PART III. COUNTRY PERSPECTIVES OF REGIONAL CO-OPERATION

Chapter 15

Tariff and Non-tariff Barriers in South Asia Trade: A Bangladesh Perspective

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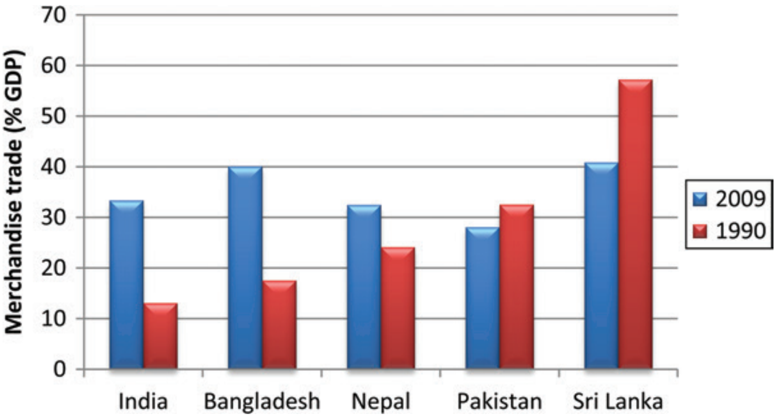
15.1 Introduction

Regional co-operation leading to economic integration in South Asia in the form of intra-regional trade and investment was uppermost in the minds of South Asian leaders who gathered to form the South Asian Association for Regional Cooperation (SAARC) in December 1985. Since then, top political leaders of member countries have met in summits more than 16 times. Yet, after 27 years of SAARC, 17 years of SAARC Preferential Trading Arrangement (SAPTA), and another 7 years of SAFTA, with its concomitant Trade Liberalization Programme (TLP), progress on the ground has faltered in the area of trade and investment under the regional accord umbrella.[1] This has happened despite several institutional processes having been put in place, such as periodic summits of policy-makers and officials with the objective of removing barriers to trade and investment.

This is not to say that the region as a whole was not making progress on the trade front. All the major countries of South Asia[2] embarked on trade reforms in the early 1990s, opening up their economies for trade and investment flows. Consequently, the volume of trade expanded significantly as is evident from the general rise in trade–GDP ratio in the countries (see Figure 15.1). South Asian countries as a group have been marching in step with the rest of the world. In the circumstances, a fair question to ask is: why has intra-South Asia trade lagged far behind the growth of the region's trade with the rest of the world. The short answer to this question is that tariff and non-tariff barriers (NTBs) to trade in the region remain substantial, which impede the growth of intra-regional trade and investment despite efforts at enhancing regional co-operation.

This chapter examines tariff and NTBs to trade in the South Asia region from the Bangladesh perspective as part of a regional effort to identify and remove existing impediments and boost intra-regional trade and investment. It will seek to explore the reasons behind the lack of progress in intra-regional trade despite the progress in trade openness, examine the veracity of some of the hypotheses that have been put forward, and then lay down a road map for greater regional integration through removing barriers to trade and increased investment in the region. The principal focus of this chapter will be on the tariff and NTBs that arguably impeded intra-regional trade in South Asia from a Bangladeshi perspective.

Figure 15.1 Merchandise trade as percentage of GDP



Source: World Bank, World Development Indicators, various years

15.2 Lack of integration hypotheses

Several hypotheses have been put forward by analysts to provide the rationale behind the lack of trade integration in the region. The major ones may be listed as follows:

- South Asia is the least integrated region of the world;
- countries in the region discriminate against their neighbours in favour of the rest of the world (RoW);
- similarity of exports of the region puts countries in competition with each other;
- there is lack of trade complementarity among the region's trading partners; and
- tariffs and NTBs are significant enough to impede the growth of trade.

Each of these hypotheses is examined in turn. The chapter concludes with some directions and suggestions for the way forward.

