the environmental goods and services (EGS) sector. The author recognizes that it is important for South Asia to examine the implications of the negotiations currently at the WTO as they must ensure that the outcomes of the Doha Development Round facilitate the addressing of both their trading and environmental concerns. Accordingly, the chapter attempts to bring to attention some of the specific issues that arise with respect to negotiations on EGS in South Asia and how they may be resolved by making recommendations for negotiating positions.

The author recognizes that the specific issues which arise for South Asia due to the liberalization of trade in environmental services (ES) relate to how there could be detrimental side-effects on regional objectives, such as the elimination of poverty and facilitation of human development. If policy makers are able to negate all these potentially detrimental issues that may arise due to the liberalization of trade in ES, the author supports the need for the continued involvement of South Asian policy makers in multilateral trade negotiations. This is due to the fact that liberalization of trade in ES at the multilateral level provides the countries in the region the potential to export, for example,

the expertise that they have accumulated regarding the management of environment-related natural disasters. These include environment-related professional services in the form of studies, assessments and consultancies.

PART

1

MACRO PERSPECTIVE

Chapter 2

Changing face: The trials and fortunes of regional cooperation in South Asia

Saman Kelegama

1. Introduction

The proliferation over the last few decades of organizations to promote regional cooperation reflects a global society which is acutely aware of, and has come to embrace, its growing interconnectedness. The formal establishment of the South Asian Association for Regional Cooperation (SAARC) in 1985 represents one instance of this. As set out in the organization's charter, the primary objective of SAARC is to utilize cooperation among its member states as a springboard for achieving cohesive development in the economic, cultural and socio-political lives of their citizens. Nevertheless, despite enormous potential for facilitating such development in a region populated by over 40 percent of the world's poor, SAARC's effectiveness has been limited and its successes far too few. In acknowledgement of such failings, a Group of Eminent Persons (GEP) Report was commissioned by the organization for consideration at its 1998 summit in Colombo. The Report points to SAARC's inadequate role in fostering regional cooperation, and then goes on to ar-

ticulate a vision of change, detailing the steps that must be taken in order to transform the organization into the fulcrum of a truly integrated and self-sustaining regional society. This article considers the obstacles, which, until now, have hindered SAARC from achieving such a transformation. It then discusses a number of new opportunities, which, if appropriately exploited, could provide a means for SAARC to close the gap between the GEP vision of an effective and productive organization for regional cooperation, and its far less desirable reality.

2. The case for regional integration

Despite persistently high levels of poverty, the South Asia region has enjoyed steady economic growth in recent years, notably spurred by a robust Indian economy. A gradual movement away from primary product dependence to a concentration on manufacturing and services has enabled these states to reposition themselves favourably in the arena of international trade (Muni 2010, 42). As an indicator, the share of agriculture in South Asian gross domestic product (GDP) fell from approximately 40 percent in the 1970s to under 20 percent in 2006 (RIS 2008, 18). Nevertheless, these economies' success in this regard has been somewhat constrained by such factors as lack of infrastructure, insufficient investment in private enterprise and skill shortages in the labour force. Regional cooperation is, ideally, a means of overcoming such obstacles to growth. Accordingly, various intra-regional infrastructure development projects, the establishment of a Common Investment Area, and the sharing of resources at many levels have all been proposed at SAARC summits and meetings over the years. In the context of trade, increased regionalism would allow these economies to improve their competitiveness, increase the export of services and add value to traditional exports. Particularly at the current juncture, in the aftermath of a global recession that has profoundly impacted many developed economies which are the customary recipients of a large proportion of South Asian exports, cooperation and trade within the region seem increasingly important. Given that South Asia is inhabited by approximately 24 percent of the global population, the potential benefits to be reaped are extensive and thus, the burden of responsibility to be borne by SAARC is immense.

This is, in fact, the very conclusion arrived at by the GEP in its seminal Report on SAARC. The Report, aptly titled *SAARC Vision Beyond the Year 2000*, "attempts to define a long-range vision for SAARC... including a SAARC agenda for 2000 and beyond" (GEP 1999, 23). In the context of trade, the Report calls for the implementation of a South

Asian Free Trade Area (SAFTA)¹, the elimination of tariff barriers over an eight-year period, and the removal of all non-tariff barriers (NTBs) to trade. Inspired by the successes of the European Union (EU), the GEP Report further recommends the creation of a similarly integrated South Asian Economic Union (SAEU) by 2020, preceded by the establishment of a Customs Union by 2015. The Report advises the adoption of the following measures as first steps towards the achievement of the SAEU: i) the creation of a Single Market for South Asia, involving an integration of transportation, energy, telecommunications and other services; and ii) the espousal of a common competition policy for all states in the region. Nevertheless, given prevailing geopolitical tensions in the region, as well as the fact that the establishment of SAFTA was already well behind schedule, the achievement of these goals by the specified deadlines seems difficult. The ideas of a Common Investment Area, a South Asian Development Bank (SADB), a reshaping of SAARC's institutional structure and the signing of a Social Charter also feature in the Report, among other recommendations for regional cooperation in terms of infrastructure, trade in goods and services, investment and finance, and macroeconomic policy.

The bulk of such recommendations have not, however, come to fruition. Indeed, despite its influence, the GEP Report in its entirety has not been fully endorsed by SAARC (Behera 2009, 37). Many of the ideas contained in the Report have been the subject of discussions at subsequent SAARC summits (examples are the notion of a common currency for South Asia and a "Schengen"-style visa for the region), and research committees have been appointed to consider the viability of some of these options (such as the establishment of the SADB and the creation of a common stock exchange), but few have grown beyond these early stages. In fact, SAARC's persistent inability to convert ideas into substantive action has long been a point of censure for critics of the organization.² The reasons for such a failing are both geopolitical and structural in nature, and will be discussed later in this article. First, however, let us consider the scope of its achievements to date.

3. SAARC successes

It must be noted that while SAARC's practical successes have been few, several are worthy of acknowledgement. The commissioning of the GEP Report is certainly one of them. The formation of a Network of Researchers on Global Financial and Economic Issues to aid SAARC in dealing with macroeconomic concerns is another notable development. Arguably, the most significant of the organization's achievements to

date is the establishment of SAFTA in 2006, although after many delays. The SAFTA Agreement calls for goods trade liberalization in the region through the reduction of trade barriers. It envisions the removal of all regional tariffs by 2016 by South Asia's least-developed countries (LDCs) – Afghanistan, Bangladesh, Bhutan, the Maldives³ and Nepal – and three years earlier by developing countries of the region. Such an agreement is clearly an important step in the direction of fostering regional trade opportunities. The foregone benefits from regional trade in the absence of an agreement of this nature are considerable: in 2006, potential intra-regional trade was estimated to be approximately US\$40 billion, compared to actual trade of US\$10.5 billion (RIS 2008, 63). As previously noted, such potential gains are of particular significance in the current global economic climate. Nevertheless, such regional trade agreements are desirable not only as a means of encouraging intra-regional trade flows but also in enabling states to reorganize their economies in a manner that derives the maximum possible advantage from specialization and economies of scale, following the example of the EU (RIS 2008, 59–60).

A large proportion of this array of potential benefits remains to be enjoyed, however, due to a number of factors which have inhibited SAFTA's efficacy. To begin with, the lengthy administrative delays involved in setting up the agreement mean that SAFTA is significantly behind schedule in its activities. The GEP Report advised that SAFTA be created in 2000, with all of its primary objectives to be completed by 2010. The current projected timeline lags substantially behind this. Secondly, member countries maintain lengthy sensitive lists for regional trade – a state of affairs which the agreement fails to preclude. A 2006 study shows, for instance, that 42 percent of Sri Lankan and 58.5 percent of Indian exports to SAARC countries feature on sensitive lists, a fact which severely debilitates the practical workings of the agreement (Weerakoon and Thennakoon 2006). In fact, the existence of parallel trade agreements which offer more favourable trade terms – such as the free trade agreement (FTA) between India and Sri Lanka, and India's FTAs with Southeast and East Asian nations – impacts negatively on states' commitment to meeting SAFTA's targets and, indeed, calls into question its usefulness in the sphere of regional trade.⁴

Another problem is the continued existence of non-tariff and para-tariff barriers to trade. The GEP Report calls for the removal of all such barriers by 2009 by LDCs and by 2007 by non-LDCs. Despite this, however, SAFTA makes no provision for such removal, and NTBs such as quotas, import licensing requirements, anti-dumping measures, and above all, regulatory barriers, continue to limit trade opportunities in

the region. Finally, the fact that SAFTA covers only trade in goods, and not in services, means that the agreement is lamentably parochial in nature. However, the signing of the SAARC Agreement on Trade in Services (SATIS) in 2010 is a positive development in the direction of expanding the scope of the FTA, although much depends on the level of market opening that will actually take place when member states' schedules of commitments are negotiated.

A criticism frequently made of SAARC is that it has, in the past, lacked a clear sense of direction in its efforts at regional integration. Thus, the SAARC Social Charter was created in an attempt to redress this issue. Like SAFTA, the implementation of the Charter suffered from long delays, but might be considered another stride, however small, in the right direction for SAARC. The Charter was finally signed in 2004 at the 12th SAARC Summit in Islamabad, and it outlines a regional plan of action for the organization, setting general targets in the areas of poverty alleviation, population stabilization, the empowerment of women and protection of children, the promotion of health and nutrition, and youth mobilization. The Social Charter is frequently lauded for its inclusive nature: its development involved input not only from the governments of SAARC member states, but also from civil society organizations, which were permitted to voice their own opinions concerning the important challenges that SAARC should aim to address in the future. Nevertheless, insufficient attention has been paid by SAARC to the monitoring of the Charter's targets, as Lama (2007, 26) observes. This may be attributed partly to a lack of resources on the part of the SAARC Secretariat and a lack of commitment on the part of its individual member states. Furthermore, the targets outlined in the Charter are broad, and a need remains for more specific, numerical targets to be agreed upon, adopted and worked towards if the Charter is to have any practical value.

Two other initiatives that SAARC can count among its partial successes in recent years are the establishment of the SAARC Energy Centre in Islamabad in 2006 and the South Asian University in New Delhi, which opened for admissions in 2010. The GEP Report emphasizes, among other things, the importance to South Asia of energy cooperation. The uneven spread of energy resources throughout the region, with oil, coal and natural gas reserves in India, as well as natural gas reserves in Pakistan and Bangladesh, means that the region as a whole would benefit greatly from cooperative energy policies. The SAARC Energy Centre is charged with the tasks of developing existing energy resources, promoting conservation and energy efficiency, and working towards the development of alternative and renewable energy sources.

Given the invariably high costs incurred by such endeavours, the pooling of regional resources in order to fund energy development projects is important. It remains to be judged, however, whether the Energy Centre is able to achieve, in practice, the aims set out for it on paper.

The South Asian University is still housed at a temporary campus location in New Delhi, with the construction of its permanent home due to begin in South Delhi in 2012. Funded by the Indian government, and with all SAARC members expected to contribute towards its operational costs, the university has the potential to achieve some measure of the cross-border flows of skills that regional cooperation is envisaged to generate. Furthermore, in providing students with a regionally recognized qualification, the South Asian University goes some way towards achieving the equivalence of qualification that is a desirable characteristic of education in a truly integrated region.

Nevertheless, such limited successes remain overshadowed by a history of inaction and inefficacy, and some critics contend that the number of SAARC's achievements is markedly disproportionate to the length of the organization's existence.⁵ While the reasons for such a state of affairs are multiform, it may be considered that the cloud of geopolitical tension and mistrust that SAARC has laboured under—virtually since its inception—bears a significant proportion of the blame in this respect. The long-prevailing atmosphere of suspicion and animosity that characterizes Indo-Pak relations is particularly important here.

4. The burden of inter-state hostilities

Disputes over Kashmir between India and Pakistan, resulting in a number of armed conflicts and highly strained relations between the two countries, have existed since the collapse of British colonialism in the sub-continental region. Attempts to heal the political breach—such as the establishment of the Delhi-Lahore bus service in 1999 in the wake of nuclear tests carried out by both nations, and the Indo-Pak ceasefire agreement of 2003—occurred at critical moments in the history of the conflict to cool hostilities. Nevertheless, such events as the attack on the Indian Parliament in 2001 and the 2008 terrorist attacks in Mumbai have led to a resurgence of political mistrust between the two nations. The prolonged existence of such a fraught relationship between SAARC's largest and most powerful member states has been a significant spoke in the wheel of progress for the organization. The Kargil War of 1999—the last of the formal Indo-Pak wars and the only one to occur after the formation of SAARC—has particularly impeded efforts at regional integration.

One of the greatest resultant losses to SAARC was Pakistan's refusal to grant India most-favoured-nation (MFN) status until the 17th SAARC Summit in the Maldives in 2011, thereby preventing an accrual of benefits to the region from the largest potential segment of trade within South Asia. A 2006 ADB study estimates the value of potential Indo-Pak trade at up to US\$10 billion (ADB 2006, 13). Notably, however, a study in 2008 concludes that trade gains for both India and Pakistan from Bangladesh are larger even than gains from trade with each other (ADB and UNCTAD 2008, xix). Even in this respect, however, opportunities have been limited by political mistrust: India maintained a ban on investment in Bangladesh until 2007 as a result of tensions over India's construction of the Farakka Dam as well as border security concerns. The limited flow of investment from Pakistan to India, and the latter's ban on investment in the opposite direction, have also hindered SAARC's attempts to redirect foreign direct investment (FDI) flows out of South Asia to regional destinations. Nevertheless, China, one of the states granted "observer" status by SAARC, is gradually increasing its presence in the region, with significant FDI outflows to Pakistan, Bangladesh, Nepal and Sri Lanka. Notably, following the 2007 Pakistan-China FTA, Chinese investment in Pakistan has increased, with 6.5 percent of Pakistan's 2008 FDI attributed to China (Sahoo 2010). This growing challenge lays pressure on India to defend its regional dominance, and could lead to more open investment and trade policies in the future.

In addition to characterizing Indo-Pak relations, an atmosphere of mutual suspicion has also doggedly marked India's dealings with other SAARC member states since the organization's establishment. In the absence of SAARC, South Asian states would need to engage bilaterally with the regional giant, India, in a manner that—given the clear economic asymmetries involved—would place the former parties in a highly disadvantageous bargaining position. Therefore, it is certainly in their interest to use SAARC as a means of levelling the diplomatic playing field. Similarly, such a balancing of power would ideally enable India to engage with its neighbours in a setting that posits it favourably, not as an evil overlord bent on achieving its own will but as a fellow member state striving for regional benefits. Nevertheless, a distinct fissure exists between idealism and reality in this instance. Most member states have historically viewed India's participation in SAARC with mistrust, suspecting it of using the organization as an indirect means of exerting control over its neighbours and increasing the scope of its regional dominance. Conversely, India has harboured reservations about SAARC in the past, believing it to be a tool of suppression for the other members in banding together against India. In fact, virtually all

its members have displayed a wary attitude towards SAARC, particularly during its early years of existence. This is, perhaps, an unfortunate repercussion of relatively recent emergence of most South Asian countries from under the control of British imperialism. The independent nation-states in South Asia are generally young and still evolving. Consequently, they guard their sovereignty jealously, and often view the actions of supra-national entities as attempts to usurp their sovereignty. Therefore, most countries have hesitated to accept the powers of organizations such as SAARC, and continue to regard them with suspicion.⁶

5. Member commitment, history and the infrastructure gap: Missing links

Partly as a result of this historical state of affairs, SAARC has suffered from a lack of commitment on the part of its members, a fact that has rendered problematic the formation of policy and the initiation of intra-regional projects. Consequently, many of the decisions passed by SAARC have been more for the sake of outward display than actual usefulness.⁷ Furthermore, often, even when members have accepted certain SAARC protocols, practical implementation—left largely in the hands of individual states—has not necessarily followed. An example of this is states' failure to substantially reduce their sensitive lists (although notably India has reduced its sensitive lists for LDCs significantly) and remove NTBs under SAFTA, and SAARC's inability to impel any action in this respect. Although agreements may be reached at SAARC summits concerning the importance of addressing certain pressing issues, such as poverty and food security in the present context, enthusiasm typically wanes in the aftermath of the summit, and SAARC has little institutional power or ability to sustain its momentum until the next summit. Other factors which impact unfavourably upon states' commitment to SAARC are the existence of alternative bilateral agreements between members (as previously discussed), as well as states' membership of parallel organizations such as the World Trade Organization (WTO). Unless SAARC is able to provide clear incentives for its members to prefer SAARC initiatives over any of these external options, it is unlikely to be able to inspire the degree of commitment that is required, at the national level, to make SAARC an effective actor in regional affairs.

Conversely, it may be argued that bilateral trade agreements of this nature could become an impetus for, rather than a hindrance to, regionalism and, as such, should not necessarily be discouraged (Kelegama 2001, 37). Yet, this is only true if the bulk of such agreements exist between regional states. In reality, however, many of these FTAs are for

the purpose of stimulating trade between a South Asian state and a non-regional partner. Examples are the FTA between China and Pakistan, the Association of Southeast Asian Nations (ASEAN)-India Free Trade Area (AIFTA) and the EU-India FTA (which is under consideration). These clearly run counter to SAARC's aim of redirecting trade flows to regional destinations. Nevertheless, despite its importance as a first step towards regional integration, intra-regional trade has proved difficult to stimulate and, indeed, such difficulties have long occupied the attention of SAARC, though to little productive purpose. Key among the reasons for such a state of affairs to persist is a single factor, namely history.

As a consequence of their shared colonial past, the majority of South Asian states have historically directed their exports towards the markets of their former colonizers and the latter's neighbours. They also are accustomed to viewing each other as competitors in trade, rather than as potential trade partners, given their exports of similar products. The weight of such a history, and the manner in which it has shaped the direction of South Asian trade policy, has certainly hindered SAARC, particularly during its earlier years. Nevertheless, a 2008 ADB-UNCTAD report suggests that the existence of competition between South Asian states is more a matter of perception than a true barrier to trade. The report points out that these countries can achieve complementarities through specialization in different stages of production, or by working towards product differentiation (ADB and UNCTAD 2008, 37). Further, it observes that, in the context of trade in services, various regional states have comparative advantages in different sectors, thereby opening potential pathways to regional trade (*ibid.*, 96). Examples of such comparative advantages are transport services for Pakistan and Sri Lanka, travel services for the Maldives and Nepal and financial services for Bangladesh.

Nevertheless, states' ability to take advantage of the benefits of trade in services has been limited to a certain extent by a lack of domestic infrastructure. The 2008 South Asia Development and Cooperation Report notes, for instance, the troubling fact of a growing disparity between infrastructure levels in developed and developing nations (RIS 2008). In recent years, a majority of South Asian countries have experienced rapid economic growth, as well as inherent structural transformations within their economies as they expand from, initially, an almost exclusive concentration on agriculture products to include the development of services and knowledge production. The consequently widening infrastructure gap in these economies is, therefore, an issue that needs to be addressed.⁸ Thus, projects to integrate transportation, energy and labour markets, as proposed in the GEP Report, would clearly benefit

the region. Nevertheless, while SAARC bears a significant portion of the responsibility for improving regional infrastructure, the lack of such infrastructure equally hinders its effectiveness. SAARC suffers, therefore, from something of a vicious circle in this regard. Accordingly, the impetus for escaping this depends largely on the individual commitment of its member states, which, as previously discussed, has been notably lacking in the past.

6. Civil society: The need for alternative SAARC channels

Another factor which might be viewed as limiting SAARC's effectiveness is an inadequate involvement of regional business and academic communities in the organization's decision-making processes. SAARC is, by nature of its construction, an organization for cooperation among state actors. Thus, the voices heard at SAARC meetings, and the opinions, concerns and ideas expressed there, are largely those of government officials. Yet, in maintaining such insularity, the organization becomes undesirably parochial in nature. It fails to benefit from a range of alternative sources of knowledge and expertise, as well as a more nuanced view of challenges and new ideas concerning the ways in which these challenges might be addressed. Indeed, given its purpose of achieving integration, it is somewhat ironic that one of SAARC's greatest problems has been its inability to achieve an integrated involvement of civil society with official government channels in its processes of policymaking and project implementation. One of the reasons that the SAARC Social Charter has been met with approval from critics is, in fact, its implicit acknowledgement that there are important contributions to be made to SAARC from non-governmental sources. Yet the involvement of civil society in the creation of the Social Charter is only a single step in a journey of many towards an integrated institutional structure for SAARC.

Behera (2009) identifies three schools of thought concerning the manner in which civil society could be brought into engagement with official government channels in SAARC processes: i) by intervention from the top down; ii) by intervention from the bottom up; and iii) through the creation of knowledge. For this purpose, we consider the existence of three parallel "tracks" or channels of involvement in SAARC. Track I is the official channel of inter-governmental decision-making. Tracks II and III represent the involvement of civil society. Track II, the "top-down" approach, consists of a form of "shadow diplomacy", involving retired policy makers, scholars and other individuals who have ready access to and established relationships with members of Track I. This

group ideally serves to bridge the divide between the government and the domestic intelligentsia. Track III, the “bottom-up” approach, involves “non-governmental organizations, peoples’ organizations, activist groups and networks that explicitly function apart from or beyond governments” (Behera 2009, 17). While the latter group likely has little or no direct access to government channels, its involvement is intended to broaden the scope of SAARC participation by stimulating public interest and thereby encouraging governments to take decisive actions within the SAARC framework.

Knowledge creation within these channels is also an important aspect of their contribution to Track I dialogues. Research bodies such as the South Asia Centre for Policy Studies (SACEPS), the South Asia Network of Economic Research Institutes (SANEI) and the Coalition for Action on South Asian Cooperation (CASAC) aim to infuse Track I processes with a more holistic and nuanced understanding of regional matters. Ideally, the formation of such regional networks outside the central sphere of policy makers would facilitate the continuance of discussion and interests concerning SAARC affairs between official summits. Furthermore, the dissemination of information through regional journals, magazines and other publications ensures that the wider South Asian community remains cognizant of emerging challenges and opportunities for regional integration, as well as of SAARC’s current initiatives in this respect.

Nonetheless, the full benefits of these alternative channels of SAARC participation remain to be enjoyed, largely due to lacunae of communication with Track I. The lack of an inherent structural connection between governmental and non-governmental SAARC participants means that the information sets under which each operates are mutually exclusive (Behera 2009, 34). This inevitably creates a cloud of suspicion and, sometimes, hostility that casts a shadow upon interactions between the two parties. Governments are, therefore, less likely to accept the views and policy advices that emerge from Track II and, particularly, Track III. Furthermore, due to the highly personalized nature of prevailing interactions with Track I, it is often the case that the body of information passed from Tracks II and III to Track I is not truly representative of the civil community in its entirety but, rather, is peculiar to certain factions that have preferential access to governments.

In fact, just as decision-making within official government channels is rendered problematic by the existence of conflicting views among domestic political parties, communication among Tracks I, II and III is somewhat garbled by the diverse, fractured and sometimes partisan nature of civil society. The prevalence of populist propaganda and in-

feasible suggestions among certain groups robs the entire channel of much of its credibility, and requires a sifting of information from these sources on the part of Track I, which is time-consuming and expends resources wastefully. Thus, the lack of coordination and collaboration among these groups hinders the creation of useful and coherent policy advice by Tracks II and III, as well as Track I's ability to give credence to, and absorb, such information.

This issue of communication and coordination is one which equally characterizes the institutional structure of SAARC itself. The highly bureaucratic chain of decision-making generates frequent delays in the formulation of policy as well as in its implementation. In fact, the waning of members' enthusiasm between summits, which has posed such a problem to SAARC initiatives in the past, may partly be attributed to this. Another related concern is that the individual roles of entities within the broader SAARC structure are not clearly defined.⁹ The inactivity of SAARC's Regional Centres may, for instance, be explained in this manner. Such a situation is highly detrimental to the organization's effectiveness, as it inevitably dissolves any sense of accountability. In the absence of a clear-cut chain of accountability, any progress must be drawn with difficulty from a well of apathy and torpor.

7. Changing face

The portrait of SAARC's past is, therefore, a somewhat disconsolate image. Nevertheless, it does not follow that its future should be painted in a similar hue. Rather, changes in geopolitical attitudes and the emergence of important new opportunities within the region provide SAARC, at the current juncture, with the necessary tools for an institutional transformation. Critical among these changes is the fact that India's attitude towards SAARC has begun to adopt a more positive tone. For instance, it expanded duty-free access to its domestic market for products from SAARC LDCs as well as contributed US\$100 million to the SAARC Development Fund, over and above its subscription for projects on social development.¹⁰ India's emergence in the present context as a global power is undeniable. In terms of population and recent GDP growth rates, its statistics are impressive. Furthermore, it currently holds a two-year non-permanent seat in the UN Security Council, and is campaigning strongly to be given a permanent seat there. Thus, its involvement in SAARC is of tremendous importance to the organization's success.

Moreover, as previously discussed, the promotion of trade in services is a crucial issue in South Asia, and one which SAARC has con-

tinually attempted to facilitate. India's fashioning of itself as a services hub, engaging in the fields of bio-information, drug testing, pharmaceutical research, engineering design and financial analysis, could have profound spill-over effects for the region and, therefore, is a highly desirable development. Exports of information technology services from India, for instance, soared from US\$4 billion in 2000 to US\$40.4 billion in 2008 (RIS 2008, 39–41). In view of this, the importance of using India's lead as a springboard for establishing South Asia as a regional information and communications technology hub has featured strongly in SAARC discussions of late (RIS 2008, 39).

Furthermore, several issues have emerged in recent years that are regional, and often global in scope – difficult or even impossible to control at the national level. Consequently, the need for deeper regional integration in order to combat these challenges provides SAARC and its member states with a fresh impetus for collaborative action. Chief among these are an increasing awareness of the threat posed by climate change, concerns about food security in the light of steadily rising global food prices and issues regarding regional migration and the steady influx of internally displaced persons in South Asia. Accordingly, SAARC has made a certain amount of progress towards an integrated response in this respect. For instance, a common SAARC position was adopted on regional climate issues – such as coastal erosion and the melting of the Himalayan glaciers – at the 2009 United Nations climate summit in Copenhagen. Member states have also established the SAARC Food Bank, which is awaiting operationalization. They have also recently agreed to establish a SAARC Seed Bank.

Nevertheless, far more effort is required by SAARC if it is to take full advantage of the fresh opportunities afforded to it at the present juncture. In particular, a progressive transformation of the organization – in terms of its structure and the manner in which it approaches the task of achieving regional integration – is greatly to be desired. This section, therefore, considers the ways in which SAARC could attempt to overcome the obstacles that have impeded its progress in the past.

As previously discussed, an issue that has relentlessly beleaguered SAARC from the very outset is that of a geopolitical climate characterized by mutual tension, mistrust and jealously guarded state sovereignty. Within such a realm of neorealist politics, the effective functioning of any organization of multiple states is likely always to be obstructed. Therefore, an important step for SAARC is perhaps to acknowledge that such political realities are unlikely to change in the near future. Consequently, instead of viewing them as an obstacle to be fought against and thereby overcome, SAARC must find ways of working with them, ide-

ally even using them to its advantage wherever possible. This would require, however, subtle and skilled diplomacy on SAARC's part, through the efforts of individuals who understand the nuances of South Asian politics. For example, the area of infrastructure building is one that merits SAARC's particular attention. This is because the costs of infrastructure development projects are often too high to be borne by a single government (particularly in a region comprised of developing nations and LDCs); therefore, cooperation in this regard is highly desirable.

Nevertheless, region-wide infrastructure development projects have proven difficult to implement, largely as a result of political challenges to the process and difficulty of coordination. Consequently, the pursuance of smaller-scale bilateral deals could be an alternative, and more feasible, means of working towards the same goal.¹¹ Furthermore, if peace talks resume between India and Pakistan in earnest, this would provide SAARC with ample opportunity to attempt a deeper involvement of these two nations in SAARC activity. In pursuance of the same goal of turning regional politics to its advantage, another desirable change is for SAARC to develop its relationships with other organizations, particularly regional ones such as ASEAN and the EU,¹² from which it can glean support, guidance and, most importantly in this instance, a better standing in the arena of regional power politics.

In addition to improving its skills at playing the game of neorealist politics, SAARC must also consider an overhaul of its organizational structure. The lack of clearly defined roles for individual SAARC entities, as well as the garbled and clogged lines of communication and authority are, as previously observed, a severe impediment to SAARC activity. Although the establishment of the SAARC Social Charter has gone some way towards remedying this situation, much more work needs to be done by the organization in this respect. Having acknowledged the importance of involving civil society in SAARC processes, one of the organization's key tasks now is to improve the flow of interactions between Tracks I, II and III. SAARC could, for instance, greatly reduce the inherent segregation of official and non-official spheres of dialogue by encouraging Track I officials to participate in Track II and Track III dialogues and to pursue sabbatical work in these alternative tracks. Similarly, greater credence could be ascribed to Tracks II and III by frequently including representatives from these channels in selected Track I dialogues. The extensive participation of all tracks in events such as the SAARC Business Leaders Conclave and the South Asia Business Summit should also be promoted, as these represent arenas in which government officials can interact with members of the other tracks freely and on fairly even footing.

Within the organization, moreover, the roles of Regional Centres and other SAARC entities need to be defined in more specific terms than those outlined in the SAARC Social Charter. Realistic deadlines must be set for these entities to achieve feasible goals, and a monitoring system needs to be implemented to ensure that they remain on track for meeting them. An example is the SAARC Food Bank, an important project in light of food security concerns, whose operationalization should be given a strict deadline by SAARC. In this manner, by setting targets for, and successfully completing, a series of projects (regardless of their size or scope), SAARC can begin to change its reputation of inactivity and inefficacy, thereby improving its standing in the eyes of its member states. For this purpose of building confidence, it is perhaps advisable for SAARC to focus its attention on “soft” projects, as well as those characterized by high visibility. The founding of the SAARC University is a good example of a success story in this respect. The creation of a channel for SAARC citizens and a green channel for SAFTA goods at regional airports are other options in a similar vein. SAARC could also work towards the promotion of greater regional air connectivity and the development of regional tourism. The latter, in addition to bearing relatively few political challenges, is important because of the notable spill-over benefits that an improved tourism sector would afford economies, both domestically and regionally. In this way, by redirecting its energies into less controversial areas of integration, SAARC can begin to establish itself as a credible presence within the South Asia region.

Having consolidated its approach to achieving these central aims, SAARC could then seek to improve its efficacy by a range of other means. Given the centrality of trade to regional integration, measures should be taken to improve the functioning of SAFTA. Significant among these are the shortening of sensitive lists, the removal of NTBs to regional trade and the extension of SAFTA to include trade in services, as previously considered. Furthermore, an allocation of resources for the purpose of hiring consultant experts for SAARC projects is also desirable, as this would prevent resources being wasted on initiatives that ultimately fail to be realized.¹³

8. Conclusion

Despite its past failings, therefore, SAARC retains the potential to radically impact the process of regional integration in South Asia. In order to fulfil that potential, however, it must successfully utilize such available tools as the GEP Report, the input of civil society, the advantages wrought by a changing politico-economic climate and its own historical

experience to refashion its approach and begin to accumulate a portfolio of successes. Time will tell if, in this way, SAARC is able – in the coming years – to significantly contribute to the synthesized development of its regional community.

Notes

- ¹ SAFTA has come into operation since July 2006.
- ² See, for instance, Muni (2010, 1–3).
- ³ The Maldives has graduated from LDC status with effect from 1 January 2011.
- ⁴ This issue is discussed in SACEPS (2008, 8).
- ⁵ See, for instance, Muni (2010, 1–2).
- ⁶ For a discussion of this, see Behera (2009, 30).
- ⁷ See Behera (2009, 29).
- ⁸ For a discussion of this, see RIS (2008, 22).
- ⁹ See SACEPS (2008, 46).
- ¹⁰ See SAARC Secretariat (N.d.) for details on the funding mechanism and sources of the SAARC Development Fund.
- ¹¹ This is suggested in SACEPS (2008, 62), particularly with regard to improving the regional energy grid.
- ¹² The importance of this is considered in SACEPS (2008, 50).
- ¹³ SAARC's shortcomings in this respect are briefly considered in SACEPS (2008, 67).

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PART

2

**MERCHANDISE AND
SERVICES TRADE**

Chapter 3

Pruning India's sensitive lists under SAFTA

Nisha Taneja, Saon Ray, Neetika Kaushal
and Devjit Roy Chowdhury

1. Introduction

In the last two decades, member countries of the South Asian Association for Regional Cooperation (SAARC) have made a number of attempts to enhance intra-regional trade. Seven of the SAARC member states¹—Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka—initiated region-wide trade integration efforts under the SAARC Preferential Trading Arrangement (SAPTA) in 1995. Following SAPTA, the Agreement on South Asian Free Trade Area (SAFTA) entered into force in 2006, envisaging a duty-free area by 2016. However, the success achieved under this agreement has been quite limited as intra-SAARC trade continues to be around 5 percent of total trade of all member countries. It has often been debated that one of the reasons for the ineffectiveness of SAFTA is the large sensitive lists maintained by its member countries (Pitigala 2005; Baysan, Panagariya and Pitigala 2006; Taneja and Sawhney 2007). These lists consist of items which are not offered concessional tariffs. The rationale for any sensitive list in a preferential or free trade agreement is to provide preliminary protection to sectors considered unfit for competition for a variety of reasons. For a

free trade agreement to be effective, such protection should be extended only for a definite period of time so as to provide the initial adjustment time to the domestic import-competing sector. Weerakoon (2010) and Weerakoon and Thennakoon (2006) point out that 53 percent of the total intra-regional import trade was excluded from the tariff liberalization programme (TLP). India restricted up to 52 percent (by value) of its total imports from SAFTA members under the sensitive list category.

According to the TLP under SAFTA, member countries are required to review their sensitive lists with a view to reducing the number of items in the lists every four years or earlier, as established by the SAFTA Ministerial Council (SMC), but there is no formal or binding commitment. Hence, reduction of sensitive lists is a voluntary decision of each member country.

Keeping in view that India is the largest economy among SAFTA member countries, it should, on its part, take asymmetric responsibility to liberalize imports by pruning its own sensitive lists with respect to other South Asian countries. In that context, the objective of this study is to examine the commodities currently in the sensitive lists of India, and to offer an approach and economic rationale to policy makers for pruning these lists.

Member countries have adopted a variety of criteria to prepare their sensitive lists. One such criterion is to provide protection to vulnerable sectors such as nascent industries (infant industry argument), small-scale manufacturers (socio-economic argument) and agriculture producers (food security concerns). However, it has been observed that often, during the process of stakeholder consultation, sectors with strong domestic lobbies seeking protection get included in the lists. Sensitive lists, particularly in the case of India, have come to be dominated largely by such sectors.

Several considerations have to be taken into account while pruning the sensitive lists. First, they often include products that cannot be supplied by partner countries; their inclusion in the list is, therefore, meaningless. Most of the items reserved for exclusive manufacturing by small industries have been there to enable firms to become more competitive. However, India's sensitive lists under SAFTA continue to have several such items which can be removed. Since there is a justification for including agriculture items for food security concerns, and tobacco and alcohol for revenue purposes, these should be retained in the lists. The remaining products need careful examination to ensure that only those vulnerable to competition stay and the others are eliminated.

We have also used the concept of Revealed Comparative Advantage (RCA)² to assess the competitiveness of India and the partner country

in each of these remaining items. Products in which the partner country is competitive in the international market are suggested for retention in the sensitive lists for a specific period. These products, however, should be eventually removed from the lists in a phased manner.

India has maintained two sensitive lists under SAFTA—one for least-developed countries (LDCs), which is applicable to Afghanistan, Bangladesh, Bhutan, the Maldives and Nepal, and another for non-LDCs (NLDCs), which is applicable to Pakistan and Sri Lanka. In addition, India has bilateral free trade agreements (BFTAs) with Nepal, Bhutan and Sri Lanka, and maintains separate sensitive lists under each of these BFTAs. Negotiations regarding the sensitive lists applicable to these countries will be carried out under the respective BFTA. The *raison d'être* for a BFTA is that it should be more liberal than a regional FTA. Hence, sensitive lists under the bilateral agreements that India has with some SAARC members should be smaller than those maintained under SAFTA. This implies that items that appear in the bilateral sensitive lists but not in the regional sensitive lists should be eliminated.

India's operational sensitive list for Sri Lanka is the one under the India-Sri Lanka Free Trade Agreement (ISFTA). Therefore, Pakistan is the only country to which the NLDC list is applicable. Among the LDCs in SAARC, India has an FTA with Nepal and Bhutan with a very small sensitive list in the case of the former³ and none in the latter. Afghanistan and the Maldives are very small economies and though the LDC list is applicable to them, they export only a few commodities. Thus, the focus of this article is on pruning the sensitive lists for Sri Lanka under the ISFTA, and for Bangladesh and Pakistan under SAFTA.

2. Sensitive lists under SAFTA and BFTAs

India has made a number of attempts to prune its sensitive lists over time but these changes do not get reflected in the notified sensitive lists either under the BFTAs or under SAFTA. The most important form of concession offered by India to Bangladesh has been the grant of duty-free access to readymade garments up to a limit of eight million pieces per year. Since this concession takes the form of a tariff rate quota (TRQ), it does not get included in the notified sensitive lists. Hence, the operational sensitive lists are different from the notified ones and have to be reconstructed by excluding the items on which concessions have been granted.

In July 2006, when SAFTA became operational, India maintained 743 items for LDCs and 868 items for NLDCs in its sensitive lists.⁴ Over a span of four years, India has repeatedly made attempts to reduce the

items in the sensitive lists as a part of the TLP. In October 2008, a further reduction was made for LDCs from 743 items to 480 items.⁵

The sensitive list under ISFTA, signed in 2000, consists of 431 items. In 2008, India allowed duty-free import of 216 garment items up to a limit of eight million pieces per year to Sri Lanka, thereby reducing the operational sensitive list to 215 items.⁶ Of the total 215 items, 86 items do not feature in the SAFTA list of 868 items applicable to the NLDCs, and therefore, should be removed because the ISFTA is a binding agreement and should be more liberal than the regional agreement. This is discussed in greater detail later.

Although India does not have a BFTA with Bangladesh, in April 2008, it offered zero duty concession on imports of 164 textile items from Bangladesh up to eight million pieces per year.⁷ In October 2008, it extended that concession to all LDCs. There is an overlap of 25 items in these two notifications. In addition, two items (HS 040900 and HS 040590) are repeated in the list. Adjusting for concessions and discrepancies, the operational sensitive list for Bangladesh consists of 331 items only as against 480 items in the LDC list at the HS 6-digit level.

Pakistan is the only country to which the SAFTA NLDC sensitive list consisting of 868 items (Table 3.1) is applicable. Moreover, further data analysis shows that the number of items included in the list is rather 910 (Table 3.2), and not 868.

Table 3.1: HS classification of items in the NLDC sensitive list

HS classification level	No. of items in notified sensitive list	% share in notified sensitive list
4-digit code	15	1.7
6-digit code	386	44.5
8-digit code	467	53.8
Total	868	100

Source: Authors' calculation.

In 2006, the original sensitive list for Sri Lanka under the ISFTA contained 92 percent of plastics and rubber, and textile and related products. With concessions being granted to several products in the latter category, the former accounted for 47 percent of the products in the operational sensitive list. Unlike Sri Lanka, Bangladesh received concessions from India in almost all categories (under concessions offered to LDCs and under bilateral concessions). Sectors where substantial reductions were made included textile and textile-related products, rubber and plastic products, and machinery and electrical equipment. Vegetable products were the largest number of items featuring in the operational sensitive

Table 3.2: Items in the sensitive lists

S.N.	Description	Sri Lanka		Bangladesh		Pakistan	
		No. of items in NSL*	No. of items in OSL*	No. of items in NSL	No. of items in OSL	No. of items in NSL	No. of items in OSL
1	Live animals	-	-	18	11	22	22
2	Vegetable products	2	2	162	153	161	161
3	Animal or vegetable fats and oils	-	-	30	29	30	30
4	Prepared foodstuffs	17	17	62	52	67	67
5	Mineral products	-	-	8	8	16	16
6	Products of chemical and allied industries	-	-	34	4	48	48
7	Plastics and rubber	100	100	97	11	98	98
8	Wood and articles of wood	5	5	5	6	5	5
9	Paper products	12	12	13	3	15	15
10	Textiles and textile articles	295	79	197	8	325	325
11	Footwear, headgear, etc.	-	-	17	1	17	17

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S.N.	Description	Sri Lanka		Bangladesh		Pakistan	
		No. of items in NSL *	No. of items in OSL *	No. of items in NSL	No. of items in OSL	No. of items in NSL	No. of items in OSL
12	Stone, plaster, cement, asbestos, mica, ceramics and glassware	-	-	5	-	10	10
13	Base metals and articles of base metals	-	-	60	41	60	60
14	Machinery and mechanical appliances; electrical equipment	-	-	27	-	27	27
15	Transport equipments	-	-	4	4	4	4
16	Optical, etc. instruments and apparatus	-	-	2	-	2	2
17	Arms and ammunitions	-	-	0	-	1	1
18	Miscellaneous	-	-	2	-	2	2
Total		431	215	743	331	910	910

*Notified Sensitive List (NSL) is the original list at the time of inception of SAFTA.
Operational Sensitive List (OSL) is the list constructed after taking all CBEC Notifications into account.
Source: Authors' calculation.

list, accounting for 46 percent of the total items on the list. Since India did not offer any concessions to NLDCs, the sensitive list for Pakistan has remained the same. Textiles and related products alone account for 37 percent of this list—a category in which India has offered concessions to Sri Lanka and Bangladesh.

It is evident from the above that India has offered maximum concessions to Sri Lanka and Bangladesh in textile and textile-related products. Therefore, this article has examined RCAs of these countries in these items to assess whether India has already offered concessions in items in which it is vulnerable. If India has offered concessions in vulnerable sectors, which is a sign of its willingness to face competition in these sectors, it needs to eliminate other items from its sensitive lists in which it is competitive. In 2007, textile and textile-related products accounted for 81 percent and 45 percent of Bangladesh's and Sri Lanka's exports, respectively. Therefore, by offering concessions in these items, India has taken a significant step to meet its asymmetric responsibility towards its smaller trading partners in the South Asia region.

3. Methodology

The objective of this article is to find out if there is scope for India to eliminate more items from its sensitive lists. In so doing, the methodology adopted by the study is discussed below.

The elimination exercise excluded items that are important for food security and revenue purposes. Therefore, these items were first identified. The Food Security Bill of India identifies wheat, rice and coarse cereals such as barley, rye, oat and maize as items that are important for food security. In the sensitive lists maintained by India, at the six-digit level, there are eight items pertaining to food security (Table 3.3). Similarly, there are 25 items pertaining to alcohol (HS Chapter 22) and tobacco (HS Chapter 24) (Table 3.4)⁸, which are important from the revenue point of view. Excluding these items, the sensitive lists under consideration is reduced to 199 for Sri Lanka, 298 for Bangladesh and 877 for Pakistan.

Table 3.3: Items sensitive to food security

Sensitive list	No. of items
ISFTA	0
SAFTA LDC	8
SAFTA NLDC	8

Source: Authors' calculation.

Table 3.4: Cigarette, tobacco and alcohol

Sensitive list	No. of items
ISFTA	16
SAFTA LDC	25
SAFTA NLDC	25

Source: Authors' calculation.

Next, the anomalies between bilateral and regional sensitive lists are identified so that sensitive lists under BFTAs are smaller than that under SAFTA. There are also several items on the sensitive list that have not been exported by the exporting countries and can, therefore, be removed from the sensitive list.

Earlier, India used to maintain an exhaustive list of items reserved for exclusive manufacturing by the small-scale sector. Over time and under the liberalization regime, it has trimmed the list to include only 22 items (Table 3.5). However, India's sensitive lists continue to contain many of the items which were earlier reserved but have now been removed from the reserved list. These items are identified and removed from the sensitive lists. The remaining items are then classified on the basis of RCAs of the exporting country and India to arrive at the pruned sensitive list.

Since RCA is central to the pruning exercise, it is important to explain why this index has been selected as an indicator of competitiveness. Kathuria (1997) points out that competitiveness can be measured by the extent of successful export performance. Export performance can be measured by export propensity, export market shares or price-based measures like nominal protection coefficients, effective rates of protection and domestic resource costs. It is common in the literature to measure comparative advantage with the help of the RCA index. According to Siggel (2007), RCA index measures competitiveness rather than comparative advantage, since cost measured in terms of market prices reflects competitive advantage rather than comparative advantage, which requires equilibrium prices. Dornbusch *et al.* (1977) first pointed out the necessity of the use of equilibrium prices in the measurement of costs. The use of RCA, hence, captures competitiveness of a country's export products vis-à-vis each other in the international market. This is very much in line with the Ricardian concept of comparative advantage which proposes that by producing the good in which it is relatively efficient (relative not to the other country but relative to the other goods), and importing the other good, each country stands to gain (Ricardo [1817] 2002). The concept of RCA can also be used by pairing the RCAs for products of an exporting country with the correspond-

Table 3.5: List of 22 items reserved for exclusive manufacturing by the small-scale sector

Product code (NIC)	Product code (HS 2007)	Product description
202501	200190	Pickles and chutneys
205101	190590	Bread
21100102	151491	Mustard oil (except solvent extracted)
21100104	150810	Ground nut oil (except solvent extracted)
276001	940330, 940340, 940350, 940360	Wooden furniture and fixtures
285002	482020	Exercise books and registers
30391201	391723	PVC pipes including conduits up to 110mm diameter
30393501	391740	Fittings for PVC pipes including conduits up to 110 mm diameter.
305301	340600	Wax candles
314201	340119	Laundry soap
317001	360500	Safety matches
318401	360410	Fire works
319902	330741	Agarbattis
321701	701810	Glass bangles
340101	940310, 940320	Steel almirah
341004	761010	Rolling shutters
34200602	940310, 940320	Steel chairs (All types)
34200702	940310, 940320	Steel tables (All other types)
342099	940310, 940320	Steel furniture (All other types)
343302	830110	Padlocks
345207	932393	Stainless steel utensils
345202	761519	Domestic utensils (Aluminium)

Source: Authors' calculation.

ing RCAs of another country. This provides an approach for classifying pairs of items for any two exporting countries on the basis of their competitiveness. This can also serve as a rationale for identifying items that are most vulnerable to competition.

In this study, the RCA for each item on India's sensitive list has been paired with the corresponding RCAs for these items in Bangladesh, Sri Lanka and Pakistan. This procedure has been used to classify the pairs of items on the sensitive lists on the basis of their competitiveness.

The overall exercise of pruning the sensitive lists was carried out in several steps as explained below.

Step 1 involved identifying and eliminating those items in the IS-FTA sensitive list which do not appear in the SAFTA sensitive list. This

would ensure that the bilateral sensitive list is smaller than the regional sensitive list.

Step 2 required identification of those items on India's sensitive lists that have not been exported by the exporting country (Bangladesh, Pakistan and Sri Lanka) for three consecutive years (2005, 2006 and 2007). Items that have not been supplied by these countries to the rest of the world are unlikely to be exported to India in the near future and will not pose any threat to Indian industry. Such items are therefore eliminated from the sensitive lists.

Step 3 involved identifying and eliminating those items that have been de-reserved. Hussain (1997) contains a list consisting of 1,025 such items. On the basis of the HS codes provided in the report, the items were identified in the sensitive lists and eliminated.

Step 4 involved categorizing the remaining items on the sensitive lists on the basis of RCAs of the exporting country and India. Items in which India was seen to be competitive and those in which neither India nor the partner country was competitive were eliminated. The remaining items in which India was seen to be not competitive in the international market but the partner country was seen to be competitive were retained. The study computed RCA for each commodity on India's sensitive list and paired it with RCA of the exporting country in the same item. Computing RCA for a pair of countries, i.e., India with each of the exporting country, the following four categories were generated:

Category I: $IRCA > 1, ERCA < 1$

Category II: $IRCA > 1, ERCA > 1$

Category III: $IRCA < 1, ERCA < 1$

Category IV: $IRCA < 1, ERCA > 1$

Here, IRCA denotes India's RCA and ERCA denotes the exporting country's RCA. Category I comprises items in which India is competitive but the exporting country is not. Such items should be removed from the sensitive list as the importing country is well-equipped to face competition in the international market and hence, can face competition in the domestic market too. Category II indicates a situation where both India and the exporting country are competitive. These items can also be removed from the sensitive list since India is already competing with the exporting country in the international market. Category III comprises items where neither India nor the exporting country is competitive. Category IV comprises items in which the exporting country is competitive but India is not. Such items can be retained in the sensitive list.

Step 5 involved adding items important on food security and revenue grounds to the pruned list to obtain the recommended sensitive list.

While the contribution of the study lies in the pairing of RCAs between India and the exporting country to identify competitive items in each country, the concept itself has certain limitations even though it has strong theoretical underpinnings. One problem is that the specification of the concept is usually in terms of pre-trade relative prices whereas the data used is generated by trade flows in post-trade equilibria (Volrath 1991). While this problem cannot be overcome, the fact that there are gaps between the inferred and true comparative advantage needs to be kept in mind while drawing policy inferences. The other problem arises due to aggregation where the commodity becomes composite and describes an industry or a sector. The present study tries to address this problem to some extent by computing RCA at the six-digit level.

Another limitation of the study is that it relies only on RCAs to assess competitiveness. It does not take into account unit values of the exporting country in relation to other competitors, and productivity dimensions related to the domestic industry.

4. Results

4.1 Sri Lanka

The operational sensitive list for Sri Lanka consists of 215 items, but after excluding items considered sensitive in terms of food security and revenue purposes, the elimination exercise was carried out on the remaining 199 items. It was also examined whether duty-free concessions granted to 216 apparel items were those in which India was vulnerable. This exercise was carried out by computing RCAs of both countries in these items and classifying them in the four categories mentioned above.