15.2.1 South Asia the least integrated region

South Asia lags behind other regions in economic integration for several reasons. First, high border barriers have traditionally limited all trade – political borders have become barriers to economic integration through trade and investment. For instance, trade and transport infrastructure – which was once fully integrated pre-1947 – remains largely fragmented along political borders making the smooth movement of goods and people tangibly difficult. Though the situation is improving, the region has been historically less welcoming of intra-regional foreign direct investment (FDI), a powerful integrating force in other regions. Political hostilities between India and Pakistan have curtailed officially recognised trade. The attempt in the mid-1990s to promote trade through a preferential trading agreement (SAPTA) was less successful than similar efforts in other regions in generating intra-regional trade. Though tariffs have come down in all countries, they are still high compared with other major regions of the world (Figure 15.2), thus presenting the first barrier to economic integration. Bangladeshi tariffs sit uncomfortably on the high side, accentuating trade barriers.

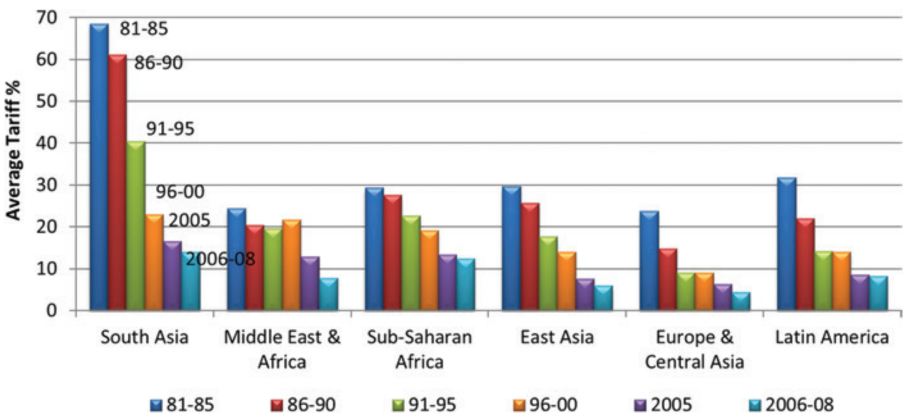
15.2.2 Countries favour trade with the RoW

Whereas the average overall trade–GDP ratio for the region is estimated to be 35 per cent, the intra-regional trade–GDP ratio works out to be less than 5 per cent, indicating a preference for trading with the rest of the world.[3] The two largest economies in the South Asia region – India and Pakistan – whose potential for bilateral trade annually is estimated by businesses to be in the region of US$10 billion, actually trade in the amount of US$1.7 billion in 2009 officially.[4] The fact that Pakistan continues to deny most favoured nation (MFN) status to India – a signatory to SAARC and SAFTA – and trades on the basis of a limited positive list of importables serves as the biggest barrier to growth of trade, thus weighing down the quantum of intra-regional trade.[5] Land ports, which should have been the principal gateway for intra-regional trade, are characterised by limited cargo handling capacity. Moreover, absence of transportation throughput across borders leaves the use of sea ports as the only viable channel for trade in large volumes. Consequently, the comparative advantage of contiguity that South Asian countries have over the RoW is all but lost. As Bangladesh is nestled between the North Eastern region (NER) of India and the rest of its territory, without any transportation throughput across borders, it is a victim as well as a cause of a lack of connectivity between countries of the subregion: NER India, Bangladesh, Nepal and Bhutan.

15.2.3 Is export similarity a problem?

Export similarity among the export basket of South Asian countries has been cited by several researchers as the reason for a lack of intra-regional trade.[6] Though all countries in the region now have a predominant share of manufacturing exports,

Figure 15.2 Average tariffs in major regions of the world



Source: World Bank, WTO, IMF various years they compete with each other in global markets of textiles and clothing, erecting high trade barriers for these and other products in which they have export interest, resulting in minimal intra-regional trade in these products. Using data for 1999–2006, Khan (2010) shows that India and Pakistan have the highest export similarity index, which also remained practically unchanged for the entire period. Bangladesh and Nepal have much lower indices implying that they have a higher potential for exports within the region, provided tariff and NTBs are lifted and regional connectivity enhanced.