A step-wise elimination of items in the sensitive list is outlined below.

Step 1: Out of the 199 items under consideration for elimination, 38 are not on the SAFTA sensitive list.⁹ Therefore, these items should be eliminated from the bilateral sensitive list. This leaves 161 items for further pruning.

Step 2: Of the 161 items, 17 items were not exported at all by Sri Lanka to the world in 2005, 2006 and 2007, which indicates that Sri Lanka does not have the capability to supply these items. Hence, these items can be eliminated from the ISFTA sensitive list, which leaves 144 items remaining.

Step 3: Of the 144 items, there are 65 items which were earlier reserved for exclusive manufacturing by the small-scale sector but have now been de-reserved. After eliminating these items, the number of items that remain on the sensitive list is 79.

Step 4: For these 79 items, RCAs are computed for India and Sri Lanka. Each such pair is classified into four categories based on whether the value of the RCA is greater than or less than unity. The number of items in Category I (India competitive), Category II (India and Sri Lanka both competitive) and Category III (neither India nor Sri Lanka competitive) are 26, 13 and 47 respectively. As discussed earlier, items in these three categories can be eliminated from the sensitive list; thus leaving only nine items on the ISFTA sensitive list.

Regarding the 216 apparel items that are granted duty free access to India, RCAs of both countries were computed, based on which they were classified into the four categories. It was found that 22 fall in Category I (India competitive), 107 in Category II (both India and Sri Lanka competitive), 27 in Category III (neither India nor Sri Lanka competitive) and 60 in Category IV (Sri Lanka competitive). A large number of items falling in Category IV shows that India has opened up its market to Sri Lanka's apparel even in the most critical category.

4.2 Bangladesh

Step 1: Out of 298 items in the sensitive list for Bangladesh (excluding 33 items important from food security and revenue perspectives), 158 items were not exported by Bangladesh to the world in 2005, 2006 and 2007. Hence, these items were eliminated from the list, thereby leaving 140 items.

Step 2: Of the 140 items, there were 25 items that belonged to the earlier list reserved for small-scale manufacturing. Eliminating these, 115 items remained in the sensitive list for further examination.

Step 3: RCAs of both India and Bangladesh in these remaining 115 items were then computed and the items were classified into the four categories. It was found that only eight items belonged to Category IV (Bangladesh competitive).

RCAs of India and Bangladesh in the 146 apparel items in which India granted duty-free access to Bangladesh showed that 49 fell in Category IV (Bangladesh competitive). As in the case of Sri Lanka, this shows that India has provided non-reciprocal and asymmetric facilities to Bangladesh.

4.3 Pakistan

Step 1: Of the 877 items (excluding those important for food security and revenue-sensitive ones), 125 were not exported at all by Pakistan to

the world in the three years between 2005 and 2007 and can, therefore, be eliminated. This leaves 752 items in the sensitive list.

Step 2: Of the 752 items, 274 items were reserved for the small-scale sector which have now been de-reserved and hence these items should be removed. This leaves 478 items in India's sensitive list for Pakistan.

Step 3: These 478 items are categorized into the four categories on the basis of RCAs of the two countries in these products. It was found that 84 items belonged to Category I (India competitive), 109 to Category II (both India and Pakistan competitive) and 218 to Category III (neither India nor Pakistan competitive). The remaining 67 items belonged to Category IV, which means India is likely to face competition from Pakistan in these items in the international market and are, therefore, a possible threat to India.

4.4 Elimination summary and pruned sensitive lists

Table 3.6 provides a summary of the elimination processes carried out in the case of all three countries and the pruned sensitive lists.

Table 3.6: Elimination summary and pruned sensitive lists

	Category	Sri Lanka	Bangladesh	Pakistan
Step 1	Items in bilateral sensitive list but not in SAFTA sensitive list	38	-	-
Step 2	Zero export items	17	158	125
Step 3	De-reserved items	65	25	274
	RCA categories:			
	Category I: IRCA > 1; ERCA < 1	26	27	84
Step 4	Category II: IRCA > 1; ERCA > 1	13	13	109
	Category III: IRCA < 1; ERCA < 1	31	67	218
	Category IV: IRCA < 1; ERCA > 1	9	8	67
	Pruned sensitive list	9	8	67

Note: Items sensitive to food security and with revenue considerations have been excluded here.

Source: Authors' calculations.

Sector-wise distribution of the pruned sensitive lists is provided in Table 3.7. For Sri Lanka, seven out of nine items are plastic and rubber products, while for Bangladesh, eight items are distributed over five sectors. In the case of Pakistan, 75 percent of the items are vegetable and textile products. After adding items sensitive to food security and with revenue implications (tobacco and alcohol) to the pruned sensitive lists, we get the recommended sensitive lists for India (Table 3.8).

Table 3.7: Sector-wise distribution of items in pruned sensitive list

S.N.	Description	Sri Lanka	Bangladesh	Pakistan
1	Live animals		1	2
2	Vegetable products	1	3	11
3	Animal/Vegetable fats and oils		1	
4	Prepared foodstuffs		2	1
5	Mineral products			2
6	Chemical and allied industries			1
7	Plastics and rubber	7		
8	Wood and articles of wood		1	
9	Paper products	1		
10	Textiles and textile articles			47
11	Footwear, headgear, walking sticks, etc.			1
12	Base metals and articles of base metals			2
Pruned sensitive list items		9	8	67

Source: Authors’ calculations.

Table 3.8: Recommended sensitive list

	Sri Lanka	Bangladesh	Pakistan
Pruned sensitive list	9	8	67
Food security items, tobacco and alcohol	16*	33	33
Recommended sensitive list	25	41	100

* There are only alcohol and no tobacco and food security items in the operational sensitive list under ISFTA.

Source: Authors’ calculations.

It may be pointed out that since India has not offered any concessions to Pakistan, the sensitive list is the largest for Pakistan, with textiles and related products having the largest share. These are items in which India has given substantial concessions to Sri Lanka and Bangladesh. Hence, India can give concessions to Pakistan also in the textile and related products category. Now that Pakistan has given most-favoured-nation (MFN) status to India, it should reciprocate by pruning its sensitive list for Pakistan.

5. Conclusion

This article provides a policy tool to prune India’s sensitive lists for Sri Lanka, Bangladesh and Pakistan. The exercise to eliminate items from the sensitive lists started by identifying items that are included in the ISFTA sensitive list but not in the SAFTA sensitive list; items that cannot be supplied by the exporting countries to the world; items that have

been removed from the list of products reserved for exclusive manufacturing by the small-scale industry in India; and items in which India is competitive and those in which neither India nor the exporting country is competitive. It is seen from this exercise that India can maintain much shorter sensitive lists for Sri Lanka and Pakistan than it currently does, although it now provides duty-free access to all the products from Bangladesh except for 25 items (such as alcohol and tobacco) by virtue of the latter being an LDC.

Even those items that would be retained on the sensitive lists for Pakistan and Sri Lanka in particular are those in which India is not competitive. Hence, retaining them on the sensitive list for long would encourage inefficiency. Therefore, it is imperative to retain these items in the list only for a definite period of time (three to five years) during which India's domestic producers make themselves able to face external competition.

Notes

- ¹ Currently, there are eight members in the SAARC after Afghanistan became its newest member in 2008.
- ² The RCA index is the ratio of the share of a given product in a country's exports to the product's share in world exports (Balassa 1965). RCA is computed using the formula $RCA_{ij} = (X_{ij}/X_i)/(X_{wj}/X_w)$, where X_{ij} represents country i 's export of commodity j , X_{wj} represents world exports of commodity j , X_i represents the total exports of country i , and X_w represents total world exports. The RCA index has been computed by averaging item-wise RCA for each of the years 2005, 2006 and 2007. An RCA index value of greater than unity implies that the country is competitive in exporting that product.
- ³ Under the India-Nepal FTA signed in 1996, India has maintained a list comprising only three items, namely alcoholic liquors, cigarettes and tobacco, and perfumes and cosmetics of non-Contracting Party origin.
- ⁴ Central Board of Excise and Customs (CBEC) Notification No. 67/2006 dated 30 June 2006.
- ⁵ CBEC Notification No. 107/2008 dated 6 October 2008.
- ⁶ CBEC Notification No. 52/2008 dated 22 April 2008; on sourcing of fabric from India up to a limit of 3 million pieces.
- ⁷ CBEC Notification No. 51/2008 dated 21 April 2008.
- ⁸ The original and the operational sensitive lists for Sri Lanka do not contain any alcohol and related products.
- ⁹ As referred to earlier, 86 items in the ISFTA were not included in the SAFTA sensitive list. Of these, 48 belonged to the textile sector. 46 textile items were removed from the ISFTA sensitive list under a TRQ in 2008 through the CBEC Notification No. 52/2008, leaving 40 items in the ISFTA sensitive list. This list included two items that were not in the list of TRQ items. Adjusting for these two items, there are 38 items which are in the ISFTA sensitive list but not in the SAFTA sensitive list.

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Chapter 4

Non-tariff barriers in South Asia: Nature, implications and measures to address the challenges

Mustafizur Rahman

1. Introduction

In recent times, non-tariff barriers (NTBs) have tended to gain growing attention of both businesses and policy makers against the backdrop of a secular decline in tariff barriers arising from trade liberalization policies pursued by most developing countries. Exporters increasingly complain about the NTBs that they have to face in importing countries when doing business.

The reasons for the existence and proliferation of NTBs are varied and diverse. It is true that oftentimes NTBs are put in place for protectionist purposes; however, NTB-imposing countries cite a host of arguments as to why such barriers are in place and are necessary. Accordingly, the defensive interests and offensive interests in the context of NTBs tend to vary depending on the nature of the interest of the exporting/importing countries.

It is to be noted that NTBs constrain not only bilateral trade flows; they have emerged as a stumbling block to trade cooperation in the context of many regional trade agreements (RTAs) as well. It is a matter of record that in many RTAs, set up in the first place to enhance intra-regional trade flows, the emergence of various NTBs has undermined and defeated the very objectives of the RTAs. The South Asian Association for Regional Cooperation (SAARC) has not been an exception in this regard. Indeed, it is precisely because of this that policy makers in the SAARC region have been giving increasing attention to this issue.

Although SAARC was established in 1985, the first institutional arrangement for stimulating intra-regional trade was put into motion only in 1993 when the SAARC Preferential Trading Arrangement (SAPTA) got off the ground. Between 1993 and 2005, four rounds of SAPTA negotiations were held in all, with each successive round having an increasingly large number of goods being accorded preferential tariff treatment by member countries. The margin of preferences was also gradually raised.¹ However, SAPTA did not deal with NTB issues in a comprehensive manner.

SAPTA was succeeded by the Agreement on South Asian Free Trade Area (SAFTA). The SAFTA Agreement, which came into operation in 2006, envisaged to bring down the existing tariff barriers in accordance with a tariff liberalization programme (TLP) agreed by the member countries (Table 4.1). The TLP included three schedules: i) a positive list; ii) a sensitive list; and iii) a residual list. Article 7 of the SAFTA Agreement took a two-track approach: one for developing-country members, and the other for least-developed-country (LDC) members. Duties on tariff lines belonging to the positive list were set at zero from the date of implementation of the SAFTA Agreement. However, a large number of tariff lines belonging to the sensitive lists continued to be traded at the existing most-favoured-nation (MFN) tariff rates. The sensitive lists were to be reviewed periodically (every four years).² Duties on items belonging to the residual list were to be reduced to between 0 and 5 percent by 2013 by developing-country members and by 2016 by LDC members.³

It should, however, be noted that in recent years, both developing countries and LDCs in SAARC have reduced their respective tariffs, primarily through various trade liberalization reforms. MFN tariff rates which used to be, on average, in the range of 50–60 percent during the early 1990s had in fact come down to 15–20 percent in recent years. Thus, the preferential margins enjoyed by members under the TLP of the SAFTA Agreement are set to provide a declining dividend. Nevertheless, the fact of the matter is that a large number of items continue to

remain in the respective sensitive lists of SAARC, undermining both the spirit and the efficacy of SAFTA (Table 4.2).⁴

Table 4.1: Tariff liberalization programme (TLP) under SAFTA

Phases	Countries	Existing tariff rates	Tariff rates proposed under SAFTA	Year to be completed
First phase	India, Pakistan and Sri Lanka	20% and above	20% max	2008
	SAFTA LDCs	30% and above	30% max	2008
Second phase	India, Pakistan	20% or below	0–5%	2013
	Sri Lanka	20% or below	0–5%	2014
	SAFTA LDCs	30% or below	0–5%	2016

Source: SAARC Secretariat (2006).

Table 4.2: Sensitive lists of SAFTA countries

	Number of tariff lines in sensitive list
Afghanistan	1,072
Bangladesh	1,233 (for LDCs) and 1,241 (for non-LDCs)
Bhutan	150
India	480 (for LDCs) and 868 (for non-LDCs)
Maldives	681
Nepal	1,257 (for LDCs) and 1,295 (for non-LDCs)
Pakistan	1,169
Sri Lanka	1,042

Source: Author's compilation.

Despite four rounds of tariff liberalization under SAPTA and tariff liberalization under SAFTA, the share of intra-regional trade in the global trade of SAARC countries remains fairly low. A little less than 5 percent of the global trade of SAARC countries is with one another (Table 4.3), compared to 61.7 percent for the European Union (EU), 45.6 percent for the North American Free Trade Agreement (NAFTA) and 23.7 percent for the Association of Southeast Asian Nations (ASEAN). Although the relative shares of trade of individual SAARC countries vary significantly across countries, the fact remains that except for Afghanistan, Bhutan and Nepal, intra-regional export is rather low for all other SAARC members. On the other hand, imports are more widely distributed. Intra-regional exports and imports of the region's dominant economy, India, are dismally low (4.5 percent and 0.6 percent of its global exports and imports, respectively).⁵

Table 4.3: Intra-SAARC trade as percentage of global trade of SAARC countries

	1985	1990	1995	2000	2005	2008
Export	4.89	3.45	4.52	4.56	6.60	6.29
Import	2.11	2.18	3.94	4.26	4.70	3.94
Total trade	3.04	2.70	4.20	4.39	5.47	4.81

Source: Computed from International Monetary Fund’s Direction of Trade Statistics, various years.

It is often argued that one of the major reasons for this low level of intra-regional trade lies in the presence of a plethora of NTBs that limit the potential benefits and opportunities emerging from the free trade accord. NTBs are perceived to be not only limiting the scope of realizing the benefits of duty-free market access; they also severely constrain the promotion of intra-regional trade in general. It is true that the SAFTA Agreement has some provisions for reducing NTBs, facilitating customs cooperation and trade facilitation. However, not much progress has been made in this context so far. There is, thus, a need to conduct an in-depth investigation into what the various NTBs to trade in the South Asia region are, how these affect intra-regional trade, how these could be addressed, and what institutional mechanisms may be put in place to resolve the attendant disputes.

This article documents the various NTBs in place in South Asia and identifies modalities to address these, based on cross-country and cross-regional experiences. Section 2 examines the various concepts and typology of NTBs;⁶ Section 3 identifies the nature of the various NTBs in place in South Asia; Section 4 discusses cross-country experiences in addressing NTBs; Section 5 documents how NTBs are being addressed within the SAFTA architecture and the lessons that can be drawn from the experience of other regions; Section 6 provides policy recommendations to address NTBs in the context of SAARC; and Section 7 concludes the article.

2. NTBs: Concept and typology

2.1 Definition of NTBs and their classification

While a tariff is a tax imposed on foreign goods and services as these enter a country through customs points, NTBs are non-tax measures which exporters often have to encounter both at the border and behind the border when goods and services are imported by foreign buyers. Such measures could provide some advantage to domestic suppliers

(by raising their real effective rate of protection) or suppliers from other countries for which such measures are not exercised. Some of the NTBs tend to have relatively unimportant trade effects, e.g., packaging and labelling requirements can impede trade flows, but perhaps not significantly. On the other hand, NTBs such as quotas, voluntary export restraints, and other non-automatic import authorizations and variable import levies would have much more significant effects on market entry as well as price competitiveness.

The broadest definition of NTBs includes any measure other than a tariff that distorts trade (Linkins 2002). Tariff barriers are easy to measure since these are quantifiable. In contrast, NTBs are often grey and come in various shapes, sizes and forms. NTBs tend to lack concrete features and are often devoid of precise data and information and involve a lot of areas that are subject to interpretative ambiguities.

The United Nations Conference on Trade and Development (UNCTAD) provides a comprehensive list of NTBs which are classified according to the typology of trade control measures. These fall under five broad categories:

- *Price control measures:* Administrative pricing (minimum import prices, administrative pricing); voluntary export price restraint (variable levies, variable components, compensatory elements, flexible import fees, variable charges); anti-dumping measures (anti-dumping investigations, duties, price undertakings).
- *Finance measures:* Advance payment requirements (advance import deposit, cash margin requirement, advance payment of customs duties, refundable deposits for sensitive product categories); multiple exchange rates; restrictive official foreign exchange allocation (prohibition of foreign exchange allocation, bank authorization, transfer delays, queuing).
- *Quantitative control measures:*
 - Non-automatic licensing (licence with no specific *ex ante* criteria, licence for selected purchasers;
 - Licence for specified use, licence linked with local production (purchase of local goods, local content requirement, barter or counter trade); licence combined with or replaced by special import authorization;
 - Authorization for sensitive product categories, licence for political reasons;
 - Quotas: Global quotas (unallocated, allocated to exporting countries), bilateral, seasonal, linked with export performance, linked with purchase of local goods, quotas for sensitive product categories, for political reasons; prohibitions: total, seasonal, tem-

- porary prohibition, suspension of issuance of licences, import diversification, prohibition for political reasons (embargo);
- Export restraint arrangements: Voluntary export restraint (VER) arrangements, multi-fibre arrangement (MFA); quota agreement, consultation agreement, administrative co-operation agreement, etc.;
- Enterprise-specific restrictions: Selective approval of importers, enterprise-specific quota.
- *Monopolistic measures*: Single channel for import (state trading administration, sole importing agency), compulsory national services (compulsory national insurance, transport);
- *Technical regulations*: Requirements for product characteristics, marking, labelling, packaging, testing, inspection and quarantine, information, requirement to pass through specified customs, etc., pre-shipment inspection (PSI), special customs formalities, return obligation.

The above discussion would indicate that NTBs are of fairly diverse nature and many NTBs operate in grey areas and are subject to interpretation. For example, PSI is mandatory in many countries, at times, for values exceeding a certain fixed amount. But exporters may consider this to be an NTB particularly when the export consignment is of small value, and in view of the additional costs that are to be incurred. It is also difficult to separate measures introduced with protectionist intent from measures originating from genuine concerns. The complex nature of NTBs makes these difficult to address, and their resolution often involve prolonged negotiations and arbitration processes.

2.2 Use of NTBs in international trade

As trade flows have increased, so have NTBs, but the structure has changed. If in the past licensing requirements, VERs, multiple exchange rates, price control and monopolistic measure were more prevalent, currently, various types of standards (including private standards), certification and technical requirements have emerged as more prominent types of NTBs.

NTBs increasingly include regulations referring to technical requirements, either directly or by referring to or incorporating the content of a (mandatory or voluntary) standard, technical specification or code of practice, with a view to protecting human or animal life or health (sanitary regulation), protecting plant health (phytosanitary regulation), protecting the environment and wildlife, ensuring human safety, ensuring national security, and preventing deceptive and unfair practices. In the

EU, the focus of regulations in recent times has been primarily on environment, health and safety. Recently, however, there have been tendencies by governments to regulate information technology and telecommunications products in terms of certain features, such as privacy and security.

NTBs often give rise to disputes of various types. It has been seen that control measures such as those in the area of sanitary and phytosanitary (SPS) measures, meant to protect humans, animals and plants, have often exceeded multilaterally accepted norms. Often, what is accepted by one country is not accepted by others. Technical barriers to trade (TBT) have often constrained trade flows, when standards, regulations and assessment systems intended to ensure safety were not applied uniformly. Experience shows that, often, duplication of testing procedures is required although this does not add value to the product but adds to the cost of compliance and undermines competitiveness.

Regulators in developed countries apply stringent rules on food quality, packaging and labelling. For example, exports of poultry products are particularly affected by sanitary regulations that encompass rules pertaining to equipment and methods used in the processing and packaging of the products. Obtaining approval often proves to be a lengthy process that involves substantial documentation and tedious bureaucratic procedures.

When perceived as protectionist measures, NTBs often get to be challenged in appropriate forums. When developed countries are members of an RTA, the dispute settlement mechanism of the RTA are put into effect whenever an aggrieved party lodges a complaint. In some instances, the Dispute Settlement Mechanism (DSM) of the World Trade Organization (WTO) has been put into effect when it was perceived to be a better route to resolve an NTB-related conflict.

According to UNCTAD, over the last 10 years, there has been a seven-fold increase in government-mandated testing and certification requirements with increasing costs that have to be borne by exporters, who have to comply with the various technical regulations and standards-related requirements. The issue has been debated to such an extent that a special working group has been created in the WTO to deal with NTBs. This working group has identified a wide variety of NTBs based on discussions with and submissions of WTO member countries.

Table 4.4 provides an idea about the prevalence of NTBs in ASEAN, whose RTA far surpasses that of SAARC in performance. It reveals that NTBs come in various forms. Table 4.5 provides data on the tariff lines affected by various NTBs. The information provided in these tables is quite revealing.

Table 4.4: NTBs reported in ASEAN (as of 2007)

Country	No. of NTBs	Typology of NTBs
Cambodia	99	Import licensing, permits, technical measures (SPS), non-automatic licensing, prohibitions
Thailand	134	Technical measures (SPS), tariff rate quotas (TRQ), non-automatic licensing, import licensing, prohibitions
Vietnam	464	Prohibitions, import licensing, internal taxes and charges, labelling requirement, technical regulations
Malaysia	1,017	Import licensing, approved permit, registration certificates, certificate of approval, technical measures (SPS)

Source: ASEAN Secretariat.

It is interesting to note from Table 4.5 that in ASEAN the overwhelming majority of NTBs are related to customs surcharges (70 percent). NTB-imposing countries tend to argue that such measures are necessary on the ground of revenue concerns and providing safeguards to domestic producers (often, ostensibly, necessitated by safeguards and incentives in place in exporting countries). However, these are not generally expressed explicitly. One would have expected trade barriers to come down with the deepening of trade liberalization. However, this has not happened. What is also interesting to note is that NTBs in the form of SPS and TBT do not figure in a significant manner in ASEAN. This is the case mainly because SPS- and TBT-related NTBs were largely resolved through agreements pertaining to mutual recognition of standards and certification. This should be seen as a matter of heightened interest to SAARC members. One could infer that a mechanism such as the one in ASEAN could play an important role in reducing the number of NTBs in South Asia.

Table 4.5: Most prevalent NTBs in ASEAN

Types of NTBs	Number (and percent) of tariff lines affected
Customs surcharges	2,683 (69.42)
Additional charges	126 (3.26)
Single channel for imports	65 (1.68)
State trading administration	10 (0.26)
Technical measures	568 (14.70)
Product characteristic requirements	407 (10.53)
Marketing requirements	3 (0.08)
Technical regulations	3 (0.08)
Total	3,865 (100.00)

Source: ASEAN Secretariat (2005).

The upshot of the above discussion is that when the issue of NTBs in the context of South Asia is considered, it will be well-advised to keep in mind that NTBs are a widely prevalent phenomenon in global trade and there is hardly any opportunity or scope to wish them away. Cross-country experiences indicate that the best way to go about to addressing the attendant issues is to build up capacities to ensure compliance, and put in place appropriate institutions to resolve the conflicts. In connection with this, it will be relevant to first examine the NTBs in South Asia with a view to identifying the nature of the NTBs and sectors which are most affected by these NTBs.

3. NTBs in South Asia

3.1 NTBs constraining intra-SAARC trade

If the UNCTAD definition of NTBs is considered, the menu of NTBs that apply to intra-SAARC trade would be quite an extensive one. A review of relevant sources indicates that all the four major trading partners in SAARC (India, Pakistan, Bangladesh and Sri Lanka) have a large number of NTBs in place. While individual members tend to consider most of their own NTBs to be genuine and WTO-compliant, they tend to consider NTBs imposed by trading partners to be trade restrictive, arguing that such NTBs have been put in place with a view to protecting the interests of domestic producers against imports. This diversity of approaches results in frequent disputes in the context of intra-regional trade in South Asia.

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; these recommendations do not entail a binding commitment on the part of the party against which the complaint was submitted in the first place.

A survey of NTBs reported by SAARC member countries to the CoE shows that NTBs that are most frequently imposed on trade among SAARC countries relate to SPS and TBT, quotas, anti-dumping measures, licence requirements, and countervailing measures. Documentation procedures and SAFTA certification for rules of origin (RoO) are also considered NTBs by some exporters. Computerization of trade transactions (cargo declaration, licensing, and duty payments) has opened up the need for new standards [e.g., Automated System for Customs Data (ASYCUDA)] and compatibility across regional systems. Those who fail to comply with the related requirements tend to perceive those requirements also as barriers.

A wide range of NTBs, albeit WTO-consistent, are in place in India. These include TRQs on a number of tariff lines at the Harmonized Commodity Description and Coding System (HS) 8-digit level, import restrictions and licensing, and restrictions in the form of entry through particular ports. Under the India-Sri Lanka Free Trade Agreement, for example, tea and garment exports from Sri Lanka to India can only be cleared through specified ports. In Bangladesh, there is a significant application of para-tariffs (e.g., surcharges and supplementary duties)—estimates are 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 import of tea and spices on the grounds that low-quality imports, if mixed with Sri Lankan products, would reduce the quality of exports and thus affect their marketability.

As can be seen from Table 4.6, information collated by the Asian Development Bank and UNCTAD (ADB and UNCTAD 2008) shows that 86.3 percent of NTBs in the region relate to SPS, TBT and related measures. Thus, the overwhelming majority of NTBs are indeed in areas where compliance with SPS and TBT are major requirements. If such measures are on an MFN basis, non-discriminatory and equally applicable for all imports, and if these relate to compliance with relevant national laws, one would be hesitant to call them protectionist measures. It is when these are applied on a discretionary basis and the required standards are more stringent than national laws that these could perhaps be considered as NTBs in the strictest sense of the term.

Table 4.6: Percentage share of NTBs in all NTBs by SAARC countries

Non-tariff barriers	Share
SPS, TBT, and other related measures	86.3
Tariff quota	9.8
Anti-dumping measures	7.4
Licence requirement	5.3
Countervailing measures	1.2

Note: Percentage shares exceed 100 percent since number of cases varies.
Source: ADB and UNCTAD (2008).

A careful review of the various NTBs faced by exporters in South Asia shows that the manifold and diversified NTBs that apply to trade among SAARC countries could be categorized according to the broad areas of: i) on the border NTBs (e.g., surcharges); and ii) behind-the-border NTBs (violation of national treatment, in various forms). Broadly,

these may be grouped into seven clusters: i) NTBs related to SPS measures; ii) NTBs related to customs regulations; iii) NTBs related to TBT and environmental measures; iv) quantitative restrictions, including ban; v) border-crossing barriers; vi) labelling requirements; vii) RoO; and viii) visa requirement.

3.2 NTBs identified by NAMA Working Group

In the context of the ongoing non-agriculture market access (NAMA) negotiations at the WTO, a special working group was set up to look into NTBs. The NAMA Working Group identified the following NTBs for Bangladesh, India, Pakistan and Sri Lanka.

Bangladesh

- Customs surcharges in the form of supplementary taxes.
- Health, religious, environmental and balance of payments purposes.
- Quantitative restrictions.
- Import through state trading enterprises (salt).
- Restricted port of entry.

India

- Tariff rate quotas.
- Import through state trading enterprises.
- Health and sanitary regulations (quarantine fees).
- Restricted port of entry and inland customs port.
- Anti-dumping and countervailing duties.
- Customs valuation.

Pakistan

- Ban on imports from India of products not on the positive list of 771 items (corresponding to about 1,500 8-digit HS tariff lines).
- Local content required in the auto industry.

Sri Lanka

- Import ban (tea and certain spices).
- Import monopoly (wheat).
- Health and sanitary regulations.

Imports of particular items face additional duties (other than customs duties) in various SAARC countries in the form of customs surcharges (supplementary taxes), additional charges (lending fee, insurance fee),

pre-shipment fees and special additional duties (SADs). Restrictive financial measures in the form of a bank guarantee, for import values exceeding a certain amount, are also in place in many countries. In many countries, monopolistic measures are in place in the form of requirement to take the service of national institutions such as national insurance companies and modes of transport owned nationally such as national flag carriers.

3.3 Connectivity barriers as NTBs

Lack of physical, industrial and communication infrastructure in the region has also contributed to restrict trade. This could also be termed NTBs in the context of its broad definition. Kabir (2007) provides a summary of the key barriers to trade in this context.

Air and maritime port facilities in South Asia are less competitive compared to those in East Asia, leading to cost escalation. While it takes two hours to clear a vessel in Singapore and Laem Chabang, Thailand, it takes 2–3 days in Chittagong. At Delhi airport, average cargo dwell time is 2.5 days. Some estimates have been made with regard to the magnitude of the NTBs in the form of lack of connectivity and infrastructure. For example, World Bank (2003) estimates savings arising from switching to rail transport (from road) along the Kolkata-Kathmandu corridor at 22–33 percent of total road cost.

Disparity in infrastructure facilities among South Asian countries has been on the rise in recent years. Additionally, progress in information technology is also considered to be as important as development of the needed physical infrastructure. This is crucial for customs and standards harmonization among the countries of the region. This is lacking in South Asia, leading to disputes regarding interpretation of customs rules and procedures.

Lack of border infrastructure and traffic planning is a major constraint to deepening trade relations in SAARC. Most border crossings among South Asian countries are not designed to handle the volume of traffic that currently passes through them. This results in severe traffic congestion and delays in handling shipments.

Land ports at border-crossing points have emerged as major stumbling blocks from the perspective of the need for providing seamless and multi-modal movement of goods across borders. Since goods are required to be transshipped, precious time is wasted at the borders. About 90 percent of the trade between India and Bangladesh is carried out through 17 land ports. These land ports do not have adequate storage facilities; oftentimes, goods have to be off-loaded on no-man's land

and are not allowed to be brought to warehouses (e.g., Indian goods exported to Bangladesh). Due to increased trade volumes, storage dwell time has been on the rise at the ports where storage capacity tends to be highly inadequate. At the Petrapole-Benapole border, it takes more time to unload vehicles at the land ports compared to the physical clearance time. All these factors undermine competitiveness and add to cost.

In some of the land ports, there is also lack of adequate human resources to deal with customs clearance work. Often, the officer is not appropriately trained, and has to send documents to the head office for the opinion of the appropriate authority. This causes inordinate delay. When goods are exported under preferential treatment, delays happen because customs officials at the border point do not have a good knowledge about tariff classification and are not adequately equipped to certify the authenticity of the certificates of origin for compliance with the relevant RoO. Many of the land customs offices at the border lack testing and laboratory facilities and have to send samples to relevant institutions which are situated far away. This is a common phenomenon faced by Bangladeshi exporters of cement and fruit juice to the North-east Indian markets. Absence of appropriate banking facilities (dealing with letters of credit opened for trade) also delays trade transaction and discourages trade.

Traders' practices also often create bottlenecks for customs authorities at border points. Importers often do not submit required clearance documents at customs points on time. Since a significant time is required to collect the formidable array of supporting documents, importers use godowns as storage facilities for the period they require to deal with the financial and documentation work involved. This is also often the case because storage charges tend to be relatively low. There is a need to raise awareness among business people with regard to the need to have the required paperwork ready when dealing with the customs.

A lack of cross-border transport agreements also creates problems for movement of goods when trade takes among SAARC countries. Due to the lack of through-transport movement, there are formidable transport inefficiencies at the interface. SAARC countries have about 3.8 million km of road network which account for about 10 percent of world road network; the railway networks are spread over 77,000 km. However, because of a lack of bilateral and multilateral road and rail transport agreements, a seamless movement of goods, and road/rail vehicles and wagons across borders is not possible. This is true for movement between Bangladesh and India, and India and Pakistan. Major obstacles here include absence of protocols, lack of standardization of technologies, operation and maintenance practices, incompatibility

of rolling stock, load restrictions on bridges, differences in rail gauges, braking system and couplings.

At present, there are also restrictions on movements of goods from Nepal and Bhutan through India to Bangladesh that are destined for third countries. Although South Asia has 25 major ports and one of the largest water systems in the world, lack of capacities, and absence of comprehensive protocols hinder cross-border movement of goods. This lack of trade facilitation is a major NTB (in the broad sense of the definition) that limits the scope of intra-regional trade and results in costly transshipment.

In recent times, discussions have been initiated, at the bilateral level, to address some of the attendant issues. Existing protocols are being reviewed to explore the possibility of greater transport cooperation among Bangladesh, Nepal, Bhutan and India.⁷ Some experts have argued that establishing a SAARC rail network will be the best way to move forward at this point of time. Addressing the issues related to transport facilitation to stimulate trade among SAARC countries will require comprehensive negotiations among the member countries to identify win-win options. Only this could lead to successfully addressing this particular variant of NTBs.

The Joint Communiqué resulting from the visit of Bangladeshi Prime Minister to India is now being followed up with several initiatives in a number of areas to foster greater sub-regional connectivity among Bangladesh, Bhutan, Nepal and India. These are to cover rail, road and waterways as well as multi-modal transport protocols.⁸

3.4 Rules of origin

The general criterion of SAFTA RoO is change of tariff heading (CTH) plus 40 percent value addition for non-LDCs and CTH plus 30 percent value addition for LDCs. There are also product-specific rules for 191 items on which the general criterion does not apply. Under regional cumulation rules of SAFTA, applicable rules relate to the provision of value addition criterion only. In this case, the regional value addition is 50 percent, of which 20 percent has to be in the final exporting country. As SAFTA moves forward, the RoO will need to be further revised and made more trade friendly to stimulate intra-regional trade.

3.5 Possible barriers to services trade

With the signing of the SAARC Agreement on Trade in Services (SATIS), the services sector has also come within the ambit of a regional arrange-

ment. Experiences with services trade agreements tend to show that barriers to services trade could be in many forms: exporters could face restrictions in the form of limit on the total value of services transaction, the number of services operations, the number of natural persons to be employed for the supply of a particular service, measures which force a service supplier to supply a service through a particular legal entity, and limits on foreign investment in particular sectors. Also, in connection with the schedule of specific commitments, there could be barriers by way of terms, limitations and conditions of market access, conditions and qualifications with regard to national treatment, undertakings relating to additional commitments, the time frame for the implementation of such commitments, and the date of entry into force of such commitments. Any future framework of dispute settlement will need to keep these possible areas of diversity of interests in perspective.

4. Global experience in addressing NTBs

A majority of RTAs have developed mechanisms to deal with NTBs. They have developed mechanisms for assessment of equivalence of qualification, licensing, and other related documents with a view to improving market access. The EU, NAFTA and the Trans-Tasman Mutual Recognition Agreement (TTMRA) (between Australia and New Zealand) are some examples. A large number of RTAs have signed mutual recognition agreements (MRAs) whereby certification and laboratory tests as well as the standards of one member country are accepted at border points by other members. Such mutually beneficial arrangements were found to be a good modality to address concerns of RTA member countries with regard to compliance with SPS and TBT requirements.

ASEAN, for example, has signed an agreement on the general framework of a process by which NTBs would be addressed, and subsequently eliminated. The process involves: i) verification of information on NTBs; ii) prioritization of products/NTBs; iii) developing specific work programmes; and iv) obtaining a mandate from the ASEAN Economic Ministers to implement the work programme.

Member countries verify the list of NTBs and products that are affected by the NTBs, which is compiled by the ASEAN Secretariat. Several criteria have been considered by the Interim Technical Working Group with a view to identifying which products/measures have to be dealt with first. These criteria are to be used individually or in combination with each other in order to set priorities. These criteria, in order of importance, are: i) the number of private sector complaints; ii) difference between domestic and world prices; and iii) trade value.

The first criterion would rely on the private sector's or exporters' complaints since they are the ones who are in a better position to tell how various measures existing in the country of destination act as a trade barrier. The second criterion relates to the price divergence between domestic and global prices. The price gap provides an indication as to the value of trade which is affected and helps to come to a reasonable understanding on to what extent prices would come down in importing countries if such barriers are not there. However, finding appropriate price data to make this type of comparison has not been easy. The third criterion prioritizes those NTB-affected products which are traded most widely (both within and outside the region). The fact that the ASEAN Secretariat has this information certainly helps.

However, it is not easy to prove whether NTBs present in a sector hamper trade or not. If the amount of trade in a particular item is significant, this may indicate that the NTB is not an important hindrance to trade; on the other hand, if that is not the case, the NTB could be identified as a major constraint. The criteria may not be mutually exclusive and could also be used jointly. Indeed, where all three criteria converge, this should give a robust indicator of the degree to which NTBs exist in that product or sector and appropriate actions may be initiated depending on this. At present, ASEAN is in the process of doing this.

4.1 NAFTA dispute settlement mechanism

The NAFTA Secretariat deals with complaints regarding NTBs under Chapter 19 and Chapter 20 of NAFTA. Chapter 19 provides for a system of bi-national panel review of decisions by a party authority on anti-dumping and countervailing duty matters. Article 1903 provides that a party may request that amendments to the other party's anti-dumping or countervailing duties be referred to a bi-national panel for a declaratory opinion on whether the amendment is consistent with the General Agreement on Tariffs and Trade (GATT) and NAFTA. Bi-national panels comprise five independent experts.

In Chapter 20, the process is "applicable to all disputes regarding the interpretation of application of the NAFTA" and "intended to resolve disputes by agreement, if at all possible". The process begins with government-to-government consultations, which can then proceed to a meeting of the ministerial-level Free Trade Commission, and finally to the creation of a five-member arbitration panel. Panel rules are designed to result in final panel decisions within 315 days of the date of a request for a panel. Within this period, strict deadlines have been established relating to the selection of panel members, filing of briefs and reply briefs

and the setting of the date for oral argument. In the event of failure to comply with the decisions of a bi-national panel on statutory amendments, the complaining state is free to adopt comparable legislation or equivalent executive action to the violating amendments, or even withdraw from NAFTA.

Chapter 20 also provides for scientific review boards which may be selected by a panel in consultation with the disputing Party, to provide a written report on any factual issues concerning environmental, health, safety or other scientific matters to assist panels in rendering their decisions. Moreover, a third party that believes it has a substantial interest in a disputed matter is entitled to join consultations or a proceeding as a complaining party on written notice.

4.2 NAMA dispute settlement proposal (NAMA 11)

Pointing to the several limitations in the existing WTO mechanisms related to resolution of trade disputes, in 2006, a group of developing countries put forward a proposal for the resolution of NTBs through a facilitative mechanism. Referred to as the NAMA dispute settlement proposal (NAMA 11), it stipulates that the WTO's DSM "which works on the principles of an adversarial process, is expensive, and the time of up to 2 years taken for an enforceable decision, often frustrates the exporter's need for a timely solution".⁹ Also, particularly for developing countries, the dispute settlement process is costly. Therefore, the proposal calls for the establishment of a "NTB Resolution Mechanism", which would be guided by the principle of "good faith" and conciliatory negotiations wherein every member would make a concerted effort to resolve the NTB at hand, under the guidance of a mutually agreed "facilitator".

According to the proposal, a solution mutually acceptable to the parties concerned and which is consistent with the covered agreements is to be preferred. In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements. One of the most important aspects of the proposal is that the recommendations on possible solutions that the facilitator would provide within 60 days would be non-binding. It would be mandatory for the parties concerned to participate in the NTB resolution procedure, but implementing the recommended solutions would not be mandatory. The proposal also mentions that during consultations, members should give special attention to the particular problems and interests of developing-country members.

4.3 EU dispute settlement proposal

The EU currently follows the WTO's DSM to deal with NTBs. However, like the NAMA 11 group of developing countries, it also points to the limitations that the existing WTO mechanism has in addressing disputes. Therefore, according to the EU Trade Commission, the following recommendations have been made to strengthen the process:

- Introduction of a system of more permanent panelists.
- Clarification of the dispute settlement understanding provisions on implementation. This covers notably:
 - The sequencing issue (the steps which need to be taken, and their order, before determining that the losing party has not complied correctly with the dispute settlement body recommendations and reacting accordingly).
 - The arbitration procedure on the level of suspending concessions.
 - The establishment of a procedure to lift suspension of concessions once a losing party has implemented changes.
- Improvement of the provisions on trade compensation to make them a more attractive option before suspending the concessions, and speeding up the process whenever this is feasible and justified.
- Greater transparency to secure continued public support and confidence in the WTO system, while preserving its inter-governmental character.

5. Dispute settlement mechanism in SAFTA and its efficacy

5.1 SAFTA CoE

The SAFTA CoE, with government officials of SAARC countries as its members, is the body that embodies the dispute settlement mechanism under SAFTA. It has been entrusted with dealing with non-tariff related issues and complaints involving SAARC countries.¹⁰ Currently, the CoE deals with notifications and responses with regard to NTBs. To begin with, contracting states notify the SAARC Secretariat about all non-tariff and para-tariff measures to their trade on an annual basis. The measures are then reviewed by the CoE, established under Article 10, in its regular meetings to examine their compatibility with relevant WTO provisions. The CoE then recommends elimination of the measure or implementation of the measure in the least trade-restrictive manner in order to facilitate intra-SAARC trade. Four sub-group meetings on NTBs have taken place, and most notifications and complaints are being dealt through bilateral negotiations.

In view of the importance of the issue, high-level meetings, both at ministerial and summit levels, have put an emphasis on a coordinated and structured response to address non-tariff and para-tariff measures that impede and discourage intra-SAARC trade. The sub-group on non-tariff measures, which was constituted at the first meeting of the CoE in April 2006, asked all member countries to notify the CoE about the non-tariff measures they were facing while exporting to SAARC partner countries. Member countries, in response, notified non-tariff measures faced by their exporters in their intra-regional trade. The sub-group, in its fourth meeting, categorized the notifications under six broad headings: i) SPS measures; ii) technical barriers to trade; iii) para-tariff measures; iv) trade facilitation measures relating to infrastructure, procedures, transparency, standards and testing; v) customs rules and procedures; and vi) others. It was decided that individual SAARC member countries would examine all notifications addressed to them by their respective partner countries to decide as to whether those met the basic principles of the WTO relating to non-discrimination and national treatment and whether their application had been made in a trade-friendly manner. It was decided that subsequent meetings of the CoE would review the responses to the notifications and identify the way forward.

Table 4.7 provides a specimen of the types of NTB-related queries and requests by SAARC countries and the related responses by partner countries. Each of the three countries, Bangladesh, Pakistan and India, submitted a detailed list of NTBs that, according to these countries, their respective exporters were facing in the markets of the other two partner countries, at and beyond the border. A close examination of the submissions and the respective responses indicate that NTBs have been interpreted by member countries from the perspective of a rather broad definition of barriers to trade. Relevant documents reveal some interesting patterns. A careful examination of the responses also indicate that all member countries have tried to justify their respective measures on the ground that such measures did not violate national treatment and non-discrimination principles of the WTO and that these originated from admissible concerns such as health-hygiene and other justified concerns.

A review of the country submissions shows that the NTBs they face mainly relate to: i) market access difficulties faced on account of requirements relating to SPS/TBT, certification, labelling, registration, laboratory testing and standardization in place in partner countries; ii) difficulties faced in partner countries due to infrastructural constraints that impede cross-border movement of goods from exporting countries (lack of infrastructure; low handling capacity; lack of warehouse facilities, etc.); iii) imposition of para-tariffs, surcharges, cess, VAT, sales tax,

Table 4.7: NTB-related notifications submitted to the
Committee of Experts: Complaints and responses

Complaints by India	Response from Bangladesh
Ban on import (poultry-related products)	To protect human and animal health. In view of the recent partial spread of Avian Influenza, Bangladesh needs to continue such measures.
Same name registration of drug in a developed country (drugs)	Registration and Free Sale Certificate (FSC) duly signed in original by the Health Authority of the country of origin and at least one FSC from a developed country.
15% value added tax (VAT) (all goods)	15% VAT is also imposed on domestic products. Therefore, imposition of VAT should not be treated as para-tariff.
Allowed through land route only (yarn)	This measure is not applicable for a specific country. The provision has been relaxed for yarn imported under back-to-back L/C through land customs.
L/C requirement (all products)	Bangladesh Bank feels that this instruction is necessary to ensure entry of imported materials/ goods into the country against paid money and this has not been applied as an NTB.
Radioactivity test (directly consumable stuff)	All imports of food items require radioactivity test report. However, radioactivity test requirement has been relaxed for SAARC countries.
Non-payment of irrevocable L/Cs by various banks (all exports)	The issue is being addressed by a joint group on the banking sector.
Complaints by India	Response from Pakistan
All products in the positive list	Bilateral trade between both the countries is to be viewed in the context of political relations since independence. The positive list has increased from 42 to over 1,800 tariff lines. 302 new tariff lines were added to the list.
Anti-dumping duty has been levied on import of phthalic anhydride from India	The measure is in line with the WTO Agreement on Anti-dumping to protect the local industry.
In many cases, Pakistani banks do not accept L/Cs issued by Indian banks	This issue is under consideration in bilateral dialogue. Understanding has been reached to open bank branches across borders with India.
Pakistan Standards and Quality Control Authority (PSQCA) is currently maintaining 15,000 standards	PSQCA developed/ adopted 4,900 standards in accordance with ISO guide 21 and they are also in line with CODEX Alimentarius Guidelines.

Cotton is allowed to be imported only through port and not by rail/road	The quarantine arrangement in other ports is inadequate.
Inadequate handling capacity at Lahore Land Customs Station (Lahore LCS)	Lahore LCS is in the process of upgrading its infrastructure facilities to handle increasing volumes of trade.
Commercial invoice and packing list must be accompanied with the consignment	This measure is necessary to safeguard government revenue and streamline clearance of goods.

Complaints by Bangladesh	Response from India
Licence from Bureau of Indian Standards (BIS) for cement, gelatin, condensed milk, electrical appliances, mineral water, steel products, leather products, x-ray equipments, dry-cell battery, thermometer, helmet and gas cylinder	The following steps have been taken: i) the number of items for which certification is needed has been reduced from 109 to 68, ii) marking fees for BIS licence has been reduced for SAARC countries, and iii) processing charge for SAARC countries has been abolished.
Requirement of laboratory testing (all products)	100 percent checks are done on only 14 high-risk food items.
Detailed product information (all pre-packaged goods)	These are statutory requirements under the Consumer Protection Act.
Special labelling of country of origin (jute bags/sacks)	The rationale is that the country of origin of the product is to be mentioned because if there is any irregularity in the quality of the imported item, the source could be tracked.
Certificate of non-halogenated hydrocarbon (jute products)	Domestic producers face the same stipulation.
Pre-shipment certificate about presence of no hazardous dyes (textiles and textile products)	The provisions are also in effect for domestic industries.
Requirement of import licence (mostly consumer goods)	Requirement of import licences are under exception clauses of Article XX and Article XXI of the GATT.

Source: SAARC Secretariat.

and other duties beyond MFN tariffs; iv) requirements of licences and permits from importing countries; v) anti-dumping and countervailing measures; vi) interpretation of rules of origin; and vii) lack of adequate L/C facilities and necessary financial intermediation.

What is perhaps not surprising is that while as a reporting (exporting) country, members have given generous interpretation of the NTB-related difficulties faced in trading with (importing) partners, in submit-

ting their own responses, the same partners have attempted to justify similar types of NTBs they themselves have put in place. The responding countries have tended to argue that their own NTBs should not be interpreted as such because: i) SPS/TBT and other related complaints should not be perceived as NTBs since these have been put in place to ensure compliance with relevant national standards, rules and regulations; ii) measures perceived as NTBs are MFN in nature, and are not directed at specific countries; iii) these measures are WTO-compatible; iv) some of the measures relate to security concerns; v) the complaining country has also imposed similar barriers; and vi) lack of domestic capacity to develop necessary infrastructure has led to infrastructure-related constraints in importing countries. In only a few cases did the partner country, in response, mention that it had taken steps to address particular complaints (building of infrastructure) or that relevant authorities (often central banks) have been asked to provide clarification as regards a particular complaint. Thus, in spite of the best efforts of the CoE, much remains to be done in resolving the outstanding NTB-related issues.

Indeed, it is understood that at the fifth meeting of the CoE, it was pointed out that submissions of responses and counter-responses may not be the most helpful way to resolve NTB-related disputes. Rather, efforts should be made to list NTBs which are trade restrictive as per the relevant WTO provisions. The sub-group of the CoE was asked to clarify whether the notified NTBs fall into any of the following categories: i) SPS; ii) TBT; iii) para-tariff measures; iv) trade facilitation measures relating to infrastructure, procedures, transparency standards and testing; v) customs rules and procedures; and vi) others. Based on the categorization, the idea was to identify barriers that were WTO-compatible and those that were not, and then propose measures to address the attendant concerns.

While member countries could go on arguing whether trade measures that they were facing were NTBs or not, and whether those were WTO-inconsistent, the fact of the matter is that intra-regional trade flows among SAARC countries continue to be significantly constrained because of the “real” or “perceived” NTBs. The task is to take concrete initiatives to address the concerns, in a positive manner, through constructive engagements at various levels. As would appear from the above discussion, initiatives will need to be taken in four broad areas: i) institutional initiatives such as signing of MRAs; ii) harmonization of customs policies and procedures; iii) capacity building in compliance-related areas; and iv) improving trade facilitation at border points.