While many argue that South Asian countries export similar products to the RoW, and thus are unlikely to be trading much among themselves, then consider the case of the huge volume of trade between Europe and North America that takes place in a wide set of largely similar products – agricultural products or technologically sophisticated goods. What makes trade possible and sustained of course is the differentiation and brand sophistication even within a similar class of products. Such a stage in trade might also happen in South Asia once its exports undergo sufficient transformation from low-end to high-value products.

15.2.4 Is trade complementarity the problem?

In trying to explain the low intra-regional trade, some research makes the argument that there is a lack of complementarity in production chains within the region, quite unlike what we see in East Asia[7], where trade in intermediate goods has now reached close to 70 per cent (Brooks and Hua 2009; Hayakawa 2007). China has indeed become the super assembler in the region, importing much of the parts and components of a wide range of electronic goods, machineries and consumer durables from other countries in East Asia, thus ensuring growth of intra-regional trade. Interestingly, China maintains a trade deficit with source countries for its intermediate inputs, yet ends up with enormous surpluses in its global trade. The strategy of creating an inter-linked production chain within East Asia in accordance with the region's comparative advantage has paid huge dividends to China as well as the component suppliers. It is this inter-linkage of supply chains and vertical integration of production that drives the high volume of intra-regional trade, something that South Asia apparently lacks, if the complementarity argument is to be believed.

But the history of intra-regional trade in South Asia reveals otherwise. At the time of partition in 1947, regional trade within South Asia accounted for 18 per cent of total trade,[8] suggesting the existence of adequate production complementarity within the region. It follows that the emergence of political borders since then has impeded, if not significantly curtailed trade transactions within the region, by fragmenting trade and transport infrastructure networks. Political borders thus took the form of economic barriers to cross-border trade and investment resulting in a miniscule volume of intra-regional trade.

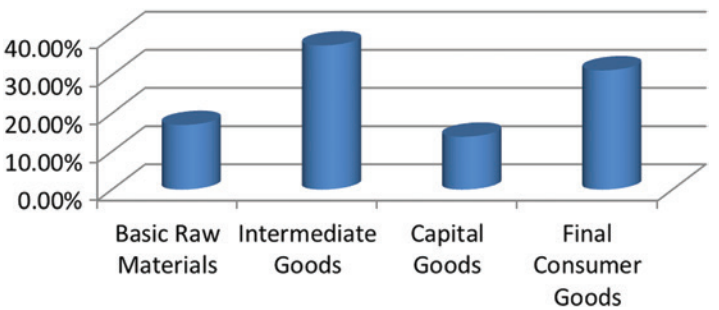
That said, a closer look at the character of goods trade between Bangladesh and its South Asian neighbours produces interesting insights into the degree of inter-linkages in production chains. An examination of imports from India at a disaggregated level reveals a high degree of intra-industry linkages: basic raw materials (17 per cent), intermediate inputs (38 per cent), capital goods (14 per cent) and final consumer goods (31 per cent), for 2008–09 (Figure 15.3). This pattern remains practically unchanged for in the late 2000s. It reveals strong intra-industry linkage between India and Bangladesh where the latter's industrial sector relies heavily on inputs from India. However, there is a difference in this form of inter-industry linkage from that of East Asia. Bangladesh's major export industry – ready-made garments (RMG) – is only partly relying on Indian supplies of yarn while most of its inputs of fabric, cotton, and even yarn are sourced from China, Korea and elsewhere. So Indian inputs are essentially feeding Bangladeshi manufacturing which caters to the domestic market. As such the current flow of inputs from India is not generating the kind of jobs and income possible were these inputs going into the export-oriented sectors.

On the other hand, India's exports have been growing at an average of 15–20 per cent since the early 1990s while continuing to be significantly diversified. Given strong export–import linkages, and supporting import liberalisation, the Indian economy also experienced rapid import deepening, reaching an import–GDP ratio of 24 per cent by 2009. With Bangladesh lacking a diversified manufacturing base with little or no production of intermediate goods, Bangladesh could hardly be the supplier of intermediate inputs, parts and components to the rapidly expanding export sector of India, at least not yet. That was the case with China playing the assembler of multifarious exports whose parts and components were supplied by their East Asian neighbours. Thus, while strong intra-industry linkage between India and Bangladesh is evident, it is not of the East Asian variety that would have reversed or at least mitigated the large unfavourable trade balance that now exists for Bangladesh with India.