Developing MRAs is also critical in the area of trade in services in

view of SATIS. Of particular relevance in this context will be trade in services with regard to Mode 4 (movement of natural persons). Absence of any institutional modality for recognition of qualifications, skills and experiences is one of the most common barriers affecting Mode 4 (Chanda 2005). This either denies market access altogether to foreign services providers or induces such suppliers to perform at a capacity that is below their respective levels of qualifications (academic or otherwise). These problems will need to be dealt with within the context of SATIS.

6. Policy initiatives to address NTBs

NTBs severely restrained the potential opportunities of trade expansion among SAARC countries and the related issues have often been politicized in a manner that have severely undermined the overall spirit of cooperation among member countries. As the discussion above would indicate, in spite of efforts at various levels to deal with the related issues, much more needs to be done by way of concrete measures. This is not to deny that some positive movements did take place within the SAARC institutional framework. However, the need of the hour is to build on the progress made thus far, and move forward at a faster pace. What follows is a discussion of a number of steps and initiatives that are required to address the concerns, based on the review of issues undertaken in the preceding sections and also taking cognizance of cross-country experiences in dealing with NTBs.

6.1 General principles

SAARC members should work towards some guiding principles with regard to NTBs. In general, the principle should be that NTBs that have not been notified to the WTO, and hence are unlikely to be admissible if contested in the WTO Dispute Settlement Body, should not be imposed on intra-SAARC trade. If a new NTB is to be introduced, if at all, member countries should be given prior notification for examination and preparation. The principle of MFN and national treatment should be guaranteed in all intra-SAARC trade transactions. An agreement may be made to have the value of all imported products ascertained on the basis of the Agreement on Customs Valuation of the WTO.

6.2 Strengthening SPS/TBT-related capacities

A majority of NTBs relate to certification, testing and SPS/TBT compliance. Two practical measures that can be taken to resolve this, which

have also been floated during SAARC meetings at various levels, are to: i) strengthen national capacities in relevant areas through capacity building of standardization institutions; and ii) put in place MRAs whereby certificates issued by standardization/accreditation institutions of one country will be accepted by those of another country. Indeed, India made an offer in the fourth meeting of the SAFTA sub-group on NTBs to assist LDCs to develop the required capacities in the areas of standards, and technical and human resources. These are to be provided on the basis of specific requests from member states. India has already started to provide some technical assistance for the strengthening of the Bangladesh Standardization and Technical Institute.

The decision to establish the SAARC Regional Standardization Organization (SARSO) in Dhaka is also a step in the right direction. SARSO is expected to provide assistance in areas of national capacity building in standardization related areas. SARSO could play an important role in the evolution of common standards related to various SPS/TBT, certification and testing-related areas, and could facilitate the signing of MRAs among SAARC countries.

6.3 Designing an appropriate dispute settlement mechanism

A workable dispute settlement mechanism is important to resolve conflicts relating to NTBs among SAARC members. As was mentioned earlier, the CoE has served as the dispute settlement authority under SAFTA till now. While the CoE has been trying to address NTB-related disputes and issues as best as it can, the fact remains that it is an *ad hoc* body, which is able to meet only periodically and does not have the required institutional and human resources to follow up on its decisions. In view of this, there is a need for a more institutionalized approach to deal with NTB issues in SAARC. The experiences of other RTAs such as ASEAN, NAFTA and the EU may be studied thoroughly to come up with an acceptable structure for SAARC in this context. The SAARC Secretariat could take the lead in this respect by i) introducing a system of permanent panelists; ii) putting in place a transparent system of arbitration; and iii) introducing appropriate procedures for lodging complaints and getting remedies.

6.4 Establishment of accreditation agencies

In order to ensure that certificates issued by the relevant agencies in one country are accepted by another country, appropriate accreditation institutions will need to be developed. These agencies will be required

to have the necessary competence in relevant areas. These could play an important role in resolving many of the compliance-related concerns. Governments should provide incentives so that such accreditation institutions are set up in the private sector. In a good move, a SAARC Arbitration Council has been set up for which nominations have been submitted by member countries for the Governing Board. Some of the administrative and financial matters have been addressed and the progress was reported in the first meeting of the Council held in January 2009.

What is now required is to ensure that the Council has the required capacity and logistical support to deal with disputes as and when needed. Indeed, the Council could serve as a clearing house of disputes. It could help keep trade flows moving by guaranteeing that trade will not be disrupted till the Council gives a verdict on the dispute being arbitrated by it. An effective Arbitration Council could play an important role in resolving NTBs such as anti-dumping duties and countervailing duties. If the Council is vested with appropriate authority and capacity, it could rule whether a specific NTB is WTO-compatible or not. The Council could also suggest ways to keep the damage to the aggrieved parties to the minimum.

6.5 Works of the SAARC Standards Coordination Board

Since varying standards in SAARC countries are one of the major reasons for disputes to arise in the first place, it is welcome that the SAARC has constituted a Standards Coordination Board. The Board has already met several times and finalized the statutes and by-laws of SARSO. The Board has also identified an initial list of products for which work has commenced with regard to harmonization of standards among countries of the region.¹¹ The important task at hand is to build the infrastructure of SARSO as speedily as possible and to ensure that the logistics and human resource requirements are speedily met. SARSO may be entrusted with the task of harmonization of standards encompassing all tradable goods in SAARC.

6.6 Improving customs cooperation

A frequent reason behind the disputes that hinder cross-border movement of goods arises from bottlenecks at customs points. Often, disputes arise because of difference in the interpretation of tariff lines and whether a particular product belongs to a particular tariff line. Exporting-country officials tend to be keen on putting items under tariff lines that

have zero or lower tariff, or enjoy preferential treatment under SAFTA. Importing-country officials, on the other hand, are often interested to put them under tariff lines with MFN duties, particularly when there is an interpretational ambiguity as to which tariff line the item actually belongs to.

There have been some initiatives aimed at customs cooperation among SAARC countries. A SAARC Agreement on Mutual Administrative Assistance in Customs Matters was finalized by the sub-group on customs cooperation.¹² The focus of attention here should be on capacity building, harmonization of tariff lines at the 8-digit level among member countries, fast-tracking customs clearance procedures, and facilitating the movement of consignments traded under SAFTA. The task at hand is to address the entire spectrum of bottlenecks. In this context, speedy completion of the harmonization and computerization of customs clearance processes and procedures at border points and ports should be given priority so that disputes at customs points, particularly at land customs points, can be reduced. It is to be noted here that four of the 17 land customs points in Bangladesh are now operating under private sector management contracts. There is a need for public-private partnership initiatives if these land customs points are to be equipped with appropriate capacities.

6.7 Dealing with para-tariffs

The practice of some SAARC countries to determine assessable values of imported items by fixing certain percentage of abatement on retail sales, or on the basis of a pre-fixed tariff value, often gives rise to disputes among member countries. In countries with a federal structure, such as India, disputes sometimes arise because exports which enter the border at zero-tariff are subjected to state-level taxes.¹³ While, per se, such “para-tariffs” can hardly be contested,¹⁴ member countries could think of coming to an agreement with regard to not imposing any para-tariffs/surcharges on intra-regional trade flows.

6.8 Signing MRAs

An effective way to resolve disputes with regard to SPS/TBT/standards is to go for: i) signing of MRAs with regard to certification, technical regulations, laboratory testing, etc.;¹⁵ and ii) putting in place the required capacities in this respect. As was noted, India has offered to provide technical assistance in building and strengthening the capacity of SAARC LDCs in compliance-related areas. However, given the im-

portance of the issue, and the need to take urgent initiatives in this area, member countries (particularly LDCs) should seek support from other prospective donors in the form of aid for trade, among others, from the European Commission, which has extensive trade-related capacity-building support programmes in place for low-income countries.

6.9 Addressing infrastructure-related trade facilitation bottlenecks

The most oft-mentioned NTBs relate to the lack of trade facilitation at border points, and the bottlenecks come in various shapes. The issue of addressing the “soft ones” (customs valuation, tariff harmonization, computerization, etc.) has been mentioned earlier. However, what hinders cross-border movement of goods, to a large extent, is the absence of physical infrastructure at border points. Some of these relate to conscious policy choices (e.g., when a country does not allow unloading of imports at its warehouses, which then has to be done on no-man’s land) or by default (when appropriate facilities such as testing laboratories and warehouses are not there). While ensuring seamless movement through regional connectivity and multi-modal transport facility is the long-term solution, from the short- to medium-term perspective, there is an urgent need to build the necessary border infrastructure to facilitate cross-border movement of goods. Coordination among partner countries in terms of development of infrastructure facilities is also critical to addressing this issue.¹⁶

6.10 Services trade and NTBs

An emerging area of dispute, particularly with respect to services trade, relates to the issue of determining equivalence of academic degrees. Approaches to mutual recognition and coverage of MRAs could vary significantly. Two basic approaches have been suggested as the basis for mutual recognition. The so-called vertical approach proposes that recognition be provided on a profession-by-profession basis through the harmonization or coordination among the parties to an MRA with regard to education and training being required by each profession (harmonization-based approach) (Zarrilli 2005). The horizontal approach, on the other hand, allows for mutual recognition to be provided without prior harmonization of curricula and training requirements, on the basis of a broad equivalence of qualifications (equivalence-based approach). While the vertical approach normally leads to unconditional market access, Zarrilli (2005) argues that the process is a long and laborious one and usually requires significant time and effort. The horizontal ap-

proach, on the other hand, leads to much faster and concrete results. It is this attribute that has led more and more countries to rely on the latter as the basis for their MRAs. South Asian countries would be well advised to follow the horizontal approach. A proposal in this vein has been submitted by India and is under consideration by the CoE.

Any progress on the issue of recognition will require initiatives to be taken simultaneously at three levels (Chanda 2005). The first is to improve the framework for MRAs. The second is to address, more broadly, the entire concept of recognition, such as the assessment of competence and determination of equivalence. The third is to address the operational difficulties facing the South Asian countries in negotiating MRAs, given the well-known institutional, technical and financial constraints, and the difficulties to deal with Mode 4 issues that fall outside the purview of the majority of MRAs. The most common method to achieve recognition has been through bilateral agreements. Article VII of the General Agreement on Trade in Services of the WTO recognizes this as permissible. There are significant differences among SAARC countries in the areas of education and examination standards, experience requirements, regulatory procedures and other related matters. All these make an agreement in the area of mutual recognition, on a multilateral basis, rather difficult. In this regard, it has been suggested that bilateral negotiations would be more effective to deal with key issues of mutual interest.

7. Conclusion

In the preceding sections, an attempt was made to situate the discussion on NTBs in South Asia in the context of cross-country experiences. A number of recommendations based on best practices available with various RTAs have also been put forward. There is now a growing recognition among SAARC member countries that NTBs not only constrain trade expansion within the region but also add tensions to bilateral relations that go beyond trade and commercial aspects and interests. It is, thus, critically important that SAARC members start to apply their collective wisdom to address the attendant issues, taking a long-term view.

This calls for policy initiatives on a number of fronts. First, in many RTAs, some categories of NTBs, particularly those related to SPS and TBT, and health and hygiene concerns, were successfully dealt with by strengthening capacities and putting in place appropriate institutional mechanisms. SAARC member countries should deal with these NTBs in a similar fashion by strengthening domestic capacities of member countries to ensure compliance in the aforesaid areas and by signing MRAs.

Second, there is a need to put in place a mechanism in the SAARC Secretariat for arbitration of NTB-related disputes which would have transparent procedures for selection of panelists, submission of complaints, appeal, remedy and sanctions. Third, many NTBs arise from ambiguities with regard to customs procedures and lack of customs harmonization, and also because of various para-tariffs and surcharges in place. The best solution, as has been found in many RTAs, is a move towards graduation to a customs union. While this can be seen as a medium-term solution, individual SAARC member countries, in the meantime, could address such “perceived NTBs” by gradually moving towards a unified customs code that does away with most para-tariffs and surcharges.

Fourth, investment in trade facilitation has emerged as a key factor in addressing NTBs in South Asia. Indeed, initiatives in the form of development of infrastructure both at and behind the border, better connectivity, and putting in place the required protocols, have emerged as the most effective means to deal with many of the NTBs in the South Asian context. If SAARC member countries are to succeed in enhancing intra-regional trade and cooperation, they will need to get on with the aforesaid tasks on an urgent basis.

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Notes

- ¹ This was mainly done through a positive list approach where particular sectors/items were identified for preferential treatment, with the preference margin ranging from 10 percent to 100 percent of the most-favoured-nation duties.
- ² Members were to have two negative lists: one for LDCs (shorter) and another for developing country members (with additional items). However, not all countries have come up with two lists.
- ³ Originally, the three developing country members were India, Pakistan and Sri Lanka and the five LDC members were Bangladesh, Nepal, Bhutan and the Maldives, which were joined subsequently by Afghanistan. However, in January 2011, the Maldives graduated from the LDC status.
- ⁴ It may be noted here that, in a welcome move, India, the dominant trading partner in SAARC, has offered to accelerate the reduction of its sensitive list

- through periodic reviews. India has taken out 264 items from its sensitive list, which now stands at 480 items. Additionally, India has also allowed tariff rate quota (TRQ) for 164 items (8 million pieces of apparels) to Bangladesh on an autonomous basis. It is also to be noted that in the recent past India agreed to take out an additional 47 items from its sensitive list.
- ⁵ It is to be reckoned that a significant volume of trade in SAARC is conducted through informal channels. While recent data on informal trade are not available, studies conducted in the mid-1990s put the ratio of formal trade to informal trade at 1:1.2.
- ⁶ It may be noted here that trade flows among India, Pakistan, Bangladesh and Sri Lanka account for about 95 percent of intra-South Asia trade of SAARC members.
- ⁷ For example, under a bilateral water protocol signed between Bangladesh and India, Bangladesh allows India to transport goods by waterways up to certain ports in Bangladesh. At present, talks have been initiated between these countries with regard to access of Nepal and Bhutan to global markets through India and allowing India limited connectivity to its northeastern states by extending the remit of the current protocol. During the January 2010 visit of Bangladesh's Prime Minister to India, an agreement was reached to allow India to use Bangladeshi ports of Khulna and Chittagong and allow Nepal and Bhutan to access Bangladeshi ports through India.
- ⁸ The Government of Bangladesh has set up a core group with five sub-committees to study the relevant issues and come up with proposals with regard to possible i) transit routes; ii) transit traffic; iii) stocktaking of key issues; iv) legal issues; and v) economic analysis and transit fees.
- ⁹ For details on NAMA 11, refer to the WTO document TN/MA/W/68/Add.1, available at www.wto.org
- ¹⁰ The CoE was constituted as per Article 10 of the SAFTA agreement. The CoE is mandated to review all NTBs and to recommend elimination of such measures or implementation of such measures in the least trade-restrictive manner to facilitate intra-SAARC trade.
- ¹¹ These include cement, sugar, biscuits, skimmed milk power, vegetables, textile fabrics, jute, etc.
- ¹² This was done during the 13th SAARC Summit in Dhaka in November 2005. The Agreement has been ratified by all countries.
- ¹³ For example, in India there are state taxes as well as cess (education cess at 4 percent) and other taxes.
- ¹⁴ Member countries (in this case, for example, India) argue that items coming from other states, when they enter the particular state, have to pay similar duties.
- ¹⁵ Indeed, India has offered, and Bangladesh has accepted, the signing of framework agreement on mutual recognition.
- ¹⁶ This is important in view of the fact that in the past it has been seen that countries have developed border facilities, particularly land ports, along one border point, while in the other country land port facilities were developed in another border point. Bangladesh and India are good examples of such type of coordination.

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Chapter 5

Services trade in South Asia: Contours of liberalization and modalities in SAFTA

Rajan Sudesh Ratna

1. Introduction

The present world economy is dominated by the services sector. According to the United Nations Conference on Trade and Development (UNCTAD), during 1990 to 2005, the share of services in the gross domestic product (GDP) of developed countries increased from 65 percent to 72 percent. During the same period, developing countries saw the contribution of services to GDP increase from 45 percent to 52 percent. Over the last few years, many countries in the world have liberalized their economies to integrate into the world market. This has been on account of their Uruguay Round Commitments in the World Trade Organization (WTO) in the 1990s and their active participation in regional trade agreements (RTAs) in the 2000s. In that course, the services sector has become very important for their long-term development strategies.

RTAs are proliferating rapidly in the present global trading system. Currently, nearly every country in the world is a member of one or more

RTAs. According to the WTO's estimate, the total number of RTAs, including both notified or otherwise, were more than 300 in 2005, and trade between RTA partners was estimated by the World Bank (2005) to be around 40 percent of total world trade.

Every major RTA has a services dimension. Inclusion of services in RTAs gained momentum after its inclusion in the North American Free Trade Area (NAFTA) in 1994 and thereafter Mexico's agreements in services (based on the NAFTA model) with Latin American countries. In the Asia-Pacific region, Australia and New Zealand signed a Closer Economic Relations Trade Agreement in 1986 that included services trade. Similarly, in 1997, the Association of Southeast Asian Nations (ASEAN) Framework Agreement on Services was signed. Now there are several RTAs among developing countries which have included services in the agreements.

2. General Agreement on Trade in Services: History and framework

Before 1995, there were no multilateral disciplines or rules for trade in services. This was mainly due to the lack of knowledge about services trade as well as the fact that while national statistical agencies captured data on goods trade, detailed trade statistics on services trade were never captured. In the late 1970s, private sector groups engaged in the services sector in the United Kingdom (UK) and the United States (US) started lobbying with their governments for a more level playing field in accessing foreign markets.

There was reluctance, initially, on an agreement to begin negotiations on services trade under the Uruguay Round. But after rounds of discussions, it was finally agreed that services trade would be a part of the negotiations. These early initiatives by services firms ultimately resulted in the inclusion of international services transactions in the Uruguay Round by putting in place the General Agreement on Trade in Services (GATS) under the WTO.¹

At the heart of GATS is a commitment (stated in the preamble) to "securing an overall balance of rights and obligations". Central to that balance is the recognition that members have the right to regulate the supply of services within their territories as long as the measures used are administered in a reasonable, objective and impartial manner and are not trade-distorting in their impact. Additionally, members are given the right to define and pursue their own national policy and economic development objectives as long as those objectives do not interfere with the multilateral obligations they have undertaken.

Depending on the territorial presence of the supplier and the consumer at the time of the transaction, GATS covers four Modes of services delivery (Box 5.1).

Box 5.1: The four modes of supply of services

Mode 1: Cross-border supply

Service crosses the border, independent of the supplier or the consumer. Examples include services provided through telecommunications or postal infrastructure, consultancy or market research, tele-medicine, distance education, etc.

Mode 2: Consumption abroad

Consumer crosses the border and consumes the service in another country. Examples include hotel or restaurant services for non-residents, training programmes for foreign students and health services provided to non-residents. Movement of a consumer's property (e.g., sending a ship or other equipment abroad for repair) is also covered by this Mode.

Mode 3: Commercial presence

Supplier of the service is a locally established affiliate, subsidiary or representative office of a non-resident service supplier, which may employ local personnel, be incorporated under local laws, etc. While the actual service provision is by a "resident", the investor is of foreign origin. Examples include local offices of multinational services firms and offices for infrastructure projects.

Mode 4: Movement of natural persons

Supplier of the service moves to another country on a temporary basis and remains a non-resident. Examples include independent services suppliers (e.g., individual consultants, health workers) or employees of a services supplier of foreign origin.

Source: www.wto.org

3. Classification of services

GATS covers all commercially traded services in any sector except those supplied in the exercise of governmental authority. It includes services whether or not they are supplied on a commercial basis or in the presence or absence of domestic competition. For purposes of discussion and scheduling, the WTO Secretariat has divided services into the following 12 sectors:

- Business (including professional and computer services);
- Communications;
- Construction and engineering;
- Distribution;
- Education;
- Environment;

- Finance (including insurance and banking);
- Health;
- Tourism and travel;
- Recreation, cultural and sporting services;
- Transportation services; and
- Other services not included elsewhere.

These 12 sectors are further divided into 155 sub-sectors. GATS addresses both the service and the service supplier. For the initial agreement, the scope of GATS is wide; however, there are some areas which are not yet covered and can impact service providers. These relate to immigration rules that mostly apply to temporary entry, fiscal policy and taxation measures, exchange rate management, etc.

4. Difference in trade in goods and trade in services

Market structure for services trade differs from that for goods trade. Unlike goods trade, trade in services is slightly more complex. While trade in goods takes place on tangible items, the same does not happen in the case of services. In some cases, services trade is embodied in goods trade (e.g., music or video on CD or DVD, software programme on CD or DVD, etc.). Historically, a number of services have been provided for the public good by the government, e.g., transportation, telecommunications, postal services, banking, insurance and reinsurance, health care, education, etc. Many services provided by the private sector are heavily regulated, often at the sub-federal level. Therefore, constraints to services trade were due as much to domestic regulatory environments as to trade policies. For a number of service providers (particularly in the professional services sector), it was easier to export services than it was to provide those services in other parts of their own country owing to regulatory restrictions.

As trade negotiators became more familiar with services trade issues, it was apparent that some key principles that had guided the liberalization of goods trade were applicable also to services, e.g., transparency, most-favoured-nation (MFN) treatment, non-discrimination and national treatment. However, they also noted some differences. First, they realized that even if non-discrimination were practised, there could still be structural barriers to market access (e.g., limits on the number of suppliers allowed). Therefore, they needed to introduce the market access principle into any agreement on services. Second, one of the basic mechanisms for liberalizing goods trade was the negotiation of schedules for reducing tariffs. While reductions in non-tariff barriers were

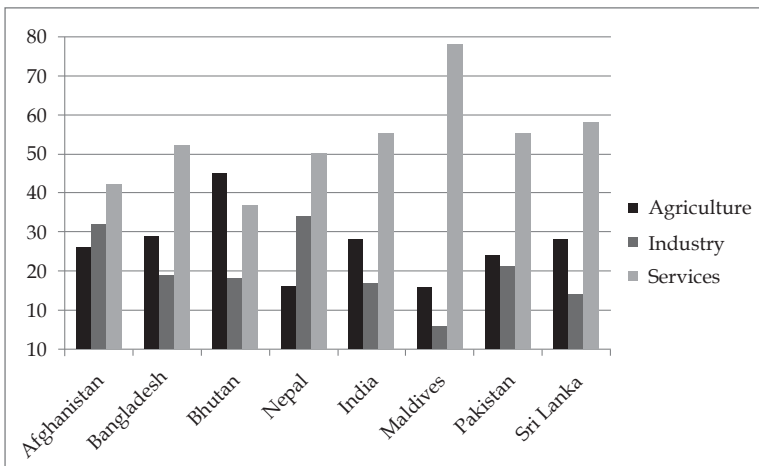
also important, tariff concessions were central to trade agreements. But for services trade, the reverse was true. The primary constraints to be negotiated for the liberalization of services trade were non-tariff barriers, which did not apply equally to all modes of supply.

5. Economic importance of services for South Asia

With an average growth rate of over 8 percent per annum sustained over the past five years, South Asia has emerged as one of the most dynamic regions in the world. The services sector has played an important part in this dynamism as is evident from the sector's contribution to over a half of South Asia's GDP and a third of its employment. In terms of contribution to GDP, the services sector has overtaken industries and agriculture, which used to be the major contributors, in almost all countries of South Asia (Figure 5.1).

With the exception of Afghanistan and Bhutan, the share of services in GDP of all SAARC members is more than 50 percent. However, in terms of its contribution to total trade, it still lags behind other sectors in most of the countries in the region. It is only India, and some of the countries where tourism is a vital economic sector, that services trade has also contributed immensely to total trade.

Figure 5.1: Contribution of agriculture, industry and services to GDP in South Asian countries (2009*)



* 2008 for Afghanistan and Maldives.

Source: www.wto.org

India's exports are driven by other commercial services, which, in 2008, accounted for 77 percent of the total commercial services exports. Over recent years, India has become a leading business process outsourcing destination (WTO 2011). One of the reasons for the changing composition of trade in services emanates from the fact that liberalization of trade in services is increasingly taking place in many SAARC countries. Sectors such as higher education, health, and banking and insurance, which were mainly under state monopolies in most of these countries, are gradually being liberalized. Increased tradability of services due to technological advancement is also an important factor in increasing the trade volumes of the region.

Several studies have pointed out the benefits that SAARC members can reap from the liberalization of services. ADB and UNCTAD (2008) have found that trade liberalizing policies with respect to services in SAARC members provide a more favourable environment for regional integration in services compared with that for goods.

6. Services in SAARC: A chronology

The importance of services, especially tourism, in the SAARC region was recognized in the 10th SAARC Summit held in Colombo on 29–31 July 1998. The 13th SAARC Summit held in Dhaka on 12–13 November 2005 recognized the potential of trade in services and decided to conduct a study to see how services could be integrated into the SAFTA process. The First Meeting of the SAFTA Ministerial Council that took place in Dhaka on 20 April 2006 approved the course of action including a completion of study on services in a time-bound manner. Subsequently, the Second Meeting of the SAFTA Ministerial Council held in Kathmandu on 26 February 2007 approved the recommendations of the SAFTA Committee of Experts and directed the SAARC Secretariat to ensure that the study on trade in services should be WTO-compliant, and WTO-plus.

Subsequently, the 14th SAARC Summit held in New Delhi on 3–4 April 2007 agreed to the vision of a South Asian community, where there was smooth flow of goods, services, peoples, technologies, knowledge, capital, culture and ideas in the region. The SAARC leaders stressed that to realize its full potential, SAFTA should integrate trade in services. Consequently, they called for the finalization of an agreement in services trade at the earliest.

The Third Meeting of the SAFTA Committee of Experts held in New Delhi on 1–2 March 2008 took note of the revised regional study conducted by the Research and Information System for Developing Coun-

tries (RIS), New Delhi. Subsequently, the Third Meeting of the SAFTA Ministerial Council held in New Delhi on 3 March 2008 considered the Study on Potential of Trade in Services under SAFTA, including the recommendations of the Third Meeting of the SAFTA Committee of Experts, and recommended that RIS be requested to draft a SAARC Framework Agreement on Trade in Services (SAFAS) by 30 June 2008. It also decided to constitute an Expert Group by 30 June 2008 to commence negotiation on the Framework Agreement on Trade in Services.

The 15th SAARC Summit held in Colombo on 2–3 August 2008 expressed satisfaction on the conclusion of the Study on Trade in Services and welcomed the decision of the SAFTA Ministerial Council to commence negotiation on the Framework Agreement on Trade in Services. Towards achieving further economic integration, they also directed that the Draft Agreement on Investment Promotion and Protection be finalized early and the SAARC Arbitration Council be operationalized.

7. Important studies on services in SAARC

Several studies have argued in favour of including services within the ambit of SAFTA. Panchamukhi (1988) has suggested that SAARC members are more homogeneous than those of ASEAN, and therefore, it would be plausible to have SAFTA cover services trade. Chanda (2005) has argued that South Asia's trade interests in the services sector are driven by its factor endowments, with export interests in the area of labour-intensive and human resource-based services, and import interests in the area of capital- and technology-intensive services. Ratna and Sidhu (2007) and Ratna (2011) have recommended that SAFTA must swiftly move towards deeper integration that characterizes most recently emerging RTAs by incorporating services, adopting a blueprint for a SAARC Investment Area and enacting agreements/protocols for trade and investment facilitation. Banga (2009) has found that South Asian countries have a competitive edge in different categories of services.

The following section discusses a few other studies and publications that are important regarding their coverage of services trade in SAARC.

7.1 Study on potential for trade in services under SAFTA

In view of the decision of the SAARC Summit in 2007, a Study on Potential for Trade in Services under SAFTA Agreement was launched within the framework of the SAARC Network of Researchers on Global Financial and Economic Issues with RIS, New Delhi, as the Coordina-

tor. Country studies were to be prepared by designated national focal points with the support of the Asian Development Bank (ADB). The terms of reference for the study, as finalized by the inception workshop, were as follows:

- Importance of the services sector in SAARC economies, and trade and sectoral composition; regulatory regimes and patterns of liberalization autonomously as well as under GATS commitments.
- Logic and imperatives of regional cooperation on trade in services under SAARC, including complementarities, and a review of ongoing attempts for liberalization at bilateral levels.
- Potential for services trade expansion in the SAARC region, including identification of select sectors of high importance and implications of trade liberalization.
- Identification of intra-SAARC barriers and constraints on services trade, including domestic regulations in selected sectors.
- Recommendations on the approaches for a possible framework for a GATS-consistent and GATS-plus intra-regional arrangement for trade in services, and suggestions on devising policy-instruments to address the prevailing barriers and constraints, including possibilities of evolving mutual recognition arrangements (MRAs), exchange of experiences and liberalization of trade.

The study summarized the importance of the services sector in the SAARC economies and examined the potential of trade in services in the region in view of their complementarities. It also looked into the potential of mutual trade in select services sectors. It examined the patterns of services trade liberalization undertaken by SAARC countries unilaterally and under their GATS commitments, and highlighted the regulations that could act as barriers. It also discussed the relevance of services trade liberalization in terms of the benefits and costs that such liberalization would entail, and listed some sectors of high-priority as identified by the country studies. Some of those high priority sectors included tourism, transport, information technology (IT), IT-enabled services and telecom, energy, education, health, and financial services.

The study proposed to follow a positive list approach to enable progressive, sequential liberalization, and provide special and differential treatment to LDCs as recognized in SAFTA. It recommended that the South Asian countries need to take steps to specialize in those services sectors in which they have the potential to expand in the domestic market as well as build their export capacity. Integration of services markets in the SAARC region may also assist countries in specializing in certain services sectors and strengthening the competitiveness of their services industry.

Finally, the study recommended that the most relevant approach to include services under SAFTA is to move ahead with SAFAS as an adjunct to SAFTA. SAFAS could provide a framework for all SAARC members to mutually benefit from services trade liberalization in a progressive manner, keeping in view the development policy objectives of all member countries. It also outlined the institutional mechanisms and implementation arrangements for such an agreement.

7.2 Quantification of benefits from economic cooperation in South Asia

This was a study jointly undertaken by the ADB and UNCTAD in 2008. The major objective of the study was to provide an in-depth assessment of the changes induced by SAFTA on South Asian countries individually and on the South Asia region as a whole. Among other things, the study has identified sectoral and modal comparative advantages in services trade of each member country and has determined the extent to which complementarities exist. The study also conducted a detailed analysis for the identified services sectors—health and related services, higher education, construction and related services, travel and tourism related services, and telecommunication services—and the possibility of MRAs.

The study has argued that given the faster growth in services in almost all South Asian countries, they have an opportunity to reap more benefits of liberalization by including services in SAFTA. Education and health, being part of the social infrastructure, and construction and telecommunications, being part of basic infrastructure, are fundamental to the overall growth of South Asian economies. While the state of development of these sectors is certainly at different stages in member countries, in view of the existing complementarities, the study has strongly argued that SAFTA member countries urgently need to expand the scope of SAFTA by including at least these identified five services sectors. It has also pointed out that these countries ought to make wider and deeper commitments than under the GATS. Further, the study has observed that South Asian countries have a competitive edge in different categories of services. In transport services, Pakistan and Sri Lanka have competitive advantage, while India has a competitive advantage in construction services, computer and information services and other commercial services. The Maldives and Nepal are more competitive in travel services while Bangladesh has a higher competitive edge in financial services. It has concluded that construction, education, tourism and health services hold special significance both from export and import interests.

7.3 Trade in services in South Asia

This book, which is a compilation of different papers and is edited by Kelegama (2009), has identified the impediments to services trade in South Asia and dealt comprehensively with issues ranging from economic cooperation, both at the governmental and private sector levels, to the need for collaboration at the political level. It has done so by examining the political economy factors in the region. An important contribution of the volume is that it has given the private sector's perspectives regarding regional integration and the role of services in South Asia.

The fact that South Asia will immensely benefit from regional cooperation is well recognized at all levels; however, this volume has delved into the many policy and institutional constraints that have contributed to the present state to make South Asia one of the least integrated regions of the world. The volume has also warned that liberalization of services in South Asia without proper regulatory mechanisms in place can be costly and has to be avoided.

8. SAARC Agreement on Trade in Services

During the 16th SAARC Summit held in Thimphu, Bhutan in April 2010, SAARC leaders signed the SAARC Agreement on Trade in Services (SATIS). The objectives of SATIS are to promote and enhance trade in services among SAARC members in a mutually beneficial and equitable manner by establishing a framework for liberalizing and promoting services trade within the region in accordance with Article V of GATS.

The Agreement provides that negotiations for schedules of specific commitments shall take place keeping in view national policy objectives, and the level of development and the size of economies of members, both overall and in individual sectors. It further states that the Agreement shall progressively cover liberalization of services trade with broad-based and deeper coverage of the majority of services sectors/sub-sectors with a view to fulfilling the objectives of Article V of GATS, and that a positive list approach for liberalizing the services sectors will be followed. It also provides that the negotiations for specific commitments for progressive liberalization would be based on a "request and offer" approach.

SATIS is mostly based on the structure of GATS. As in the case of GATS, services related to government procurement are out of the purview of SATIS. Similarly, provisions relating to safeguard action, restrictions to safeguard balance of payments, and general and security

exceptions also form part of this Agreement. SATIS does not apply to subsidies or grants, or to any conditions attached to the receipt or continued receipt of such subsidies or grants, whether or not such subsidies or grants are offered exclusively to domestic services, service consumers or service suppliers. It also provides for having recognition agreements and identified areas of cooperation, including development of regulatory capacity, among others. Special and differential treatment for the LDC members has also been built in the Agreement.

9. Future road map

Despite the commitments made at various levels, including at a number of SAARC Summits to include services in SAFTA, the signing of SATIS took a long time. SAARC members should realize that liberalization of services under SATIS has to be done in a time-bound manner.

It is encouraging to note that negotiations on schedules of specific commitments under SATIS have already started; now they should continue uninterrupted. The commitments should be additional to what the members have committed under GATS or else there will be no meaning of regional integration. Since several studies have identified the strength(s) of each South Asian country in specific services sectors, members should take note of these studies and liberalize the sectors of their interests. Members should also cooperate in building the capacity of other members in the sectors in which they are less competitive.

Although the “positive list” and “request and offer” approaches have several limitations, most of the SAARC members are familiar with the process due to their exposure to the process under GATS in the WTO. Hence, the same approach can be followed under SATIS. This would also enable SAARC members to successfully negotiate the commitments within the agreed time frame.

10. Challenges ahead

Deepening integration among SAARC members by including services in SAFTA is much desirable for regional prosperity and development; however, the path to such integration is not easy. Despite the existence of complementarities in several services sectors, there are a number of issues that need to be addressed as conflicting and varied interests in some other sectors may impede this effort.

In the process of liberalizing services, each country will be required to make commitments to liberalize their sectors in different Modes. However, the preparedness of members, especially the LDCs, to iden-

tify their offensive and defensive interests under SATIS is lacking. They have also not fully understood the implications of committing liberalization in services. Another challenge that SAARC members would face relate to their commitments under GATS and the need to commit even more under SATIS. For those members that have already committed to the maximum extent possible to liberalize their services sectors under GATS, it might be a challenge to liberalize more under SATIS. And without doing so, there will not be any meaningful liberalization and effective preferential market access.

SAARC members are at various stages of economic development. Therefore, their level of ambition must be realistic. At the same time, it is equally important that effective domestic regulations are put in place. An effective but simple regulatory regime is an essential prerequisite for services liberalization. Unfortunately, very little work has been done in this area. How individual members address this issue will be important for their long-term developmental goals.

One of the historical features of SAFTA has been constant interruptions in the progress of liberalization for regional welfare and development. Most of the time, national interests or bilateral relations have prevailed over the regional vision or goal. Unlike trade in goods, most of the benefits in services trade will not come with a bilateral trade focus. Countries need to follow a fast-track approach to conclude MRAs for facilitating services trade.

Given the nature of geographical boundary and porous borders, any liberalization in Mode 4 will have to be pragmatic and affordable. In recent times, many security issues have been raised worldwide on the movement of natural persons, which is applicable in the case of SAARC also. It is likely and understandable that smaller economies in the region may demand market access in Mode 4 and the bigger economies may demand market access in Mode 3. Resolving such complex issues on the negotiating table is going to be a difficult task.

One major challenge that SAARC members will be facing relate to lack of detailed and reliable services trade data. No member has detailed disaggregated data and hence no impact assessment—whether *ex ante* or *ex post*—can be conducted. Therefore, a larger question that looms ahead is how members would take trade remedial actions if domestic industry would be hurt due to preferential market access.

11. Conclusion

Liberalization of services under SATIS is going to have both positive and negative impacts. While countries can reap the benefits of services

liberalization in sectors of their comparative advantage, they would also have to face competition in sectors in which others are competitive. However, given the historical background of South Asia, there is a strong case for the inclusion of services in SAFTA. Since most countries participating in SATIS are smaller in size, there could be quick benefits of liberalization. At the same time, the real or perceived risks of services liberalization would be checked and verified quickly in the regional context. The risks are much less than if the members have to take equivalent commitments at the WTO—with a much larger number of countries. Nevertheless, it should be noted that the smaller countries would need the support of larger countries to overcome their supply constraints apart from gaining market access for their exports.

Services trade is also linked to foreign direct investment. Hence, services liberalization will offer significant investment opportunities in the region. Given the fact that the services sector is growing faster than agriculture and manufacturing in the region, it is essential that the ongoing regional integration process encompasses the sector. In view of the comparative advantage that this region has in the services sector, it is expected that the integration of services in SAFTA will provide further momentum for growth and will help sustain that.

Note

- ¹ The Uruguay Round was a historic series of trade negotiations covering not only further liberalization of goods trade but also the establishment of frameworks for liberalizing trade in services, investment measures and trade-related intellectual property rights. When the Round was launched in Punta del Este (Uruguay) in September 1986, it was assumed that the outcome would be a broadening of the framework of the existing General Agreement on Tariffs and Trade (GATT). The Round concluded in Marrakesh (Morocco) in April 1994, with the formation of the World Trade Organization (WTO) which covered the revised General Agreement on Tariffs and Trade (GATT) 1994 that covered trade in goods, the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

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PART

3

**REGIONAL
CONNECTIVITY AND
TRADE FACILITATION**

Chapter 6

Air services liberalization in South Asia

Anushka Wijesinha

1. Background

The mutual interdependence between regional economic integration and transport connectivity is clear. Transport connectivity is necessary for increased exchange of goods and people-to-people connections, which would, in turn, stimulate investments and business transactions. At the same time, transport linkages will not materialize in a substantial manner unless there is a certain degree of regional integration. Therefore, these two factors are interdependent and mutually reinforcing. It has long been recognized that South Asia is one of the least economically integrated regions in the world, with intra-regional trade stagnating at around 5 percent of the region's global trade. At the same time, transport connectivity in the region is also weak, characterized by a lack of direct capital-to-capital connectivity in many cases.¹ Accordingly, in order to travel between these cities, it is necessary to transit in the Middle East (usually Dubai or Doha) or Southeast Asia (Singapore or Thailand), increasing both cost and time of travel. These limitations in intra-regional connectivity undermine the potential for interaction of traders and investors to engage in business transactions.

In this context, it is important to identify the factors that contribute to limiting connectivity, particularly air connectivity, in the region. Global air services are among the most restricted and regulated sectors of international exchange. This is influenced by the fact that the beneficiaries of liberalization are numerous and fragmented, and receive relatively small marginal benefits, while the losers are large, usually politically influential industries such as entrenched domestic airline monopolies. International air services have long been governed by a complex matrix of Bilateral Air Services Agreements (BASAs), which specify limitations on air traffic rights, number of airlines allowed to operate, methods on setting capacity on a route, and tariffs and destinations that can be operated on flights between two countries. Air Services Agreements (ASAs) are notoriously opaque, with many provisions not being available for public consumption due to confidentiality clauses.

In recent years, as a result of bilateral negotiations, ASAs have become more flexible and liberal on the global scale, but in South Asia they still remain relatively restrictive. Countries in the Organisation for Economic Co-operation and Development (OECD) have made substantial headway over the last two decades in liberalizing market access and ownership. A few examples in that regard are the pioneering United States (US) domestic deregulation of 1978, the Australia-New Zealand Single Aviation Market Arrangement of 1996, and the European Single Aviation Market completed in 1997. Moreover, in the last two decades, over 85 “open skies” BASAs providing full market access without restrictions on designation, traffic rights, capacity, frequency, tariffs or code sharing have been completed by around 70 countries (Findlay and Goldstein 2004).

Although the current level of air transport activity in South Asia is only a fraction of what exists in other regions, for example in Southeast Asia, there are strong prospects for future growth. Hence, the key objective of this article is to identify the factors which inhibit air connectivity in South Asia, and to suggest policy measures that could lead to greater air connectivity.

2. Economic benefits of air services liberalization

The economic impact of the aviation sector, in general, is strong and pervasive. It contributes about US\$700 billion to the global tourism industry and to the logistics industry. The industry also has a catalytic economic impact as improved aviation connectivity can contribute to higher national productivity by enhancing access to markets, enhancing communications and interactions between and within firms, and

providing access to a larger labour/talent pool (Tretheway 2010). In a panel regression study covering 48 countries over nine years, Tretheway (2010) finds that a 10 percent increase in aviation connectivity² per US\$1 billion of gross domestic product (GDP) increases labour productivity by 0.07 percent.³

Recent history has shown that the economic benefits of liberalized regional air services agreements are substantial and compelling. It is no coincidence that the most developed economic regions in the world enjoy liberal air services markets. Nations have long since recognized that BASAs stifle regional progress, and steadily push for those agreements to be replaced by liberal multilateral agreements. The US was the first to initiate liberalization of air travel, closely followed by the European Union (EU). In 1997, the Association of Southeast Asian Nations (ASEAN), inspired by successes in the US and the EU, took significant steps to liberalize regional air travel (Tham 2008).

It may be argued that the rapid worldwide growth in air traffic over the last few decades is due to the removal of air services restrictions within economic regions. Accelerated development of air services (through the removal of restrictions) was prompted by the growing development in global and regional production networks and the advent of Just-in-Time (JIT) logistics (Tham 2008). These networks and processes required strong support services, such as air travel. Further, the growth in tourism and trade in newly industrialized and emerging markets necessitated speedy civil transport services. Regarding the different benefits that relaxation of air services regulations could bring to South Asia, three key areas are identified and discussed below.

2.1 Creation of aviation industry jobs

As stated previously, liberalization of air services stimulates growth, which subsequently creates more jobs in the industry. This, in turn, will have a catalytic effect on the economy as a whole (discussed later). The expansionary effect of liberalization (of air services) is best illustrated through a graphical presentation by Button and Drexler (adapted by Grancay 2009). In his illustration, Grancay compares the effects of liberalization on supply and demand within the air services market, both at present, and in the future.

According to Balaz and Williams (2006), within the EU, the overall number of employees in civil aviation increased from 435,000 to 489,700 after liberalization in the period 1988 to 1996. Liberalization, which creates increased air services, results in the creation of new airlines, branch offices and airports. The new jobs created necessarily include flight

crews, administrative staff and ground handling staff. For example, the easing of the restrictive Bermuda II agreement between the United Kingdom (UK) and the US resulted in the creation of just over 25,000 jobs in the US and the UK by 2004 (InterVISTAS 2006 cited in Grancay 2009).

In the long-term, liberalization will have a catalytic effect (discussed below), creating more trade and jobs, which results in economies of scale. These economies of scale will create a new price at the predicted equilibrium point. This phenomenon can also be illustrated as a chain as presented in Figure 6.1.

Figure 6.1: Impact chain of aviation liberalization



Source: InterVISTAS (2006) cited in Grancay (2009).

2.2 Trade and economic growth

Removal of air services restrictions opens up new destinations and creates more frequencies and better flight connections, which result in new markets for international businesses (Grancay 2009). Piermartini and Rousova (2008) have found that trade development is positively correlated with increase in international air passenger transport. They state that passenger transport is important for trade because travel is necessary to set up and maintain long distance business relationships. Relaxation of restrictions and falling costs encourage travel, which expedite business negotiations and stimulates investment and commercial transactions in the long run. Ease of travel also encourages greater people-to-people connectivity, which has indirect implications for stimulating regional cooperation and commerce. All these factors are of particular significance in the SAARC region.

Additionally, more comprehensive and cost-efficient air connectivity complements and catalyses global and regional value chain development. Global value chains have transformed international production fragmentation worldwide, and firms are increasingly adopting new strategies of vertical integration and vertical specialization. Better air services connectivity intra-regionally, as well as between this region and others, would help South Asian firms better integrate into “global production networks”.

Also, large multinational corporations treat proximity to airports as an important criterion in deciding where to invest (Grancay 2009). They also consider flight routes and flight costs to and from a particular territory before making their investment decisions. Hence, by increasing flight frequencies and giving consumers greater choice in flight routes and travel packages, liberalization of air travel will encourage multinational firms to invest in the region.

However, the benefits should not only be looked at from an investment point of view. Air transport also enables businesses achieve higher efficiency through exploiting economies of scale (Grancay 2009). Developments in air travel help strengthen destination networks, which in turn facilitate JIT processes, resulting in diminished warehousing costs. Further, ease of travel allows for freer transfer of human resource across the region and provides companies access to the best human resource.

Finally, liberalization of air services paves way for changes in market structures (Grancay 2009). Producers and buyers get access to foreign markets; transport becomes more cost-efficient and administrative processing is minimized, thus changing market dynamics and increasing competition.

2.3 Tourism

Tourism is an economic driver for many developing regions, and South Asia is no exception. Tourism makes a significant contribution to the South Asian GDP, and is one of the top foreign exchange earners for the smaller nations in the region. The industry is entirely dependent on the discretionary spending of travellers, and, therefore, ease of travel will factor heavily in the traveller's decision on whether to patronize a particular tourist destination. This relationship between tourism and development of air services was recognized and established by Piermartini and Rousova (2008) using a gravity type model. They believe the development of air services is essential for the tourism sector, especially for remote locations.

South Asia would also benefit by promoting tourism in a regional manner, drawing on the vast diversity of attractions in the region, enabling the promotion of a unique product with several complementary facades. However, to make such options a reality, it is essential that travel within the region can occur in a simple, timely and cost-effective manner. This is far from reality today. It should be noted that tourism was a key reason why ASEAN nations included air services as an area for development in the Action Plan for Transport and Communication in 1997.

3. Background to air services regulations

Given the technical nature of the subject, it would be useful at this stage to provide a background of the nature of regulation of the global air services industry.

Civil aviation services for passenger and goods transport have always constituted a *sui generis* market, possibly with the exception of the pioneering days when entry to global air services was essentially unrestricted. Some core characteristics distinguish the civil aviation market from the others, and they include⁴:

- Dominance of state-ownership of airlines, except in the US and the UK.
- High degree of immunity from competition laws, partly on grounds of national security and national pride.
- Rigid controls on market entry, capacity and tariffs regarding size of investment needed and the presence of network externalities.
- Existence of an international regime with specific international organizations and institutions.
- High degree of vertical integration, with *de jure* or *de facto* control and ownership links between physical infrastructure and air and ground-handling services.

As mentioned in the introduction, global air services are regulated by a mesh of BASAs between individual countries. These ASAs detail regulatory provisions governing a number of issues (Table 6.1).

Among the most important of these regulations is the grant of rights. There are various degrees of rights which determine the openness of the ASA in question (Box 6.1).

The grant of 1st freedom right through 4th freedom right are standard in any ASA, but the extent of provision of rights from the 5th freedom and beyond is what influences the extent of liberalization in an ASA.

4. Air services agreements in South Asia

This article specifically looks at the status of air connectivity among five major economies in the SAARC region, namely, India, Pakistan, Sri Lanka, Bangladesh and Nepal. We begin with an assessment of the restrictiveness of the ASAs that operate within this region using an index created by the WTO. Based on the Quantitative Air Services Agreements Review (QUASAR), the WTO secretariat has developed a scoring system that rates the openness of different ASAs in the world. The scoring structure of this Air Services Liberalization Index (ALI) selects key



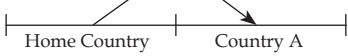
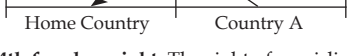




Table 6.1: Features of ASAs that restrict air services

Restriction	Description
Grant of rights	Defines the rights of carriers to provide air services between two countries, such as 5th freedom right (transport of freight/passengers of two countries by an airline of a third country, with the flight originating/terminating in the home country of the airline); 7th freedom right (allows an airline to carry passengers between two countries with no connection to the airline's home country); and cabotage (allows an airline to carry passengers within a country with origin/termination in the home country of the airline).
Capacity	Refers to restrictions on volume of traffic, frequency of service and aircraft types. Pre-determination requires that capacity is agreed prior to the commencement of service; Bermuda I regime gives limited right to the airlines to set their capacities without a prior governmental approval and free determination leaves the capacity determination out of regulatory control.
Tariff approval	Regulates the regime of price determination. Ranges from dual approval, whereby both parties have to approve the tariff before this can be applied, to free pricing, when prices are not subject to the approval by any party.
Withholding	Defines restrictions on the ownership of the foreign airline operating in the country with whom the agreement stands. The most restrictive of these requires the airline to be the flag carrier of the partner country. More liberal regimes include community of interests (where country can designate airlines) and principal place of business removes the requirement for substantial ownership.
Designation	Defines the number of points between which airlines can operate between the two countries in question.
Cooperative agreements	Regulates the freedom of airlines to enter into code-sharing and alliance formation.
Exchange of statistics	Requirement of airlines to disclose statistics to governments enabling the latter to monitor changes in traffic and other areas. This is, in general, perceived as a restrictive feature.

Source: Author's compilation.

features of BASAs that affect air traffic and gives scores according to the degree of liberalization of each feature, i.e., designation, withholding⁵, tariffs, capacity, traffic rights, absence of exchange of statistics, allowance of cooperative arrangements (e.g., dual approval of tariffs, a very restrictive provision, is attributed zero points, whereas free pricing, the most liberal of the tariff provisions, is given eight points). The ALI has four different rating schemes, each providing a different weight to a particular feature of restrictiveness that may be particularly influential

Box 6.1: Air freedom rights


1st freedom right: The right of an airline of one country to fly over the territory of another country without landing.

2nd freedom right: The right of an airline of one country to land in another country for non-traffic reasons, such as maintenance or refuelling, while en route to another country.

3rd freedom right: The right of an airline to carry freight and passengers from the home country (country of registry) to another country.

4th freedom right: The right of an airline to carry freight and passengers to the home country from another country.

5th freedom right: The right of an airline of one country to carry freight and passengers between two countries outside of its own country, with origin/destination in its home country.

6th freedom right: The right of an airline of one country to carry freight and passengers between two countries on two routes via its home country (combination of 3rd and 4th freedoms).

7th freedom right: The right of an airline to operate stand-alone services entirely outside the territory of its home country, to carry freight and passengers between two foreign countries (on a route with no connection in its home country).

8th freedom right or Cabotage: The right of an airline to carry freight and passengers between two points within the territory of a foreign country (on a route with origin/destination in its home country).

Source: Second Review of the Air Transport Annex, www.wto.org

depending on the nature of an ASA. The first scheme is a standard ALI, the second provides additional weight to the provision of the 5th freedom right, the third gives additional weight to ownership (withholding) and the fourth gives extra weight to the designation clause. We use this to generate ALI ratings for the ASAs that operate in South Asia (Table 6.2), for which data are available.

Table 6.2: Air services liberalization indices of South Asian BASAs

Bilateral ASA	ALI Standard	ALI 5+	ALI O+	ALI D+	Type
Sri Lanka-Pakistan	8	13.5	6.5	7	i
Sri Lanka-India	6	12	5	5.5	c
Bangladesh-India	10	15.5	8.5	13	e
Bangladesh-Nepal	6	12	5	5.5	c
Pakistan-Nepal	6	12	5	5.5	c

Notes: i = incomplete data; c = 3rd, 4th and 5th freedom rights, double approval of tariffs, single designation, substantial ownership and effective control, pre-determination of capacity; e = 3rd, 4th and 5th freedom rights, double approval of tariffs, multiple designation, substantial ownership and effective control, pre-determination of capacity.

Source: WTO Air Services Liberalization Analytical Tool, www.wto.org

The maximum ALI score that is possible is 50, and this applies to all four different scoring schemes in the above table. From this perspective, it appears that South Asian ASAs are very restrictive, with the highest ALI (standard) being 10. However, as mentioned earlier, most ASAs that operate globally remain somewhat restrictive, and therefore, one finds that even the most liberal of the ASAs do not score very high (Table 6.3).

Table 6.3: Weighted Air Services Liberalization Index (WALI) of high-traffic BASAs

ASAs concerned	WALI
Top 67 ASAs	16.6
Top 100 ASAs	16.1
Top 200 ASAs	15.4
All QUASAR ASAs (1970)	14.0

Source: www.wto.org

Nonetheless, it is clear that South Asian ASAs are even more restrictive than average ASAs that operate globally. South Asian countries are relatively more liberal in terms of BASAs with third parties than within the region (Table 6.4).

Table 6.4: ASAs between South Asian and select extra-regional countries⁶

Country	Singapore				Japan				UK			
	St	5+	O+	D+	St	5+	O+	D+	St	5+	O+	D+
Sri Lanka	14	19	12	16.5	10	15.5	8.5	13	14	12	12	16.5
India	10	15.5	8.5	13	12	17	10	14.5	10	15.5	8.5	13
Pakistan	14	19	12	16.5	-	-	-	-	14	12	12	16.5
Nepal	17	21.5	14.5	15.5	10	15.5	8.5	13	8	7	7	11
Bangladesh	10	15.5	8.5	9	6	12	5	5.5	-	-	-	-

Source: WTO Air Services Liberalization Analytical Tool, www.wto.org

Thus, the restrictiveness of BASAs in South Asia could potentially be an important determinant of limited connectivity in the region. We now examine the extent to which the region is connected by air.

5. Extent of air connectivity in South Asia

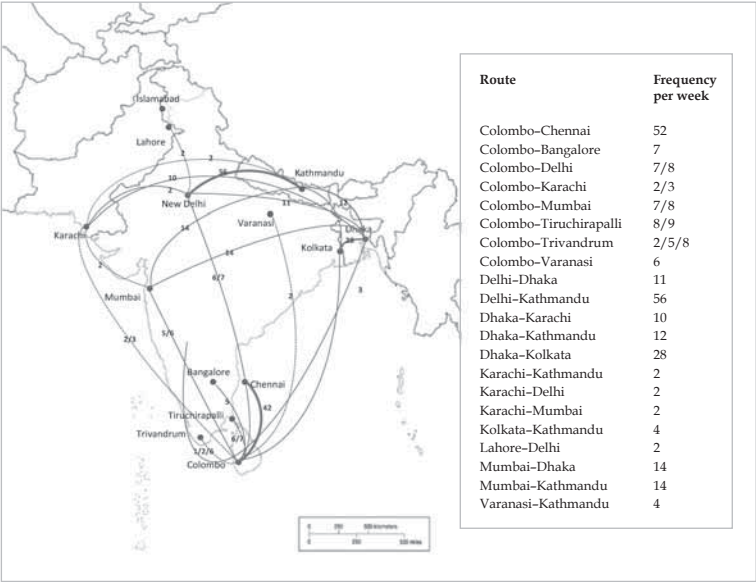
Currently, there are three routes that are considered “commercial routes” in South Asia (more than double daily flights). They are Colombo–Chennai, Delhi–Kathmandu and Dhaka–Kolkata. Mumbai–Kathmandu and Mumbai–Dhaka are considered “well-serviced routes” with double daily flights. Three other routes, Dhaka–Karachi, Dhaka–Delhi and Dhaka–Kathmandu, are considered “adequately serviced routes” with more than 10 flights a week. Figure 6.2 shows all the existing air connectivity within the region.

It is evident that India is the most connected country in the region while Pakistan is the least connected. There is no direct flight between Sri Lanka and Nepal; therefore, air travel between the two countries takes place via Delhi, Bangkok, Singapore, or the Middle East. In a recent development, the Sri Lankan budget carrier, Mihin Airlines, has started a Colombo–Dhaka direct flight, which flies three times a week.

As Table 6.5 illustrates, the extent of country-to-country air connectivity in South Asia is disappointing. The situation is even worse if capital-to-capital connectivity is considered. For example, Colombo is not connected directly to Kathmandu or Islamabad; and Kathmandu and Islamabad are also not directly connected.

It needs to be seen whether such poor air connectivity in South Asia is a result of excessive regulations or whether other factors are at work. To supplement the quantitative findings pertaining to the restrictiveness of ASAs with qualitative research, we collected perspectives of representatives of airlines operating in the region, and of aviation officials. The next section discusses the findings of this exercise.

Figure 6.2: Air connectivity in South Asia



Source: South Asian airlines’ websites.

Table 6.5: Connectivity in South Asia (flights per week)

	India	Pakistan	Sri Lanka	Bangladesh	Nepal
India	-	6	120	53	78
Pakistan	6	-	3	10	1
Sri Lanka	120	3	-	3	0
Bangladesh	53	10	3	-	12
Nepal	78	2	0	12	-

Source: South Asian Airlines’ websites

6. Stakeholders’ views

Interviews were conducted with key airlines and governments in the region, which included Sri Lankan Airlines, Jet Air, Kingfisher Airlines, Civil Aviation Authority of Sri Lanka and the Ministry of Tourism and Civil Aviation in Nepal. It was not possible to interview representatives of Pakistan International Airways and Bangladeshi Airlines. A summary of the findings of these interviews is presented below.

6.1 Commercial viability

A unanimous perception of stakeholders was that air services in South Asia were not commercially viable. It is because the region remains relatively poor with low per capita incomes, and so the demand for air travel in most countries other than India is sub-optimal. This is particularly true for intra-regional travel. The demand for flights for tourism and commercial purposes within the region is very low. Such low demand for flights is one factor that makes more frequent scheduled flights between these countries less commercially viable.

Sri Lankan industry players noted that India has moved forward a little in granting more rights (on capacity) to metro airports, and granting even more rights to operate into secondary airports. They noted that commercial potential is limited in these secondary airports, and so opening up more capacity rights to metro airports will be key to expanding air services to India. An example cited by one of the interviewees was that instead of offering more capacity on the Colombo–Mumbai route, which is seeing greater traffic potential, India offered more capacity on a new Colombo–Pune route as an alternative. This is of little use as passenger traffic to Mumbai would not prefer travelling to Pune as a connecting destination instead. However, it is important to bear in mind that commercial viability (as determined by demand for air travel) influences, and is also influenced by, economic integration, which is low in the region at present.

6.2 Code sharing

Stakeholders noted that there are certain aspects of regulation that could provide a marginal boost to intra-regional connectivity, and code sharing is one such factor. Civil aviation regulatory bodies in the region place restrictions on code sharing in some cases. Stakeholders who were interviewed stated that both Pakistan and Bangladesh do not allow code sharing between two third-party airlines, and expect all agreements to take place with their national carriers. One of the interviewees was of the opinion that one of the biggest barriers to travel from Sri Lanka to Bangladesh is the restriction on code sharing. He pointed out that only 10–15 passengers per flight travel from Sri Lanka to India with the intention of disembarking in Bangladesh. Therefore, allowing Sri Lanka to share code with a third-party airline will reduce costs and inconvenience to passengers.

At present, divergence in quality and safety records deter certain airlines from code sharing with other national carriers in the region.

For example, Sri Lankan Airlines is reluctant to share code with Bangladesh's Biman Airways and Nepal Airlines. However, Sri Lankan Airlines, for instance, could access the Bangladeshi market via a code sharing arrangement with a third-party airline that flies from, say, India to Bangladesh. At present, most BASAs place restrictions on code sharing, for instance, by allowing code sharing only with the national carrier of that country, and not allowing code sharing with a third-party airline.⁷ By completely liberalizing restrictions on code sharing in ASAs, or at least allowing unrestricted code sharing on a priority basis on key routes where code sharing could have a positive impact, it would be possible to create more convenient routes connecting passengers travelling within South Asia. Such liberalization will result in greater competition for national carriers, especially on commercially lucrative routes.

6.3 Operational costs

Another factor that could affect the commercial viability of routes is the magnitude of operational costs. The commercial viability of a route is contingent on the potential revenue and the cost of operating the route. Therefore, a reduction in the latter could, to an extent, mitigate shortfalls in the former. In South Asia, high operational costs are prevalent in many cases in ground handling, airport charges and a number of other expenses. Some of these could be addressed by policy changes such as revisiting monopoly rights accorded to ground handling, for example, in the case of Sri Lankan Airlines in Sri Lanka. In other cases, it is important to continuously emphasize enhancing ground handling efficiency and other airport operations across the region.

Low-cost carriers are particularly conscious of high operating costs at airports, especially high airport taxes/charges, as their profit margins over budget air ticket prices are slim. Recently, Malaysia-based AirAsia has remarked that airport taxes in certain Indian airports are crippling, noting that as much as half of the ticket price (on an average US\$100 fare) goes towards paying airport taxes (Aviation Week 2011). Newer airports have tended to be particularly hawkish in charging high taxes. For example, the new Hyderabad Airport has begun charging a "user development fee", a move that may prompt other new airports or new terminals to follow suit.

6.4 Visa bottlenecks

Another problem identified by stakeholders is that in some cases, immigration laws and visa processes undermine smoother connectivity.

It was pointed out that the process of obtaining double-entry transit visa to India is cumbersome and this makes it difficult for passengers to transit via India while travelling through the region. The visa regime is relatively more liberal between India and Sri Lanka. This is one reason for the existence of a relatively better air connectivity between the two countries that has led to the spurring of tourism, thereby creating much required commercial demand for air connectivity within the region.

Given the present limitations in economic integration and interaction within South Asia (other than on a bilateral basis with India), business visitors alone will not be sufficient to generate sufficient air traffic within the region. Therefore, increasing intra-regional tourism will play a central role, and flexible visa regimes are an important determinant of this.

6.5 Geographic issues

Another prohibitive factor for greater regional air connectivity is the geography of the region. One interviewee illustrated the difficulties in navigating through the mountainous terrain surrounding the Kathmandu airport and the requirement of a non-automated “visual landing”. He pointed out that airlines have to set aside additional funds to pay for specialist pilots who are licensed to land in mountainous terrain, particularly when visibility is sub-optimal (a frequent occurrence at Kathmandu airport due to geographical reasons) and after dark. It was noted that only one international airline operates a night flight owing to the requirement of specially trained pilots in landing at night at Kathmandu airport.

6.6 Route-specific issues

Interviewees also pointed out factors influencing the lack of flights between certain specific routes. They are discussed below.

Colombo–Kathmandu: As far as Kathmandu is concerned, the geographic positioning of the airport makes night flights challenging. Sri Lankan Airlines’ representatives indicated that their entire schedule will need to be altered to accommodate this destination point.

Colombo–Dhaka: Since Bangladesh does not allow code sharing with third party airlines, and Sri Lankan Airlines is not willing to share codes with Biman, this route seems unviable.

It was also pointed out that with regard to routes such as Colombo–Kathmandu and Colombo–Dhaka, even if 5th freedom rights are

granted by neighbouring countries, air travel in these routes must be economically viable to utilize those rights. Commercial viability would require at least 100 passengers on a given flight to make the route feasible, which is not the case regarding these routes.

India–Pakistan: Being the two largest economies in the region, there is undoubtedly potential commercial viability in this route. However, the interviewees opined that the political relations between the two countries have compromised negotiations between airlines of the two countries. The negative spill-over of political tension has undermined connectivity between these two countries.

6.7 Challenges from liberalization

Stakeholders' perceptions were also taken on the key challenges that might result from a more liberal environment in civil aviation regulations in South Asia. Their responses are briefly discussed below.

6.7.1 *Low-cost carriers*

Deregulation will lower entry costs for low-cost carriers (LCCs) which will threaten national full service carriers (FSCs) in terms of commercial viability. Existing LCCs too will thrive and expand in an open aviation market. However, rather than creating a new market through low pricing, LCCs will tend to infiltrate and erode the target market of FSCs. The end result is that new benchmark pricing would be created below the breakeven point of FSCs (at least in some routes).

However, while LCCs are always a challenge, LCCs and FSCs could thrive side-by-side as in other regions. The need for FSCs will not cease to exist just because of a greater advent of LCCs. The moot point will be the distribution of gains and losses between countries in such a liberalized environment. It is likely that inefficient airlines, which could be national carriers in certain countries, would lose out to LCCs or even more competitive FSCs in a liberal environment. There will obviously be stringent opposition to liberalization through which such outcomes manifest. Measures to alleviate such distributional effects will need to be taken at the highest political levels, balancing overarching regional benefits against short-run national costs. Of course, the ultimate objective would be to enhance efficiency of all airlines in the region in order to meet the demands of a more competitive environment. However, it would be a mistake to wait for this to happen prior to embarking on steps to enhance liberalization in the region.

6.7.2 Infrastructure

While capacity is not significantly affected by shortfalls in infrastructure at present, both in terms of airport capacity and airlines capacity, these problems need to be remedied in the long run in order to accommodate potential increased traffic in a liberalized environment.

Tretheway (2010) shows that in several countries, investment in airport infrastructure (along with investment in airlines capacity) provides strong rates of return, by increasing connectivity and contributing to increases in national GDP (Table 6.6).

6.7.3 Political economy factors

As noted in an earlier section, the beneficiaries of air services liberalization are numerous and fragmented, and receive relatively small marginal benefits, while the losers are large, usually politically influential industries such as entrenched domestic airline monopolies. Therefore, deregulation poses inherent political economy challenges. For example, deregulation of airline-related services at Sri Lanka's main international airport, currently held in monopoly by the fully state-owned national flag carrier, is not considered an option.⁸ Much of the losses of the airline's direct operations have been more than offset by the monopoly profits earned from its ground handling and catering services provided to all airlines.

7. Policy road map for South Asia

The case for greater liberalization of air services in South Asia is strong. South Asian policy makers and stakeholders examining the issue need to take note of the substantial evidence from other research studies which demonstrate the economic benefits of air services liberalization in the region. They include reduced fares and some employment creation in the short run, and catalytic growth of direct and indirect employment, and enhanced trade, in the longer run.

While some efforts are made to formulate a more liberal South Asian air services connectivity framework, other related issues, for instance, introducing more competition in national air transport and support services markets and addressing infrastructure constraints, need to be simultaneously addressed. A SAARC-led collaborative programme could give the necessary impetus for South Asian countries to begin addressing these issues. It would be useful if such a programme is informed by an examination of other regions' efforts at tackling similar issues.

Table 6.6: Investment in air transport: Developing-country rates of return

Country	Airport investment (US\$ million)	Aircraft investment (US\$ million)	Percent increase in connectivity 2000–2005	Percent increase in national GDP	National GDP in 2000 (US\$ million)	GDP increase (US\$ million)	Annual rate of return
Cambodia	248	538	61	0.323	31,085	100	19
El Salvador	256	546	43	0.245	34,592	85	16
Jordan	26	334	76	0.385	26,048	100	28
Jamaica	23	168	34	0.199	13,123	26	16
Kenya	61	348	85	0.417	50,007	209	59

Source: Tretheway (2010).

Sector stakeholders need to be made aware of the process and measures adopted by these regions.

The section below outlines some key steps in enhancing the commercial viability of air services in the region; suggests some measures for a broader liberalization of air services under a phased approach; provides, as a case study, a brief overview of the India-Sri Lanka bilateral effort to liberalize air services; and highlights the emphasis placed on connectivity within the SAARC agenda which provides the impetus to move aggressively towards air services liberalization in the region.

7.1 Enhancing commercial viability

Some policy-related measures could help enhance the viability of certain routes. These include:

- Enabling code sharing with third-party airlines.
- Reducing operational costs in the region, for example, through liberalizing ground handling by breaking monopolies and introducing competition in some cases.
- Granting 5th freedom rights on certain routes, which will also be important to consider the “quality” of liberalization. For example, if 5th freedom rights are granted by a country, there is a need to ensure that allocated landing times are of a commercially viable nature.
- Simplifying visa processes.
- Investing in airlines to enhance competitiveness, for which encouraging greater foreign equity in national airlines could be an option.

These measures need to be supplemented by greater overall investment in airline-related infrastructure, particularly airport capacity and airline strength. To catalyse such infrastructure development, South Asian countries would need to place more emphasis on involvement of the private sector. India has already strongly embraced this, and is the forerunner in promoting public-private partnerships (PPPs) in airport development in the region.⁹

While these would address some of the key infrastructure bottlenecks, a significant driver of increased connectivity would be greater demand for travel within the region, and this would require greater regional integration in general, on fronts such as commerce, tourism and people-to-people transactions. The case of Indo-Lanka air services liberalization set out later in this section highlights the central role played by the relaxation of visa regulations by Sri Lanka in spurring demand for flights between the two countries.

In the current environment of limited demand for flights, it appears that the regulatory environment of the BASAs is not the only significant

inhibitory factor. However, assuming that demand increases in the long run as economic integration and tourism increase, regulatory factors will pose greater constraints. Additionally, it must be borne in mind that as regional air services connectivity is further liberalized, this would have dynamic effects, which may, in turn, cause certain routes that are currently commercially unviable to become viable. For instance, a current commercially unviable route connecting two South Asian capitals, as identified in earlier sections of this article, may become viable due to the granting of 5th freedom rights in a country. Sri Lanka's own experience of the initial attempts to move towards open skies via unilateral liberalization of air services with India highlights the positive spill-over effects of such liberalization – increased tourist arrivals and greater people-to-people connections, which stimulate investment and commerce.

7.2 Measures towards greater liberalization: A phased approach

It will be necessary for SAARC to move towards greater air services liberalization in a phased manner as was done by ASEAN and the EU. The ASEAN region, for instance, began by enabling foreign equity participation in domestic airlines, which would help airlines face increased competition in times of downturn. The relatively easy and less contentious measures such as easing capacity controls and tariff restrictions could be implemented first before moving on to more complicated areas. Such a staggered approach to liberalization will give airlines in the region time to adjust in terms of costs entailed in the process. The key challenge for policy makers in the region will be to balance regional interest with national interests of countries whose carriers are likely to struggle to survive in an increasingly competitive environment.

The following steps in liberalizing BASAs in South Asia could be taken as a tentative road map for air services liberalization in South Asia in the longer term.

Easing restrictions on withholding: Allowing foreign investment in airlines can enhance the quality and magnitude of services. This is also important for enabling code sharing and ensuring an increase in flights since the current airline capacity in many South Asian countries is limited, and for countries like Nepal, even viable routes cannot be serviced due to a lack of aircraft.

Easing restrictions on designation (double designation) and capacity (Bermuda I): It is important to reduce limits on the number of destinations that airlines are allowed to fly into and also the number of passengers permitted. This will benefit the smaller countries in the region since they can tap into the Indian market better in the same way as Sri Lanka was

able to enter the Indian market as a result of increased flights allowed into Indian cities.¹⁰ Such a venture into the Indian market can help airlines in the region increase their profitability, which would facilitate a move to the rest of the region in the longer term.

It is also essential to fully liberalize capacity (free determination) for 3rd and 4th freedom rights for capital-to-capital flights in the region; allow multiple designations (i.e., multiple destination points); liberalize tariff and extend 5th freedom right across the region.

While the exact nature of the steps to be taken could change according to circumstances, the road map presented here is a starting point for further liberalization of air services in South Asia. It is important to see this initial road map as a precursor to a much more ambitious and proactive liberalization plan by SAARC, possibly even adopting the ASEAN plan, with suitable adaptations to suit SAARC's context.

8. India-Sri Lanka bilateral air services liberalization experience

Liberalization of air services between India and Sri Lanka began from 2000. According to the Joint Study Group Report on India-Sri Lanka Comprehensive Economic Partnership Programme, "between 2000 and 2003 the number of Indian destinations to which Sri Lankan Airlines flies increased from 5 to 8, the number of flights from 29 to 44 per week and the number of seats from around 8,000 to nearly 9,500, representing a significant increase in capacity." In 2003, it was agreed between the two countries to eliminate the requirement of commercial agreements between the designated airlines of the two countries for asymmetrical operation. By around 2005, Sri Lanka had the most flights into India for any international carrier and was soon operating 110 flights a week before the global economic crisis reduced the demand for travel.

Sri Lankan Airlines' venture into the Indian market helped it stay afloat after a debilitating terrorist attack on Sri Lanka's international airport in 2001 that resulted in reduction in travel to and from Sri Lanka. A key factor that influenced the increase in flights between the two countries was the extension of visa on arrival by Sri Lanka to Indian visitors (which was later extended to 73 countries worldwide). This facilitated travel to a great extent and resulted in increased demand for Indian visitors to Sri Lanka. Unsurprisingly, India soon became Sri Lanka's leading source of tourism. At the same time, movement of Sri Lankans to India was also increasing for educational, medical and business activities. The fact that the two countries had a very visible and effective bilateral FTA helped spur business travel between the two countries as bilateral trade and investment grew exponentially. At the same time, increase in capac-

ity allowance enabled Sri Lankan Airlines to position itself as a gateway to and from India, connecting India with Southeast Asia. After Sri Lankan Airlines got direct flight access to numerous Indian cities, people, who did not necessarily want to fly directly to the popular metros such as Delhi and Mumbai because of various problems, got the option to fly to cities of their choice. Liberalization of regulations also enabled Sri Lankan Airlines to design its strategy in a more flexible manner, keeping in mind long-term commercial viability.

The case of India and Sri Lanka shows that for air services to increase, there needs to be both a viable market for air services (and this was created by the relaxation of visa requirements and the increase in economic interaction and exchange between the two countries) and relaxation of the stringent BASA. The problem among many South Asian countries is that, other than in terms of bilateral relations with India, economic and tourism integration between them is still at a nascent stage. If one were to pin point the driver of increased air service operations between India and Sri Lanka, the relaxation of visa regulations by Sri Lanka would be a key candidate, with tourism being an important determinant. This is further illustrated by the fact that it was only in November 2010 that many Indian airlines began operations on the Colombo-Delhi route as demand increased following the end of war in Sri Lanka.

9. Conclusion

This article examined the nature of air services connectivity in South Asia and found that regulatory issues, as per the BASAs that operate within the region, are fairly restrictive, but there are several other related issues that have caused the region to be characterized by limited air connectivity. According to stakeholders, the limited number of economically viable routes poses a key challenge to profitably expanding air connectivity in the region.

With a forecast of stronger growth of passenger aviation and air cargo in Asia in general, and in South Asia in particular, it is important for South Asia to critically evaluate the various elements affecting the growth of its civil aviation industry. The nature of BASAs, the level of competition and contestability in domestic airport services markets, the level of investment in and competitiveness of airlines, and the level of supporting infrastructure need to be investigated and anomalies and barriers addressed on a SAARC-wide, collaborative basis.

South Asian policy makers need to note the significant interdependence between regional economic integration and transport connectivity. A significant driver of increased connectivity would be greater

demand for travel within the region, and this would require greater regional integration in general, on fronts such as commerce, tourism and people-to-people transactions. In the longer run, South Asia needs to embark on a more ambitious framework of liberalization on a regional basis since restrictive air services regulations between countries stifle air travel, trade, business interactions, and tourism, and in turn, economic growth and job creation.

Better and freer air services can spur a virtuous circle of increased dynamism in South Asia in terms of air transport markets, reduced fares, higher passenger flows within the region, and increased air cargo, all of which would complement the broader effort to improve multi-modal intra-regional connectivity in the SAARC region. It will also help lower transaction costs of doing business in the region, catalyse intra-regional trade, boost South Asian exports in global production networks, and enhance trade and tourism.

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Notes

- ¹ As a matter of fact, most capitals in the region are not connected to more than three capitals of other South Asian countries by direct flights. Although Figure 6.2 provides connectivity map for five countries in the region, based on available information, it does not include Kabul (Afghanistan) and Male (the Maldives), which are least connected to regional capitals. However, Paro (Bhutan), which too is not included in the figure, is connected to three capitals, namely, Dhaka, Kathmandu and New Delhi.
- ² As per the aviation connectivity index supplied by the International Air Transport Association.
- ³ An example cited in this study is the case of Poland where the connectivity index increased by 27 percent with flights to the United Kingdom (UK) increasing from 58 per week to 250 (seats increasing from 7,000 to 40,000), which resulted in a cumulative increase in productivity of 0.19 percent, valued at approximately US\$600 million. The UK too saw a rise in productivity, with the corresponding figure at US\$45 million.
- ⁴ Adapted from Findlay and Goldstein (2004).
- ⁵ The term “withholding clause” is used by the International Civil Aviation Organization, but this clause is often referred to as “designation” or, more frequently, “ownership” clause, given that the “standard” requirement is that, to be designated by a Contracting State to utilize the rights granted in an ASA, an airline has to be “substantially owned and effectively controlled” by the nationals of that Contracting State.
- ⁶ Singapore, Japan and the UK are selected since data for these countries’ ASAs

- with almost all the selected South Asian countries were available.
- ⁷ Of the Indian carriers, Sri Lankan Airlines shares code only with the national flag carrier, Air India.
 - ⁸ At a discussion in March 2011 on Sri Lanka's civil aviation sector, responding to a question on the need to deregulate airline-related services to infuse competition and thereby reduce operating costs, the state-owned airports company (Airport and Aviation Services Limited) stated that "allowing a second ground handler is not seen as possible at this point".
 - ⁹ Several Indian airports have been developed under the PPP model since the Indian authorities opened the sector to private investment over 5 years ago, e.g., development of existing airports at Delhi and Mumbai, building "green-field" airports in Hyderabad and Bangalore, and calls for investment for proposed second airports in Chennai and Navi Mumbai.
 - ¹⁰ However, an important parallel measure was extension of visa on arrival in Sri Lanka.

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Chapter 7

Improving transport connectivity in South Asia

M. Rahmatullah

1. Introduction

Surface transport network in South Asia continues to remain fragmented despite the existence of basic infrastructure and facilities. Due to lack of integration of the transport system, logistic costs in South Asia are very high and range between 13 percent and 14 percent of the commodity value compared to 8 percent in the United States (US). Intra-regional trade among members of the South Asian Association for Regional Cooperation (SAARC) has been around 5 percent for several years, which is much less compared to other regional groupings in the world. Had overland transport connectivity among SAARC countries been improved, intra-regional trade could have been enhanced.

At present, for bilateral trade between India and Bangladesh, Bangladesh and Nepal, and Bhutan and Bangladesh, goods are transshipped at the border between trucks. Freight trains are not allowed to move across borders. For example, in the case of freight trains between India and Bangladesh, rail wagons are pulled by Indian locomotives up to Bangladesh's border and Bangladesh Railway locomotives pull these to their destinations within Bangladesh.

Before 1947, goods from Northeast India used to pass through territories which now lie in Bangladesh. These territories were part of East Pakistan after India was divided into two countries in 1947. However, rail and inland water transport (IWT) transit traffic movement across these territories continued until the war between India and Pakistan in 1965, and was suspended thereafter. After East Pakistan seceded from West Pakistan (now Pakistan) in 1971 to form Bangladesh, transit only by IWT was restored, but restrictions on movement of transit traffic by road and rail continued. Currently, there is only limited bus transport movement between India and Bangladesh.

Northeast India is virtually a landlocked territory, and traffic from Northeast India is required to travel 1,400 km–1,650 km to reach the port in Kolkata, which is the only port available to it. If Bangladesh would allow transit through its territory, goods from Northeast India would have to travel only 450 km–700 km to reach the Kolkata port.

Consequences of poor connectivity in South Asia are huge. Currently, a 20 ft. container takes at least 30 days to move between New Delhi and Dhaka through the maritime route (via Mumbai and Singapore/Colombo to Chittagong and then by rail to Dhaka), which costs around US\$2,500. Direct rail connectivity between the two cities could reduce the time to 4–5 days and the cost to around US\$850.

One of the earliest initiatives to establish regional connectivity in South Asia was taken by the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) through two regional projects initiated in 1959 and 1960, respectively. Similarly, the SAARC Regional Multi-modal Transport Study, completed in 2006, was another major initiative to strengthen regional connectivity in South Asia. However, a real breakthrough in this regard occurred with the signing of the Joint Communiqué by India and Bangladesh on 12 January 2010 following a historic India-Bangladesh Summit in New Delhi. The Joint Communiqué set the tone to achieve a long-lasting cooperation in transport connectivity in the northeastern sub-region of South Asia.

This article critically reviews the various initiatives taken to ensure transport connectivity in the region and identifies issues that need to be addressed urgently to achieve concrete results on the ground.

2. Past initiatives to address connectivity

2.1 The UNESCAP initiative

UNESCAP undertook pioneering efforts to establish regional connectivity in South Asia through two of its famous projects – the Asian High-

way (AH) and the Trans Asian Railway (TAR)—initiated in 1959 and 1960, respectively. The AH Agreement has already been signed by 28 countries out of 32 which would be crisscrossed by the proposed highway, and entered into force on 4 July 2005. AH1 and AH2 are the two major routes which connect Southeast Asia and South Asia with Europe (Map 7.1).

Map 7.1: Asian Highway



The TAR network has also been identified. The Southern corridor from Indonesia via India to Turkey, which is of direct interest to South Asia, covers a length of 35,200 km. Five gauges are involved in this network, and there are still several missing links, such as Thailand–Myanmar, Myanmar–Yunan Province of China, Myanmar–India, Pakistan–Iran, etc. (Map 7.2).

Map 7.2: Trans-Asian Railway



In order to operationalize the TAR network, a separate agreement needs to be signed by the countries concerned, spelling out various details, which is yet to take place.

2.2 SAARC initiatives

The 12th SAARC Summit held in Islamabad in 2004 decided to strengthen transport, transit and communications links among South Asian countries. This was followed by a SAARC Regional Multi-modal Transport Study (SRMTS), which was completed in June 2006. SRMTS identified 10 road corridors, 5 rail corridors, 2 IWT corridors, 10 maritime gateways and 16 aviation gateways for regional transport connectivity. The 14th SAARC Summit held in 2007 in New Delhi approved the recommendations provided by SRMTS and urged Transport Ministers to oversee their implementation. The Summit also decided to extend SRMTS to include Afghanistan and directed the Inter-Governmental Group on Transport to identify and develop sub-regional and regional projects based on the prioritized recommendations of SRMTS.

At the 14th SAARC Summit, some sub-regional projects were also proposed by Bhutan, India and Sri Lanka, and their implementation was reviewed by a meeting of Transport Ministers held in Colombo in July 2009. Progress to that end, so far, has been marginal except that a transport agreement has been put in place. The Transport Ministers' Meeting also agreed to run a demonstration container train from Pakistan to Bangladesh through India and Nepal, which is still to be pursued by the SAARC Secretariat. Lately, a SAARC expert group has been set up which is reviewing the drafts of the Motor Vehicle Agreement and the Railway Agreement for finalization.

3. A recent initiative: India-Bangladesh Joint Communiqué

During Bangladesh's Prime Minister Sheikh Hasina's visit to India in January 2010, the two countries signed a Joint Communiqué covering several issues of bilateral as well as regional importance. Regarding transport connectivity, the Joint Communiqué included the following:

- Making available Mongla and Chittagong Sea Ports for use by Nepal, Bhutan and India.
- Making available Rohanpur/Singabad-Katihar-Raxaul-Birgunj broad gauge rail link for Nepal's third-country trade through Mongla Sea Port, and for bilateral trade between Bangladesh and Nepal.
- Constructing Akhaura-Agartala rail link.
- Designating Ashuganj as a new port of call and a transshipment port

for Indian transit traffic by IWT and then for onward movement to Tripura by road transport.

- Allowing goods between India and Bangladesh to be carried in containers through rail and water transport routes.

The Joint Communiqué, if implemented fully, will strengthen Bangladesh's connectivity with India, Bhutan and Nepal. India will also stand to gain considerably in terms of cost and time savings. Bangladesh could trade in transport services and earn foreign exchange through transport charges in the form of rail charges, port charges, road transport charges and water transport charges, depending on the routes being used. Bangladesh should be able to earn transit fees as well (a part of the cost savings that Indian transit traffic would be gaining, besides huge time savings).

Besides easing trade between Nepal and Bangladesh, Bhutan and Bangladesh, and Northeast India and mainland India, such transport connectivity would also provide an opportunity to Bangladesh to establish itself as the "transport hub" of the sub-region. Similarly, providing port facilities to neighbouring countries is also expected to increase patronage for Bangladesh's Deep Sea Port Project at Sonadia (south of Chittagong). Bangladesh has already invited India and the Yunnan Province of China (having capital at Kunming) to use the Deep Sea Port and join hands in its development. Meanwhile, Myanmar has also indicated its willingness to establish, through its territory, a road link between Kunming and Chittagong.

4. Implementation of the Joint Communiqué

Bangladesh's roads have been designed for 8.2 ton axle load and are only two-lane wide. Hence, these roads can be used only in a limited way, mainly to carry high-value commodities. Most goods have to be carried mostly by rail and IWT. Therefore, to facilitate movement of road traffic across Bangladesh and access to the sea ports, a thorough assessment was made of the various initiatives undertaken and investments needed to implement each of the decisions included in the Joint Communiqué. Some of the major findings of the assessment are discussed below.

4.1 Maximizing the use of Mongla and Chittagong Ports

According to the assessment made by the Government of Bangladesh (GOB), Mongla and Chittagong Ports currently have around 80 percent and 40 percent spare capacity. Therefore, to utilize the spare capacities, some investments have already been planned to modernize these ports.

GOB has already decided to operate the New Mooring Container Terminal through the private sector on a lease holding basis.

Furthermore, to facilitate efficient use of the Chittagong Port, major projects that need to be implemented include:

- Recommissioning of Kulaura–Shahbazzpur–Mahissasan (39 km), plus a transshipment facility near Shahbazzpur, to be financed through GOB's own resources.
- Construction of Akhaura–Agartala rail link (approx. 10 km), to be financed through an Indian grant outside the US\$1 billion line of credit (LOC).
- Construction of three major sections along the Dhaka–Chittagong route as double tracks, to be financed by the World Bank, the Asian Development Bank (ADB) and the Japan International Cooperation Agency.¹
- Construction of second Bhairab Rail Bridge and second Titas Rail Bridge, to be financed out of the US\$1 billion LOC to be provided by India.
- Construction of an inland container depot (ICD) at Dhirasram near Tongi, to be financed by the World Bank.
- Construction of a second rail bridge on Jamuna river, for which the ADB has already committed funds for a feasibility study.
- Strengthening of several rail sections, modernization of signalling and acquisition of rolling stock, to be financed through a number of sources.

4.2 Improving road transport

Since major roads in Bangladesh are only two-lane and they also suffer from structural weaknesses, loaded Indian trucks are not allowed to use Bangladesh's roads. Therefore, to facilitate movement of both national and regional road traffic, a number of road sections, including Brahmanbaria–Mainamati, Sutarkandi–Sylhet and Benapole–Jessore–Khulna need upgradation.

Temporarily, and as an immediate solution, Bangladesh's road transporters could provide transshipment facilities from one border to another border across Bangladesh to carry some of the Indian high-value commodities. Alternatively, a Joint Venture Trucking Company could be set up by Bangladesh's road transporters with shareholders in India, Nepal and Bhutan, with double registration (e.g., vehicles registered both in Bangladesh and India) for the company's multi-axle vehicles (truck trailers, covered vans, etc.). Double registration will allow these vehicles to pick up containers from inside India, Nepal and

Bhutan and move across Bangladesh to deliver goods to destinations without any transshipment at the border. Such a system could reduce transportation costs appreciably. However, to set up such a company and ensure its smooth operationalization, strong political support of the governments of all four countries would be essential.

4.3 Operationalizing the Rohanpur–Katihar–Birgunj rail link

Currently, movement of goods between Nepal and Bangladesh is allowed only through the Kakarvitta (Nepal)–Phulbari (India)–Banglabandha (Bangladesh) route. The Joint Communiqué signed between India and Bangladesh has stated that the Rohanpur (Bangladesh)–Katihar (India)–Birgunj (Nepal) rail link will be made available to Nepal for its third-country trade via Mongla Port. This is an attractive alternative for Nepal; however, this route will face tough competition from the existing Birgunj–Kolkata rail route since it is shorter (around 700 km) compared to the new route, which is 900 km (Map 7.3). Nevertheless, the new route can still be competitive if the dwell time in Mongla Port can be kept as low as possible, and transshipment facilities for containers at the Khulna Railway Station and the 44 km truck-trailer service between the Khulna Railway Station and Mongla Port are made efficient. Still, once the Khulna–Mongla rail link and the bridge on Rupsa River are built, there could be a drastic change in the situation.

Since Kolkata Port is already facing congestion and siltation problems, Mongla Port has a fair chance of surviving the competition, provided that the port operations are modernized, adequate infrastructure facilities are ensured and port charges are kept comparatively lower. To this end, Mongla Port has initiated several projects to enhance its efficiency. It is being modernized through installation of modern container handling equipment, undertaking dredging to increase draft of the main channel, introducing night navigation and dredging of outer bar. A major part of these investments is being financed by the GOB through its own resources.

4.4 Constructing the Akhaura–Agartala rail link

At present, Northeast India's connectivity with Bangladesh by railway is only through Shahbazpur/Mahissasan. A new link, Akhaura–Agartala (around 10 km), is going to be built soon through an Indian grant outside the US\$1 billion LOC. The alignment has been finalized by the India-Bangladesh Joint Technical Group, and the recommendation has been submitted to the respective governments for approval. Once ap-

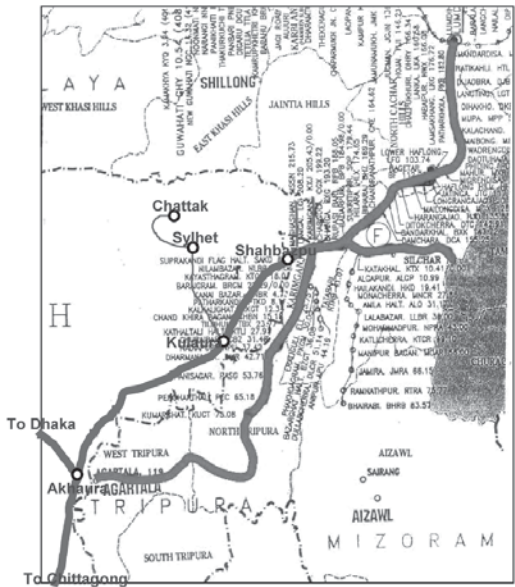
Map 7.3: Rohanpur-Katihar-Birgunj rail link



proved, a feasibility study will be undertaken and tenders called for construction.

The Akhaura–Agartala metre-gauge link will become a direct competitor to the existing Kulaura–Shahbazpur/Mahissasan link (Map 7.4).

Map 7.4: Rail link between Northeast India and Bangladesh



4.5 Making Ashuganj a new transshipment port

A transshipment facility for containers is going to be developed in Ashuganj. This will facilitate the movement of containers between India's northeastern states and Kolkata. For the facility, Bangladesh is expected to make an investment of around Taka 2.5 billion out of the US\$1 billion LOC to be provided by India. Development of this facility will provide India's northeastern states a shorter IWT-cum-road transport link to Kolkata. As a result, India will gain considerably in terms of transport cost savings per ton of cargo moving across Bangladesh, besides substantial time savings. Bangladesh should also be able to earn IWT charges, road transport charges, transshipment charges as well as "transit fees" (a part of the savings in transport cost per ton when the transit cargo will be travelling through a shorter route across Bangladesh versus the existing long route through the chicken's neck).² The amount of "transit fee" to be charged shall have to be decided based on discussion between India and Bangladesh to make it a win-win deal for both countries.

4.6 Ensuring container movement by rail and IWT

As stated earlier, there is no direct overland container movement between India and Bangladesh. All containers move along rail-cum-sea route via Mumbai, Singapore and Chittagong. According to the Joint Communiqué, direct container movement by rail and IWT would now be allowed. In this context, it may be noted that the Jamuna Bridge in Bangladesh has no restriction for ISO container³ movement. But there is a limitation on the number of trains that can pass through the bridge in 24 hours, and the utilization rate has been almost fully saturated. Therefore, there is a need to allow more trains to cross the bridge in specific intervals. After crossing the Jamuna Bridge, containers can move up to Dhaka ICD through dual gauge. An IWT container terminal in the public sector is under construction at Pangaon, and some private sector IWT container terminals are also under development. These IWT terminals, when developed, will facilitate direct container movement between Kolkata and Dhaka as well as between Dhaka and Chittagong, and Dhaka and Mongla.

5. Identification of routes through Bangladesh

Based on a review of the major corridors identified by SRMTS, 13 routes were selected for further investigation (Table 7.1). Assessments were

made of each route with regard to their suitability to serve as the most cost-effective and efficient route for transit traffic through Bangladesh—to reach the sea ports (for Nepal and Bhutan) as well as Kolkata (for India's northeastern states).

Recently, the GOB set up a high-level core committee to look into transit issues among Bangladesh, India, Nepal and Bhutan. Five sub-committees were set up to work on the various aspects involved. The mandate of one of the sub-committees was to identify possible routes for transit traffic. It is quite likely that many of the routes considered by the sub-committee and listed in Table 7.2 will receive priority attention for the movement of transit traffic across Bangladesh.

Of the 17 routes (A, B1 and C) listed in Table 7.2, only a few can be operationalized immediately because the others suffer from acute infrastructural deficiencies. It might take about three to five years to improve, modernize and fully operationalize all the identified routes.

Table 7.1: The 13 routes analysed by SRMTS

S. N.	Selected routes
A. Road routes (7)	
1	Road route 1: Silchar–Sutarkandi–Paturia Ferry–Benapole/Petrapole–Kolkata
2	Road route 2: Agartala–Akhaura LCS–Paturia Ferry–Benapole/Petrapole–Kolkata
3	Road route 3: Guwahati–Dawki/Tamabil–Chittagong Port
4	Road route 4: Silchar–Sutarkandi–Chittagong Port
5	Road route 5: Agartala–Akhaura–Chittagong Port
6	Road route 6: Kathmandu–Kakarvitta–Phulbari/Banglabandh–Mongla Port
7	Road route 7: Thimphu–Phuentsholing/Jaigaon–Burimari–Mongla Port
B. Rail routes (5)	
8	Rail route 1: Silchar–Mahisassan/Shahbazpur–Dhaka ICD–Darsana–Kolkata
9	Rail route 2: Silchar–Mahisassan/Shahbazpur–Chittagong Port
10	Rail route 3: Agartala–Akhaura LCS–Dhaka ICD (Dhirasram)–Darsana/Gede–Kolkata
11	Rail route 4: Agartala–Akhaura–Chittagong Port
12	Rail route 5: Birgunj–Katihar–Rohanpur–Khulna–by road to Mongla Port
C. IWT route (1)	
13	IWT route: Kolkata–Raimongal–Mongla–Narayanganj–Ashuganj–by road to Agartala

Table 7.2: Details of the various routes considered by the sub-committee

A. Road routes

S.N.	Route	Beneficiaries
1	Kolkata–Petrapole/ Benapole–Dhaka–Akhaura/ Agartala	Tripura and Mizoram
2	Agartala–Akhaura–Chittagong	Tripura and Mizoram
3	Silchar–Sutarkandi–Chittagong Port	Nagaland, Manipur and southern part of Assam
4	Silchar–Sutarkandi–Paturia Ferry–Benapole/Petrapole–Kolkata	Nagaland, Manipur and southern part of Assam
5	Samdrup Jonkhar (Bhutan)–Guwahati– Shillong–Tamabil–Sylhet–Chittagong	Eastern part of Bhutan, Guwahati, part of Assam and eastern part of Meghalaya
6	Kathmandu–Kakarvitta/ Phulbari–Banglabandh–Mongla/ Chittagong	Eastern and central regions of Nepal
7	Thimphu–Phuentsholing–Jaigaon/ Burimari–Mongla/ Chittagong	Capital region of Bhutan

B1. Rail routes

S.N.	Route	Beneficiaries
1	Silchar–Mahisasan/Shahbazpur–Dhaka ICD (Dhirasram)–Bangabandhu Bridge–Darsana/Gede–Kolkata	Nagaland, Manipur, southern part of Assam
2	Silchar–Mahisasan/ Shahbazpur–Chittagong Port	Nagaland, Manipur and southern part of Assam
3	Agartala–Akhaura–Dhaka ICD (Dhirasram)–Bangabandhu Bridge Dar- sana/Gede–Kolkata	Tripura and Mizoram
4	Agartala–Akhaura–Chittagong Port	Tripura and Mizoram
5	Kolkata–Petrapole/ Benapole–Khulna–Mongla Port	West Bengal and parts of Bihar and Orissa
6	Birgunj/Raxual–Katihar–Singhabad/ Rohanpur–Khulna–Mongla Port	Eastern and central regions of Nepal
7	Jogbani/Biratnagar–Radhikapur/ BiroI–Parbatipur–Khulna–Mongla Port	Biratnagar region of Nepal

(Continued in next page)

(Continued from previous page)

B2. Potential rail routes for future development

S.N.	Potential routes	Beneficiaries
1	Agartala–Akhaura–Dhaka ICD (Dhirasram)–Padma Bridge–Benapole/Petrapole–Kolkata	Tripura and Mizoram
2	Hashimara–Holdibari/Chilahati–Parbatipur–Khulna–Mongla Port	Northern part of West Bengal

C. IWT routes

S.N	Route	Beneficiaries
1	Kolkata–Namkhana–Shiekhbaria–Mongla–Kawkhali–Barisal–Chandpur–Bhairabbazar/Ashuganj–Sherpur–Zakiganj–Karimganj	Tripura and Mizoram
2	Kolkata–Namkhana–Shiekhbaria–Mongla–Kawkhali–Barisal–Chandpur–Mawa–Paturia–Sirajganj–Chilmari–Daikhawa–Dhubri–Pandu–Silghat	Tripura and Mizoram
3	Kolkata–Namkhana–Shiekhbaria–Mongla–Kawkhali–Barisal–Chandpur–Ashuganj (by waterway) then Ashuganj–Akhaura (by road) as a multi-modal route	India–Bangladesh–India (Proposed route)

Note: Tripura, Mizoram, Nagaland, Manipur, Assam and Meghalaya are India's northeastern states, and Guwahati is the capital of Assam. West Bengal and Orissa are states in the eastern part of India.

6. Benefits of cooperation

Cooperation in transport connectivity in South Asia would be beneficial to user countries (India, Nepal and Bhutan) as well as the transit facility-providing country Bangladesh. These benefits are discussed below.

6.1 Benefits to India, Nepal and Bhutan

Benefits that will accrue to users of transit facilities may be categorized as static benefits such as transport efficiency in terms of time and costs, as well as productivity gains, and dynamic benefits such as employment creation, poverty reduction and trade creation. Once regional transport connectivity through Bangladesh is established, users of transport services are expected to benefit from lower transport costs due to establishment of shorter and direct routes through Bangladesh, and time savings due to reduction in travel time, mostly due to shorter routes.

India will also benefit from earnings from transport charges (rail or road transport charges) for the segment of the route that belongs to India.

For example, if a truck trailer carries a container from Kolkata to Agartala, India will earn transport charges for the segments from Kolkata to Petropole and from Akhaura to Agartala, while Bangladesh would earn transport charges from Benapole to Akhaura. There will also be benefits through substantial transport cost savings for using shorter transit routes through Bangladesh. According to a study (SACEPS and CPD 2010), the percentage of savings per ton could be in the range of 12 percent to 76 percent of the existing transport costs. It shows that the highest savings (76 percent) could be along the Agartala–Akhaura–Chittagong port by rail versus the Agartala–Kolkata port via the chicken’s neck, and the lowest savings (12 percent) along the Guwahati–Tamabil–Chittagong port by road versus the Guwahati–Kolkata port via the chicken’s neck.