15.2.5 High tariffs remain as trade barriers despite SAFTA

The low levels of regional trade cannot be faulted for the dearth of efforts at the highest policy level. Top political leaders have repeatedly endorsed moves to open up respective markets with India taking the lead. These moves notwithstanding, freer trade still faces serious antithetical political economy developments in each member country. At the ground level, therefore, results are not so notable, as mind sets of

Figure 15.3 Imports from India by categories (%) fiscal year 2008–09



Source: Policy Research Institute staff estimates and NBR ASYCUDA database business leaders and bureaucrats are still mired in the old tradition of suspicion and occasional downright resistance to opening their own markets.

Realising that South Asian countries had some of the highest tariffs globally, something that was surely hurting intra-regional trade, the leaders agreed to scale down these tariffs on an accelerated schedule under the auspices of SAFTA, though giving the least developed countries (LDCs) of the region slightly more time to adjust. As is shown in Table 15.1, India moved to the ultimate tariff range of 0–5 per cent within two years of SAFTA implementation. LDCs like Bangladesh had until 2013 to implement the reduction schedule which also has been complied with (Table 15.2). SAFTA customs duty (CD) rates are significantly below applied general rates of duty (Figure 15.4). Table 15.3 shows that, given current CD tariff slabs, Bangladesh will be in compliance of the 0–5 per cent range of CD by 2013. However, the problem, as far as Bangladesh is concerned, lies with the significant proportion of para-tariffs in

Table 15.1 SAFTA tariff reduction schedule: India

Date	Pace of Reduction
1 July 2006	33.33% MoP
1 July 2007	33.33% MoP
1 July 2008	0–5%

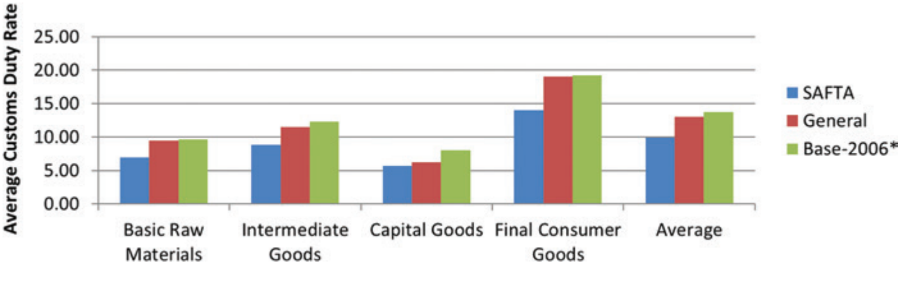
Note: MoP = means of production
Source: SAFTA agreement

Table 15.2 SAFTA tariff reduction schedule: LDCs

Date	Pace of reduction
1 July 2006	10% MoP
31 December 2006	30% MoP
31 December 2007	30% MoP
31 December 2008	25–30% MoP
31 December 2008 up to 31 December 2012	15% MoP per year

Source: SAFTA Agreement

Figure 15.4 Bangladesh: Comparison of unweighted average SAFTA custom duties with general applied rates, fiscal year 2009–10