6.2 Benefits to Bangladesh

As a transit facility-providing country, Bangladesh could enjoy the following benefits depending on the routes and facilities used:

- Transport charges earnings (rail freight, road transport and water transport charges).
- Port charges earnings (for international traffic using the sea ports).
- Border crossing charges earnings at land ports for transit traffic.
- Toll charges earnings for using major bridges such as Jamuna bridge and major road infrastructures, and ferry charges earnings.
- Transit fee earnings.⁴

6.3 Other benefits

Of the various studies undertaken to analyse the implications of having regional transit arrangements through Bangladesh, most of them have concluded that sizeable traffic could get diverted to shorter routes through Bangladesh. There are estimates that up to 100 percent interstate and international traffic could get diverted from the Indian states of Manipur, Nagaland, Mizoram and Tripura. Similarly, partial diversion could occur from the southeastern part of Assam and the eastern part of Meghalaya. However, there are also findings that such diversions might not take place. For example, Murshid (2010) states that there may be no diversion from Assam and Meghalaya. Nevertheless, a majority of studies claim that there will be sizeable diversion from Assam and Meghalaya. In the cases of Nepal and Bhutan also, most of the studies have revealed that 50 percent of freight traffic to and from Nepal could potentially be diverted,⁵ while for Bhutan, 100 percent diversion along the Bangladeshi routes could be possible.

There will not just be diverted traffic using the new routes through Bangladesh. There will also be sizeable “generated traffic”. Although Northeast India is rich in natural resources, these have not been exploited so far in the absence of access to sea ports. Now that Bangladesh has agreed to allow India to use its Chittagong and Mongla ports, natural resources of Northeast India could be exploited with the prospects of exporting them through Bangladeshi ports. Thus, the actual benefit to Bangladesh and India from transit traffic movement through the new routes would be much more than what has been estimated so far.

7. Investments needed to improve Bangladesh’s transport system

In 2008/09, Bangladesh prepared a draft Integrated Multi-modal Transport Policy (IMTP). Within the framework of the draft IMTP, sectoral master plans were prepared for roads, railways and inland water transport. Investment requirements to implement the master plans were projected for a 20-year period, in four phases of five years each.

Meanwhile, in order to meet the commitment made by Bangladesh as part of the Joint Communiqué signed between India and Bangladesh in January 2010, a number of projects are required to be implemented on a priority basis. At the same time, Bangladesh’s transport system needs to be improved to ensure continued national growth of more than 6 percent, and a sizeable investment is needed for this purpose. Estimates have put the figures for such investments over the next 10 years to be at least US\$7 billion.

8. India’s financial assistance

As part of the Joint Communiqué signed by India and Bangladesh in January 2010, the Government of India announced an LOC of US\$1 billion for Bangladesh to implement a range of projects, including railway infrastructure, supply of broad gauge locomotives and passenger coaches, rehabilitation of Saidpur Railway Workshop, procurement of buses including articulated buses and dredgers, construction of some road links, and transshipment facility at Ashuganj inland port. It is to be noted that this is the largest loan that India has ever provided to any country in the world.

The loan carries 1.75 percent interest per annum, and is to be repaid over a period of 20 years, with a provision of 0.5 percent commitment fee per year on unused credit after 12 months from the date of contract approval.

By the end of 2010, 14 projects with estimated costs of around US\$601 million were identified to be implemented under this assistance. One of the 14 identified projects includes the power gridline of 400 KV between Bheramara and the border that would cost US\$150.86 million. But this project has been proposed to be financed by the ADB. Therefore, effectively there are 13 projects that have been identified to be implemented under India's financial assistance, and the tentative costs of their implementation would be around US\$450 million. Efforts are under way to identify other projects that could be implemented using the remaining US\$550 million.

Out of 13 projects identified, eight are of interest to both Bangladesh and India, three are only of Bangladesh's interest and two projects, namely transshipment port at Ashuganj and reconstruction of Sarail-Brahmanbaria-Sultanpur-Akhaura-Senarbad road are directly related to the development of facilities for transit traffic.

9. Conclusion

The political leaders of India and Bangladesh, through their New Delhi Summit that took place on 10-12 January 2010, set the tone for a long-lasting regional cooperation in South Asia, mainly in the area of connectivity, and other areas of concern covering water sharing, land boundary demarcation, resolving maritime boundary, removal of non-tariff barriers, etc. Most of the outstanding problems have been identified by the Joint Communiqué and leaders have committed to solve them. Now the challenge before both the governments is to honour the commitments and take necessary actions to address the outstanding problems.

The GOB is seriously implementing the various understandings reached at New Delhi, mainly in relation to resolving transit-related problems and improving regional connectivity. Once the priority projects identified by Bangladesh are complete, transit traffic from North-east India, Nepal and Bhutan would find it attractive to transit through Bangladesh, and use its port facilities.

Also, once regional traffic movement starts across Bangladesh, and Northeast India gets access to Chittagong Port, there would be enough incentives for the exploitation of untapped natural resources in North-east India, where Bangladesh would also get an opportunity to invest in joint venture projects. Such developments would give rise to large-scale "generated traffic". That would also generate additional employment opportunities and have several other types of multiplier effects. Thus, the ultimate benefits that would accrue from such regional connectivity would be much higher than what have been estimated so far.

Regarding modes of transport to be used for transit traffic movement, railways and IWT will be the most important ones. To facilitate movement of high-value and perishable commodities across Bangladesh, a network of expressways (toll roads) will have to be developed by involving the private sector on a build, operate and transfer basis. Since Bangladesh has 40-metre-wide right of ways along its National Highways, these could be used to build the expressways, without having to undertake major new land acquisition, which could create problems and delays.

While part of the investments required to implement the identified projects can be financed through the LOC provided by India, Bangladesh will have to mobilize the rest of the resources, of which some are already in the pipeline.

Notes

- ¹ Funds have already been committed for this project, but their release has been tied to reforming the Bangladesh Railway, which is still pending.
- ² The chicken's neck is a narrow stretch of land (21 km to 40 km) that connects India's northeastern states with the rest of India.
- ³ ISO containers meet the specifications set by the International Organization for Standardization (ISO) and are suitable for multiple transportation methods such as truck and rail, or rail and ship.
- ⁴ There are evidences of collecting transit fees in the world, e.g., Egypt and Panama receive transit fees from the passage of shipping freight through the Suez and Panama Canals under their territories.
- ⁵ Partial diversion of Nepalese traffic is due to cost disadvantage of Birgunj–Rohanpur–Mongla Port rail corridor versus Birgunj–Kolkata Port, which is shorter by 200 km.

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Chapter 8

Role of government regulations in trade facilitation: Case of Nepal

Pushpa Raj Rajkarnikar

1. Background

Trade facilitation is an important part of trade reform. Reducing transaction costs, it enhances trade competitiveness. It reduces not only direct costs such as cost of preparing documents, cost of complying with regulations and cost of moving goods from the exporter to the importer, but also indirect costs such as opportunity costs associated with delays in moving goods from the seller to the buyer. These costs have been estimated to account for about 80 percent of total transaction costs (ADB and UNESCAP 2009).

Besides cutting red tape, trade facilitation also reduces uncertainties and makes trade transactions predictable. It is even argued that Asia-Pacific economies have gained more from trade facilitation than from tariff liberalization (UNESCAP 2009). In view of the increasing importance of trade facilitation in international trade, the World Trade Organization (WTO) has also included trade facilitation in the negotiation agenda of the Doha Development Round, albeit with limited scope. The

negotiation agenda concerns improving the relevant aspects of Article V (freedom of transit), Article VIII (fees and formalities) and Article X (publication and administration of trade regulations) of the General Agreement on Tariffs and Trade (GATT) 1994. The importance of trade facilitation for trade creation and expansion is not only a developed- or industrialized-country concern. It is paramount for growth and development of developing countries too (ITC 2005).

Trade facilitation cuts across a wide range of issues and sectors, including government regulations. It is crucial that trade-related government regulations be cost effective, transparent and as easy to comply with as possible in order for trading firms to remain competitive internationally.

2. Definition of trade facilitation

There is no universal definition of trade facilitation. Various international and regional organizations have defined trade facilitation according to their mandates and objectives. For example, the United Nations Economic Commission for Europe (UNECE) defines trade facilitation as a comprehensive and integrated approach to reducing the complexity and cost of the trade transactions process, and ensuring that all these activities can take place in an efficient, transparent and predictable manner, based on internationally accepted norms, standards, and best practices, while the Organisation for Economic Co-operation and Development (OECD) defines it as the simplification and standardization of procedures and associated information flows required to move goods internationally from the seller to the buyer and to make payment in the other direction. The OECD also defines it broadly as all the steps that can be taken to smooth and facilitate the flow of trade, covering import and export procedures at the border (customs, licensing and quarantine), transport formalities, payments, insurance and other financial requirements. Similarly, according to the Asia-Pacific Economic Cooperation (APEC), trade facilitation generally refers to the simplification, harmonization, use of new technologies and other measures to address procedural and administrative impediments to trade.

The International Chamber of Commerce defines trade facilitation as that which focuses on improvements in the efficiency of the processes associated with trading in goods across national borders (ICC 2009). This requires the adoption of a comprehensive and integrated approach to simplifying and reducing the cost of international trade transactions and ensuring that all relevant activities take place in an efficient, transparent and predictable manner, based on internationally

accepted norms, standards and best practices. Trade facilitation is not just a matter of improving customs procedures; it is also about targeting the growing range of controls being implemented at national borders by other authorities.

The World Bank defines trade facilitation as encompassing the domestic policies, institutions and infrastructure associated with the movement of goods across borders. The WTO definition, however, limits trade facilitation to the simplification and harmonization of international trade procedures, including activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade. Thus, in a narrow sense, trade facilitation may be defined as the systematic rationalization of customs procedures and documents. In a broader sense, it covers all the measures that affect the movement of goods between buyers and sellers along the entire international supply chain (ADB and UNESCAP 2009).

3. Trade transaction procedures

A large number of activities need to be performed to complete an international trade transaction. Different procedures set by the governments of exporting and importing countries as well as transit countries are required to be followed in performing these activities as they are governed by government regulations of the country concerned. The United Nations Centre for Trade Facilitation and Electronic Business (UN/CEFACT) has developed an International Trade Transaction Model. According to this model, to complete an international trade transaction, the following procedures have to be followed:

- Commercial procedures that establish business contract between buyer and seller. These also include activities of packing, certification, accreditation and warehousing of goods in trade.
- Transport procedures refer to the process of managing transport for moving goods from exporters to importers.
- Regulatory procedures refer to compliance with trade control regulations.
- Finance procedures refer to the process of payment settlement between buyers and sellers and also the process of insuring goods

4. Improving trade procedures

Trade facilitation aims to improve trade procedures so as to make domestic firms more competitive in the international market and reap

the benefits of international trade. These procedures can be improved through better transport connectivity, better information and communication connectivity, efficient and automated customs, harmonization of standards, better government regulations, etc.

Transport services form the basis for trade efficiency. Not only physical connectivity but also adequacy and effectiveness of transport services are critical for facilitating international trade. This is more so in the case of landlocked countries like Afghanistan, Bhutan and Nepal. Infrastructure quality and transportation costs are two of the major determinants of cross-country variations of trade flow. According to an estimation by Anderson and van Wincoop (2004), transport cost accounts for 21 percent of total trade cost in industrialized countries. This cost may be much higher in landlocked least-developed countries. A transport network requiring minimum transshipment helps traders to reduce their transaction cost.

An efficient communication network links all related parties of international trade and provides a basis for them to share information in the easiest and fastest way through electronic means. Information technology has a significant role in simplifying and harmonizing trade procedures that ultimately facilitate trade. Information and communications technology (ICT) has been identified as a key to trade facilitation by rapidly growing nations such as South Korea, Singapore and Malaysia, which are moving towards paperless trade from the traditional document-based trading system. Korea, for example, has adopted ICT in cargo clearance as a crucial component of its overall trade facilitation initiative (Yang 2009).

South Asian countries have also automated their customs in varying extent and scope. For example, Nepal started automation of its customs in 1996 with the introduction of the Automated System for Customs Data (ASYCUDA), a software developed by the United Nations Conference on Trade and Development (UNCTAD). Sri Lanka has also adopted ASYCUDA since 1992. Most South Asian countries are moving towards ICT-based single window system. Automation in customs makes customs clearance faster and reduces time and cost for traders. While the use of ICT also reduces the regulatory burden for traders, acceptance of electronic lodgment of documents by customs reduces paper documents and also enhances the efficiency of customs administration. A leading concern expressed in the private sector surveys of trade facilitation conducted in Bangladesh, China, India and Nepal in 2006 was the irregular payments that had to be made for the clearance and release of goods (Albuero 2007). Automation reduces human interface and thereby reduces the opportunity for bribery.

Traders need to fulfil product standards while performing an international trade transaction. These standards are primarily set by government authorities to protect the life and health of human beings, animals and plants. For example, emissions standards are set for protection from air pollution. The implementation of standards involves time and costs, arising from the testing and certification of the product to be traded. For traders in Asia and the Pacific, meeting such standards is found to be difficult and has become one of the most problematic issues of trade facilitation. For instance, a Nepalese exporter of vegetable ghee to India has to spend 10 to 15 days to get a certificate of test from Indian laboratories since Indian importers do not recognize certificates issued by Nepalese laboratories (Rajkarnikar 2010a).

Indian exporters have encountered standards-related problems in exporting, for example, peanuts, mango and pulses to countries of the European Union. Although imposed to protect public interest, standards that are not based on international norms may restrain trade and limit market entry. It follows that the appropriateness of the regulatory requirements pertaining to standards needs to be ensured for trade facilitation. Harmonization of standards through international standards-setting organizations such as the Food and Agriculture Organization of the United Nations (FAO) and the International Organization for Standardization (ISO) may be an effective way to reduce difficulties faced by traders in fulfilling the standards. Standards should also be transparent.

Trading activities need to take place in conformity with government regulations. Governments enforce trade-related regulations to improve trade efficiency while protecting public interest. The primary goals of government regulations are to address market failures, protect consumers from anti-competitive behaviour of firms, and reconcile the interest of firms and wider social goals.

A right regulatory regime facilitates trade but governments often fail to realize the true objectives of improving regulations. Restrictive regulations open up opportunities for corruption, create unnecessary delays in trade transactions and thereby increase the cost of trading. Such regulations also increase uncertainty and risk for traders. Regulatory reform is, therefore, important. Good regulations reduce complexities in the trade process and also reduce trade costs while enhancing the competitive strength of firms. Trade potential can be optimally harnessed only with a trade-friendly regulatory regime. However, having good regulations is not enough; they need to be implemented in the most efficient way. Improving regulatory environment is one of the basic elements of trade facilitation.

5. Government regulations

Governments enforce different regulations. Some of them are directly related to trade and are enforced to implement the trade policy of the country while some others may be indirectly related to trade. Trade regulations refer to the acts, rules and regulations that govern the activities of trading across the border. They can be classified broadly into:

- Trade control regulations.
- Customs regulations.
- Technical regulations.
- Product-specific regulations.
- Sectoral regulations.

5.1 Trade control regulations

Trade control regulations are those regulations through which governments impose non-tariff barriers (NTBs) on exports and imports to achieve certain objectives like correction of balance of payments imbalance, protection of domestic industries and domestic supply management. Governments exercise trade controls through licensing, quantitative restrictions and canalization of imports or exports. In the wave of trade liberalization, the licensing system has been squeezed to a great extent in almost all countries. For example, in Nepal, no licence is required for the import of goods other than a few prohibited and quantitatively restricted items.

Quantitative restrictions on the export or import of goods through quota allotment are yet another means of trade control. Quota allotment by India for the import of zinc, copper wire, acrylic yarn and vegetable ghee from Nepal is a case in point. Export or import is also controlled by designating a particular institution for the import and/or export of a particular product. For instance, the Government of Nepal designates the Salt Trading Corporation as the sole importer of salt in Nepal. Such controls reduce competition and thereby efficiency in international trade.

5.2 Customs regulations

The primary tasks of a customs administration relate to the movement of goods across countries. These tasks include the enforcement of quantitative restrictions on the import or export of particular commodities; the detection and seizure of prohibited items; the enforcement of sanitary and phytosanitary restrictions and of rules relating to endangered spe-

cies, antiques, arms and ammunitions, and intellectual property rights; and collection of revenues from import tariff and charges on exports. The customs of developing countries are more revenue oriented.

The process of accomplishing the tasks of customs is established by customs regulations. Clearance and release of goods, valuation, tariff classification, advance lodgment, advance ruling and appeal mechanism are the major aspects of the customs process in relation to the export or import of goods. Inspection of cargo is the most time-consuming part of the customs process. Quick clearance and release of goods is very important as a trade facilitation measure because delays in movement may cause considerable loss to traders. A document-intensive and manual process of clearance takes a longer time to be completed. Hence, customs automation is one of the means to reduce clearance time.

Similarly, the introduction of a risk assessment system, which has been considered to be an important element of customs reform in many countries, reduces the need for physical inspection of cargo. In this system, physical examination of cargo is carried out only on a selective basis. The major benefit to traders from the system of risk assessment is that for most traders, clearance of the bulk of the cargo will happen quickly without it being subject to physical examinations. In this system, the customs administration concentrates on high-risk transactions. The World Bank's *Doing Business 2011* shows that the introduction of a risk-based inspection system was one of the main factors behind Peru being able to significantly improve its trading-across-borders performance in 2010. Although the foregoing discussion underscores the importance of the risk-assessment system in trade facilitation, it needs to be supported by audit-based controls, including post-clearance audit and post-clearance inspection, to control any misuse.

Customs valuation is one of the key areas of trade facilitation. Valuation of goods is important since tariff and tax liabilities are usually calculated *ad valorem*. Recognizing the importance of an efficient and transparent customs valuation process, WTO members have signed the Agreement on Customs Valuation (ACV), which requires the customs administration to accept the transaction value declared by the trader, unless the authenticity of the supporting invoice can be unequivocally disproved by the authorities. The basic purposes of the ACV are to require countries to adopt a valuation system that is fair, neutral and uniform, and protect traders from use of arbitrary or fictitious values by the authorities. Thus, the WTO method of valuation is trader friendly. But evasion of duty through undervaluation of imports is an acute problem for administrations in developing countries (Walsh 2003). Valuation fraud is serious particularly in developing countries having relatively

high rates of duties and other taxes on the import of goods. Therefore, customs regulations should be balanced and strong so that they can effectively control undervaluation on the one hand, and make valuation fair, transparent and predictable on the other.

In order to avoid misunderstandings and confusions, the customs regulation on valuation should be clear and comprehensive with specific provisions on matters like exchange rate, release of goods, and transportation and insurance costs. The price of imported goods is generally expressed in foreign currency in the invoice. It should be clear in the regulation whether the exchange rate at the time of exportation or importation is to be applied while converting the foreign currency-quoted price into domestic currency. Similarly, the regulation must be clear on whether the goods can be released from customs control taking a guarantee in a situation where the final determination of the value is delayed for certain reasons. The regulation also needs to determine whether transportation and insurance costs are to be included in the dutiable value of imported goods.

The tariff classification of goods is essential to verify the accuracy of the assessment process. A large number of misclassification is reported due to difference in interpretation of nomenclature; attempts by traders to declare under tariff lines with lower rates; and attempts by customs officials with large discretionary power to extract rents. Lack of efficiency in classification leads to considerable loss of revenue and to a distortion in tariff protection levels. Almost all countries now use the Harmonized Commodity Description and Coding System (HS). However, there are instances of differences in interpretation of goods not only between customs and traders but also between customs and other government agencies as well as among customs. Such a situation provides discretionary power to customs officials regarding decisions on tariff classification of goods and creates a grey area of corruption in customs administration. Therefore, a clear and comprehensive guideline for tariff classification of goods based on the HS is essential.

Advance lodgment of customs declaration and supporting documents prior to the arrival of goods can greatly facilitate the rapid release of goods because this enables customs authorities to process data in advance and use them for risk assessment, and to reach a decision on the required action before the goods actually arrive in the customs territory. With this provision, traders will also know the amount of duty payable in advance. Many countries provide advance ruling facilities in various customs matters. China and India, for example, provide some binding rulings on valuation and classification. Such a regulation makes trading across borders more predictable.

An appropriate mechanism of appeal for reviewing and correcting administrative decisions related to customs matters is essential for providing justice to parties to international trade. The ACV of the WTO also requires that member countries provide for the right of appeal to the importer in relation to the determination of customs value. Avenues for appeal should be made available at different levels. A fair and independent review mechanism needs to be established within the customs administration in the first instance, with the right to judicial authority in the second instance. Appeal procedures exist in most countries but the mere existence of appeal procedures does not help traders. Process in this regard should be simple, fast and inexpensive as, otherwise, it will be of no use. For example, the appeal rate is very low in Nepal as it is costly and time consuming.

Customs clearance is done by customs agents on behalf of traders. In some countries, it is mandatory that goods be cleared through licensed agents only. In such a situation, the role of customs agents or customs brokers becomes crucial for trade facilitation. Government regulations should set minimum standards for these agents to enhance their efficiency and thereby reduce delays in customs clearance of goods.

5.3 Technical regulations

Technical regulations are mainly related to manufactured goods, raw materials and agriculture products and they are issued to ensure the standards of products so as to protect the health and life of human beings, animals and plants, and also to protect the environment. These regulations not only lay down product characteristics but also determine the process of conformity assessment and product certification. Such standards and processes are product specific. WTO rules aim at ensuring that technical regulations do not constitute unnecessary barriers to trade. There are two WTO agreements in this area: the Agreement on Technical Barriers to Trade (TBT) and the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS). Both agreements urge governments to use internationally agreed standards (e.g., ISO standards), where they exist, as a basis for their national standards. The TBT Agreement addresses the issues of product characteristics and related processes or production methods. The agreement also requires that technical regulations conform to the basic principles of transparency and non-discrimination (Wilson 2002).

According to WTO rules, the norms and standards for industrial goods that are established by member countries should be normally applicable to all imports, irrespective of their origin [the most-favoured-

nation (MFN) principle] and the size of the exporting enterprise. Under the SPS Agreement, application in respect of only one or a few countries is permitted, provided the measure does not arbitrarily or unjustifiably discriminate between countries with identical or similar conditions. It should be noted that the flexibility to deviate from the MFN principle is permitted only for SPS measures that aim at preventing the entry of plant- or animal-borne pests and diseases into a country from certain territories where unique condition prevails. SPS measures aiming at ensuring food safety would ordinarily have to be applied on an MFN basis (ITC 2001).

Governments are free to fix their own product standards. But the WTO encourages members to adopt internationally recognized standards. A member can apply stricter standards only when the government considers and justifies that international standards are inappropriate. As developed countries are adopting rigorous standards, problems relating to the implementation of obligation under the TBT and SPS Agreements rank high among developing-country concerns.

5.4 Product-specific regulations

Governments may enforce special regulations in the trading of specific products. For example, the Government of Nepal has issued regulations requiring a distinct procedure to be followed for the import of pharmaceuticals. Similarly, in addition to general trade regulations, exporters of handicrafts in Nepal have to obtain a certificate from the Department of Archaeology for the export of such items.

5.5 Sectoral regulations

Regulations of different sectors such as industry, transport, communication and finance exert an impact on trading across the border. A business-friendly industrial regulation, for example, may be an attraction for foreign investment in different sectors of an economy, including transport and communication, which play a crucial role in trade facilitation. The economic case for regulations in any sector—goods or services—arises essentially from market failure attributable to natural monopoly or oligopoly, asymmetric information and externalities (Gamberale and Mattoo 2002).

A pro-competitive regulation in the transport and communication sectors may enhance trade facilitation, reducing transaction costs. Similar is the case of banking regulations. Whether a trader has easy access to trade finance at reasonable cost depends on the quality of banking regu-

lations. Tighter regulations issued by the central bank put a constraint on the supply of trade finance and raise the cost of finance. Constraints on the supply of trade finance reduce the capacity of firms to trade and a high cost of finance reduces the competitive strength of traders. A 10 percent decline in trade finance could lead to a drop in total trade of US\$129 billion in developing Asia, representing 3.6 percent of its total trade (Liu and Duval 2009). The issue of trade finance has become more prominent after the global economic crisis and the implementation of the Basel II charter¹, which raised the required capital adequacy ratio of commercial banks, resulting in a rise in the cost of trade finance. Central banks of almost all countries have incorporated Basel II charter in their domestic banking regulations.

Banking regulations direct not only the lending process but also the process of payment settlements in international trade. The letter of credit is the most popular banking instrument used in settlement of payments in international trade. Foreign exchange regulation is yet another regulation that has a direct impact on trade competitiveness. A realistic and flexible foreign exchange regulation is an essential trade enabler in the dynamic market of international trade.

As there are several types of risks in moving goods from exporters to importers, insurance is essential for trading across borders. Thus, domestic regulations creating a competitive insurance market have a positive impact on trade facilitation. International trade is thus affected by not only trade regulations but also various sectoral regulations.

5.6 Regulatory environment

Regulatory environment is considered as an indicator for measuring trade facilitation efforts. It constitutes regulations, and their implementing mechanisms and institutions. Trade regulations are issued and implemented by different agencies. All government agencies should work together to create an integrated regulatory environment. This avoids duplication of regulatory compliance, saves time and reduces cost. In order to facilitate trade, the cost and complexity of compliance with regulations should be reduced as far as possible.

Similarly, in order to reduce complexities, all regulations should be supported by clear guidelines. In order to encourage voluntary compliance, trader support services should be made accessible to all. Simplicity, transparency, consistency and cost efficiency are the major characteristics of a good regulation. While good regulations are required to facilitate trade, even good regulations become ineffective if they are not supported by good institutions. For example, customs regulations can-

not be effectively implemented if customs offices are not efficient for whatever reason.

Efficiency of institutions largely depends on good governance and infrastructure. For example, corruption, lack of equipment, and congestion in customs yards have been sources of inefficiency in the customs of some South Asian countries. According to surveys conducted in Bangladesh, Nepal, India and China (Bhattacharya and Hossein 2006; Rajkarnikar *et al.* 2006; Chaturvedi 2006; Wenjing and Wei 2006), elimination of bribery and other corrupt practices of officials involved in the clearance and release of imported goods ranks first in priority ranking of trade facilitation measures by the private sector.

Similarly, in a more recent survey conducted among freight forwarders and exporters in Nepal, 77 percent of the respondents reported that logistic facilities at customs points are not adequate (Rajkarnikar 2010b). All these evidences show that there is considerable scope to improve the regulatory environment in South Asian countries so as to make it trade friendly.

Trade performance is affected by not only the trade-related regulatory environment but also the general business environment. Generally applicable domestic business regulations may have an impact even greater than that of trade-specific regulatory barriers. *The Asia Pacific Trade and Investment Report 2009* says that most countries in the Asia-Pacific region have scope to increase their trade competitiveness by tackling non-trade specific regulations affecting all domestic businesses (UNESCAP 2009). Non-trade specific regulations include regulations related to business registration, taxation, competition, bankruptcy, property rights, investment, etc. The Doing Business Indicators of the World Bank cover 10 business regulatory areas, namely, starting a business, dealing with construction permits, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and closing a business.

A trade-friendly coherent trade and business regulatory environment is warranted to facilitate trade. But the Business Regulatory Coherence Index for 2007/08, despite recording an improvement over 2006/07, shows overall regulatory coherence in Asia Pacific, and South and Southwest Asia to be low (Duval and Utokthan 2009).

5.7 Access to regulations

Trade regulations are to be implemented by different government agencies and complied with by traders. Therefore, these regulations should be made easily available to all stakeholders on time through diversified

but appropriate means of dissemination. Regulatory changes should be publicly notified well in advance of implementation except for some sensitive provisions related to government revenue. If publication of regulations lags behind implementation, it means confusion and trouble for stakeholders, resulting in an adverse impact on trade performance. Such is the importance of timely availability of information on trade regulations that Article X of the GATT requires all WTO member countries to publish all laws, regulations, judicial decisions and administrative rulings relevant to importing and exporting in a manner as to enable government agencies and traders to become acquainted with them (ITC 2005).

The WTO, under its various agreements, has made provisions that require members to publish regulations. For example, the Agreement on Import Licensing Procedures requires members to publish the basis on which licences are granted. Similarly, the SPS Agreement requires member countries to publish all SPS measures and changes to them.

5.8 Regulations and stakeholder consultation

Although governments have the sole authority to formulate, enforce and amend regulations, it is better to consult with traders while formulating or amending them. Such consultations enhance public confidence in regulations and generate support from the private sector in implementing them. The consultations also provide an opportunity for policy makers to improve regulatory quality and create a conducive regulatory environment for traders. Therefore, such consultations should not be on an *ad hoc* basis; they should be institutionalized.

For example, in Nepal, there are institutionalized consultative arrangements with traders at different levels and on different aspects. Trade Policy 2009 has incorporated a provision of constituting a Board of Trade at the central level, comprising representatives from the government, the private sector and the academia, to facilitate trade, maintain inter-agency coordination and help policy formulation. Similarly, there is a Trade Facilitation Committee in the Department of Customs, comprising representatives of both the government and the private sector, to discuss and resolve customs-related problems.

6. Trade facilitation in South Asia

In the process of regional integration, the South Asian Association for Regional Cooperation (SAARC) has made attempts for gradual liberalization of intra-regional trade. It initiated the SAARC Preferential Trad-

ing Arrangement (SAPTA) and later replaced it with the Agreement on South Asian Free Trade Area (SAFTA). As in other regional trade agreements, several provisions have been made for trade facilitation in the SAFTA Agreement. For example, Article III of the Agreement states “SAFTA shall entail adoption of trade facilitation and other measures and the progressive harmonization of legislations by the contracting states in the relevant areas”.

Furthermore, Article VIII of the SAFTA Agreement has put forward 12 additional measures of trade facilitation, which include harmonization of standards, harmonization and simplification of customs clearance procedures, customs cooperation, simplification of banking procedures, and development of communication systems and transport infrastructure (SACEPS 2008). Realizing its importance, SAARC countries have taken several measures in the area of improving trade facilitation. However, South Asia ranks the last among all world regions in terms of road density, rail lines and mobile tele-density per capita. The regulatory constraints introduced at gateways and border crossings have been an important impediment to both regional and international trade (World Bank 2011).

By all indicators of trade facilitation – be it the Logistics Performance Index or the relevant indicators of the Global Competitiveness Index or the trading-across-borders indicator of the Doing Business Indicators – South Asia lags behind many other regions of the world. *Doing Business 2011* shows a deterioration in the business environment in most SAARC countries (Table 8.1). Only Bangladesh, India and the Maldives have improved their overall environment of doing business. But in terms of the ease of trading across borders, the ranks of almost all South Asian countries dipped, reflecting a deterioration in their trade facilitation status.

Table 8.1: Doing business in South Asia (rank out of 183 countries)

	Ease of doing business		Trading across borders	
	2010	2011	2010	2011
Afghanistan	165	167	183	183
Bangladesh	111	107	110	112
Bhutan	140	142	154	161
India	135	134	93	100
Maldives	96	85	125	138
Nepal	112	116	161	164
Pakistan	75	83	78	81
Sri Lanka	102	102	66	72

Source: World Bank (2010).

7. Trade facilitation initiatives in Nepal

As part of overall economic reforms, Nepal initiated trade liberalization in 1985, which gained momentum in the early 1990s. In a continuous process to make its economy market oriented and integrated with international markets, Nepal became a member of the WTO in 2004 through accession. In the process of accession, Nepal had made commitments to liberalize trade in goods and services, among others. Some of the commitments are directly related with trade facilitation. For example, Nepal had committed to implement the WTO Agreement on Customs Valuation. In view of the importance of trade facilitation and also in the context of commitments made at the WTO, Nepal has been implementing trade facilitation measures since the late 1990s. The major trade facilitation measures so far initiated in Nepal are discussed below.

7.1 Customs reform

Customs reform lies at the core of trade facilitation. To strengthen the ability of the Department of Customs to cope with an increasing demand for speedier clearance of imports and provide better services to the trading community, enhance effectiveness in revenue collection, and align the national customs system with the international standard, Nepal introduced ASYCUDA in 1996 and its use is being gradually expanded in different customs offices.

The Department of Customs designed and implemented a three-year customs reform action plan in fiscal year 2003/04. This programme accorded high priority to institutionalizing scientific customs valuation procedures, simplifying checking procedures, reducing documentary requirements, automation of customs processes, and selectivity checking based on risk analysis.

The new Customs Act and rules (2007) include many provisions in line with the Revised Kyoto Convention and other international agreements. The main features of the Act and rules are that they prescribe the number of documents required for clearance. The customs rules specify nine documents for import and four documents for export, but in practice, the documentary requirement is much more than specified in the customs rules. In the “Enabling Trade Index” of the World Economic Forum, Nepal ranks 117th out of 118 countries in efficiency of customs administration. This means that there are certain shortcomings in customs procedures. Taking all these into consideration, an Action Plan (2009–2013) has been launched with the objective of facilitating legitimate trade and industry, and thereby encouraging voluntary compli-

ance. The Action Plan has set the objective in line with international conventions and standards, which are to provide the basis for re-engineering all of the customs clearance procedures, including documentation, data requirements, and procedures and use of risk management. The Customs Act 2007 has a provision for using a selective method under Clause 20.

The Customs Act 2007 has fully incorporated the WTO valuation rules, which recognize transaction value as the basis for customs valuation. There is also a provision for a Valuation Review Committee in line with WTO rules. The trader can challenge the valuation decision made by the customs office.

7.2 Transportation

Nepal is a landlocked country and has to depend on India for transit facilities for third country trade. An efficient transportation in transit is crucial to Nepal's foreign trade. Establishment of inland clearance depots, also known as "dry ports", play an important role in easing trading across borders for a landlocked country. The Government of Nepal established the Nepal Inter-modal Transport Development Board (NITDB) in 1997 with the objective of overseeing the economic and efficient management of ICDs for the facilitation of Nepal's foreign trade. The main functions of the NITDB are to develop, manage and promote ICD terminals and prescribe criteria for determining service charges. This institution was also entrusted with concluding a railway operation agreement with the Indian Railways. Nepal also launched the Nepal Multi-modal Transit and Trade Facilitation Project in 1998 to construct rail-based and road-based ICDs in different parts of the country and to manage other legal and infrastructural requirements to operate these ICDs. The main objectives of the ICDs are to reduce transport costs, achieve competitiveness in imports and exports, and resolve transit hassles. Currently, three road-based and one rail-based ICDs are in operation.

7.3 Information and communication

The Ministry of Commerce and Supplies and the Department of Customs have upgraded their webpages with additional trade-related information. In order to integrate Nepal into the global trade point network, two domestic trade points have been developed. A WTO reference centre has also been established under the Department of Commerce to enhance the flow of trade-related information among stakeholders.

Likewise, enquiry points have been established to respond to queries on SPS measures, TBT and services trade.

7.4 Special economic zone

The Trade Policy 1992 aimed to, among others, establish export processing zones. Accordingly, the government has initiated the process of setting up special economic zones and export processing zones in different places of the country. Such zones are expected to provide different export incentives in the form of tax rebates, credit benefits and flexible labour laws in order to reduce transaction costs and enhance the competitive strength of Nepalese exports. In the absence of the required laws, no special economic zone, however, has been established in the country so far. The Government of Nepal has prepared a draft Special Economic Zone Act, which is pending in the Parliament.

7.5 New trade policy

The government announced a new trade policy in 2009, replacing the one in place since 1992. The new policy has provisions related to recent developments in international trade such as TBT and SPS requirements. One of the main strategies of the policy is to reduce transaction costs through the strengthening of institutions and the simplification of procedures. According to the policy, trade facilitation-related policies, laws and procedures will be made internationally compatible.

7.6 Single window services

A “single window” is defined as a facility that allows parties involved in trade and transport to lodge standardized documentation and/or data with a single entry point to fulfil import-, export- and transit-related regulatory requirements (UN/CEFACT Recommendation No. 33). The concept of a single window is at a very early stage in Nepalese customs. A study conducted by the Department of Customs in 2004 on “customs processing steps” in Birgunj (the biggest trading point for Nepal’s foreign trade) found that the clearance process entails more than 19 steps. It recommended operating a “single customs window”. This was implemented in the Birgunj customs office in 2006 on a trial basis for overseas cargo. Processing steps were redesigned and reduced. But these changes were not fully in compliance with the ideal single window in customs. The Customs Action Plan (2009–2013) in its objectives has included the development of a single window system and its operation.

8. State of trade facilitation in Nepal

According to the *Doing Business* reports for the years 2008 to 2011, the number of documents required in Nepal for export and import remained unchanged during these four years. The number of documents required remained 9 and 10 for export and import, respectively. Similarly, the number of days required for export continued to be 41 days for the years 2009–2011. It was 43 days in 2008. Thus, though a slight improvement was recorded in the first year of the review period, no further improvement was recorded during the last three years. The number of days required for imports, however, remained 35 days for all four years. But the cost of exporting showed a rising trend and amounted to US\$1,960 per 20-foot container in 2011 as compared to US\$1,600 in 2008. The cost of importing also increased every year except in 2010. The cost of importing in 2008 was US\$1,725 per 20-foot container, which reached US\$2,095 in 2011. These figures reveal that despite the implementation of several reform measures, the state of trade facilitation has not improved in Nepal (Table 8.2).

Table 8.2: State of trade facilitation in Nepal

	2008		2009		2010		2011	
	Export	Import	Export	Import	Export	Import	Export	Import
Document (number)	9	10	9	10	9	10	9	10
Time (days)	43	35	41	35	41	35	41	35
Cost per 20-foot container (US\$)	1,600	1,725	1,764	1,900	1,764	1,825	1,960	2,095

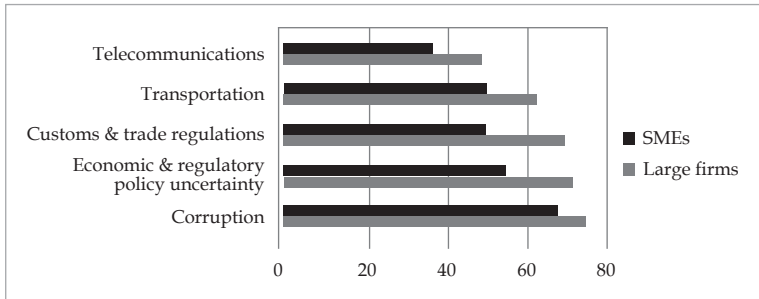
Source: *Doing Business* reports, various issues.

9. Major problems of trade facilitation

There are several studies in the area of trade facilitation, identifying problems of trade facilitation at the country, regional and international levels. Figure 8.1 shows business firms' perceptions on the obstacles to business in South Asia. Corruption appears to be the top-most obstacle to business for both large firms and small and medium enterprises in South Asia, followed by economic and regulatory policy uncertainty, customs and trade regulations, transportation, and telecommunications.

Corruption not only increases transaction cost and reduces competitive strength, but also impedes movement of goods. Timely delivery is

Figure 8.1: Major problems of trade facilitation in South Asia



Source: Li and Wilson (2009).

much more important than price competitiveness in modern-day international business. Therefore, corruption has been identified as a serious bottleneck to trade facilitation. Even good regulations remain only on paper if implementing officials are corrupt.

Nevertheless, good regulations are essential to boost trade. Cumbersome and costly regulations reduce trading efficiency of domestic firms in the international market. Similarly, frequent changes in policies or regulations exert additional cost of adjustment to businesses. Policy stability or stability in regulations largely depends on political stability or government stability. In South Asia, Nepal is the most unstable country in this sense. As uncertainty makes business environment more risky, investors are discouraged to invest in such a situation.

Transport is very intimately connected to the flow of goods from the exporter to the importer. Telecommunications relate to the establishment and execution of business relations among different actors of international trade such as bankers, freight forwarders, regulators, exporters and importers located in distant places. The trade impact of internet services in the modern world is expected to be very significant. Thus, transport and telecommunications occupy a pivotal role in international trade. Transport improvement can reduce the time and cost of trading. For example, reforms made in the Greater Mekong Sub-region North-South Transport Corridor reduced the time to cross a 270 km section of dirt track along the corridor of Lao PDR between China and Thailand from three days to four hours. A restrictive transport and telecommunications sector deprives the trading community of efficient transportation and telecommunication services. The problem of transportation is more severe in landlocked countries. Landlocked developing coun-

tries suffer from time-consuming procedures and additional costs in the transit country for both imports and exports. For instance, according to *Doing Business 2010*, a Nepalese exporter has to bear US\$900 per 20-foot container of exports, while a Bangladeshi exporter has to bear only US\$140 for the same purpose.

10. Regulatory reform: Some issues

Regulatory reform is required to make the regulatory environment trade friendly. In the process of reform, various issues are to be addressed. Some pertinent issues in this regard are discussed below.

10.1 Issue of coordination

Various government and private sector agencies issue trade-related regulations. Coordination among these agencies is required to avoid duplication and inconsistencies among regulations issued by different agencies. Contradictions among regulations create confusion and delays in trading processes. Therefore, the issue of coordination should be well addressed for smooth and easy flow of goods, related information and documents, and money. Coordination is required not only among regulatory bodies within the country (behind the border) but also among related institutions beyond the border. Thus, coordination could be at national, bilateral, regional or international levels.

10.2 Issue of use of ICT

The use of ICT is rapidly increasing in different aspects of trade transactions not only in developed countries but also in developing countries. Using ICT, developed countries are moving towards a paperless trading system. Market search is done through the internet, while business relations are established through email. Similarly, payments are done electronically and data are submitted to as well as interchanged among regulatory agencies electronically. All related information is shared among the parties to trade through a telecommunications network. Use of ICT in trade can save transaction costs significantly. But it is essential that appropriate hardware and software be developed for optimal and efficient use of ICT. This requires a large amount of money and knowledge.

It is also essential that people involved in different activities of trade are capable of adopting and using modern technologies of information and communications. In developing countries, the technical competence

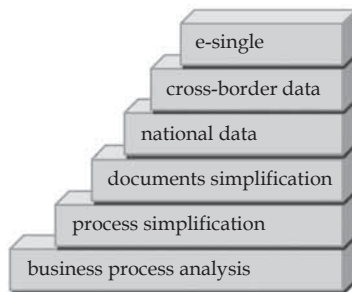
of people to adopt and use ICT is generally low. The fast-changing ICT has made the global trading mechanism easier for capable people who keep pace with the changing technology, but more complex for people who do not. For example, Nepalese small and medium enterprises lack the capacity to absorb trade-related information supplied by different agencies through various means of telecommunications (Rajkarnikar *et al.* 2006).

For proper use of ICT, comprehensive cyber laws and regulations are required. In the absence of such laws and regulations, the risk of fraudulent activities emerges, which in turn makes trade difficult and costly. But being a new concept, the drafting and enforcement of cyber laws and regulations is a challenging task for developing countries. Further, its implementation demands a large amount of financial resources and knowledge.

10.3 Issue of single window

A single window helps to simplify trade processes and procedures, and improve transparency and predictability in international trade transactions. The concept of a single window is gaining wider acceptance. Some countries have already adopted this system. A number of countries in the Asia-Pacific region are in the process of establishing a national single window. A single window can also be established at regional and international levels. But establishing a single window is a difficult and challenging task, in terms of capital, technology and human resources required. The UN/CEFACT has developed a step-by-step approach to establish an electronic single window and paperless trade environment (Figure 8.2).

Figure 8.2: Step-by-step approach to developing an electronic single window and paperless trade environment



Source: www.unece.org/cefact/

Accordingly, in the process of establishing a single window, the tasks of business process analysis, simplification and harmonization of processes, simplification and alignment of documents, harmonization of national data, and cross-border data harmonization and exchange are to be completed in a phase-wise manner prior to the establishment of a single window. These tasks can be performed only with the integrated efforts of all the parties concerned. A single window can be established and run only with the support of an appropriate legal and institutional framework. It also requires an adequate and efficient IT infrastructure, both hardware and software. Thus, it demands a huge budget and this is one of the reasons for the failure of developing countries to catch up with developed countries in this process. Filling this gap is a serious issue in global trade.

10.4 Issue of regulation cost

Regulatory reform demands new laws, rules and regulations or amendments to existing laws, rules and regulations. Costs are involved in both the stages of formulation and enforcement of laws and regulations. There are dissemination costs too. New laws and regulations or amendments to existing laws and regulations may also require new institutions to be established or existing institutions to be dissolved or restructured — all of which entail cost. Similarly, regulatory reform may require new physical facilities. For example, changes in regulations recognizing electronic submission of customs declaration require computers in customs. Cost is also involved in the training of personnel as required by the regulatory reform. Such trainings are needed not only for government regulatory officials or staff but also to the other relevant people belonging to the private sector such as freight forwarders, bankers, exporters and importers. Therefore, the cost factor has to be seriously considered while amending the regulations.

10.5 Issue of resistance to change

If changes are difficult to comply with and costly, even if they are beneficial in the long run, people tend to resist change. Resistance to change generally comes from government or regulatory officials and staff as they are not the immediate beneficiaries. Therefore, reform should be conducted in such a way that the parties concerned do not take it as a burden. Reform should be implemented in a flexible way and enough time should be provided to the parties concerned for adjustment. Adjustment has costs, and this is also a reason for resistance. So, to avoid

resistance, reform should be initiated in such a way that adjustment costs are minimized to the extent possible.

Frequent changes to regulations reduce predictability and hence are resisted by traders. Therefore, even for the sake of reform, frequent changes to regulations are not desirable. The stability factor also needs to be considered in the process of regulatory reform. Only a regulatory reform with farsighted vision will be stable and acceptable to the trading community.

10.6 Issue of transit-country regulation

Landlocked countries also need to comply with the regulations of transit countries. Transit countries issue regulations unilaterally, often exerting serious adverse impacts on the traders of landlocked countries. Nepal has experienced such a situation several times despite bilateral treaties on transit and trade with India, the transit country. Transit-country regulations are often unpredictable. The difference in the regulations of the transit country and the trading country creates additional costs and delays in trade transactions of the landlocked country. These issues can be addressed to a great extent if the principles and good practices set by international organizations such as the WTO and the World Customs Organization are strictly followed by the transit country in this regard. According to Article V of the GATT, which is related to freedom of transit with respect to regulations, transit traffic should be treated no less favourably than domestic goods by the transit country. Similarly, relevant transit-related laws and regulations should be published and reviewed regularly.

11. Conclusion

The reduction of tariff and non-tariff barriers to trade has increased the importance of trade facilitation in boosting world trade. Countries are now giving priority to trade facilitation. According to the second Aid for Trade Global Review, many recipient countries of aid for trade put trade facilitation among their top three priorities (UNESCAP 2009).

The role of government regulations is crucial in trade facilitation. Regulations are enforced to achieve the twin objectives of facilitating trade and protecting the social interest of the people. Thus, government regulations should be business friendly on the one hand and effective to attain social objectives, on the other.

Regulatory reform is needed to make regulations transparent, predictable, stable and business friendly, thereby reducing the cost and time

of transaction and enhancing efficiency and competitiveness. Building competitive strength is vital to trading in today's international market of keen competition. Regulations should be compatible with the developments taking place in the international trading system. There are costs associated with complying with regulations. Excessive regulation impedes trade and increases costs unnecessarily, eroding competitive strength. The number of regulations should be as minimum as possible. But they should be prudent and effectively implemented.

Regulatory reform can be considered as a key component of trade facilitation. The state of trade facilitation in South Asia is still far below than that in other regions of the world. The burden of government regulation is still high in a majority of South Asian countries (Jayaratne 2010). A joint effort is essential towards improving such a situation. Regulatory harmonization may also make a remarkable contribution in this regard.

Countries are at different levels in terms of trade facilitation. Considering their trade facilitation status, and resource and knowledge availability, more aid for trade and technical assistance should be directed towards least-developed and landlocked countries so that they can develop both hardware and software components of trade facilitation. Nepal has to improve its trade facilitation status, including through regulatory reform, massively, for which it needs a huge amount of financial and technical resources for not only software components but also hardware components. Nepal is in dire need of physical facilities in the customs to improve its cross-border trade. Nepal is still in a very early stage of developing an e-trade system. Technical assistance is needed in different aspects, including regulation, for a speedy move towards it.

Notes

- ¹ Basel II charter is a set of banking regulations put forth by the Basel Committee on Bank Supervision, which regulates finance and banking internationally.

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PART

4

DEVELOPMENT ISSUES

Chapter 9

The financial crisis in the Gulf and its impact on South Asian migration and remittances

S. Irudaya Rajan and D. Narayana

1. Introduction

The financial crisis that had its origins in the United States (US) in 2008 spread to Europe, and then to Japan. The effect of the crisis has been slow to manifest in the six Gulf Co-operation Council (GCC) countries.¹ Their basic strengths—a public-funded banking sector and a huge trade surplus due to the export of oil, the price of which saw an unprecedented increase in a span of six months in 2008—shielded the GCC economies from the adverse impact during the initial days of the crisis. This, coupled with significant inward foreign direct investment (FDI) flows to all GCC countries, except Kuwait, also had a beneficial impact (ESCWA 2008).

The GCC economies, however, began to feel the impact of the global crisis from the last quarter of 2008. The most significant indicator was the slowdown in the gross domestic product (GDP) growth rate in 2008 and the negative growth rate in 2009 in some of these economies. In the financial sector, the stock markets in all GCC countries recorded a

decline, owing to the withdrawal of foreign institutional investors. A number of private-funded domestic and international projects in the Gulf region had reportedly been cancelled or abandoned, leading to a large number of layoffs or retrenchment of the workforce. Countries that are more exposed to global capital, investment and consumption demand face a greater risk of being affected by the crisis than others. For instance, Dubai in the United Arab Emirates (UAE), which depends heavily on international capital, tourism and real estate, seems to be more adversely affected than other countries. On the other hand, Saudi Arabia, which has only 25 percent foreign workers compared to much higher proportions in the other GCC economies, might be much less affected than others (Zachariah and Rajan 2009). The slowdown in the growth rates of GCC economies has particular significance for South Asian expatriates, who are the main migrant labour in GCC countries.

In this context, this article focuses on the following questions:

- How did the crisis affect the demand for South Asian migrant workers in the Gulf countries?
- What strategies did the emigrants adopt to cope with the situation at their place of work (countries of destination) and what is the likely impact of the crisis on the home country in terms of decline in remittances, if any?
- Did countries in South Asia see large-scale return emigration? Did they find a decline in the outflow of emigrant labour to Gulf countries, and inward remittances from them?

2. Approach and methodology

Following an assessment of the trends in expatriate workers and employment structure in GCC countries based on published data, an attempt is made to map the trends and patterns of international migration, preferred countries of destination and trends in remittances over a long period of time. In addition to the macro assessment of the situation, this article also draws on two surveys, concerning: i) return emigrants in the countries of origin who lost their jobs in the countries of destination due to the financial crisis; and b) return emigrants who came back as per the migration terms of contract.

2.1 Survey of crisis-led return emigrants

This survey was conducted among the emigrants who lost their jobs and were forced to return home because of the financial crisis in the Gulf. It was also aimed at examining their coping mechanism after their

return to their home country. The survey was canvassed among 50 return emigrants each in four South Asian countries: Bangladesh, Nepal, Pakistan and Sri Lanka. In India, the survey was canvassed among 250 return emigrants in five states of India, 50 each in Andhra Pradesh, Tamil Nadu, Kerala, Maharashtra and Punjab. Thus, the total number of return emigrants surveyed was 450 among the five countries of origin in South Asia. However, we confess that it was difficult to locate the emigrants who lost their jobs in the countries of destination and returned to the countries of origin. The return emigrant survey collected information on household characteristics, the profile of return emigrants, household economic assets, employment, remittances and their utilization, household expenditure pattern, reasons for return, and adaptation and coping mechanisms.

2.2 Resurvey of regular return emigrants

Return migration from the Gulf is the normal process of contract migration. Migrants from South Asia go on contract work to destination countries, and once the contract ends, they, in the normal course, return to their countries of origin. As of now, we have no estimate of return emigration from the Gulf to South Asia. However, the Centre for Development Studies (CDS) has completed four large-scale migration surveys (1998, 2003, 2007 and 2008) over the last decade. To assess both regular return emigrants and the crisis-led return emigrants from the Gulf, in 2009 we revisited emigrant households from the 15,000 households of the 2008 Kerala migration survey. We estimated the extent of crisis-led return emigrants in Kerala after the revisit. In a later section of this article, we apply the same methodology to estimate the number of return emigrants from the Gulf to South Asia. In addition, the resurvey also estimated the number of emigrants who lost their jobs in the Gulf, but had chosen to remain there without returning to their countries of origin. This new information ("lost job, but have not returned") is also generated for South Asia as a whole.

3. Financial crisis and growth in the Gulf²

The global crisis originating in the US, spreading to Europe and to Japan, has affected the Middle East through a large fall in price of oil, reversal of capital inflows, depression of property and equity markets, and losses in sovereign wealth funds. The effect of the crisis varied across the countries depending upon country characteristics, such as high share of oil exports in total exports, large quantum of re-exports, and a sizeable

share of services in GDP, especially transportation, trade, hotel and restaurants. In the region as a whole, growth declined from 5.1 percent in 2008 to 2.4 percent in 2009. Among oil-producing countries, the sharpest slowdown was in the UAE, where the exit of external funds contributed to a large contraction in liquidity, a sizeable fall in property and equity prices, and a substantial pressure in the banking system. At the other end of the spectrum is Qatar, which grew by about 9 percent in 2009.

Interestingly, a comparison of the growth forecast for 2009 and the realized growth shows some important patterns. For developed countries, the contractions forecast and realized hardly show much of a difference, but the recovery is expected to be quicker. For South Asian countries as a whole, the realized growth is much better than the forecast, and the recovery is also rapid. The GCC countries show a mixed pattern: both the UAE and Kuwait witnessed contractions greater than the forecasts; the rest of the countries except Qatar reported growth rates higher than the forecasts; the growth recovery in 2010 and 2011 is on expected lines.

3.1 Gulf economies: Population and GDP growth

The population of GCC countries increased by 8.39 million between 2000 and 2008, an increase which is almost the size of the GCC excluding Saudi Arabia in 2000. The large increase in the populations of almost all the Gulf countries is accompanied by a high average growth of GDP between 2000 and 2009. Only Kuwait showed a large increase in population with a relatively low increase in GDP (Table 9.1). Along with population growth, the proportion of expatriates in the population has increased. In Qatar and the UAE, expatriates constitute over 80 percent of the total population, and in Kuwait they account for close to 70 percent of the total population. In Saudi Arabia and Oman, expatriates constitute slightly over a quarter of the population, while Bahrain has over 40 percent non-nationals in the total population. The proportion of expatriates in the labour force is linked to their proportion in the population. Over 60 percent of the expatriates are from South Asia and in some countries, such as Oman and Bahrain, they account for over 90 percent of the expatriates (Table 9.2). Overall, the flow of South Asian migrants to GCC countries is a function of GDP growth in the latter.

3.2 Employment structure in GCC countries

In GCC countries, over 50 percent of the workforce is employed in manufacturing, trade and construction. Kuwait and Saudi Arabia are the exceptions, where the share of public administration and defence is

Table 9.1: Growth of population and GDP in GCC countries

Country	Population (million)				GDP growth 2000–2008 (%)
	2000	2009	Change 2000–2009	Change 2000–2009 (%)	
Kuwait	2.217	3.443	1.226	55.30	6.68
Qatar	0.606	1.098	0.492	81.19	11.17
Saudi Arabia	20.474	24.897	4.423	21.60	3.91
UAE	2.995	4.764	1.769	59.07	7.74
Bahrain	0.670	0.779	0.109	16.27	6.29
Oman	2.402	2.769	0.367	15.28	5.36
Total	29.364	37.750	8.386	28.56	-

Source: International Monetary Fund, World Economic Outlook Database, April 2009.

Table 9.2: Profile of expatriates in the Gulf, 2009

Country	Population (’000)	% Expatri- ates in total population	% of South Asian expatriates in total expatriates	% of expatriates in the labour force
Kuwait	3,443	68.8	52.8	83.9
Qatar	1,098	86.5	68.4	92.5
Saudi Arabia	24,897	27.8	54.9	55.8
United Arab Emirates	4,764	81.0	68.7	89.8
Bahrain	779	43.0	95.1	58.3
Oman	2,769	28.4	89.0	64.3
GCC	37,750	40.3	61.8	-

Source: Compiled from various sources such as Country Reports prepared by the CDS team, figures reported by the respective embassies in the Gulf, and United Nations (2009), Kapiszewski (2006), Taattolo (2006) and Shah (2009).

rather high (Table 9.3). The share of construction in total employment increased rapidly during 2001–2008 in some of the GCC countries. For instance, in the UAE, the share of construction sector employment increased by 5 percentage points during the period. In Saudi Arabia, the increase in employment in the construction sector during the period was about 300,000.

As construction is one of the major sectors attracting expatriate labour, it is important to analyse the effect of the crisis on this sector. Project finance and utilities have taken a severe beating along with financial institutions in the crisis. A survey of projects (worth at least US\$10 million) in mid-2009 reported 10 percent to 30 percent cancellations or

Table 9.3: Share of employment (%) across
economic activities in GCC countries, 2007

Activity	Bahrain	Oman	Kuwait	Qatar	Saudi Arabia	UAE
Agriculture, hunting and forestry	0.47	9.09	2.60	1.92	4.69	5.0
Fishing	0.01	0.44	0.08	0.43	*	*
Mining and quarrying	0.49	1.96	1.90	5.27	1.32	1.3
Manufacturing	17.54	10.77	4.43	8.69	7.28	13.0
Electricity, gas and water supply	0.13	0.33	0.01	0.66	0.96	1.2
Construction	29.86	34.68	14.23	37.14	10.22	20.6
Wholesale, retail trade and car repairs	24.62	16.18	14.03	12.28	16.10	20.0
Hotels and restaurants	6.55	5.97	2.89	1.96	3.20	4.2
Transport, storage and communication	4.20	1.30	3.85	4.33	4.42	6.2
Financial intermediaries	3.46	0.29	1.21	1.09	1.08	1.4
Real estate and renting services	7.54	1.77	5.59	3.43	3.22	3.3
Public administration and defence	0.01	–	14.75	6.35	18.03	10.8
Education	1.24	0.76	5.23	3.16	11.96	**
Health and social work	0.24	1.91	2.40	2.55	4.33	**
Community and personal services	2.11	1.08	4.18	1.54	2.26	4.5
Domestic services	0.06	9.96	21.86	8.79	10.79	8.4
Extra-territorial organizations and bodies	0.21	2.59	0.11	0.21	0.13	-
Not classified by economic activity	0.30	0.90	0.66	0.18	0.01	0.01
Total	100	100	100	100	100	100

*Fishing is included in agriculture, hunting and forestry.

**Education and Health are included in Public Administration and Defence.

Note: For Bahrain and UAE, figures show paid employment by economic activity. For Oman, figures show expatriate workers in the private sector. Kuwait figures are for 2005.

Source: International Labour Organization, Labour Statistics; Ministry of National Economy, Oman, Statistical Year Book 2008. For Saudi Arabia and UAE, figures are taken from the country reports.

orders put on hold in GCC countries (Table 9.4). Dubai, which has about 60 percent of all projects in the GCC, has taken the largest hit, which in turn has affected the GCC as a whole. Interestingly, the crisis has affected all sub-sectors – from commercial projects to residential properties – as the illustration from the UAE shows (Table 9.5).

Table 9.4: Projects affected by the crisis in the GCC

Country	Projects under construction	Projects cancelled/on hold	Total project worth (US\$ billion)*	Cancellation (%)
Kuwait	90	18	114	17
Qatar	124	7	42	-
Saudi Arabia	442	106	387	19
UAE	1,372	566	900	29
Bahrain	148	54	36	27
Oman	95	8	38	8

*All projects, including cancelled/on hold.

Source: Proleads.

Table 9.5: Projects affected by sub-sectors, UAE

Sub-sector	Projects under construction	Total number of projects	Projects cancelled and cancellation rate (%)
Commercial projects	340	487	147 (30)
Hospitality business	288	406	118 (29)
Residential properties	495	712	217 (30)
Retail projects	249	333	84 (25)
Total	1,372	1,938	566

Source: www.gulfbase.com/site/interface/NewsArchiveDetails.aspx?n=110724

While new project starts have come down in the UAE, there is continuing high-level activity in ongoing projects that would be “the envy of many” elsewhere in the world. There is evidence of increased construction activity in Abu Dhabi, Sharjah and Ajman. Thus, while new starts have come down and those about to be started have been put on hold, a lot of activity is continuing in ongoing projects.

3.3 Gulf crisis and South Asian labour: The Links

The link between economic growth and labour flow is through the growth in manufacturing, trade and construction. Construction, in particular, attracts large numbers of expatriate labour from South Asia. Any of the factors adversely affecting construction would affect labour. The quick rebound of oil prices by mid-2009 and the not-too-depressing current account and budget balances have made the governments of GCC countries bolder and induced them to continue major infrastructure investments. The increase in government expenditures (as a percentage of GDP) was close to 10 percentage points in most of the countries (Table 9.6), except Bahrain and Qatar. Fiscal policy has played a crucial role in cushioning the impact of the global crisis on GCC countries.

Table 9.6: Government expenditure in GCC countries, 2006–2011 (% of GDP)

Country	2006	2007	2008	2009	2010	2011
Kuwait	31.83	29.94	40.15	47.36	43.22	44.28
Qatar	26.42	25.37	24.52	26.66	23.22	22.47
Saudi Arabia	31.96	34.36	30.81	44.54	42.80	40.75
UAE	18.39	18.98	21.22	32.11	28.34	23.07
Bahrain	28.48	28.70	28.00	31.42	30.83	29.53
Oman	34.44	35.33	29.42	38.73	37.38	37.02

Note: Figures for 2010 and 2011 are projected.

Source: World Economic Outlook Database, October 2010.

Interventions in the banking sector have also been decisive. A further boost has been the healthy, albeit lower, GDP growth in the whole of South Asia in 2009 and the forecast of higher growth rates in 2010. South Asia and China have emerged as the major trading partners of GCC economies and the trade outlook does not look very depressing.

However, continuing adverse factors have been the depressed real estate and equity prices in GCC countries, particularly in Dubai. The recovery will remain fragile as long as private investment does not stimulate growth. FDI, which had played a major role in the high growth of the pre-crisis days, fell drastically in 2009 in almost all GCC countries, except Oman, Qatar and Saudi Arabia. In the UAE, FDI fell from US\$13.7 billion in 2008 to US\$4 billion in 2009 (UNCTAD 2010).

4. Impact of the crisis on South Asian migrant workers

This section is devoted to an assessment of the impact of the crisis on South Asian migrant workers in terms of return emigration; flows of labour emigration from Asia to the Gulf; and inward remittances to South Asia. The assessment is based on the summary results of two surveys conducted to understand the coping mechanisms of individuals and families in times of crisis.

4.1 Return migration to South Asia from the Gulf, 2009

All agencies working on migration and remittances in South Asian countries and the Gulf region predicted an exodus of return emigrants from the Gulf to their countries of origin following the crisis. CDS, Kerala, which has undertaken four large-scale migration surveys in Kerala during the last 10 years to estimate the number of emigrants and return emigrants, and remittances, revisited the households of the 2008 survey (CDS 2008) in 2009³ to arrive at reliable estimates of return emigrants.

All those in the original sample who had returned were asked to cite the reasons for returning to Kerala. The questionnaire provided 10 possible reasons for the return, among which the following three could be attributed to recession: job loss and return due to financial crisis, expiry of contract (renewal of contract did not take place as expected due to recession), and compulsory expatriation. Estimates of return migrants due to the crisis are provided in Table 9.7.

Table 9.7: Number of return emigrants in Kerala due to recession in 2009

	Sample	Total
Total emigrants in 2008 based on 2008 Kerala Migration Survey	3,953	2,193,412
Return emigrants among emigrants of 2008 in Return Migration Survey in 2009	304	168,681
Return emigrants in Kerala due to financial crisis and recession	110	61,036

Source: Zachariah and Rajan (2009).

If we deduce that out of the stock of 2.19 million emigrants from Kerala, about 61,036 crisis-led migrants returned, then what could be the number of return emigrants from the Gulf to South Asia? According to data available from various formal and informal sources, there are about 9.5 million South Asian emigrants in the Gulf; and the number of projected return emigrants from the Gulf to South Asia is 263,660 (Table 9.8).⁴ The number of return emigrants from the Gulf to countries in South Asia can also be estimated. For instance, India had a stock of 1.7 million migrants settled in the UAE, and the projected number of Indian return emigrants from the UAE was 47,000.

Table 9.8: Estimates of return emigrants in South Asia from the Gulf due to financial crisis, 2009

Country/state	Stock of emigrants	Return emigrants due to crisis
Kerala	2,193,412	61,036
India	5,050,000	140,526
Pakistan	2,300,000	64,002
Bangladesh	900,000	25,044
Nepal	250,000	6,957
Sri Lanka	975,000	27,131
South Asia	9,475,000	263,660

Source: Survey (see text).

Why are these numbers so small compared to numerous predictions? We postulate two important features of Gulf migration from South Asia as responsible for this: i) the cost of migration to the Gulf; and ii) the peculiarities of the channel of migration.

South Asians incur huge costs to migrate to the Gulf. According to the Kerala Migration Survey 2008, the cost of migration to the Gulf varied between Indian rupees (INR) 53,951 for Kuwait and INR 74,606 for Saudi Arabia, that is, between US\$1,200 and US\$1,660 at an exchange rate of INR 45 per US\$1 (Table 9.9). This applies to all South Asian countries (also see United Nations 2009; Zachariah and Rajan 2009; Rajan and Prakash 2009). The high cost of migration to the Gulf caused many emigrants to borrow from various financial sources. Under such conditions, even if the expatriates lost their jobs in the Gulf, they would prefer not to return home fearing inability to repay the debt already contracted there. They would rather accept any job at a lower wage and send home remittances to repay their loans even during a crisis in the destination country.

Another characteristic of South Asian migration to the Gulf is the part played by the social network, which consists of friends and relatives, who perform a major role in the channel of migration flows by arranging visas and other requirements for the emigration process. For instance, an all-India survey conducted by CDS for the International Labour Organization and the Ministry of Overseas Indian Affairs revealed that close to 80 percent of Indian emigrants utilized their friends and relatives as an important channel for migration (Table 9.10). This also ensured that in the event of a job loss, they could rely on someone to provide them temporary support.

Table 9.9: Average cost of emigration for different
migration corridors from Kerala, 2008

Countries	Average cost (INR)
Kerala-Bahrain	57,172
Kerala-Kuwait	53,951
Kerala-Oman	56,840
Kerala-Qatar	66,316
Kerala-Saudi Arabia	74,606
Kerala-UAE	61,308
Kerala-UK	56,589
Kerala-US	42,080

Source: Survey (see text).

Table 9.10: Channels of migration by emigrants, 2007

Channel	Male	Female	Total	Male	Female	Total
Government agency	3	0	3	0.7	0.00	0.5
Foreign employer	41	7	48	9.2	3.35	7.3
Private recruitment agencies	71	17	88	16.01	8.1	13.5
Total	445	209	654	100	100	100

Source: Rajan *et al.* (2009).

4.2 Emigrants who lost jobs in the Gulf and have not returned

There are migrants who lost their jobs in the Gulf but have not returned home as they continue to look for jobs in sectors less/not affected by the crisis, at lower wages and in poorer working conditions. The Return Emigrant Survey 2009 conducted in Kerala offered a unique opportunity to estimate the number of those who lost their jobs in the Gulf countries due to the crisis there. According to the estimate made by the authors, of the 2.2 million stock of emigrants from Kerala, about 39,396 persons lost their jobs between 2008 and 2009 but have not returned to their country of origin (Zachariah and Rajan 2009). Applying the same methodology to estimate the number of South Asian migrants who lost their jobs in the Gulf yields the number 170,181 (Table 9.11).

Table 9.11. Estimates of emigrants who lost their jobs
in the Gulf but have not returned, 2009

Country	Stock of emigrants	Number of emigrants who lost their jobs but have not returned
Kerala	2,193,412	39,396
India	5,050,000	90,703
Pakistan	2,300,000	41,310
Bangladesh	900,000	16,165
Nepal	250,000	4,490
Sri Lanka	975,000	17,512
South Asia	9,475,000	170,181

Source: Survey (see text).

4.3 Outflow of workers from South Asia to the Gulf, 2009

As there were no official data to show the extent of outflow of workers from South Asia to the Gulf, we estimated the possible trends using reasonably well-managed databases from these countries. All the countries in South Asia, except Sri Lanka, have reported decline in the flow

of workers to the Gulf. The projected decline for India is huge – about 280,000 – followed by Pakistan with just 12,000 (Table 9.12).

Table 9.12: Outflow of migrant workers from
South Asia to the Gulf, 2005–2009

	India	Pakistan	Bangladesh	Nepal	Sri Lanka
2005	454,628	127,810	207,089	88,230	192,004
2006	618,286	172,837	307,620	128,306	170,049
2007	770,510	278,631	483,757	182,870	188,365
2008	818,315	419,842	643,424	169,510	215,793
2009	538,090	407,077	n.a.	152,272	226,299

Source: Based on country papers for this study prepared by the respective country teams in the countries of origin.

As regards the destination, the decline was large for the UAE, which has been more severely affected by the crisis than the other countries in the Gulf. But this was more than compensated by the increase in the numbers who left for Saudi Arabia. This pattern holds for India, Pakistan, Sri Lanka and Nepal. Thus, the crisis has changed the migration and demographic dynamics of South Asian workers in the Gulf region.

4.4 Inward remittances to South Asia, 2009

The money that migrants send home is important not only to their families, but also to their countries' balance of payments. In many developing countries, remittances represent a significant proportion of GDP as well as foreign exchange receipts. Among South Asian countries, India ranked first in terms of the volume of remittances, at US\$52 billion (or 4.2 percent of GDP), in 2008. Bangladesh ranked eighth and Pakistan ranked 11th in terms of remittances. Nepal was one of the top 10 countries in the world in terms of remittances as a percentage of GDP, at 22 percent. When the crisis hit in 2008, the World Bank stated that the outlook for remittances for the rest of 2008 and 2009–2010 remained as uncertain as the outlook for global growth, oil and non-oil commodity prices, and currency exchange rates. After several years of strong growth, remittance flows to developing countries began to slow down significantly in the third quarter of 2008 in response to a deepening global financial crisis.

Our estimates based on the simple average of remittances for the available months from the country reports prepared by the country teams suggest that all the countries of South Asia are resilient to the crisis in terms of remittances (Table 9.13). Our estimates put the growth in

remittances to India at 3 percent, from US\$51.6 billion in 2008 to US\$53.2 billion in 2009.

Table 9.13: Inward remittances to South Asian countries
from migrant workers, 2000–2009 (US\$ million)

	India	Pakistan	Bangladesh	Nepal	Sri Lanka
2000	12,890	1,075	1,968	111	1,166
2001	14,273	1,461	2,105	147	1,185
2002	15,736	3,554	2,858	678	1,309
2003	20,999	3,964	3,192	771	1,438
2004	18,750	3,945	3,584	823	1,590
2005	22,125	4,280	4,314	1,212	1,991
2006	28,334	5,121	5,428	1,453	2,185
2007	37,217	5,998	6,562	1,734	2,527
2008	51,581	7,039	8,995	2,727	2,947
2009*	47,000	8,619	10,431	3,010	2,892
2009 ⁺	53,227	8,856	10,525	2,812	3,308
% change					
2000–01	10.73	35.91	6.96	32.43	1.63
2001–02	10.25	143.26	35.77	361.22	10.46
2002–03	33.45	11.54	11.69	13.72	9.85
2003–04	-10.71	-0.48	12.28	6.74	10.57
2004–05	18.00	8.49	20.37	47.27	25.22
2005–06	28.06	19.65	25.82	19.88	9.74
2006–07	31.35	17.13	20.89	19.34	15.65
2007–08	38.60	17.36	37.08	57.27	16.62
2008–09*	-8.88	22.45	15.96	10.38	-1.87
2008–09 ⁺	3.19	25.81	17.01	3.12	12.25

* World Bank estimates; ⁺ Authors' estimates.

Source: World Bank and the country reports prepared by the research team.

Remittances did not decline in South Asia for the following six reasons: i) the debts contracted to meet the high cost of migration kept the emigrants from returning to their home countries in spite of the lay-offs; ii) the predictions of a large exodus of emigrants from the Gulf did not come true; iii) though the outflow declined in the first half of 2009, it did not significantly affect the stock of South Asian migrants in the Gulf; iv) the appreciation of the US dollar vis-à-vis South Asian currencies; for instance, the current exchange rate of the Indian rupee to the US dollar is much higher than what it was during the crisis period; v) the continuous rise in oil prices generating more income in the Gulf; and vi) the “reverse migration” of the crisis-led return emigrants back to the Gulf.

5. Conclusion

The impact of the crisis on output and employment in the US had generated an anticipation of large-scale retrenchment of expatriate labourers in the Gulf region. The anticipated misery and the need for rehabilitation had got some governments in South Asia thinking about plans for the returning migrants. We find that the dimensions of the impact were not as large as was feared earlier. For a stock of approximately 9.5 million South Asian emigrants in the Gulf, the number who returned due to the crisis is estimated at 264,000 (just around 2.78 percent); and the number of workers who lost jobs but were continuing to stay in the Gulf was about 170,000 (1.8 percent). Overall, less than 5 percent of the South Asian emigrants had lost jobs owing to the crisis. The yearly flow of out-migrants from South Asia was also not adversely affected much.

As regards remittances (in US dollars), the annual percentage increase since 2004–05 has been over 20 percent for South Asian countries, except for Sri Lanka. The rate of increase has taken a hit all over South Asia, except Pakistan from where the outflow of migrants had been increasing at around 50 percent every year since 2005. But remittances have not fallen following the crisis; either it has remained stagnant or has shown a mild rise depending upon the estimates. As most of the South Asian currencies have depreciated against the US dollar (to which the GCC currencies are pegged) from late 2007, remittances in terms of domestic currencies have shown an increase. Surveys of migrant households in South Asia confirmed these estimates as 94 percent of the households reported regular remittances during the crisis period also as in previous years, and no significant change in the use of remittances was reported by these households.

Overall, less than 5 percent of the stock of South Asian migrants in the Gulf had lost jobs and had either returned or were struggling to continue staying in the Gulf. The flow of workers from South Asia to the Gulf had also not been affected in any significant extent, but there were changes in the origin (in favour of Pakistan) and the destination (in favour of Saudi Arabia) of the flow. The volume of remittances into South Asia had also not fallen to any significant extent. In sum, the crisis of 2008–2009 was a blip on the radar of labour migration to GCC countries from South Asia. A few thousands lost jobs and had to return home, but the number migrating to the Gulf has hardly fallen.

This article is based on a study funded by the Asian Development Bank, Ministry of Overseas Indian Affairs, Government of India, and Department of Non-Resident Keralite Affairs, Government of Kerala.

Notes

- ¹ GCC countries are: the United Arab Emirates (UAE), Saudi Arabia, Qatar, Bahrain, Kuwait and Oman.
- ² This section is based on the six country reports prepared by the research team at the Centre for Development Studies (CDS). Most of the members of the research team visited the Gulf to assess the reality by talking to stakeholders, and additional research was done by the authors of this article.
- ³ Return Emigrant Survey 2009 was conducted by CDS and sponsored by the Department of Non-Resident Keralite Affairs, Government of Kerala (for more details of the survey report, see Zachariah and Rajan (2009)). The field work was carried out during 16 June–7 September 2009.
- ⁴ These could be underestimates as the composition of migrants from Kerala would have a lower proportion of unskilled workers.

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Chapter 10

LDC Integration Fund in South Asia

Ratnakar Adhikari

1. Introduction

It is natural that gains from any regional economic cooperation arrangement (RECA) are not likely to be shared equally by all the partner countries of the arrangement. The asymmetric benefits within any RECA are a by-product of a large variation in the size of the economies of the member countries, their economic structures, institutional endowments and policy-intervention mechanisms in place (Razzaque 2007; Adhikari 2010). However, the sustainability of any RECA depends on the extent to which benefits are equitably shared by all the participating countries. RECA should be considered a public good in the sense that the benefits of such an arrangement transcend national boundaries. This is more so when there is a shared vision of regional prosperity and the ensuing peace dividend. Several RECAs, including the European Union (EU), Southern Cone Common Market (Mercosur) and Association of South-east Asian Nations (ASEAN) Free Trade Area (AFTA), which are guided by the philosophical underpinning of “regional public good”, have made every possible attempt to ensure that the benefits of RECA are shared more or less equitably by all the participating members.

The Agreement on South Asian Free Trade Area (SAFTA), dubbed “too little, too late” by some commentators, is moving at a glacial pace in terms of enhancing trade within the region. This is evident from, *inter alia*, the share of regional trade in the total trade of the region, which has hovered around 5 percent for more than a decade now. Lower volume and value of trade may not in itself be so much of a problem if the benefits from SAFTA are shared more or less equitably by all the member countries. However, what is disquieting is the fact that the benefits of regional integration are reaped by relatively better-off countries in the region while the least-developed countries (LDCs)¹ continue to be marginalized from the mainstream of regional trade. Although SAFTA recognizes this asymmetry as well as the need to accord special and differential treatment to the LDCs in the region, provisions according such treatment have not moved beyond rhetoric and can be described as “best endeavour” clauses.

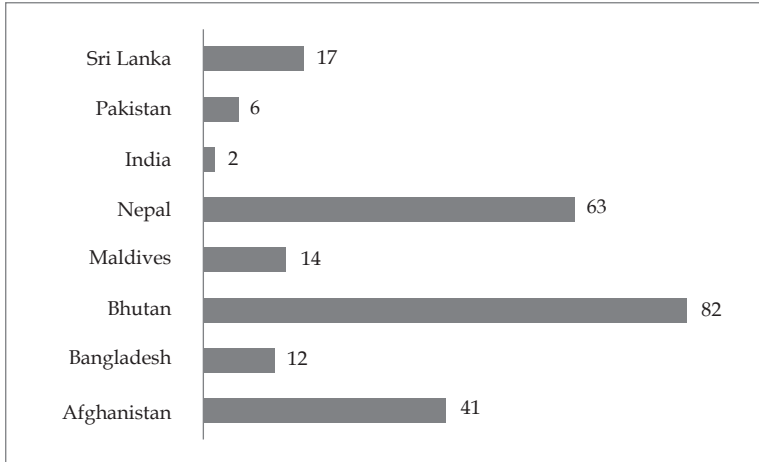
Against this backdrop, the objective of this article is to highlight the inherent asymmetry in trade benefits that accrue to various countries within the region and identify the reasons for such anomalies. One of the assumptive foundations of the article is that LDCs are being marginalized from the regional trade mainstream, which is reminiscent of the discussions at the global level, due to their supply-side constraints. Therefore, the article provides the rationale for the establishment of a relatively large-sized LDC Integration Fund (LIF) in order to address the challenge. It also proposes the contours and modalities of the LIF.

2. Situation analysis

Among SAARC member countries, LDCs have a higher stake in regional economic cooperation because of their excessive dependence on regional trade. Figure 10.1 provides the share of regional trade in the total international trade of SAARC member countries. In 2008, while Bhutan’s dependence on regional trade was 82 percent, Nepal’s share was 63 percent and Afghanistan’s share was 41 percent. Although the dependence of Sri Lanka, a developing country, on regional trade (17 percent) is more than that of two LDCs—the Maldives (14 percent) and Bangladesh (12 percent)—India and Pakistan have a negligible dependence on regional trade.

What is even more worrying is LDCs’ dependence on the two largest economies of the region, namely India and Pakistan. Figures 10.2a and 10.2b provide the level of dependence of LDCs on these two countries in terms of both exports and imports. Barring the Maldives, which is not dependent so much on India for its export trade within the region,

Figure 10.1: Dependence of South Asian countries on regional trade (as % of their global trade), 2008



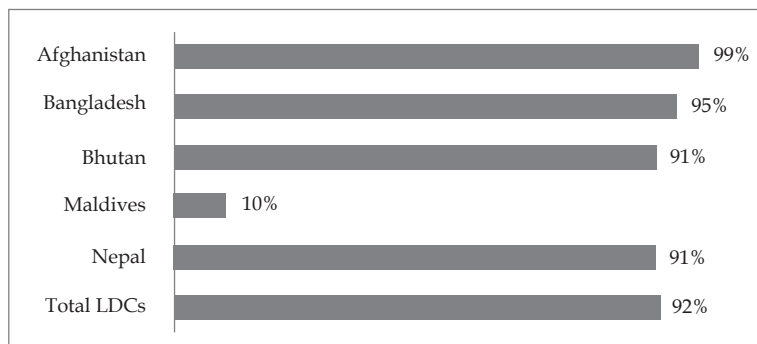
Source: International Monetary Fund (IMF) Direction of Trade Statistics (DOTS) online (accessed 21 April 2010).

and which has a very limited dependence on Pakistan for its exports, all other LDCs in the region are dependent on these two countries for more than 90 percent of their regional exports. The dependence of all LDCs, including the Maldives, on the two largest economies in the region for their imports is even more glaring.

The Agreement on SAFTA, in effect since 2006, is not expected to transform the historically tardy process of regional economic cooperation in South Asia; however, five years of implementation record of the agreement leaves much to be desired. It is even disappointing in the case of LDCs' participation. Despite their excessive dependence on regional trade, LDCs, with the possible exception of Bhutan, are increasingly being marginalized under SAFTA in terms of exports. Their imports from the region are increasing more rapidly than their exports to the region, with the result that their shares in intraregional exports have been shrinking, causing widening trade deficits.

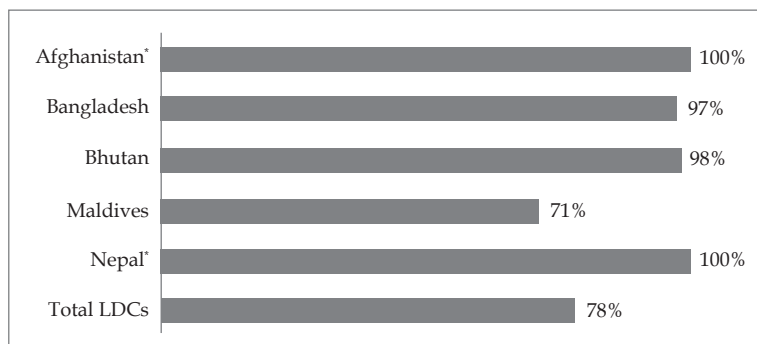
A comparison of trade figures for 2000 and 2008 reveals that trade deficits of LDCs vis-à-vis their regional trading partners have increased significantly (Table 10.1). Trade deficit at the bilateral level, or even at the regional level, may not be a cause for concern as long as the countries with these deficits have trade surpluses vis-à-vis countries outside

Figure 10.2a: LDCs' dependence on India and Pakistan
for their regional exports (percentage), 2008



Source: IMF DOTS online (accessed 21 April 2010).

Figure 10.2b: LDCs' dependence on India and Pakistan
for their regional imports (percentage), 2008



*100% due to rounding up.

Source: IMF DOTS online (accessed 21 April 2010).

the region. While this is true, to some extent, in cases of LDCs such as Bangladesh and the Maldives, Bhutan and Nepal have not been as fortunate. It is this asymmetry that needs to be corrected in order to help the LDCs in the region realize their development potentials.

One of the natural corollaries to the development discussed above is that the shares of LDCs in regional exports have decreased significantly in 2008 compared to 2000, as can be seen from Figure 10.3.² The shares of all LDCs in regional exports have reduced, whereas two developing countries, namely India and Pakistan, have seen their shares increase in

Table 10.1: Regional trade balance of South Asian countries,
2000 and 2008 (US\$ million)

	2000			2008		
	Exports	Imports	Trade balance	Exports	Imports	Trade balance
Afghanistan	60	169	-109	175	2,331	-2,157
Bangladesh	93	1,050	-957	431	3,916	-3,485
Bhutan	-	-	-	164	171	-7
India	1,820	454	1,366	9,449	2,410	7,039
Maldives	14	90	-76	18	216	-198
Nepal	309	587	-278	881	2,110	-1,229
Pakistan	404	291	113	2,919	1,272	1,647
Sri Lanka	190	707	-517	725	3,213	-2,488

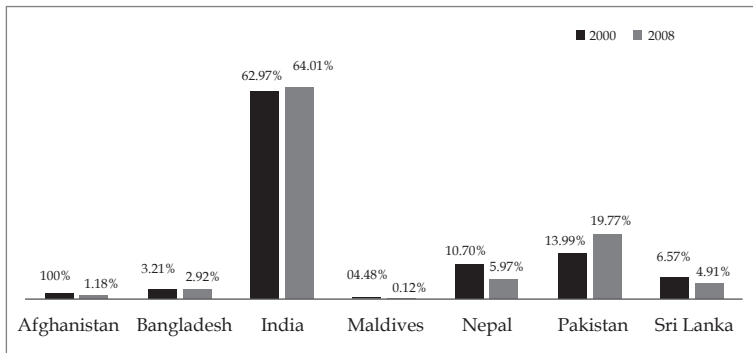
Note: Since data for Bhutan's trade are not available, they are calculated based on the export and import data of Bhutan's trading partners.

Source: IMF DOTS online (accessed 21 April 2010).

2008 as compared to 2000. The only exception among developing countries is Sri Lanka, which has seen its share decline.

Several factors are responsible for such deterioration of regional export performance of LDCs, one of them being market access barriers, which will be discussed below. It needs to be noted that some LDCs in the region, notably Bangladesh, have considerably increased their exports to countries outside the region, which could have also resulted in reduction in the share of their intra-regional exports. Despite this, Table 10.1 and Figure 10.3 provide evidence in support of our central argu-

Figure 10.3: Share of intra-regional exports of
South Asian countries, 2000–2008



Source: IMF DOTS online (accessed 21 April 2010).

ment that LDCs, in general, have not benefitted much from the regional trade agreement in South Asia.

3. Barriers to effective participation of LDCs in SAFTA

Although there are a host of market access barriers impeding the prospects of South Asian LDCs to better integrate themselves into the regional trade mainstream, two stand out in the case of most LDCs: i) sensitive list as a tariff barrier; and ii) rules of origin (RoO) and standard-related barriers as non-tariff barriers.³ While the significance of sensitive list as a tariff barrier is on the wane in the case of India, due to the unilateral pruning of the list by India,⁴ Pakistan and Sri Lanka do not even provide a different sensitive list for LDCs as required by the SAFTA Agreement.

RoO remains a barrier for LDCs' exports to developing-country markets in the region largely due to the lack of backward integration within LDCs. This, in turn, owes much to the level of industrialization in LDCs. However, what is more pernicious as a trade barrier is the standard-related trade barriers, whether in the name of promoting health and safety of plants and animals, or in the name of protecting the environment.

There is no denying that these measures may be necessary to protect the legitimate policy goals of developing countries. However, if they are imposed due to political economy factors and to afford disguised protection to domestic enterprises, they are not justified. There have been reported cases of arbitrary imposition of such barriers.⁵

Another issue that is important from the perspective of LDCs is that their efforts to diversify their trade beyond India (in the case of Bangladesh, Bhutan and Nepal) and Pakistan (in the case of Afghanistan) within the region is hampered by several geographical factors. Among them, the geographical situation of three LDCs (Afghanistan, Bhutan and Nepal) deserves special mention. Because of the landlocked status of these countries and frequent transit-related hassles being encountered by them, they are unable to diversify their trade with other developing countries as well as LDCs within the region.⁶

4. Supply-side constraints

LDCs in the region face severe supply-side constraints⁷ that limit their ability to export products for which market access barriers do not impose binding constraints. Although some of these constraints are due to natural handicaps, a majority of these owe to governance failure, implying the inability of the government to make optimal provision-

ing of public goods. These include deficiencies in infrastructure, human capital and trade facilitation measures coupled with limited access to finance and technology.

These issues are often overlooked in mainstream literature as well as policy documents due to two main reasons. First, standard trade theory assumes that supply response is invariably automatic. It assumes that once market access is provided, resources will switch to export sectors, which will help enterprises exploit the opportunity. Second, policy makers, including trade negotiators, have their focus predominantly, if not exclusively, on the reduction of trade barriers while engaging in any trade negotiations.

Various studies conducted in the context of South Asian LDCs have identified five supply-side constraints as the most pressing ones: i) infrastructure; ii) human capital; iii) trade facilitation; iv) access to finance; and v) access to technology.⁸

Adhikari (2011b), based on a survey conducted in Bangladesh and Nepal, finds the first three as the most binding supply-side constraints faced by these countries.⁹ In order to gauge the severity of the problem, comparisons between South Asian developing countries and LDCs have been made using various globally available indicators, of which two prominent ones are those in the *Global Competitiveness Report* and the *Doing Business* report. The precarious nature of supply-side constraints faced by South Asian LDCs is reflected in their rankings in the *Global Competitiveness Report 2010–2011*, which bases its analysis on 12 different components of competitiveness. While all the factors analysed by the report are necessary to measure the level of competitiveness of an economy, this article focuses on four factors, namely infrastructure, human capital (represented by health and primary education), access to finance (represented by ease of access to loan), and access and adaptability to technology (represented by technological readiness) that have been identified as the major constraints by earlier studies discussed above (Table 10.2).

Table 10.2 shows that in terms of various competitiveness rankings, Nepal and Bangladesh fall below other South Asian countries on infrastructure, ease of access to loan, and technological readiness, although both of them have better indicators than Pakistan in the case of health and primary education. In terms of ease of access to loan, Sri Lanka is the country with the best indicator within the region, followed by India and Pakistan. However, Bangladesh and Nepal rank much lower in this indicator as well.

What is still missing is the indicator of trade facilitation, an area in which South Asian LDCs lag far behind developing countries in the re-

Table 10.2: Select competitiveness rankings and indices, 2010–2011

Country/ Economy	Infrastructure		Health and pri- mary education		Ease of access to loan		Technological readiness	
	Rank	Index	Rank	Index	Rank	Index	Rank	Index
	N = 139	(1 to 7)	N = 139	(1 to 7)	N = 139	(1 to 7)	N = 139	(1 to 7)
Bangladesh	133	2.1	106	5	79	2.6	126	2.7
India	86	3.5	104	5.2	39	3.3	86	3.3
Nepal	139	1.8	109	4.8	88	2.5	134	2.5
Pakistan	110	2.8	123	4.3	40	3.3	109	2.9
Sri Lanka	70	3.8	35	6.2	38	3.3	84	3.4

Source: World Economic Forum (2010).

gion, as is evident from the trading-across-borders indicators included in the *Doing Business* report published by the World Bank (Table 10.3). Of particular note is the number of documents required for imports and exports, and the number of days taken for imports and exports. These are also reflected in the cost to import and export in LDCs. In the case of Nepal and Bhutan, the costs to import and export are very high—almost three times higher than the least costly exporter (Sri Lanka) and importer (Pakistan) in the region. Although the landlocked status of these countries is partly responsible for this, the lower quality of domestic infrastructure seems to have equally contributed to this.

While some constraints discussed above such as absence of requisite human capital or finance are purely supply-side constraints, others such as lack of institutional apparatus to comply with the standards and regulatory requirements of the importing country or RoO can be considered as both market access barriers and supply-side constraints. Given the fact that these two barriers are considered major non-tariff barriers in the context of South Asia, we need to bring these issues under sharper focus. For example, the inability of a country to fulfil the RoO requirement imposed by the importing country or under any regional trade agreement for the export of manufactured products is due to low level of industrialization of the exporting country in general and a lack of backward integration in particular. Similarly, the inability of an exporting country to meet, for example, the standard for pesticide residue in agriculture product prescribed by the importing country is also a supply-side issue. Therefore, time has come to view these problems as supply-side constraints rather than considering them as purely market access barriers.

Table 10.3: Trading-across-borders indicators for South Asian countries, 2010

Indicators	South Asian LDCs					South Asian DCs		
	AF	BD	BT	MV	NP	IN	PK	SL
Doing business – trading across borders (rank out of 183)	183	112	161	138	164	100	81	72
No. of documents required for exports	12	6	8	8	9	8	9	8
No. of days process required for exports	74	25	38	21	41	17	21	21
Cost to export (US\$ per container)	3,865	985	1,210	1,550	1,960	1,055	611	715
No. of documents required for imports	11	8	11	9	10	9	8	6
No. of days process required for imports	77	31	38	22	35	20	18	19
Cost to import (US\$ per container)	3,830	1,390	2,665	1,526	2,095	1,025	680	745

Note: AF = Afghanistan; BD = Bangladesh; BT = Bhutan; MV = Maldives; NP = Nepal; IN = India; PK = Pakistan; SL = Sri Lanka.

Source: World Bank (2010).

5. Addressing the constraints: Lessons from elsewhere

It is clear that LDCs are unable to overcome these challenges on their own. Adhikari (2011b) considers governance problems and resource constraints as two major impediments in this regard. While the issue of governance is important for LDCs to overcome the above-mentioned constraints, the focus of this article is on resource constraints. Although the Aid for Trade initiative, which was launched during the Hong Kong Ministerial Conference of the World Trade Organization, too intends to serve a similar purpose, this article focuses on a regional mechanism modelled on the time-tested mechanism of the EU, which is considered to be, by far, the most successful example of a RECA. It has followed what can be considered as “distributional sensitive” economic cooperation strategy, which is stated clearly in its Regional Policy document: “Regional policy is...the expression of the EU’s solidarity with less developed countries and regions, concentrating funds on the areas and sectors where they can make the most difference. Regional policy aims to reduce the significant economic, social and territorial disparities that still exist between Europe’s regions. Leaving these disparities in place would undermine some of the cornerstones of the EU, including its large single market...”¹⁰

This concern for collective prosperity that is underpinned by the philosophy which views pan-European economic cooperation as a “regional public good” is the bedrock of the EU regional policy. As suggested by Winters (1997), in order to provide practical shape to the idea, the European Regional Development Fund was created, with the main objective of assisting relatively poorer countries—Greece, Portugal, Spain and Ireland, the late entrants to the Union. Significant transfers were made to these countries in order to help them address their supply-side constraints, build credible institutions and indeed catch up with the rest of the members of the Union. Similarly, according to Ismail (2008), who provides a historical account of European economic growth as well as economic integration trajectory, success of their integration effort is largely attributed to transfers made by the European Commission to the relatively poor countries and regions through a structural and cohesion fund. In keeping with this policy, the EU continues to provide such resources to the less developed regions within the Union.

The fact that 10 new countries from Eastern Europe joined the EU in May 2004 as relatively less developed countries compared to the rest of the Union seems to have redoubled the significance of the Fund. For example, during the period 2007–2013, the EU is expected to invest a total of €347 billion in uplifting the status of various less developed regions within the Union.¹¹ An indicative list of areas for which funding is provided includes: i) improving transport links to remote regions; ii) boosting small and medium-sized enterprises in disadvantaged areas; iii) improving education and skills; iv) encouraging innovation through investment in research and technological development; v) building information and communication capabilities; and vi) developing new products and production methods.¹²

6. LDC Integration Fund

Building on the above model, a policy paper prepared by Coalition for Action on South Asian Cooperation (CASAC), which offered its perspective on the Report of the SAARC Group of Eminent Persons, had realized the constraints faced by LDCs in the early 2000s. It had made a plea for the “creation of a reasonably large sized fund” for the development of LDCs’ infrastructure, human resources, export production and diversification of export capacity (CASAC 2001, 19). Despite its potential contribution to enhancing regional integration in general and helping LDCs in the region obtain equitable benefits from the integration initiatives in particular, not much attention has been paid to this proposition. Therefore, this article recommends the revival of this idea

and the creation of an LDC Integration Fund (LIF), with the expectation that this would provide a much-needed shot in the arm for spurring regional economic integration in South Asia as well as for preventing marginalization of LDCs from the system.

6.1 Modality for financing and operation of the LIF

When we discuss about mobilizing resources to fund the LIF, financing immediately becomes a major challenge for SAARC, which is currently under-funded to implement several joint initiatives to give practical shape to the guidelines provided by various SAARC Summits. For the creation of the LIF, since a “reasonably large sized” fund is not defined, we need to first determine the size of the Fund. Since it is difficult to quantify the size of the Fund without adequate needs assessment, we propose the creation of a Fund with an annual contribution of US\$1.1 billion, calculated at 0.07 percent of the GDP of SAARC member countries. This figure is 10 percent of what the United Nations has urged the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD) to contribute in the form of Official Development Assistance. The following modality is proposed for financing the initiative:

Core contributions: There are three major types of core contribution that South Asian leaders could think of tapping into. First, SAARC member countries, including LDCs, would be required to contribute at least 50 percent of the resources based on the share of their regional trade. Second, SAARC observers should be urged to contribute 25 percent of the total requirement. Third, other multilateral donors and bilateral donors, which are not observers to the SAARC, can be urged to contribute 25 percent of the total requirement.

Project-based contributions: Since creating regional public goods such as cross-border road linkages, communication and trade facilitation aimed at promoting intra-regional as well as extra-regional trade are among the priority agenda of the multilateral Aid for Trade initiative, it would be possible to tap into these resources for project-based funding. Two successful examples of the Aid for Trade initiative are: i) a multi-donor North-South corridor initiative jointly implemented by three regional groupings in Southern Africa; and ii) an Asian Development Bank (ADB)-funded Greater Mekong Sub-regional project. Although the ADB has also been implementing a similar project in South Asia under the South Asian Sub-regional Economic Cooperation programme, it is yet to show tangible results. A similar model can be replicated in the case of South Asia as well.

Although the Second Meeting of the Sub-Group on Technical Assistance to Least Developed Contracting States under Article 11 (d) of SAFTA has identified 10 such areas and some of them can be counted as assistance for addressing supply-side constraints and enhancing competitiveness of LDCs, there has been little movement, if any, on the delivery of actual assistance, let alone contributing to a certain level of desired outcomes.¹³ While the non-implementation has its root in the “best endeavour” nature of this provision, the areas identified represent largely “software” component of trade-related assistance as opposed to “hardware” components such as creating infrastructure or upgrading testing facilities. Since bilateral technical assistance tends to be driven more by political and foreign policy objectives rather than by trade-promoting objective, this initiative should be regionalized and merged with the proposed LIF, with the developing member countries in a position to provide such assistance making direct contributions to the LIF, over and above their core contributions.

While the operational modality could be decided once the funding issue is settled, entrusting a professional management team with the responsibility to manage the Fund is a *sine qua non* for the successful implementation of the projects in the priority areas. The management modality could, therefore, be close to what is being currently followed in the case of the SAARC Development Fund.

The following represents an indicative non-exhaustive list of priority areas, over and above what has already been identified by the Sub-Group on Technical Assistance for LDCs:

- Development of transport corridors to improve regional connectivity.
- Construction of a regional grid to facilitate trade in electricity.
- Trade facilitation, particularly modernization of customs, to reduce costs of trading across borders.
- Construction of laboratories and testing facilities to meet relevant standards.
- Construction of warehouses and cold storages to facilitate trade in agriculture products.

7. Conclusion

Despite LDCs constituting a majority of its membership, mechanisms under SAFTA are yet to adopt a “distribution sensitive” approach to trade integration and regional economic cooperation as followed by the EU. The idea of better integrating LDCs into the regional trade agreement and arresting their marginalization from the system is, therefore,

not being considered as a priority issue. This can be seen not only from their deteriorating export performance, but also from the absence of concrete initiatives to put the special and differential treatment provisions contained in the SAFTA Agreement into practice.