Source: NBR ASYCUDA database

Table 15.3 Status of Bangladesh tariffs and SAFTA reduction schedule

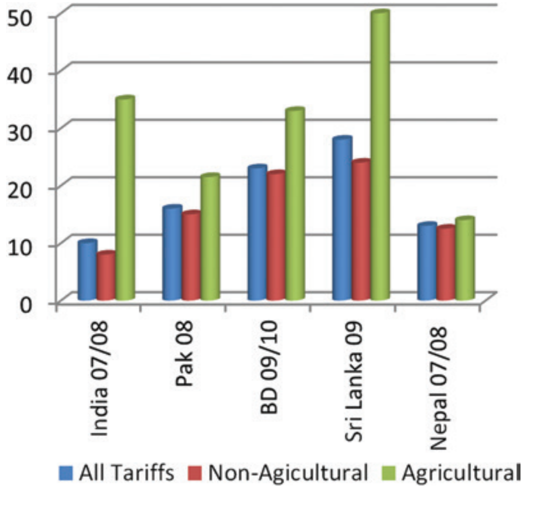
Tariff slabs	31 December 2006, scheduled reduction: 5% MoP	31 December 2007, scheduled reduction: 5% MoP	31 December 2008 – 31 December 2013, 0–5%[a]
25	23.75%	22.50%	4.50%
12[b]	11.4%	10.80%	2.16%
5	4.75%	4.50%	0.90%
3	2.85%	2.70%	0.54%

[a]Subject to reductions of equal annual instalments of not less than 10% annually.
[b]The budget of fiscal year 2013–14 scaled down this slab to 10% from 12%. So the final SAFTA reduction will be affected proportionately
Source: SAFTA Agreement

its nominal tariff structure, whereas SAFTA reductions only encompass CD, leaving effective protective tariffs at relatively high levels.

Figure 15.5 summarises South Asian tariffs in the post-SAFTA period, which are lower than the pre-SAFTA tariffs. One more problem that remains is the substantial size of sensitive lists (World Bank 2010a). Though members tried hard to limit the proportion of SLs to 10 per cent, they had to reach a cap of 20 per cent of 5224 HS six-digit codes, along with rules of origin requirements that did not help matters either. That allowed a lot of scope for keeping markets restricted for most products that members produced (Table 15.4). In mapping the SLs to imports of SAFTA member countries, Weerakoon (2010) finds that some 53 per cent of South Asian imports are actually excluded from the SAFTA tariff liberalisation scheme (Table 15.5), rendering the tariff reductions largely ineffective in significantly

Figure 15.5 South Asia tariffs post-SAFTA



Sources: India and Nepal – UNCTAD TRAINS database; Pakistan, Sri Lanka–Policy Research Institute staff estimates from various country reports; Bangladesh – NBR ASYCUDA database

Table 15.4 Size of sensitive lists and rules of origin

Country	SL tariff lines	Rules of origin
India	480 LDC 865 non-LDC	CTH + 40%
Bangladesh	1,249 LDC 1,254 non-LDC	CTH + 30%
Bhutan	137	CTH + 30%
Maldives	671	CTH + 30%
Nepal	1,335	CTH + 30%
Pakistan	1,183	CTH + 40%
Sri Lanka	1,065	CTH + 35%

Note: CTH change in tariff heading, SL sensitive list
Source: SAFTA Agreement

Table 15.5 Trade impact of sensitive lists under SAFTA

	Value of imports from SAARC subject to SL (%)	Value of exports to SAARC subject to SL (%)
Bangladesh	65	22
India	38.4	56.5
Maldives	74.5	57.6
Nepal	64	46.4
Pakistan	17.2	34
Sri Lanka	51.7	47
Total	52.9	

Source: Weerakoon (2010)

boosting regional trade. The array of SLs formulated by the SAFTA members makes a classic study of the political economy of South Asian trade regimes. A remarkable confluence of protectionist mindsets among bureaucrats, policy-makers and business leaders continues to guide and influence trade policy decisions. Looking at the SLs in their totality, they practically cover the entire spectrum of goods produced by the member countries for their respective domestic markets or for exports. The exclusion mechanism of the sensitive lists therefore effectively obliterates potential competing imports from the region.

In so far as tariffs are concerned, Bangladesh is not in a good position. Prior to 2002, India had the highest average tariffs and the most restrictive trade regime in South Asia, with Sri Lanka as the most open economy. However, post-war Sri Lanka has become the most protected economy in view of heavy revenue demands coming after the end of its insurgency. Bangladesh continues to have average tariffs at relatively high levels, with para-tariffs assuming significant proportions in the nominal tariff structure (Table 15.6).