The article argues that while the major focus in mainstream discussions have been on the market access issue, the issue of supply-side constraints, which need to be tackled upfront to enhance the general level of competitiveness of LDC exports, both within and outside the region, has not received the attention it deserves. This article recommends the creation of an LDC Integration Fund, modelled on the trajectory followed by the EU and based on a proposal developed by CASAC. It is envisaged that the Fund should be utilized to help these countries overcome binding constraints, particularly those related to hard infrastructure, so as to help them reap the benefits of regional trade integration espoused by SAFTA. The article also provides the options available for the financing of the Fund and proposes an operational modality as well as priorities to make it meaningful, operational and effective.

Notes

- ¹ At the time of writing, there were five LDCs in the region, namely Afghanistan, Bangladesh, Bhutan, the Maldives and Nepal.
- ² Since baseline data for Bhutan are not available, the figure presents a comparative picture for seven South Asian countries (four LDCs and three developing countries).
- ³ See Adhikari (2011a) for further details.
- ⁴ India's initial sensitive list for LDCs consisted of 763 goods, which has been unilaterally reduced twice and now brought down to 480.
- ⁵ See, for example, Raihan (2009) in the case of Bangladesh and MoCS (2010) in the case of Nepal.
- ⁶ See Adhikari and Kharel (2011) for further details.
- ⁷ We define supply-side constraints as constraints on supply capacity that limit the ability of a country to produce and supply goods and/or services to the international market in a competitive manner.
- ⁸ Razzaque (2005); Eusuf *et al.* (2007); SAWTEE and ActionAid Nepal (2007); Adhikari (2010).
- ⁹ One of the major limitations of the study is that it focuses only on two South Asian LDCs. However, given the fact that these two countries represent both coastal and landlocked countries with different development trajectories, they can be considered to be largely representative of South Asian LDCs as a whole.
- ¹⁰ http://ec.europa.eu/regional_policy/what/index_en.cfm (accessed 24 January 2012).
- ¹¹ European Commission (2006).
- ¹² http://ec.europa.eu/regional_policy/what/index_en.cfm (accessed 24 January 2012).
- ¹³ See Adhikari (2011a) for further details.

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PART

5

DRIVERS OF REGIONAL COOPERATION

Chapter 11

Roles of peoples' representatives and non-state actors in strengthening regional cooperation

Nihal Rodrigo

1. Introduction

There has been a considerable amount of scepticism, sarcasm and cynicism about the effectiveness of the South Asian Association for Regional Cooperation (SAARC). Some of the many critical comments about the Association are justified and need to be frankly acknowledged and addressed.

SAARC, established in 1985, is relatively a latecomer as a regional association compared to other such associations such as the European Union, Organization of African Unity and the Association of Southeast Asian Nations (ASEAN). As a former Sri Lankan Head of State once remarked, SAARC has grown like a large tree that has taken deep root, with many branches of activity, much foliage and verbiage, but not enough fruit. Yet, it is indispensable for South Asia, and its agreed goals need to be pursued with greater dedication, political commitment and coordinated action.

2. People and politics in South Asia

In order for SAARC to deliver, it is important to secure the engagement of the people in the region. These include political representatives, particularly those in the parliamentary processes, the political Executive, the Legislature and the Judiciary, and those representing the corporate sectors, professional organizations, academic groups and civil society. One such initiative was taken as early as in 2000 by S. M. Krishna, the then Chief Minister of Karnataka, when a business conference was organized in the state bringing together politicians, corporate executives, representatives of chambers of commerce and industry, economists, academics and the SAARC Secretariat together. The conference emphasized the need for all groups to work more closely together.

In respect of the impact of the current global situation on each South Asian country, and the complexity of the issues involved, individual national concerns as well as sectarian interests internally within each country do clash and are sometimes in open conflict, even spawning acts of violence at local levels. This tends to render coordinated responses at the regional level much more complex. In this situation, careful interactions among all concerned groups, with support from the general public, are required to grapple with the issues concerned. This needs to be done, first, at the national level before coordinated regional approaches can be taken up.

Akmal Hussain, a Pakistani economist, once remarked that governments in South Asia are required, as the media reported, to “move out of a mind-set that regards an adversarial relationship with a neighbouring country as the emblem of patriotism; affluence of the few at the expense of the many as the hallmark of development; individual greed as the basis of public action and mutual deionization as the basis of inter-state relations”. He later said that the media had erroneously reported his words since what he referred to was “demonization” and not “de-ionization”. However, given that “splitist”, divisive tendencies are often visible in the development processes, which involve so many diverse actors—although some of them are constrained to act like mere “extras” clashing sometimes even violently, and ineffectively with the more powerful political and corporate “lead” players—I feel that both words were appropriate.

Regrettably, some adversarial bilateral issues such as border disputes, which still remain as lingering legacies of the colonial period, in India and Pakistan for example, have even delayed, at times, the convening of SAARC Summits.

3. Parliaments and democracy

Among the South Asian bodies officially accorded “recognition” by the SAARC is the Association of Speakers and Parliaments, which has had a number of meetings in various capitals in the region since its first meeting in 1994 when it was known as the South Asian Parliamentarians’ Association. Democratically elected governments currently characterize the political scene in all SAARC member countries, although in some, the need to contend with certain complex issues is hampering smooth governance. In February 2009, the Conference of SAARC Ministers of Parliamentary Affairs bearing the theme, “Good Governance through Parliamentary Democracy”, evoked a comment from the SAARC Secretary General that “good governance was an ideal which is complex in its totality”, but that however, “the lack of it was felt at the people’s level quite intensely”.

In their Declaration adopted at the 16th SAARC Summit in Thimphu in April 2010, Heads of State/Government, while “appreciating that all the Member States had evolved into multi-party democracies”, also “underlined the challenges faced by them in ensuring effective, efficient, transparent and accountable governments, recognized the need to draw on the democratic and participatory tradition represented collectively by the Parliamentarians of South Asia for the progress of SAARC”. A draft Charter of Democracy already on the SAARC anvil is being shaped up for eventual adoption/ratification and practical action by the governments in the region. It is expected to affirm that broad-based participation of the people in the institutions and processes of governance would create a sense of ownership and responsibility, and thereby, could help in the promotion of greater interaction among different sectors of each of the South Asian states.

The role of the South Asian Members of Parliament (MPs) and other people’s representatives in the collaborative regional process, built on the foundations of their respective national processes, is indeed complex. At the closing Session of the Fourth Conference of the Association of SAARC Speakers and Parliamentarians, the Deputy Speaker of the Indian *Lok Sabha* underlined the need for parliaments everywhere to devise mechanisms to ensure that the public good could always prevail over private interests.

There needs to be deeper and substantial interactions among Members of National, Provincial and other chambers, and the people and representative interest groups whose support and votes they seek and whose interests they are expected to represent and seriously promote

for specific action. In February 2009, the Conference of SAARC Ministers of Parliamentary Affairs decided that every endeavour should be made to make the people aware of the functioning of the government. It declared that measures should be introduced to ensure greater devolution of powers at the grassroots level to ensure maximum participation of the people in the decision-making and implementation processes. Where this fails, public protests, resort to demonstrations, sometimes even of a violent disruptive nature, could be the result.

4. Engagement of the corporate sector, professional associations, civil society and literary/cultural associations

SAARC is primarily an inter-state organization. However, after much consideration, it has given formal "recognition" status to a number of region-wide associations, including Chambers of Commerce and Industry and other groups serving and promoting the corporate sector. It has also accorded recognition to professional and other associations with region-wide membership, for example, of accountants, architects, creative artists and writers, the media, medical doctors, lawyers, etc. These groups have provided means for fruitful economic, professional, cultural and other regional interaction and cooperation. South Asian writers and creative artists, who interact with each other across the region, project a regional identity and give voice to the many who suffer and endure in silence.

SAARC has formally accorded recognition to the Foundation of SAARC Writers and Literature, which organizes festivals promoting literary and cultural activity. It draws participants from even remote depressed regions in South Asia to participate in these festivals and project their myriad unique personalities and ways of life. Thus, while there have been some efforts to engage the corporate sector and other truly representative groups in the SAARC process, it is time that parliamentarians be in close consultation and cooperation with these groups to deal with the manifold issues relating to regional integration. Some of the major issues to contend with currently include climate change, food security and energy. These are issues that have direct bearings on the most vulnerable groups in every SAARC country.

MPs in every South Asian country are duty-bound to monitor and assess the views and concerns of the people they represent and articulate them, where necessary. They should not only bring forward such views and concerns in parliaments and at public meetings, but also before the eventual decision-making processes of governments to ensure their proper implementation.

The role of MPs is essential in explaining to their own electorates what benefits would accrue to the country from national decisions once they are made. Therefore, beyond individual national contexts, closer interaction among MPs of SAARC countries would be essential to deal with economic issues which have a regional dimension. Shared borders, which are in bilateral disputes—the historical legacies of colonial times—have often obstructed broader regional economic and political connectivity. Apart from exceptional circumstances, political issues of this nature should not interfere in, nor obstruct, regional economic collaboration for the common benefit of the people of South Asia.

5. Connectivity in SAARC

The importance of connectivity for regional integration is well documented. It has also been reiterated time and again by SAARC leaders. For example, India's Prime Minister Manmohan Singh once stated that connectivity is a vital factor in advancing South Asian economic development and cooperation. Similarly, Sri Lanka's President Mahinda Rajapaksa, at the 15th SAARC Summit in Colombo in 2008, while strongly acknowledging the importance of connectivity as an essential aspect of growth, also stressed the practical necessity of ensuring "continuity, consistency and coordination of initiatives, decisions and measures to sustain the momentum in regional economic integration" lest they linger or remain confined to noble words in declarations. Here, I discuss connectivity not only in terms of transport connectivity, but in a broader context.

There are five vital aspects of connectivity, summarized below, which could help or hinder, in certain contexts, economic cooperation and good relations among SAARC countries.

First, there is lack of connectivity, within individual SAARC member countries, between economic progress and success in certain areas and the continuing lack of economic development in others. It is urgent to ensure that economic successes also reach the poorest sections of every country in the region and for that, infrastructure development is essential. Also, politicians elected to serve in such areas need to work with greater practical dedication to improve living conditions as well as to shield the innocents from religious, gender, caste and other forms of vile discrimination rampant in some areas where these differentiations are even given some degree of implicit social acceptance.

Second, there must be connectivity and coordination between the organs of the State, parliaments and corporate sectors, and the bureaucracy, which is the vital implementing arm of the State. The bureaucracy

must faithfully implement national/regional decisions taken, or boldly and clearly indicate, when necessary, if decisions are flawed or bring no benefit to the people. Bureaucrats have distinct roles and responsibilities in exercising their duties without merely surviving as servile “yes-men” and “yes-women” who accommodate corrupt and unscrupulous politicians seeking private gain over public good.

Third, there must not be any entanglement of contentious bilateral issues between member countries with the larger and more vital issues of regional cooperation. Bilateral issues need to be dealt with by the concerned countries outside the regional context without contaminating the atmosphere for cooperation with other SAARC member countries. SAARC meetings, particularly Ministerial Meetings and Summits, do provide opportunities for discrete, quiet engagement, at the highest political levels—on the sidelines of formal meetings—to deal with and even resolve long-stagnant contentious bilateral issues. In the past, there have been some close encounters of this kind, including at the 11th SAARC Summit in Kathmandu and the preceding Ministerial Meeting in Nuwara Eliya, Sri Lanka. These have played a particularly important role in clearing bilateral controversial issues, which were then obstructing progress on SAARC action.

Fourth, infrastructure connectivity, within the region and beyond, is also vital for SAARC's economic development. From Sri Lanka's perspective, transport connectivity figures prominently. In 2009, Shyam Saran, then Special Advisor to the Indian Prime Minister, indicated that around 70 percent of maritime cargo in and out of Indian ports transit through the port of Colombo. The port also provides facilities for break-bulk of Indian cargo before it is dispersed to multiple destinations. Hambantota, a port in the south of the island, which served as a point of connectivity for the ancient Silk Route of the Seas, is being currently developed with China's assistance to provide enhanced services for South Asian economic interaction as well as to provide connectivity beyond the region. Hambantota is situated virtually at the centre of the Indian Ocean and is an important transit point in South Asia, connecting eastwards to China, Japan, Korea and the ASEAN states; and westwards to Africa, the Arab Middle East and thence to Europe. The port is situated a few miles north of what are assessed as the busiest sea-lanes in the world. Sri Lanka's ongoing infrastructure development strategies cover aspects of naval connectivity as well.

The Sri Lanka Navy commemorated its 60th Anniversary in 2010. The then Navy Commander Vice Admiral Thisara Samarasinghe stated that the presence of representatives of South Asian and other navies on the occasion in the island provided an opportunity to discuss In-

dian Ocean regional maritime security, which was being threatened by international criminal cartels involved in human trafficking, arms smuggling, drug trafficking, and more recently, by increasing piracy. These are affecting regional security and economic development as well as causing immense suffering to victims of unscrupulous human traffickers. At conferences on Indian Ocean security, some think tanks have made graphic power-point presentations in which the naval ports of Sitwe in Myanmar, Chittagong in Bangladesh, Hambantota in Sri Lanka and Gwadar in Pakistan are depicted as strategically yoked as “a necklace of pearls” strangling India. Shiv Shankar Menon, Security Adviser to the Indian Prime Minister, stated at a lecture at the Indian National Maritime Foundation that “for China, as for India and Japan, her energy security is intimately linked to keeping the sea lanes open in the Indian Ocean”. He also declared that there were no Chinese bases in the Indian Ocean. Speaking of energy security as distinct from military security, he said it was natural, for example, for Indian companies to operate oil tank farms in Trincomalee – another port in Sri Lanka having one of the deepest natural harbours in the world – for economic reasons.

Fifth, and finally, economic connectivity between SAARC member countries and nations now accepted as observers in the Association needs to be carefully developed for mutual benefit. Following considerable reservations held in the past about the possibility of extra-regional interference, functional cooperation is now being discussed and is gradually developing with the following observers in SAARC: Australia, China, Iran, Japan, Republic of Korea, Mauritius, Myanmar, the United States and the European Union. No region in today’s globalized world can thrive in isolation although entanglements in certain evil trends, such as human smuggling, do constitute non-traditional security threats that are increasing. Financial contributions from the observers to the SAARC Development Fund are now being accepted under certain understandable conditions relating to their purpose, deployment and usage. Here too, attitudes and views expressed in the media and in politico-strategic circles come into play and need to be rationally analysed.

When discussing the role of peoples’ representatives in strengthening the regional cooperation process in South Asia, there is no denying that with regard to national policies and approaches to regional cooperation, foreign policy debates in parliaments need to dispassionately approach interrelated issues of regional development, security and rising non-traditional security threats.

Chapter 12

Private sector in South Asia: Stumbling blocks or building blocks to regional integration?

Anura Ekanayake

1. Introduction

The struggling United States (US) economy and the ongoing debt crisis in several European Union (EU) economies suggest that the global economic slowdown may not ease in the near future. There is also a high likelihood of short-term volatility in financial as well as commodity markets. Clearly, South Asian exports cannot be expected to grow rapidly if they continue to be directed primarily towards the developed world. On the other hand, the experience of Southeast Asia, where China as an emerging global export powerhouse exerted an enormous influence in a rapid growth of intra-regional trade, may offer a beacon of hope to South Asia where India can play a similar role aided by its vast domestic market as well as exports. This is, however, not to say that South Asian nations can do away altogether with trade with the US and other large economies in the West (see Athukorala and Yamashita 2009).

Amid calls for a rebalancing of the global economy in the wake of the global financial and economic crises—which means that exports to

the developed West must reduce and the East must import more—the case for strengthened intra-regional trade in South Asia has become even stronger than in the past. A commonsense argument here is to start with the neighbours and then move further eastwards.

In the following sections of this article, South Asia's current trade flows will first be briefly examined in comparison to other regional trading blocs of similar vintage. The case for free trade for development and the debate on stumbling blocks and building blocks will be taken up thereafter as a precursor to the specific context within which the "stumbling blocks and building blocks" terminology is used in this article. This will lead us to an examination of the role of the private sector for the understanding and managing of stumbling blocks and building blocks. The ongoing debate on the Indo-Sri Lanka Comprehensive Economic Partnership Agreement (CEPA) will be taken up as an example. Finally, the potential role of the trade chambers in creating dynamic building blocks will be discussed.

2. Current trade flows in South Asia

Intra-regional trade in the South Asian Association for Regional Cooperation (SAARC) is extremely low. About 5 percent of the global trade of SAARC countries is intra-regional trade, compared to about 24 per cent in the Association of Southeast Asian Nations (ASEAN) and about 62 percent in the EU.

The EU and the US are key export destinations for four of the SAARC countries, namely Bangladesh, Sri Lanka, Pakistan, India and the Maldives, in that order of priority. The exceptions are Nepal and Bhutan, two landlocked neighbours of India whose major trading partner is, understandably, India.

Similarities in the trade profiles of SAARC countries, tariff barriers, non-tariff barriers and high trade costs have been identified as among the reasons for the low volume of intra-regional trade. Among the trade costs are transportation costs, information costs, use of different currencies, lack of trade facilitation, language barriers and local distribution costs (Banik and Gilbert 2008). In addition, geopolitical tensions arising from, among others, ethnic concerns, border disputes, separatist movements, terrorism and subversive activities, communalism and religious conflicts (Bhatta 2004) have compounded the economic factors.

The issue in the context of the slow recovery of the US and the EU economies and the desired and perhaps inevitable global rebalancing is that the scope of increased exports to these destinations from South Asia will be limited. Further, to the extent exports can drive the growth of

economies, particularly those of the smaller ones, there is a need to first look for closer destinations and thereafter more eastwards for South Asian exports.

3. Stumbling blocks and building blocks

That open trade generally leads to higher levels of economic growth and employment is widely accepted today. At the same time, the reality that there are costs in moving towards freer trade and that those impacted by such costs lobby against trade liberalization and, therefore, their concerns must be addressed is also well accepted. The final report of the Organisation for Economic Co-operation and Development (OECD), the International Labour Organization and the World Bank prepared for the G-20 Summit of November 2010 opens thus:

The message is clear: open markets can contribute to growth and better employment outcomes; this was true before the crisis and remains so today. In the near term, given pressures on governments, the financial sector, and households to strengthen balance sheets, further trade opening can generate an additional stimulus that will create employment opportunities for the world as a whole. The benefits of trade generally outweigh the costs associated with the reallocation of labour and capital to more efficient uses. However, if support for open markets is to be sustained, those costs need to be recognized and policies put in place to assist workers and communities to adjust to a more competitive environment (OECD 2010).

The last sentence of this quote with regard to costs of liberalization is of much relevance to the substance of this article and will be further elaborated later. In the meantime, the timing of the assertion that “open markets can contribute to growth and better employment outcomes” is of significance since this statement was made in the immediate aftermath of the global financial crisis during which there were fears of increasing restrictions on trade.

In general, liberalization is desired on the grounds that:

- Trade encourages flow of resources from low-productivity sectors to high-productivity sectors leading to an overall increase in output.
- With unemployed resources, an increase in exports leads to an overall expansion in production and a fall in the unemployment rate.
- International trade allows for purchase of capital goods from foreign countries and exposes an economy to the technological advances of industrialized countries.

In the so-called “stumbling block or building block” debate sparked off by a phrase of Jagdish Bhagwati in 1991, trading blocs are stumbling blocks if they prevent or slow multilateral tariff cutting, while they are building blocks if they accelerate or at least do not hinder multilateralism (see Panagariya 1999). The underlying premise is that trade liberalization is a necessary condition for development. In this article, the same “stumbling block or building block” phrase is applied in a somewhat different context where the actions/behaviour of the private sector are identified as stumbling blocks if they hinder the promotion of regionalism and as building blocks if they do not hinder such efforts.

A brief enquiry as to whether this application of the “stumbling block or building block” terminology is consistent with its original usage is warranted. Emerging evidence that regionalism may in fact promote multilateralism instead of thwarting it is the best defence we can offer in this regard.

Based on case studies of the Greater Mekong Sub Region (GMS) and the ASEAN Free Trade Area (AFTA), Menon (2005) found that the GMS programme is assisting its members to integrate more closely with ASEAN and, through this, with the rest of the world. As a programme based on market rather than institutional integration, the GMS was observed to promote both regionalism and multilateralism. Thereafter, he examined the relationship between regionalism and multilateralism and concluded that if members pursue open regionalism and offer their trade and other preferences to non-members on a non-discriminatory basis, this would be consistent with the principles and objectives of multilateralism. Further, he observed that for the original ASEAN members, GSM has actually hastened the speed at which these countries have moved towards their goal of free and open trade because of the ambitious liberalization programme that AFTA had committed them to.

Hill and Menon (2010) echo these sentiments, pointing out that most of the ASEAN region’s trade is extra-regional and that in order to minimize the potential costs of trade diversion, the original ASEAN members have been reducing their external tariffs in conjunction with reducing barriers to intra-ASEAN trade. Instead of jeopardizing multilateralism, AFTA has hastened the speed at which these countries have moved towards their goal of free and open trade.

4. The role of the private sector

As stated earlier, there are costs of trade liberalization, and those adversely affected tend to oppose them. The fact that potential benefits accrue over an extended period of time (long-term) and, therefore, may

not be seen to be real or tangible beforehand while losses are more immediate (short-term) gives greater impetus to lobbying by those who are likely to suffer losses. Also, potential losers tend to invoke politically powerful nationalistic arguments and appeal to patriotism which appears to have much effect in developing nations such as those of South Asia. It is, therefore, necessary to understand such issues as how the private sector/business community behaves and what drives its behaviour before considering action to win it over towards trade liberalization and/or counter its arguments effectively.

In 2002, the International Trade Centre (ITC) undertook a study (ITC 2002) to identify and analyse the operational constraints that hinder trade policy-related advocacy activities by developing-country and transition-economy industry associations and enterprises. It was based on the premise that industry associations, which frequently represent small and medium enterprises and large enterprises, have a strong interest in taking a proactive stand both at the national and international levels in respect of the preparation for multilateral trade negotiations. At the same, it was observed that developing-country business communities have not been very successful in assuming that role in the past. This study provides a simple and effective framework for understanding business advocacy in trade policy, the basis for differences in the behaviour of the business community and the potential role of the private sector in trade policy negotiations. Much of what follows in this section will be based on the above study unless stated otherwise.

Business advocacy in trade policy as undertaken by business groups to influence government policymaking affecting international trade involves:

- Monitoring trade policymaking for a group interest.
- Building a case in favour of that interest.
- Presenting it to policy makers for their acceptance and support.
- Assisting the authorities in reaching the desired outcome in trade negotiations.
- Controlling the advocacy process, evaluating the benefits obtained and communicating the results to stakeholders.

It is of interest here to note that the ITC identifies the Ceylon Chamber of Commerce, the premier trade chamber of Sri Lanka established way back in 1839, as an example out of three such entities involved in business advocacy in trade policy as described above.

Among the varying objectives of business groups are:

- *Shelter*: Desire for protection from foreign competitors through tariffs, quotas and other protective measures which will give domestic producers a producer's rent.

- *Special privileges:* Obtaining special privileges such as landing rights for airlines, exclusive rights to conduct certain banking operations, or for privileged access to government procurement contracts.
- *Government support:* To obtain special financial privileges that provide additional competitive edge such as subsidies and tax exemptions.
- *Improved competitive position in foreign markets:* Improved access to foreign markets and regulations that improve their competitive position such as protection of intellectual property rights and recognition of national standards in international markets.
- *Limiting the pressure of other interest groups:* Advocacy to neutralize the efforts of other pressure groups.

Changes in the status quo towards a reduction in the level of protection meet with opposition from groups likely to lose from such trade liberalization. Business advocacy in trade policymaking often tends to be biased in favour of import-competing industries. The problem is that individual gains from reforms—while in the aggregate usually greater than costs—tend to be dispersed, while losses are concentrated. Consequently, those who face losses resulting from liberalization have a greater incentive to invest in lobbying than those that gain from it. This explains why trade liberalization is not an easy process in most nations and the firms that expect to gain from it should mobilize themselves to counterbalance the conservative pressures of import-competing industries. Hence, in developing countries, trade policymaking is increasingly perceived as a process of negotiation involving compromises between main interest groups and government departments. In a changing trading environment and faced with a variety of pressures previously described, industry leaders must be aware of the need to build relationships with strategic actors concerned with trade policy matters and the importance of lobbying to defend industry's interests.

The long-drawn debate in Sri Lanka for and against a CEPA with India illustrates the difficulties in the regional integration of South Asia. The role played by the private sector of Sri Lanka in this case may well be repeated in other countries in South Asia as well.

5. Debate on the Indo-Lanka CEPA

The India-Sri Lanka Free Trade Agreement (ISFTA) was signed in 1998 and came into effect in March 2000. This resulted in a rapid increase in bilateral trade, and India became the largest source of imports and the third largest export destination after the US and the EU for Sri Lanka. While Sri Lanka's ranking as an export destination for India improved,

it was of a relatively lower magnitude (from 18th position in 2000 to 13th position in 2005) given the size and scale of the Indian economy and its exports. Similarly, Sri Lanka's rank as an import source for India improved from 60th position in 2000 to 31th position in 2005. Based on such success, the Joint Study Group of the two countries recommended in 2003 that the ISFTA be developed into a CEPA. The proposed CEPA was to cover—in addition to expanded coverage of trade in goods—trade in services, investment and economic cooperation.

While bilateral trade under the ISFTA has grown rapidly, the margin of preference under the ISFTA has declined due to unilateral tariff reductions as a result of globalization; trade in products in the sensitive lists has also grown; and the highly differentiated external tariffs in some sectors have resulted in trade deflection (Behera and Mukherji 2011). Accordingly, a movement towards a deeper cooperative arrangement, incorporating the lessons learned, such as a CEPA or a revamped ISFTA is recommended (*ibid.*).

The bilateral negotiations on CEPA commenced in 2005 and following 13 rounds of technical discussions, an agreement was ready to be signed by July 2008. The actual signing, however, did not take place due to the protests by some sections of the business community as well as some political parties. Since then, steps have been taken to resume a formal dialogue on the CEPA. However, a clear timeline in this regard with milestones is not available in the public domain.

The views expressed by the then Indian Finance Minister Pranab Mukherjee in November 2009 in Colombo may be taken as one of the best articulations of the Indian official position on the CEPA:

It is with a view to take our economic engagement to a higher trajectory that the two countries finalized the CEPA (Comprehensive Economic Partnership Agreement) last year. Given the preponderant importance of services sector to the Sri Lankan economy, we are confident that Sri Lankan companies can leverage their access to the Indian markets and realize economies of scale through greater investments. To replace lost export demand, an ideal option is to expand investments. But when protectionist voices and mutual suspicion get juxtaposed against an economic downturn, there is bound to be some apprehension about how the CEPA will affect Sri Lanka. With lower growth and higher unemployment, calls for protectionism are bound to increase. While we wait for you to develop a domestic consensus on this issue, I can assure you one thing—at a time when global players are investing in India to leverage their synergies with us, including in services, CEPA can only be a win-win situation for both India and Sri Lanka (Mukherjee 2009).

Since the aborted attempt to sign the CEPA agreement in July 2008, the debate for and against the CEPA has continued in the media. There have also been a few public seminars organized by those who oppose the CEPA, who acknowledge the merits of such an agreement, as well as those who are neutral. The Government of Sri Lanka, however, has not made its position public so far. The only indication has been that the government will not go ahead with signing the CEPA if some sections of the private sector oppose it. It appears as if the “ball is squarely in the court” of the private sector.

What is attempted below is a summary of the points made for and against the CEPA based on some of the articles which appeared in some English-language newspapers.¹ The views against the CEPA² can be broadly categorized as follows:

- *“Negative” experiences under the ISFTA:* The view that India benefited more from the ISFTA with Indian exports to Sri Lanka increasing from US\$500 million to US\$1,820 million while Sri Lankan exports to India increased from US\$45 million to US\$322 million during the period 1999–2009; and the specific “bad” experiences in India of a handful of Sri Lankan businesspeople.
- *Concerns arising from India’s size and the range and scale of industries:* The population difference of 1.2 billion versus 20 million; large-scale production capacity versus small-scale; the financial strength of Indian conglomerates compared to the very modest capacity of Sri Lankan businesses and the former’s ability to engage in price wars to the detriment of Sri Lankan businesses; the reach of Indian television channels into Sri Lanka directly and via satellite and the resulting brand communication/brand advertising advantage; strong Indian bureaucracy versus “weak” Sri Lankan bureaucracy in the administering of the “rules of the game” of the CEPA, etc.
- *Worry of a “big brother” approach by India:* As alleged in the case of other neighbouring countries such as Nepal, Bhutan and Bangladesh and the sending of an Indian Peacekeeping Force to Sri Lanka (Weerakoon 2010), and the fear that such interventions may increase with the CEPA.
- *Worries of the professional community of being swamped by Indian professionals with services sector liberalization under the CEPA:* The large Indian labour force and the professional community implying a “one-way traffic” flow of Indians, thereby depriving Sri Lankans of jobs. Views in favour of the CEPA, on the other hand, are as follows:
- *Successes of the ISFTA:* While Indian exports to Sri Lanka increased fourfold, Sri Lankan exports to India increased sevenfold; there are several success stories of Sri Lankan ventures in India.

- *Access to a large market:* Allowing the realization of economies of scale, the ability to integrate into large value chains as well as access to investment.
- *Diversification imperative:* The need for diversifying Sri Lanka's export destinations from the stagnating West.
- *Stimulating growth:* The potential of the proposed agreement to stimulate growth and reduce political friction.

It is apparent that there is a high degree of misinformation, misinterpretation and baseless speculation among some of the positions taken in this debate. For example, the performance of the ISFTA is seen as positive for Sri Lanka by those who favour the CEPA and the same is seen as negative by those who are not in favour (see Samarajeeva 2010; Wijewardena 2011). This is the reason the same numbers are used by one group from an absolute sense and by the others in a relative sense. The conclusions are diametrically opposite.

The debate on the CEPA is still continuing. Authorities, by and large, are silent. Those against it are more vociferous and those in favour of it are rather subdued. Those against it invoke more political and nationalistic arguments in support of their case and as the then Indian Finance Minister Pranab Mukherjee observed, "protectionist voices and mutual suspicion" appear to stand in the way of a domestic consensus. Somehow in the public arena, the bad news appears to resonate better with the prevailing fears and prejudices in the minds of the Sri Lankan public with regard to India.

6. Potential role of trade chambers

It is clear from the above that there is no consensus among the Sri Lankan private sector with regard to the CEPA. Given that the private sector is not monolithic or homogeneous, such differences in views are not surprising. The question then is what should be the role of trade chambers in such a situation.

Three different basic positions have been observed in the Sri Lankan case with regard to the CEPA by different trade chambers and associations:

- Take a national interest-based position.
- Take a sector- or firm-based position.
- Take a national interest-based position but try to mitigate any adverse effects/adjustment costs of specific sectors or firms.

The Ceylon Chamber of Commerce (CCC) has been involved in the CEPA negotiation process by representing various sector-wise interests and concerns as in the case of the negotiation of the ISFTA. The CCC

has a history of advocacy in trade policy, as noted earlier. Soon after the CEPA was put on hold due to the very vocal opposition to the CEPA which emerged on the eve of its planned signing, the CCC offered to the government its support in wider stakeholder consultations in order to:

- Increase transparency and minimize misinterpretation and speculation; and
- Address genuine stakeholder concerns and mitigate them.

This is, in fact, the third position listed above. Clearly, the first position is unrealistic since even the most beneficial course of action for the nation can be stalled if there is heavy resistance from affected stakeholders. The second position is untenable, though not unlikely, on the part of a chamber or association, as experienced in Sri Lanka with regard to the CEPA.

Responsible trade chambers must then take the leadership in explaining the pros and cons to the others in an intellectually coherent manner with a public interest perspective along with practical measures to mitigate adverse effects on those affected. The same prescription is valid for the government.

In brief, the role of trade chambers in making the private sector a “building block instead of a stumbling block” can be expressed as follows:

- Take a national interest-based position.
- Recognize that change creates winners as well as losers.
- Find ways to address/mitigate costs of change for the losers and lobby accordingly.
- Look at the challenge as an opportunity and not as a threat.
- Educate the individual members/firms of the private sector.
- Engage with other chambers/associations with different views.
- Educate the general public.
- Be an active and constructive partner in the trade negotiation process, not a mere observer and a destructive critic.
- Learn and be knowledgeable on trade negotiations/trade agreements—ignorance sometimes can be the main reason for fear and resistance.
- Build in-house expertise to conduct research to assess costs and benefits from a private sector perspective.

It has to be acknowledged, however, that addressing concerns arising from geopolitical, security, ethnic and religious perspectives can be very difficult, if not impossible, for trade chambers. While developing in-house expertise and capability with regard to trade matters is feasible as seen in the case of the CCC, to do the same in the case of all other areas of expertise can be feasible, if at all, only for a university or a re-

search institution. In the specific case of the India-Sri Lanka CEPA and in any future attempts at regional economic integration of South Asia, such issues may outweigh purely economic issues and dominate the debate. This is an area which requires inter-disciplinary research and concerted action.

Notes

¹ *Daily Mirror, Financial Times, Sunday Times and Sunday Leader.*

² See Waduge (2011); Weerakoon (2010).

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PART



6

**CLIMATE CHANGE
AND REGIONAL
COOPERATION**

Chapter 13

Trade and climate change: South Asian agenda at the UNFCCC and the WTO

Nitya Nanda

1. Introduction

At the 16th Summit of the South Asian Association for Regional Cooperation (SAARC) in April 2010, apart from the usual Summit declaration, SAARC countries also adopted the Thimphu Statement on Climate Change with a view to making South Asia a world leader in low-carbon technologies and renewable energy. Among other things, the Statement emphasized the promotion of climate resilience that would promote both development and poverty eradication in a sustainable manner. This is important as South Asia appears to be among the most vulnerable regions in terms of climate change impacts due to its social, economic and environmental conditions.

Climate change is expected to reduce access to drinking water, negatively affect the health of poor people, and pose a real threat to food security in many countries in Africa, Asia and Latin America.¹ It is also likely to increase the frequency and magnitude of extreme weather events such as droughts, floods and storms. Hence, the impacts of cli-

mate change are likely to be superimposed on existing vulnerabilities of developing and least-developed countries, including in South Asia, which have very limited institutional and financial capacity to anticipate and respond to the effects of climate change.

Climate change impacts are going to be varied. In seasonally dry and tropical regions, crop productivity is projected to decrease for even a small increase in temperature (IPCC 2007). Climate change is also expected to exacerbate current stresses on water resources, which, in turn, would result in decreased availability of water, thereby affecting hydropower potential as well as agriculture production, particularly in Asia where irrigation plays an important role. This will directly impact a huge population in developing and least-developed countries, including in South Asia, where a majority of people depend on climate-sensitive sectors such as agriculture and fisheries for their livelihoods.

Another important concern regarding climate change is its impacts on health. Since most developing countries are in the tropical region, any increase in temperature is likely to increase the incidence of tropical diseases, which already is the cause of a large number of deaths in these countries. Also, arrival of new diseases cannot be ruled out as behaviour patterns of microbes might change due to climate change. This will impact not only on human health, but on animal and plant health as well, and hence have adverse effects on agriculture and allied activities.

For many developing countries, sectors such as agriculture and fisheries are also the major sources of their exports. Therefore, besides affecting livelihood and food security in developing countries, climate change is also likely to adversely affect their macroeconomic and trade performance. As if that were not enough, developing countries now face the spectre of climate- or carbon-related tariff and non-tariff trade barriers, which developed countries intend to impose on products coming from developing countries to make adjustment for their own carbon reduction measures. In fact, some private non-tariff trade barriers related to climate change are already in practice. Such adjustment measures can impose significant economic costs on developing countries by affecting market access and reducing export revenues. This might, in turn, affect their ability to deal with the challenges of climate change mitigation and adaptation.

2. Climate change and the global initiative

Recognizing the threats posed by climate change, the global community, at the United Nations Conference on Environment and Development (also known as the Earth Summit) at Rio de Janeiro on 3–14 June

1992, adopted a new international instrument called the United Nations Framework Convention on Climate Change (UNFCCC). Parties to the UNFCCC are classified into three groups: i) Annex I countries (industrialized countries and economies in transition); ii) Annex II countries (developed countries which pay for the costs of developing countries); and iii) developing countries.

An important process at the UNFCCC is the annual Conference of Parties (COP). The third COP (COP3), held at Kyoto in Japan in December 1997, adopted the Kyoto Protocol. Under the Protocol, most industrialized nations and some central European economies in transition (all defined as Annex B countries in the Protocol) agreed to legally binding reductions in emissions of greenhouse gases (GHGs) in the range of 6–8 percent below 1990 levels between 2008 and 2012. The Protocol came into force in February 2005. The United States (US), which was to reduce emissions by 7 percent, did not ratify, as the Bush administration rejected it in 2001. Like the COP at the UNFCCC, the Kyoto Protocol also agreed to have Meeting of Parties (MOP) which is normally held back-to-back with COP. COP11/MOP1 at Montreal in 2005 extended the life of the Kyoto Protocol beyond its 2012 expiration date and agreed to negotiate deeper cuts.

2.1 Recent developments at the UNFCCC

In 2007, Parties to the UNFCCC met at Bali for COP13/MOP3 and agreed to have a shared vision for long-term cooperative action. They also agreed to adopt measures on mitigation, adaptation, finance and technology transfer. Although no specific figure was quoted in the Bali Action Plan, there have been suggestions from several quarters to contain the temperature within 2°C from the pre-industrial level, and accordingly a per capita emission of 2 ton per annum by 2050 and 1.5 ton by 2100.

With the above target in place, the emissions path from 2050 to 2100 appears to be more clearly defined, but there is much less clarity on the path up to 2050. What kinds of emissions paths developed and developing countries will follow is also a contentious issue. A principle that has been accepted at the UNFCCC is “common but differentiated responsibilities (CBDR)”, but the principle is being interpreted differently by different countries. While developing countries are reluctant to accept any binding commitment on mitigation in the near future, developed countries are insisting that they do so.

Much of the focus in this regard has been on large nations like China, India and Indonesia. These countries do have high carbon emissions,

but their emissions per capita are far lower than those of many other developing countries whose per capita emissions are as high as those of developed countries, and in some cases, even higher. For example, Malaysia, South Africa and Brazil have per capita emissions comparable to many developed countries. South Korea has higher per capita emissions than Japan; but while the latter has emissions reduction targets, South Korea does not. In West Asia, in several countries such as the United Arab Emirates (UAE), Saudi Arabia, Qatar and Kuwait, per capita emissions are higher than those of the US. However, energy-producing countries are a different category since other countries import a significant part of the energy they produce. But to categorize some countries such as South Korea and Singapore as developing, which are actually developed countries for all practical purposes, and providing them concessions in terms of emissions reduction, might not be justifiable.

Countries with larger populations tend to have more GHG emissions in total. But it is not fair to only measure total emissions since they are largely based on population size. Thus, a useful comparison across countries would be to measure in terms of carbon dioxide emissions per person. Moreover, for climate change implications, it is important to look at the stock of GHGs in the atmosphere. Developed countries, of course, cannot take back their contribution to the stock of GHGs, but it is incumbent upon them to take the responsibility for mitigation and adaptation, even in developing countries. Although it is true that flow is linked to stock, the focus of the global discourse on climate change currently is more on the flow of emissions rather than on the stock.

The Kyoto Protocol specified targets and actions only until 2012. The process of determining an action plan for the post-2012 period was planned to take place at the COP15 held in Copenhagen in December 2009. It was expected that countries would agree to a long-term target for restraining temperature rise and for some framework and measures covering areas of mitigation, adaptation, technology transfer and finance. However, they could not reach an agreement in Copenhagen.

Nevertheless, a few countries (mostly from the developed world and some large developing countries such as India and China) agreed on a Copenhagen Accord, which is a political agreement and is not legally binding. The Accord covered all the main elements of the Bali Action Plan, including long-term goal; mitigation; adaptation; issues related to finance, technology and forests; and measurement, reporting and verification. Among other things, the Accord called for establishing a Copenhagen Green Climate Fund as one channel for delivering finance and setting up a high-level panel "to study the contribution of the potential sources of revenue" towards funding goals. The Accord has been

quite an issue of discord as many developing countries were opposed to it. In the COP16 held in Cancun from 29 November to 10 December 2010, however, countries agreed on a broad framework and extended the mandate of the Ad Hoc Working Group on Long-Term Cooperative Action (AWG-LCA) so that the outcome could be adopted at the next COP. The next COP (COP17) took place in Durban from 28 November 2010 to 9 December 2011 and adopted the outcome of the AWG-LCA.

2.2 Managing differential abilities at the UNFCCC

As stated above, one important principle in the UNFCCC is CBDR. But how it will be operationalized is a debated issue. The General Agreement on Tariffs and Trade (GATT)/the World Trade Organization (WTO) also follows a similar principle called “special and differential treatment (S&DT)” in that the WTO Agreements contain special provisions which give developing countries special rights and privileges. The two purposes of providing S&DT to developing countries under the GATT/WTO are: i) to help development, and ii) to help the international system by easing the integration of developing countries into it (Page 2004). While the second purpose is equally valid in the case of climate change mitigation, the first purpose may have a different connotation. Developed countries might not have had development concerns under the GATT/WTO, but in the context of climate change, even developed countries are yet to move into a sustainable low carbon path. Moreover, “to help development” will mean that developing countries should not be forced into obligations that might thwart their development efforts. However, CBDR has another important dimension, that is, developed countries have the historical responsibility to take the burden due to their past emissions. Interestingly, historical responsibility has also been a factor that led to the provision of S&DT for developing countries at the GATT as colonial relations in the past played their role in the origin and evolution of S&DT (Page 2004).

Some special provisions that were made to operationalize the principle of S&DT at the GATT/WTO include:

- Longer time periods for implementing agreements and commitments.
- Measures to increase trading opportunities for these countries.
- Provisions requiring all WTO members to safeguard trade interests of developing countries.
- Support to help developing countries build the infrastructure for WTO work, handle disputes, and implement technical standards.

Similar approaches can be followed in establishing a global architecture in dealing with the challenges of climate change. In fact, the role of finance and technology transfer has already been recognized in this regard. However, the post-Uruguay Round² experience showed that even though commitments made under various WTO Agreements were binding, the promised technical or financial assistance did not reach the targeted countries, at least not to the extent expected. Hence, in the Doha Round of negotiations, the July 2004 Framework, which was crucial to revive the stalled WTO negotiations after the “failed” Ministerial Conference at Cancun in 2003 (equivalent to UNFCCC COP), compliance with new trade rules by developing countries (at least in one area, namely trade facilitation) were linked to technical assistance. But this is yet to be put into practice as the Doha Round is yet to be concluded. A similar approach can be taken in climate change negotiations.

3. Trade issues at the UNFCCC

Non-binding commitments of developing countries along with mandatory emissions reduction commitments by developed countries in the Kyoto Protocol have been cited as the justification for adopting border trade adjustment to ensure “level playing fields”. However, neither the UNFCCC nor the Kyoto Protocol provides for specific trade measures. In fact, Article 3.5 of the UNFCCC stipulates that measures taken to combat climate change, including unilateral ones, should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade. This has been interpreted differently by different experts. While some interpret this to mean that unilateral trade measures cannot be used (Dasgupta 2009), others argue that trade measures can be used provided that they are not disguised restrictions on trade or do not lead to arbitrary or unjustifiable discrimination (Howse and Eliason 2009). In any case, it is doubtful whether such measures would amount to subversion of the principle of CBDR as developing countries would be forced to share the burden of climate change mitigation in the name of avoiding carbon leakage and protecting competitiveness.

There is yet another view (Petsonk 1999), however, which argues that the Kyoto Protocol’s exclusion of developing countries in international emissions trading would amount to a violation of WTO’s non-discrimination principle if emission credits could be defined as either “goods” or “products” under the GATT or “services” under the General Agreement on Trade in Services (GATS). But this may not be tenable as developing countries can enjoy S&DT under the WTO. Also, this can be in line with the CBDR principle at the UNFCCC.

Amidst this controversy, developing countries, spearheaded by the Group of 77 countries (G77) and China, wanted that the UNFCCC reiterate its position that developed countries shall not use climate change as a tool to introduce unilateral trade measures against developing country imports. India and China also made specific suggestions (Box 13.1) for the negotiating text in Copenhagen. Finally, in the Cancun Agreement (Para 90), which is essentially a reflection of the UNFCCC provisions, the Parties reaffirmed that they “should cooperate to promote a supportive and open international economic system that would lead to sustainable economic growth and development in all Parties, particularly developing country Parties, thus enabling them better to address the problems of climate change; measures taken to combat climate change, including unilateral ones, should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade”.

Box 13.1: India's and China's proposed texts on unilateral trade measures

India

“Developed country Parties shall not resort to any form of unilateral measures including countervailing border measures, against goods and services imported from developing countries on grounds of protection and stabilization of climate. Such unilateral measures would violate the principles and provisions of the Convention, including, in particular, those related to the principle of common but differentiated responsibilities (Article 3, Paragraph 1); trade and climate change (Article 3 paragraph 5); and the relationship between mitigation actions of developing countries and provision of financial resources and technology by developed country Parties (Article 4, Paragraphs 3 and 7).”

China

“Recalling Article 3, paragraph 1 and 5, and Article 4, paragraph 3 and 7 of the Convention, developed country Parties shall not resort to any form of unilateral measures including countervailing border measures, against goods and services imported from developing countries on grounds of protection and stabilization of climate.”

Source: UNFCCC (2009).

4. Climate change issues at the WTO

Whether trade measures can be used to combat climate change, or to be more specific, whether trade can be restricted on the basis of climate friendliness of production process, is still a contested territory. But this is not the only issue that the WTO might have to deal with in the context of climate change. The existing WTO agenda on trade and climate

change includes the issue of the relationship between trade agreements and multilateral environmental agreements. But there has hardly been any progress on this. The issue that has received much attention in this regard is the elimination or reduction of tariff and non-tariff barriers to trade in environmental goods and services (EGS).

The likely proliferation of carbon standards and labelling is another issue that might have to be dealt with in the WTO. This is also linked to the issue of border tax adjustment as carbon standards and labelling can be used as trade measures in practice. The existing WTO provisions on standards and labelling are not sufficiently elaborate to deal with carbon-based standards and labelling. Also, technology transfers and the impact of prevailing intellectual property right (IPR) regimes on such transfers have been highlighted at the UNFCCC and there are demands for reforms in the global IPR regime. However, it has not received the same level of attention at the WTO. Nevertheless, any reform in the global IPR regime is contingent upon reforms of the IPR regime under the WTO.

5. Climate change and trade performance

Climate change will affect trade performance of South Asian countries mainly through its impact on agriculture. Wheat yields in central India may drop by 2 percent in a pessimistic climate change scenario. As one study (Kumar and Parikh 2001) has estimated, even after accounting for farm-level adaptation, a 2°C rise in mean temperature and a 7 percent increase in mean precipitation will reduce farm-level net revenues by 8.4 percent. In Pakistan, cereal crops are already at the margin of stress and it has been estimated that wheat yields are predicted to decline by 6–9 percent in sub-humid, semi-arid, and arid areas with 1°C increase in temperature. For important cash crops like cotton, mango and sugarcane, even a 0.3°C decadal rise could have a severe impact. In Sri Lanka, temperature rise by even just 0.5°C is predicted to reduce rice output by 6 percent, and increased dryness will adversely affect yields of key products like tea, rubber and coconut.

Climate change is likely to increase the frequency of droughts and extreme rainfall events leading to floods and events like cyclones. Bangladesh is already badly affected by such events on a regular basis. Many other South Asian countries are also affected in different ways from time to time.

Several studies have shown that fluctuations in monsoon and temperature affect the productivity of several crops grown in the region. In the Himalayan nations of Nepal and Bhutan, it is expected that in-

creased severity and frequency of storms and flooding could aggravate the occurrence of landslides, which, in addition to the danger to life and property, would deposit sediments in agriculture lands or in irrigation canals and streams and contribute to deterioration in the quality of agriculture lands and hence in crop production (Kelkar and Bhadwal 2007).

Agriculture and allied activities, on average, constitute about 25 percent of Sri Lanka's exports and about 20 percent of Pakistan's exports. In the case of India, the share of agriculture goods in its export basket is much lower (less than 15 percent). However, for both India and Pakistan, which export textile and textile products that are based primarily on cotton produced domestically, agriculture generates indirect exports. The share of agriculture goods in Bangladesh's export basket too is not very high, but the country is a net food-importing country. The share of food items in its import basket is about 12 percent of its total imports. Similarly, the shares of agriculture products in Nepal's total exports and total imports are about 25 percent and 20 percent, respectively, and Nepal is also a net food-importing country. Climate change might exacerbate the already bad situation of both Bangladesh and Nepal in terms of food security.

6. Border tax adjustment

Developed countries have demanded that if they have to take emissions cuts, they must be allowed to put in place some border tax adjustment mechanism for imports coming from countries that do not undertake emissions cut commitments. However, it is not clear whether such unilateral measures would be compatible with WTO rules. The general approach under WTO rules has been to acknowledge that some degree of trade restriction might be necessary to achieve certain policy objectives as long as a number of carefully crafted conditions are respected. The Appellate Body's observations in the "Shrimp-Turtle case" indicate that there is a possibility of allowing trade measures based on environmental concerns (Box 13.2). However, the issue is still not very clear as emissions-related trade measures would be extremely difficult to implement. It may, however, be noted that the recent academic literature in Europe has been more supportive of such trade measures which can have influence on any case at the WTO as and when they might come up (Dröge *et al.* 2004; Green 2005).