Earlier, we described the state of current Bangladesh tariffs in light of the TLP under SAFTA. It was also noted that, like other SAFTA members, Bangladesh is on track to meet the phased reduction of tariffs in accordance with the agreement. However, it

Table 15.6 Trends in nominal protection rate with customs duty and para-tariffs

Fiscal year	Avg. CD	Avg. para-tariffs	Avg. NPR	Para-tariff in NPR (%)
FY 01	21.10	7.44	28.54	26.07
FY 02	21.02	8.41	29.43	28.58
FY 03	19.91	6.51	26.42	24.64
FY 04	18.82	10.29	29.11	35.35
FY 05	16.31	10.19	26.50	38.45
FY 06	15.49	10.98	26.47	41.48
FY 07	14.85	9.42	24.27	38.81
FY 08	15.93	7.94	23.87	33.26
FY 09	13.82	6.26	20.08	31.18
FY 10	13.68	10.20	23.88	42.71
FY 11	13.52	10.16	22.11	38.94

Source: National Board of Revenue (2010)

would be premature to make an assessment of the degree of removal of tariff barriers on the basis of reduction in CD alone when Bangladesh's tariff structure comprises other levies and charges on imports in addition to CD. In order to make an assessment of the degree of trade openness created under the SAFTA umbrella, it is necessary to look at the broad structure of tariffs and their restrictive impacts on imports from the region or RoW.

In reviewing the structure of Bangladeshi tariffs, what is clear is that trends in CD alone fail to give the true picture of trade restrictiveness arising from tariff barriers, because of the existence of other levies and charges, such as supplementary duty (SD), infrastructure development surcharge (though removed in 2008), and even the supposedly trade-neutral VAT, all of which take the shape of para-tariffs. The fact is that the SAFTA TLP applies only to CDs, leaving para-tariffs out of its ambit.

A review of trends in Bangladesh's overall tariff structure, based on ex ante levels of tariffs and para-tariffs during 2001–10, reveals the actual state of affairs. Average unweighted CDs have indeed trended downwards, from 21 per cent in 2001 to 13.7 per cent in 2010. But the decline in the average nominal protection rate (NPR) appeared less steep thanks to the presence of para-tariffs which trended upwards, their share in NPR rising from 26 per cent in 2001 to 43 per cent in 2010. A closer look at the trend in para-tariffs reveals the predominance of SDs which were ostensibly levied on top of the top CD rate of 25 per cent in order to discourage imports of luxury and non-essential consumption goods. In reality, a closer examination of the range of goods subject to SDs shows that roughly 70 per cent of SDs imposed on some 1,100 tariff lines serve protective ends.[9] To conclude, NPR trends give a better picture of the restrictiveness of Bangladeshi tariffs on imports from SAFTA countries as well as from RoW. With over 40 per cent of protection coming from para-tariffs, SAFTA tariff concessions that apply only to CD have little effect in stimulating SAFTA imports into Bangladesh. Consequently, growth of SAFTA imports has lagged behind typical growth of imports from RoW.

15.2.6 Non-tariff barriers to SAFTA trade

As far as tariffs are concerned, SAFTA TLP appears to be on track with all members complying with the agreed phased reduction in tariffs. India took early initiatives and implemented an accelerated schedule. In the previous section, we described the problem with the Bangladeshi tariff structure where the existence of significant para-tariffs undermines SAFTA tariff reductions. Nevertheless, it is fair to conclude that tariffs facing intra-regional trade are now substantially lower than existed in the late 1990s. Yet the outcome in terms of trade volumes appears minimal with little or no noticeable improvement in intra-regional trade. In the circumstances, attention has now shifted to NTBs with a chorus of complaints from members about significant NTBs faced by exporters to the region.