Carbon taxes have already been implemented by several countries such as Finland, Sweden and Denmark, but none of them have introduced border tax adjustment so far. However, in the US, the American

Box 13.2: The shrimp-turtle case

The US government, by virtue of its enabling legislation (Sec. 609 of US Endangered Species Act) imposed a ban on the import of shrimps that were harvested without using Turtle Excluder Devices (TED) because this way of trawling killed endangered species of sea turtles. The affected parties regarded the action as a unilateral measure restricting the entry of their products into the domestic market of the US, contrary to GATT rules. Therefore, India, Pakistan, Malaysia and Thailand lodged complaints at the WTO in early 1997, claiming that Section 609 violated a number of WTO rules.

On 6 April 1998, a dispute settlement panel at the WTO ruled against the shrimp embargo. However, the Appellate Body reversed the stand of the Panel. In its report, the Appellate Body made clear that under WTO rules, countries have the right to take trade action to protect the environment (in particular, human, animal or plant life and health, and endangered species and exhaustible resources). The Appellate Body also observed that the ban was not imposed in a non-discriminatory manner. The US, therefore, won the case.

Source: http://www.wto.org/english/tratop_e/envir_e/edis08_e.htm

Clean Energy and Security Act (Waxman-Markey Bill), which was introduced and passed by the US House of Representatives in June 2009, proposes to put a cap on GHG emissions by requiring high-emitting industries to reduce their output to specific targets between now and 2050. The Bill also envisages putting in place measures to levy additional charges on imports of carbon-intensive products from countries that do not adopt similar climate change mitigation measures as it does. In such cases, US importers of such products would have to buy carbon allowances. There has been demand for similar measures in Europe as well. In particular, French President Nicolas Sarkozy is in favour of implementing a direct carbon tax on some industries along with border tax adjustment. The EU is reportedly considering a possible carbon equalization mechanism to create a level playing field for EU companies in energy-intensive sectors with significant risks of carbon leakage.

The Waxman-Markey Bill proposed a cap-and-trade system with mandatory limits on emissions from 2012. The Bill proposed distribution of emissions allowances through auctions. To address carbon leakage and competitiveness concerns, the Bill has provisioned an output-based rebate (OBR) mechanism wherein rebates will be provided to eligible carbon-intensive manufacturers. Manufacturers are presumed eligible if they meet 5 percent energy intensity or GHG intensity threshold and 15 percent trade intensity. From 2020, imports of goods that are energy intensive or have high exposure to trade may require the submission of emissions allowances, which represents a form of border tax. This requirement would take effect if there is no internationally binding

agreement on emissions reduction by 2018 or if countries do not demonstrate comparable climate action in a sector that is covered under the US emissions reduction programme.

It would also not take effect in a given sector if at least 85 percent of the sector's imports come from countries meeting one or more of the following criteria: i) the country is party to an international treaty and has agreed to emissions reduction at least as stringent as those in the US; ii) the country is party to an international sectoral agreement to which the US is a party; and iii) the country has an energy or GHG intensity in that sector no higher than that in the US. This requirement will also not apply to imports from least-developed countries (LDCs) or nations that account for less than 0.5 percent of global GHG emissions and less than 5 percent of US imports in a particular sector. The eligibility of sectors for OBR as well as border tax adjustment is based not only on carbon intensity of the sector but also on trade intensity, which may be difficult to justify under Article XX of the GATT even if border tax adjustment is allowed.

Another controversial issue is regarding the countries against which border tax adjustment will be used. Ostensibly, the Bill wants to target large developing countries such as China and India, and it has exempted imports from LDCs or nations that account for less than 0.5 percent of global GHG emissions and less than 5 percent of US imports in a particular sector. However, according to the WTO's "most favoured nation" principle, such discrimination may not be allowed. LDCs, of course, may be exempted due to their special status. In South Asia, there are three countries that are not LDCs. Hence, along with India, Pakistan and Sri Lanka may also be targeted. Even the Maldives, which has now graduated from LDC status and Bangladesh, which is likely to graduate from LDC status by 2020, could be targeted.

As far as the impact of such a measure in South Asian countries is concerned, except India and Pakistan, others do not have much energy-intensive products in their export baskets. Even for India and Pakistan, the share of such products (excluding petroleum products) in their export basket is not very high. The combined share of goods such as steel, aluminum, cement, paper and chemicals remains less than 10 percent, in terms of both their global exports and exports to developed countries. However, as per the proposed law in the US, border tax adjustment may be applied not only for goods with high energy intensity but also in sectors with high trade intensity. Hence, even textile and clothing products could be targeted. If so, that would be to the detriment of Pakistan and Sri Lanka since textile and clothing products constitute more than 40 percent of their export basket.

Nevertheless, such a measure would be difficult to implement in a fair manner. Emissions would be different for different producers and they would also be difficult to measure. Thus, a single adjustment rate for all producers is likely to be discriminatory. Moreover, such a single rate would be a serious disincentive for producers adopting energy efficiency measures on their own. Even otherwise, the case for border tax adjustment may not be very strong as a study (World Bank 2007) has shown that the overall impacts of domestic policies like carbon tax and energy efficiency standards on competitiveness have not been very strong. While they have been negative in some sectors, in others the impacts have actually been positive due to subsidies and exemptions. A recent Pew Center analysis projected that most energy-intensive sectors face only a modest competitiveness impact—losing on average 1 percent of production to imports—at a price of carbon dioxide at US\$15 per ton (Aldy and Pizer 2009).

Border tax adjustments do not fully counterbalance competitiveness issues since manufacturers in the tax imposing country would still be at a disadvantage in global markets. Moreover, the affected countries might adopt retaliatory measures which can vitiate the global atmosphere and endanger the spirit of cooperation that might be required to tackle the problem of climate change. Since most developing countries are operating well below their bound tariff rates in most product lines, they might resort to increasing their applied rates by remaining within WTO rules.

As Box 13.3 illustrates, the issue of border tax adjustment has been dealt with in the GATT/WTO framework where products were found to be eligible for border tax adjustment, provided that the inputs were detectable and physically incorporated (Howse and Eliason 2009). An

Box 13.3: A case of border tax adjustment at the WTO

In the US-Superfund case, Canada, the European Economic Community (EEC) and Mexico jointly challenged the legality of US measures imposing discriminatory tax rates on imported and domestic petroleum as well as taxes imposed on certain imported substances that were allegedly not imposed on like domestic products. The US successfully defended the latter issue as a permissible case of border tax adjustment as envisaged under GATT Article II:2(a), which says “nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part.”

Source: WTO (1987).

engineering approach, of course, may not consider energy consumed as physically incorporated. Moreover, emissions are not even an input but a by-product to produce energy consumed in the process of production. It is thus not clear if the US-Superfund case will have any validity for border tax adjustment based on emissions. The OBR mechanism envisaged in the US Waxman-Markey Bill may be in conflict with the provisions of the WTO Agreement on Subsidies and Countervailing Measures, which prohibits subsidies that are specific to an enterprise or industry. Free allowances to industrial units in energy-intensive sectors can very well be considered as subsidies.

7. Issues with environmental goods

WTO members have been discussing the liberalization of trade in EGS. A key challenge facing WTO members in this regard is that there is no universally agreed definition of what constitute EGS. The Committee on Trade and Environment (CTE) of the WTO has studied definitional issues at great length but could not reach any conclusion.

Some WTO members have put forward lists of what they regard as environmental goods (EGs). However, many developing countries, including India, have opposed such a list-based approach to liberalizing trade in EGs. Alternatively, India has suggested a project-based approach. India's argument is that many products have multiple uses and they may not be used for environmental purposes once imported into a country. Hence, a list-based approach might not meet the objectives. But a project-based approach will ensure that the product(s) in question are used for environmental purposes. For example, pipes are used to transport petroleum products, but they are also used as sewer pipes. If a list-based approach is followed, even pipes used to transport petroleum products would be covered by the liberalization process, thus defeating the objective of liberalizing trade in EGS, whereas if a project-based approach is followed, tariff and non-tariff barriers on pipes that would be used for sewage purposes only would be reduced/eliminated. However, there have been too few takers of this approach. Countries such as Argentina, Brazil and China have proposed other approaches, including combinations of list-based and project-based ones, as well as request-and-offer approaches as in the case of services trade liberalization.

A study by the World Bank (World Bank 2007) has identified a list of 43 goods that can be good for the climate and the list has been discussed at the WTO. The list is widely referred to as the World Bank list, though it has not been officially endorsed by the Bank. This list, however, seems to be *ad hoc* as it has not been prepared with any defined criteria.

There is another problem too with the list-based approach. As is known, technology is dynamic in character. Therefore, EGs, including climate-friendly goods, are always evolving. What may be construed to be an EG today may not be treated the same in the future as new products with better environmental performance might enter the market. In fact, such a phenomenon has already been observed. For example, compact fluorescent light (CFL) is considered as an environment- or climate-friendly good and many countries have argued for its liberalization. But another technology, light emitting diode (LED), came into commercial use not long after CFL was brought to commercial use. LED is much more energy efficient than CFL. It also does not use mercury (which CFL does) that is environmentally hazardous. Therefore, if a list-based approach is followed, it could be that more environment- friendly products would be discriminated against in favour of the not-so-friendly ones. And revising the list on a regular basis would also not be easy.

Therefore, even if a list-based approach is followed, it is important to have a “living list”. An option that has been suggested in that respect is to have two lists: one core and another complementary, which can be updated over time. Another option that has been suggested is to update the list between rounds of negotiations. Again, however, the problem is that negotiation rounds may not take place on a par with technological progress. Nor would it be easy to agree on an updated list.

Hence, a more practical option could be to allow member countries to include a new product in the place of a product included in the existing list if it can be shown with scientific evidence that the new product has substantially better environmental performance compared to the one that is included in the existing list. But there could be problems in this approach too. Many countries could resort to dispute settlement due to arbitrary changes in the lists.

Other concerns related to the liberalization of EGS include the issue of infant industry protection raised by developing countries. Their argument is that free import of EGs might hinder the development of their like industries. If so, the objective of environment protection might be difficult to achieve because, without domestic capabilities in the production of EGs, their wide use might not be possible.

There is also no guarantee that energy-efficient goods might be helpful in meeting the emissions reduction objectives since increased energy efficiency could increase the use of these products, a phenomenon referred to as the Jevon's Paradox. For example, if cars and air conditioners become more energy efficient, people might use them more. It is also doubtful that technology can be the only solution to climate change. Developed countries have good access to technologies and financial re-

sources; yet the levels of emissions in these countries are 5 to 10 times higher than the acceptable levels. It is also noteworthy that North America and Western Europe have similar levels of standards of living as well as similar access to technologies; yet the emissions level in North America is almost double that in Western Europe.

8. Technology, IPR and the WTO

Surprisingly, the issue of technology transfer has not received much attention in WTO discussions on trade and environment although it is an important component in the UNFCCC agenda. Nevertheless, the issue regarding access to environment-friendly technologies and the role of IPR has been raised by some countries in the CTE. Most notably, Cuba has demanded the shortening of patent protection period to facilitate transfer of clean technologies (WTO 2008).

The issue of IPR is also not explicitly mentioned in the Doha Agenda on trade and environment. Similarly, there has not been any remarkable development regarding this issue in the Working Group on Trade and Technology Transfer at the WTO.

Much of the discussion on technology transfer has been concerned with the issue of climate change mitigation. However, for developing countries, technology would probably be more important for adaptation. They are mainly in need of technology in agriculture that would help crops withstand the impacts of climate change. They are also in need of technology to deal with water stress as well as to deal with greater occurrence of existing diseases and arrival of new ones.

Technologies protected by IPRs need to be licensed, and the nature of IPR regime determines the terms of licensing. Therefore, there is likelihood of production and usage costs going much higher because of payments made in order to obtain these licences. In some cases, the owner may just refuse to grant a licence altogether as such technologies are used as barriers to entry (Aoki and Small 2004). Often, production of relevant goods that embody such technology is cheaper in developing countries even after payments of royalties. Given this context, it has been suggested that the issuance of compulsory licences can be a tool for faster diffusion of climate-friendly technologies (Barton 2007; Khor 2008). Compulsory licences ensure competition, and hence make relevant goods and services cheaper (Box 13.4).

Contrary to popular belief, there are several grounds on which compulsory licences can be issued even within the WTO's TRIPS framework. Rights of member countries to make use of compulsory licences in the interest of public health have been explicitly recognized in the Doha

Box 13.4: Compulsory licensing and the WTO

The term “compulsory licence” does not figure as such in the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). However, it is incorporated in Article 31: Other Use Without Authorization of the Right Holder. Exceptions to rights of patent holders and principles on measures for preventing the abuse of IPRs by right-holders, or the resort to practices which unreasonably restrain trade or adversely affect the international transfer of technology also provide reasonable flexibility for resorting to the provision of compulsory licence (Article 8 of TRIPS). Article 30 allows members to provide limited reasonable exceptions to the exclusive rights conferred by a patent, if it does not unreasonably prejudice the legitimate interests of the patent-owner and takes into account the legitimate interest of third parties.

Similarly, Article 31 (c) provides that a country can use such a measure “to remedy a practice determined after judicial or administrative process to be anti-competitive”. Hence, countries can invoke their competition law where “abuse of dominance” is included as one of the anti-competitive practices and the source of dominance is an IPR. However, Article 31 provides that the possibilities of obtaining a voluntary licence must be exhausted before a compulsory licence is sought. Also, Article 40 dealing with control of anti-competitive practices in contractual licences states, “Nothing in this Agreement shall prevent Members from specifying in their legislation licensing practices or conditions that may in particular cases constitute an abuse of intellectual property rights having an adverse effect on competition in the relevant market”. Hence, under-servicing the market and refusing to provide licence can be taken as an anti-competitive practice.

Declaration on Public Health and the August 2003 Decision by WTO members regarding the implementation of the Declaration. Pursuant to these, the General Council of the WTO amended the TRIPS Agreement on 6 December 2005 to incorporate the decisions made in favour of the use of compulsory licences.

The effectiveness of the use of compulsory licensing to promote technology transfer, however, will depend on market conditions of relevant products and the technology market. It is important that there will be capable and willing firms to receive a compulsory licence. This will require that there will be a sufficient number of firms operating in the same or similar products. Markets for climate-friendly products and technologies are unlikely to meet such conditions as they are highly concentrated. Such concentration is even higher in particular segments of the industry (Sawhney 2006). When a firm remains a virtual monopolist for a sufficiently long period of time, it becomes extremely difficult for any other firm to enter that industry.

The US is the world’s largest producer of environmental technologies and enjoys about 33 percent share of the international market. Other major suppliers are the EU, particularly Germany and Japan. The Office of Environmental Industries of the US proudly claims that developing

nations simply do not have the technologies (Nanda 2008). It is very likely that the situation would be quite similar in case of technologies that relate to climate change mitigation. In a recent study based on patenting between 1978 and 2003, it was found that innovation in climate change technologies is highly concentrated in three countries, namely Japan, Germany and the US, and they collectively account for two thirds of total climate innovations in 13 technologies (Dechezleprêtre *et al.* 2008). It is important to note that climate-friendly technologies and products are different from pharmaceutical products. Therefore, even an LDC like Bangladesh has capabilities to produce pharmaceutical products, but even a relatively advanced developing country like India does not have much capability in climate change mitigation technologies.

In such a situation, it would be difficult for developing countries to operationalize a compulsory licensing arrangement to promote access to technology. A requirement in TRIPS Article 31(f) is that production under compulsory licence has to be predominantly for the domestic market. This was a major concern for developing and least-developed countries, and therefore, at the Doha Ministerial Conference of the WTO, they raised this concern in the context of TRIPS and public health. Accordingly, an amendment was made, as per which countries without pharmaceutical manufacturing capability could issue compulsory licence to foreign firms as well. However, this exemption from Article 31(f) of TRIPS was provided only for public health needs, and the same cannot be used for climate-friendly goods and technologies.

Even if the flexibility of using compulsory licence is extended to include climate-friendly goods and services, it might not be too helpful for developing countries. They might find it difficult to use the compulsory licence provision due to political pressure from the developed world, particularly the US (Wise 2006). In that case, a political statement by developing countries at the global level will certainly strengthen their position, and a public health type exemption to issue compulsory licence to foreign firms would certainly be a welcome move. However, it might be necessary to extend such facility to all developing countries, and not just LDCs (Nanda 2009).

9. Carbon standards and carbon labelling

Eco-labelling is a relatively new concept and practice adopted mainly by developed countries. It tries to ensure that exports from a country, on environmental grounds, are harmless for consumers and the environment of the importing country. In doing so, it looks at the entire life cycle of the product in question and analyses its production- and

process-related criteria. Eco-labelling has been a major issue for developing countries and LDCs since they do not have the requisite capacity to fulfil the set criteria. It has been observed that exports from developing countries to developed countries, mainly the EU and the US, have already been considerably affected by the latter countries' eco-labelling requirements.

Various governments and non-governmental organizations have been supporting eco-labelling programmes, which cover thousands of products in more than 20 countries. There have also been efforts to standardize environmental labelling schemes at the international level. Therefore, there are possibilities that carbon labelling, which is a part of eco-labelling, may emerge as significant trade concerns in the years to come (Nanda and Ratna 2010); and that emissions norms will enter the eco-label criteria in greater measure (OECD 1997; UNESCAP 1997; CUTS 2005).

In the early 1990s, a private initiative was taken in the UK to forward a concept called "food miles". The main feature of the concept is that through labelling, which is one way of carbon labelling, consumers are informed about the distance that a particular item has covered to reach the store so that consumers would use their informed judgement as to whether to buy that particular product. Campaigns are also organized to discourage consumers from purchasing products that have been imported from far-off places. The concept has now gained immense popularity and is now supported by a range of environmental, community and farmer groups, including the World Wildlife Fund and Soil Association. It is also getting momentum in other European countries, the US and Australia.

When international architectures like the UNFCCC, the Intergovernmental Panel on Climate Change (IPCC) and experts like Nicholas Stern favour the adoption of carbon labelling requirements, they might not have considered the impacts that such requirements can have on small producers and poor people of developing countries. Complying with carbon standards will require estimation of the carbon footprint of all suppliers. For many small producers, there may not be fixed suppliers. They might source their supplies from the market without any knowledge of the original suppliers. This would mean that complying with standards or measuring carbon footprint will be extremely difficult.

Though standards, labelling and air miles are more prevalent in food items, they are likely to make ways into non-food items as well in the near future. For developing countries, adoption of carbon labelling even on a voluntary basis is a matter of concern. Much of the demand for carbon standard and labelling is fuelled by the fear that producers

in developed countries will lose competitiveness and outsource their production to developing countries.

It is very likely that most products coming from developing countries will have lower emissions. A significant portion of the export basket of most developing countries constitutes small producers' products, which are not energy intensive. Even in a country like India, which has a relatively diverse industrial structure in the developing world, the share of energy-intensive products in its exports is less than 10 percent. Therefore, developing countries will have difficulties in meeting the carbon labelling requirements as the costs of compliance would be very high, particularly for small producers. A growing number of private standards may also confuse consumers, thereby diminishing their intended effects. However, their effects on trade restriction will remain.

Prima facie, the idea of food miles appears to be justified as transportation is a highly energy-intensive activity. However, the issue is much more complex than it appears. It is perfectly possible for a product to remain less carbon-intensive even after it has been airlifted from Africa to a store in Europe compared to similar products grown in the neighbourhood if carbon intensities of the production processes in Europe are much higher than those in Africa.

The concept of food miles, however, raises important concerns. Not only that it can have adverse impacts on food exporters which can have economic, social and ethical dimensions, its reliability on the impact on climate change itself is suspect. Food miles indicate only a part of the carbon emitted in the life cycle of a product. The concept indicates carbon emitted in the process of transportation only while ignoring carbon emitted in other phases in the life cycle of the product. There is already some evidence that food miles can be a misleading indicator of carbon emissions in the food supply chain. For example, a study found that cut roses grown in Kenya for the British market, based on a life-cycle analysis, are 5.8 times more carbon efficient compared to Dutch greenhouse flowers even after accounting for emissions caused by air freight (Appleton 2009).

It has often been argued that carbon labelling is a better alternative than promoting the concept of food miles to address the issue of carbon emissions in international trade (Muller 2007). Countries such as Australia and New Zealand, which are developed countries and major exporters of agriculture goods, also subscribe to this view (Hogan and Thorpe 2009). But some concerns remain. Carbon labelling will involve significant transaction costs along with the issue of quality assurance. Further, there is no guarantee that promotion of carbon labelling will automatically stop the promotion of food miles. It would also be almost

impossible to have a measure of carbon emissions of a product on a life-cycle basis. It may be possible to measure emissions of a product up to the factory gate. But emissions due to transportation from the factory gate to the consumer would be difficult to measure as they will vary not only from market to market but also on the mode of transport. Measuring emissions due to disposal would be even more difficult as nobody can have control over it.

Standard-setting and labelling activities come under the Agreement on Technical Barriers to Trade (TBT) of the WTO irrespective of whether they are mandatory and voluntary and though the applicable provisions are different. There is, however, no consensus on whether standards or technical regulations on non-product-related processes and production methods and private labelling schemes will fall within the purview of the Agreement. Hence, private standards and labelling schemes are possibly taking advantage of some loopholes in the TBT Agreement and essentially defeating the very purpose of it. WTO members have already been discussing the issue of private standards and have recognized the need to deal with them so that they do not unnecessarily restrict trade (Box 13.5).

Box 13.5: Carbon standards and the WTO

The TBT Agreement covers standards set by central government bodies, local government bodies as well as non-governmental bodies. As was seen in the US Superfund case, if the processes and production methods (PPM) are detectable and embodied in the product itself, they may come under the agreement. However, carbon emissions are not detectable and measuring it is also a difficult task. In the US Shrimp-Turtle case, the import ban was examined under Articles XI and XX of the GATT, and hence does not shed any light on the applicability of TBT.

It is, however, debatable if activities of organizations and corporations like the Soil Association, Bio Suisse, Tesco, and Marks and Spencer should be considered as standardizing or simply marketing or strategic issues. Many WTO members are not in favour of standards based on non-product-related PPM, and hence, such standards have not been allowed to accede to the TBT Code. An interesting case is that of Forest Stewardship Council. It is widely recognized by many WTO members and its standards and labels are recognized globally. It is also listed by the World Standards Services Network as an international standardizing body.

Source: Appleton (2009).

10. Conclusion

In most developing countries, including in South Asia, per capita emissions are very low; in some cases even lower than two tons per capita, which some suggest to be the target for 2050. Also, since these countries

already operate at a very low level of energy use, their mitigation efforts are not likely to contribute much to the possible global emissions reduction. It is also true that some degree of climate change is inevitable no matter what we do now. Developing countries thus need to have elaborate preparations for adaptation to climate change. They need to develop technical, institutional and human capabilities to face up to these adaptation challenges. They cannot, of course, ignore the issue of mitigation as that is linked to their energy security even if mitigation need not be a priority, particularly in countries where emissions are low. Moreover, since developing countries are relatively more vulnerable to the effects of climate change, they have significant interest in mitigation efforts made by the global community as a whole.

It is in the interest of humanity that a global deal is achieved to curb emissions, but developing countries cannot be treated on a par with developed countries in this regard. In the case of South Asia in particular, since the region is home to the largest number of poor people on earth, countries in the region have to deal with many socio-economic problems. Hence, it is important that CBDR is implemented in its true spirit and South Asian countries do not have to accept undue obligations. There have been some concerns that if sufficient progress is not made in the UNFCCC and the WTO in resolving relevant issues, that might legitimize the potential unilateral trade measures adopted by developed countries. This, however, is unlikely to make developing countries rush towards multilateral settlement of such issues if they are not convinced that the results of negotiations will be in their interest. After all, trade measures, if at all adopted, are likely to impact only a segment of their economy, but commitments at the multilateral level will impact the whole economy.

However, trade measures like border tax adjustments are likely to be discriminatory and unlikely to serve any useful purpose. It is another matter that such measures would be extremely difficult to implement and might even be disallowed by the WTO. In South Asian countries, the export sector is not the major source of greenhouse gas emissions. Hence, trade measures are unlikely to be effective in forcing countries to adopt climate change mitigation measures. Competitiveness concerns are best addressed through international agreements rather than unilateral measures. Since an important item on the WTO trade and environment agenda is the clarification of the relationship between WTO agreements and multilateral environmental agreements, issues like border tax adjustment can also get addressed here. Developing countries are also likely to be forced to take some mitigation measures to maintain their trade performance as there is proliferation of private initiatives taking

place in developed countries that might restrict imports from developing countries. It is not clear if there would be appropriate measures at the WTO or other forums to discipline such measures, some of which are arbitrary, particularly in case of food miles. Even if some rules are adopted in this regard, the question of whether they will be effective enough will remain.

The issue of climate change has already entered the WTO arena through its discussion on trade and environment, but the discussion is mainly focused on liberalization of trade in environmental or climate-friendly goods. Moreover, there has not been much progress in the discussions due to definitional problems. It is indeed difficult to define environment-friendly or climate-friendly goods, and it is also not clear as to what extent liberalization of such goods would contribute to meeting the environmental or climate objective.

In reality, climate change is hardly a concern on the WTO agenda on trade and environment. It is more of a market access agenda, and the environmental objective is expected to be achieved through liberalization of trade in EGS. It is oblivious of the fact that some of the existing WTO provisions like rules on subsidies and tariffs can thwart climate change mitigation efforts at national levels. If reforms are proposed at the WTO to promote climate-friendly technologies, South Asian countries might support such initiatives.

Climate change has not been discussed enough under TRIPS, which has major implications for access to technologies that are important for climate change mitigation and adaptation. Interestingly, some developing countries have proposed a more liberal IPR regime, including relaxation of compulsory licensing framework, but developed countries, particularly the US and the EU, have opposed it. It should also be noted that compulsory licensing alone may not do much and hence other measures will also be required. Moreover, in the global discourse on trade and climate change, mitigation issues get the most focus whereas for developing countries, the issues of adaptation to climate change, effects of climate change on their trade performance and access to technology are much more important.

Notes

¹ <http://www.oecd.org/dataoecd/60/27/2502872.pdf>

² The WTO was established after a number of rounds of negotiations. The last and the longest of those rounds was the Uruguay Round, which established the WTO.

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Chapter 14

WTO negotiations on environmental goods and services: South Asia's interests

Fahmida Khatun

1. Introduction

The environmental issue has emerged as an important area of concern for policy makers in South Asian countries. These countries face multiple problems in the areas of environment, ranging from air and water pollution to soil degradation and desertification to depletion of forest and fish resources, loss of biodiversity and ecosystem, urbanization and congestion. South Asian countries are also vulnerable to the risk of climate change, which is feared to lead to sea level rise with severe impacts on the lives and livelihoods of a large number of people in the region. At the same time, South Asian economies have been integrating into the global economy at a fast pace over the last decade. Their economic policies have focused on trade liberalization to promote the growth of the export sector and stimulate overall economic growth.

In the context of higher intensity of environmental problems and increased economic interdependence among countries, trade and environmental policies need to be formulated in a manner which can ensure

sustainable economic growth. Recognizing the interface between trade and environment, the World Trade Organization (WTO) addresses the issue through various agreements, most of which contain exceptions from the trade liberalization rule in order to legitimize the efforts of its members to protect the environment (WTO 2001). Paragraph 31 (iii) of the Doha Ministerial Declaration mandated negotiations on “the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services” as part of the single undertaking.¹ Since the launch of the Doha Round of the WTO in 2001, negotiations on the trade-environment issue have not gained sufficient momentum. However, an outcome on trade and environment is expected to be part of a larger package of the agreements achieved when the Doha Round negotiations are completed.

Participation of South Asian countries in trade and environment negotiations has been limited. Given these countries' environmental vulnerabilities and the importance of trade in their development efforts, it is important that South Asia examines the implications of these negotiations at the WTO. This article attempts to examine some of the specific issues with respect to negotiations on environmental goods and services (EGS) in South Asia and make recommendations for negotiating positions. Based on secondary data, the article estimates the pattern of environmental goods (EGs) trade in South Asia, its share in global merchandise trade, and major EG exports and imports of South Asian countries. Data on environmental services (ES) related to South Asia are not available from published sources; hence, analysis in this area is constrained.

2. Overview of negotiations on EGS

2.1 Environmental goods

The definition and coverage of EGs has been a contentious issue at the WTO. Key issues that complicate defining EGs include: i) whether “environmental goods” should include products with multiple end use; ii) the mechanisms of capturing goods by the Harmonized Commodity Description and Coding System (HS); and iii) how goods and services that correspond to local concerns can be identified as EG in the global trade context (Jha 2008).

Definitions by the Organisation for Economic Co-operation and Development (OECD) and the Asia-Pacific Economic Cooperation (APEC), which developed two separate lists of EGs, were starting points in the discussion of EGs in the context of the Doha Round. The OECD list was

developed in the context of an analytical work on the role of EGS in environmental policy and industrial competitiveness. The APEC list resulted from negotiations on trade liberalization among APEC countries. WTO members also proposed their own products in the context of the EG negotiations based on their perceived interests and comparative advantage. In 2007, the “Friends of EGs” submitted a list of EGs comprising 153 items under 12 broad categories.

A number of suggestions have been made in the Committee on Trade and Environment Special Session (CTESS) for purposes of identifying EGs. These include focusing on the product’s “end use” or “direct use”, but concerns have been raised about the dual or multiple uses of these products. On the other hand, it has been stressed that distinctions based on processes and production methods should not be used as the basis for the identification of EGs. Other considerations relate to the concept of environmentally preferred products, which, according to the United Nations Conference on Trade and Development (UNCTAD), are those goods whose production and sale contribute significantly to the preservation of the environment (UNCTAD 2003). The debate lies in the fact that for most developing countries, their export interest lies in environmentally preferred products. It is in their interest, therefore, that these products be covered by the definition or approaches finally adopted in the EG negotiations at the WTO. Such products include, for instance, natural fibres and colorants, other non-timber forest products and renewable energy products, including ethanol and biodiesel.

Developed countries are advocating a “list-based” approach to identifying specific environmental goods while many developing countries support alternative approaches, particularly the liberalization of EGS associated with a specific environmental project. Under the list approach, countries would identify specific EGs and then negotiate the elimination or reduction of bound tariffs and non-tariff barriers (NTBs) permanently on those goods, on a most-favoured-nation basis. Suggestions have been made for a “development list” to be developed by developing and least-developed countries to identify EGs subject to lower tariff reductions based on the principle of less than full reciprocity. The list approach has been criticized on the ground that it may lead to the liberalization of goods that have both environmental and non-environmental end uses.

The project approach spearheaded by India would allow imports of goods and services at concessional terms for environmental projects approved by a designated national authority based on criteria developed by the WTO Committee on Trade and Environment (CTE). This approach is said to recognize the diversity in environmental standards

and articulate the concept of common but differentiated responsibilities by developing countries, integrating environmental and development concerns in the approach to the negotiations. Developed countries have criticized the project approach, however, for failing to provide predictable, binding and permanent trade concessions, and have questioned its consistency with WTO rules.

A third alternative is an integrated approach requiring the CTESS to multilaterally pre-identify the categories of environmental projects and EGs used in such projects that would benefit from tariff and NTB concessions. Yet another approach is a "request-offer" approach whereby each country will identify products that contribute to the environment and seek tariff concessions on those products while also indicating the products in which it is prepared to undertake liberalization commitments as requested by other members.

2.2 Environmental services

Similar to the situation with EGs, there is no universally accepted definition of ES. The General Agreement on Trade in Services' (GATS) Sectoral Classification List (W/120) sorts ES as: i) sewage services; ii) refuse disposal services; iii) sanitation and similar services; and iv) other services (cleaning services of exhaust gases, noise abatement services, nature and landscape protection services, and other ES). The OECD argues, however, that such classification is too narrow. The OECD/Eurostat classification is wider: seven groups of ES are listed and under them there are 10 sub-categories (OECD 1999). The GATS Sectoral Classification List (W/120), which is based on the United Nations provisional Central Product Classification (CPC), was revised as CPC version 2 in 2008. This classification includes seven broad categories of ES under which there are sub-categories.

In the course of negotiations, WTO members have proposed to divide ES into a "core" group and a "cluster". The "core" group would encompass services which can undisputedly be classified as "purely" environmental, categorized according to environmental media such as water, noise, solid and hazardous waste, among others. In the "cluster" approach, conceptual services such as design, engineering, research and design, and consulting services can be considered as a special cluster since these have environmental end use. In fact, it is difficult to separate EGs and ES for purposes of trade analysis. EGs are often used to provide a service. But a good is tangible whereas a service is not. There is a significant overlap between the services segment and the equipment segment of environmental products.

3. EG trade by South Asian countries

South Asia's share in EG trade is very little compared to South Asia's share in global trade. The share of EG exports in total exports by South Asian countries was 2.97 percent and the share of EG imports in total imports by South Asian countries was 4.58 percent in 2007. India has emerged as a major exporter and importer of EGs in South Asia. With a share of 90 percent, the market for EGs is, however, dominated by developed countries. Even among the developed countries, the European Union (EU), the United States (US) and Japan together account for 85 percent of the total market (OECD 2001). Based on data of the Trade Map of the International Trade Centre (ITC), the UN Comtrade and the World Integrated Trade Solution (WITS), it is estimated that total global exports and imports of EGs stood at US\$783.2 billion and US\$753.8 billion, respectively, in 2007. Total exports and imports of EGs increased from US\$323 billion and US\$333.8 billion, respectively, in 2001. These EGs are those defined in the "WTO 153 list" categorized at the HS 6-digit level.

The share of South Asian countries in global trade of EGs is very small. In the absence of the latest data, this analysis is based on 2007 data. The share of South Asian EG exports in total global EG exports was 0.71 percent while the share of South Asian EG imports in total global EG imports was 1.75 percent (Table 14.1). Among South Asian countries, India's share in both exports and imports was the highest, at almost 91 percent and 79 percent respectively. Bangladesh stood second with 6.34 percent share of total South Asian EG exports while Pakistan secured the second position in case of EG imports with 12.87 percent share in total South Asian EG imports. Afghanistan, Bhutan, Nepal and Sri Lanka had very little shares in EG trade.

Disaggregated data according to 12 broad categories under the WTO's "153 list" reveal that in the case of both exports and imports, "renewable energy plant" and "waste water management and portable water treatment" have been the two most important items for South Asian countries (Table 14.2). The top 10 EG export products comprise 46.06 percent of all South Asia EG exports. The list includes the following items:

- Parts for diesel and semi-diesel engines;
- Taps, cocks, valves and similar appliances;
- Static converters;
- Wind-powered generating equipment;
- Photosensitive semiconductor device, photovoltaic cells and light emit diodes;

Table 14.1: Total export and import of EGs (US\$ million)

Country	Total export		Total import	
	2001	2007	2001	2007
Afghanistan	0.00	1.71	4.76	156.15
Bangladesh	137.29	351.10	297.31	488.00
Bhutan	0.27	0.27	1.53	9.28
India	940.39	5,022.09	1,807.96	10,360.44
Maldives	0.10	0.00	24.06	68.76
Nepal	0.00	29.95	0.01	50.17
Pakistan*	40.13	88.65	523.69	1,696.17
Sri Lanka	13.57	48.02	172.25	351.60
Total South Asia	1,131.74	5,541.78	2,831.57	13,180.57
Total trade of South Asia (all products)	n.a.	186,706.62	n.a.	287,783.23
Total world trade of EGs	323,041.99	783,206.37	333,793.60	753,796.24
Share of South Asian EG trade in total trade of South Asia	n.a.	2.97	n.a.	4.58
Share of South Asia in total world EG trade	0.35	0.71	0.85	1.75

Note: *For Pakistan, 2003 data instead of 2001 data.

Source: UN Comtrade, Trade Map and WTO Trade Database.

- Jute and other textile fibres, raw or retted;
- Articles, iron or steel;
- Towers and lattice masts, iron or steel;
- Parts of machines and mechanical appliances having individual functions; and
- Sacks and bags for package of goods of jute or of other textile fibres.

In the case of imports at HS 6-digit level, the top 10 EG imports comprise 34.35 percent of the region's EG imports. These are as follows:

- Machines and mechanical appliances having individual functions;
- Air or gas compressors, hoods;
- Static converters;
- Taps, cocks, valves and similar appliances;
- Parts of electric motors, generators, generating sets and rotary converters;
- Articles, iron or steel;
- Measuring or checking instruments, appliances and machines;
- Parts for diesel and semi-diesel engines;

- Parts of machines and mechanical appliances having individual functions; and
- Gears and gearing, ball screws, gear boxes, speed changers/torque converters.

On the top five EG imports by each South Asian country, the effective applied tariff rates range from 0 percent to over 40 percent (Table 14.3). Parts of diesel and semi-diesel engines face the highest tariff, at 40.74 percent, and pumps face 35.83 percent in the Maldives. Static converter, which is among the top five EG import items in Bangladesh, India, Nepal and Sri Lanka, faces tariffs ranging from 3.8 percent to 15 percent. Even though tariffs on EGs in developed countries are very low, South Asian countries will benefit from liberalization of EGs since their EG exports are also destined to a number of developing countries where they face high import tariffs for EGs. In developing countries such as China, Mexico, Syria and the United Arab Emirates, major EG exports from Bangladesh and Nepal face tariffs ranging from 4.7 percent to 30.3 percent.

Table 14.2: South Asia's EG trade by broad
product category, 2007 (US\$ million)

Product category	Export		Import	
	South Asia	World	South Asia	World
Air pollution control	546.72	75,596.15	1,889.88	74,586.29
Management of solid and hazardous waste and recycling systems	628.44	130,729.82	2,157.42	120,349.17
Clean up for remediation of soil and water	65.30	5,904.99	111.29	5,469.29
Renewable energy plant	1,591.11	202,314.18	3,319.86	190,689.40
Heat and energy management	73.19	13,399.67	202.17	12,493.87
Waste water management and portable water treatment	1,415.59	198,215.95	2,879.80	193,121.96
Environmentally preferable products, based on end use or disposal characteristics	385.83	547.50	110.38	436.53
Cleaner or more resource-efficient technologies and products	11.99	8,251.71	71.44	9,741.66
Natural risk management	37.62	7,320.41	176.77	6,172.38
Natural resources protection	29.46	861.25	10.47	654.34
Noise and vibration abatement	570.32	56,677.40	538.57	57,615.68
Environmental monitoring, analysis and assessment equipment	204.93	87,046.71	1,783.35	86,023.91

Source: Author's calculations based on UN Comtrade and Trade Map.

Table 14.3: Tariffs on top five EG imports of South Asian countries, 2007

HS code	Product description	Applied tariff (%)
Afghanistan		
841581	Incorporating a refrigerating unit and a valve for	5
Bangladesh		
847989	Machines & mechanical appliances having individual functions	1.67
850440	Static converters	7.33
853710	For a voltage not exceeding 1,000 V	8.5
841480	Air or gas compressors, hoods	9.13
840999	Parts for diesel & semi-diesel engines	5
Bhutan		
730820	Towers and lattice masts	20
730690	Tubes, pipe & hollow profiles, iron or steel, welded	20
842121	For filtering or purifying water	10
853710	For a voltage not exceeding 1,000 V	20
847420	Crushing or grinding machines	10
India		
847989	Machines & mechanical appliances having individual functions	12.5
850440	Static converters	12.5
848180	Taps, cocks, valves & similar appliances	12.5
850300	Parts suitable for use solely or principally with	12.5
841480	Air or gas compressors, hoods	12.5
Maldives		
840999	Parts for diesel & semi-diesel engines	40.74
848180	Taps, cocks, valves & similar appliances	19.82
841381	Pumps	35.83
730490	Tubes, pipe & hollow profiles, iron or steel, smls	25
842121	For filtering or purifying water	19.3
Nepal		
530310	Jute and other textile bast fibres, raw or retted	5
850720	Other lead acid accumulators	15
847420	Crushing or grinding machines	5
854140	Photosensitive semiconductor devices, including...	0
850440	Static converters	15
Pakistan		
841480	Air or gas compressors, hoods	14.87
847989	Machines & mechanical appliances having individual functions	5

850239	Electric generating sets	5
841989	Machinery, plant/laboratory equipment for treatment of...	20
847420	Crushing or grinding machines	5
Sri Lanka		
841182	Of a power exceeding 5,000 Kw	2.5
730630	Other, welded, of circular crosssection, of iron...	1.72
850440	Static converters	3.83
848180	Air or gas compressors, hoods	2.22
732690	Articles, iron or steel	8.48

Source: WITS database.

4. Issues and strategies for negotiation on EGS liberalization

Social, political and economic factors in their respective countries need to be considered by South Asian negotiators when they participate in discussions on what goods and services to liberalize, how to liberalize and what approaches to be adopted. Though the issue of export of EGS is in fact part of the overall market access issue from which South Asia may benefit, opening up of domestic markets of South Asian countries for foreign products and companies is a sensitive issue.

South Asian countries have to participate effectively in international negotiations on EGS so that they can make an informed assessment of the opportunities and challenges associated with EGS liberalization. While the principal objective of such negotiations should be whether reduction or elimination of tariffs and NTBs will protect the environment while expanding national trade, South Asia has to consider a number of aspects, discussed below, while adopting strategies for EGS negotiations.

4.1 Negotiations on EGs

The list approach does not emphasize the need for technology transfer adequately. On the other hand, the project approach stands to offer better opportunities for South Asia in terms of market access since this approach is supposed to enable technology transfer, which, in turn, can help improve South Asian countries' compliance with technical and sanitary and phytosanitary (SPS) requirements. Many enterprises in South Asia are in the category of small and medium enterprises, which lack financial and technological capability to comply with requirements set by the importers of developed countries.

Standards, certification requirements and environmental regulations limit trade to a great extent. Products from developing countries and LDCs face difficulties in entering foreign markets due to stringent standards set by destination governments, often to protect domestic suppliers. Identification, harmonization and elimination of NTBs for products identified as EGs are needed in order to facilitate trade in such goods.

Developing and least-developed countries have demanded flexibility in the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) in order to solve problems of patented climate-friendly technologies. For LDCs, it is important that Article 66.2 of TRIPS, which mandates developed-country members to take measures to encourage technology transfer to LDCs, is effectively implemented for climate technologies. South Asia should also be watchful of any attempts of dumping of old technologies by developed countries in the name of technology transfer.

In order to take full advantage of EG liberalization, technical and financial assistance is essential. Such assistance is needed not only for buying clean technologies but also for addressing any probable negative impact of liberalization on South Asian countries. Support can be sought from the WTO's Aid for Trade initiative.

4.2 Negotiations on ES

The Doha Ministerial Declaration placed services negotiations in the overall timeframe of the Doha Round. It reaffirmed the Guidelines and Procedures for the Negotiations adopted by the Council for Trade in Services on 28 March 2001 as the basis for continuing the negotiations, with a view to achieving the objectives of the GATS.

Analysis of South Asia's interests in trade in ES is difficult since there are no data available on this. The main way to trade in ES is through Mode 3 and Mode 4 of the GATS. Under Mode 3, services are provided by a subsidiary or a branch in a host country through its commercial presence, and under Mode 4, services are provided by professionals temporarily working abroad. A number of issues stand in the way of better trade performance under both these Modes.

Provision of environmental infrastructural services in South Asia requires high levels of investment and expertise. South Asian countries may benefit from such investments through commercial presence under Mode 3 in the area of increased access to safe water through treatment of polluted water or wastewater management. However, the issue of affordability of these essential environmental services is a concern for South Asian governments. Water is a public good and privatization of

such services would create conflict of interest as the provision of this good would be on a profit-making basis, ignoring the affordability of the poor in the face of weak regulatory capacity in South Asian countries. Profit-driven motivation behind the supply of essential goods like water creates the risk of exclusion of people who cannot afford such private services.

Liberalization may also act to undermine many traditional and local technologies and methods of ES in favour of advanced and modern techniques and tools imported from abroad. In the process, region-specific, cheap, simple and cost-effective innovations may be encouraged instead of expensive, complex and sometimes out-dated technologies exclusively imported from abroad (Sugathan 2007).

The interplay between trade and environment is an evolving issue and subject to debates as the relationship can exhibit both positive and negative results on poverty and human development. Therefore, the opportunities and challenges of liberalization of ES should be examined through in-depth cost-benefit analyses on a case-by-case basis, that is, on a country-by-country and service-by-service basis. The objective of such an exercise is to explore mechanisms to ensure efficiency and equity if liberalization of ES trade takes place. In order to ensure accessibility and affordability of essential products and services such as drinking water and sanitation, there should be regulations on prices and business practices of domestic and foreign companies. In South Asia, the monopoly of the government in these sectors is justified on equity grounds. Commercial presence of foreign enterprises under Mode 3 may contribute to increased investment and capital formation, improvements in the coverage and quality of environmental services, transfer of technology and capacity building. However, without an understanding of the implications of liberalization of essential environmental infrastructural services such as water, South Asia should not make any commitments in this area.

Commercially meaningful liberalization of environmental infrastructural services requires market access in environmental support services such as construction, engineering, legal and consulting services, where Mode 4 is an increasingly relevant factor. Market access of services providers from South Asia to developed countries is constrained by stringent immigration and recruitment policies of importing developed countries. Services providers are also affected by restrictions such as licensing requirements and prerequisites relating to qualification and work experience. Though export of ES by South Asia is not very significant, some of these countries could reap economic benefits by exporting environment-related professional services in the form of

studies, assessments and consultancies. For example, countries which suffer from environment-related natural disasters such as flood, cyclone and drought are better equipped with the expertise for dealing with such catastrophes.

5. Issues for South Asian LDCs

There are four LDCs in South Asia—Afghanistan, Bangladesh, Bhutan and Nepal. LDCs have a number of special issues in the WTO with regard to market access, preference erosion and technology transfer, among others. Growth without domestic innovation and capacity building through free trade would not be environmentally and economically sustainable for LDCs in the long run. LDCs should use liberalization as a tool to import foreign technologies at a lower cost to enhance their capacity and proficiency in utilizing their resources rather than have only foreign firms do the job.

The United Nations Framework Convention on Climate Change (UNFCCC) has mandated transfer of technology and know-how related to environmentally sound technologies. The Seventh Conference of the Parties to the UNFCCC held in Marrakesh in 2001 adopted a framework for technology transfer to enhance adoption of climate-friendly technologies. The importance of transfer of energy-efficient and low-carbon technologies to developing and least-developed countries has been emphasized in the Stern Review as well (Stern 2006).

The issue of intellectual property rights (IPRs) and technology transfer has to be resolved for enabling technology transfer to LDCs. Though studies indicate that IPRs may act in both positive and negative ways (Park and Lippoldt 2008), appropriate technology and its efficient utilization can contribute to the economic progress of countries around the world.

From the point of view of developed countries, a strict IPR regime is essential for protecting technologies. Developing countries, on the other hand, can benefit from lax IPRs to access technologies and re-engineering processes. The reconciliation between protection of IPRs and dissemination of climate-friendly technologies is a challenge. LDCs demand flexibility in the TRIPS Agreement in order to solve problems of patented climate-friendly technologies. Article 66.2 of TRIPS should be effectively implemented for climate technologies. Transfer of technology, one of the key elements of the Bali Road Map, is of vital importance for all developing and least-developed countries for mitigation as well as adaptation. The IPR regime is a barrier to technology transfer to LDCs, and this needs to be reviewed.

Technology transfer through aid and technical assistance for environmental technologies has been mentioned both in the list and project approaches to EG negotiations submitted by developed and developing countries, though at a less-than-adequate level by the former group. Though the IPR regime has not been very strict with respect to technology transfer to LDCs, actual transfer has been slow due to various supply-side constraints such as lack of capacity and financial resources. Hence, for LDCs to take full advantage of liberalization of EGS, technical and financial assistance is essential. Such assistance is needed not only for buying clean technologies but also for addressing any possible negative impact of liberalization on LDCs. In LDCs, small and medium enterprises dominate the industrial sector, which are not in a position to buy clean technologies to comply with domestic environmental regulations even if there is marginal reduction of prices of technologies due to tariff changes. LDCs should submit proposals to receive support from the WTO's Aid for Trade initiative. WTO members should avoid dumping old technologies in the name of technology transfer, and should facilitate technological innovation.

It is likely that many of the EGs will fall under various preferential programmes offered to LDCs by developed countries. Therefore, if these products are listed as EGs, tariff will be reduced at a faster pace for these items which will erode LDCs' preferences in those markets and reduce their competitiveness. South Asian LDCs should demand special and differential treatment for improved market access for their products which have less negative environmental impact and which are derived in an environment-friendly way.

6. Conclusions

The EG trade pattern of South Asian countries reflects the fact that these countries require technologies for renewable energy plant, wastewater management and potable water treatment, management of solid and hazardous waste, recycling system and air pollution control. In order for these countries to access such technologies, import duties may be reduced in the importing countries. They should also be made available at a concessional price by developed countries.

With respect to preference erosion suffered by South Asian LDCs due to liberalization of EGS, the loss should be compensated by developed countries and those developing countries in a position to do so by way of full duty-free and quota-free market access, simplified rules of origin, technology transfer and financial support through various mechanisms, including soft loans and aid for trade.

Liberalization of EGs through tariff reduction may not increase South Asian EG exports unless NTBs are removed. Though EG exports to developed countries face either zero or very low tariffs, they may still face various NTBs such as product standards, technical requirements, SPS measures and certification. South Asia should participate actively in global standards-setting bodies in order to ensure that standards reflect their priorities and are not discriminatory. They also require financial and technical support to be able to certify environmental requirements credibly.

For meaningful participation in ES trade, domestic regulatory frameworks should be in place prior to allowing foreign direct investment in environmental services. The issue of affordability of essential environmental services such as water should be the priority for South Asian countries as the majority of their populations live in poverty. South Asian countries have a comparative advantage in exporting environmental services providers under Mode 4. This will require capacity building in these countries for ES providers and relaxation of various measures by importing countries that act as barriers to the cross-border movement of services providers.

Note

- ¹ WT/MIN/(01)/DEC/W/1, 2001.

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