By far the largest number of NTB complaints has been directed against India, the largest importer and exporter of the region. These complaints range from problems with inter-state movement of imported goods to the standard World Trade Organization (WTO)-compatible rules relating to sanitary and phytosanitary (SPS) and technical barriers to trade (TBT) measures (Ratna and Sidhu 2009). Often there appears to be confusion with regard to SAFTA tariff concessions and the WTO-compliant practice of national treatment when imports into India cross state boundaries leaving SAFTA concessions at the border (Taneja and Prakash 2010). It turns out that imports are subject to the same state taxes and levies as domestically produced goods. However, it is also true that WTO-compliant rules such as SPS, TBT, anti-dumping and countervailing duties could all be stretched to serve protective ends and restrict trade. This is seen to happen in bad times such as the 2008 global economic crisis, which saw enormous growth of anti-dumping proceedings, including by India. There is ample evidence around the globe of countries manipulating WTO-compliant rules to serve protectionist ends. Such efforts tend to rise when times are bad. The challenge for SAFTA policy-makers is to ensure that member countries, while adhering to WTO-compliant regulations, do not let administrators get carried away to the point that these legitimate rules turn into trade barriers or NTBs in the region.

15.3 Potential non-tariff barriers for exports to Bangladesh

This section comments on the current status of NTBs on exports to Bangladesh.

1. Specific limitations on trade:
   - (a) Sensitive list: The first NTB faced by SAFTA exporters to Bangladesh is the large sensitive list (1,245 tariff lines).
   - (b) Quotas: Bangladesh has a clean slate as far as protective quantitative restrictions (QRs) are concerned, though restrictions apply for health, national security, religious or environmental grounds.
   - (c) Import licensing requirements were also eliminated back in 1991.
   - (d) Proportion restrictions of imported inputs in domestic goods (local content requirements) are non-existent.

2. Customs and administrative entry procedures:
   (a) Valuation system: Though Bangladesh is a signatory to the WTO Agreement on Valuation, which stipulates duty assessment on the basis of normal values (typically invoice values of imports), the customs administration is generally suspicious of invoice values and tends to impose its own valuation criteria. Pre-shipment inspection (PSI) certification of a clean report of findings (CRF), now covering some 50 per cent of tariff lines, usually averts any valuation hassles. Typically, imports from South Asian countries are valued at an average of 5 per cent above invoice values for assessment purposes. Disputes over valuation could delay import clearance unless the importer chooses to go along with the customs assessment of value.
   (b) Though all SAFTA members follow World Customs Organization (WCO) classification standards of HS six-digit codes, at the eight-digit national classification in Bangladesh, some classification disputes arise due to discrepancies between SAFTA notification and Bangladesh Customs Tariff.
   (c) For a number of tariff lines with bulk imports (e.g. sugar), tariff values are assigned which amounts to arbitrary fixation of value.
   (d) Anti-dumping practices: this could assume the role of an NTB but Bangladesh has not instituted any anti-dumping proceedings so far, though the requisite act exists.
   (e) Documentation requirements: Bangladesh has adopted United Nations Conference on Trade and Development (UNCTAD)'s import–export clearance package, ASYCUDA++ (Automated System for Customs Data), which does help rapid clearance. There is plenty of scope to improve electronic clearance of customs cargo with greater utilisation of ASYCUDA capacity with the imminent installation of the next version, ASYCUDA World.
3. Standards – SPS and TBT:
   (a) Lack of harmonisation of standards creates hurdles for cargo clearance.
   (b) Bangladesh Standards and Testing Institution (BSTI) is not recognised for its efficiency and competence in performing an acceptable job of testing and certification and lacks regional or international recognition. Intergovernmental acceptances of testing methods and standards can improve the situation. Efforts are under way to raise the capacity of BSTI.
   (c) Packaging, labelling and marking: These TBT requirements are being applied universally. Improvements in Bangladesh's domestic market on these aspects of product marketing will ensure minimal hassles for cross-border trade.
4. Para-tariffs:
   (a) Supplementary duties (SDs): Bangladesh applies supplementary duties on the top rate of CD (25 per cent) for a wide range of consumer products – 1,100 tariff lines. Though originally conceived as a trade-neutral tax to ostensibly discourage import of luxury and non-essential goods, SD has,

over the years taken the form of a protective para-tariff that restricts competing imports.

(b) Variable levies: a number of variable levies exist, such as advance trade VAT (ATV) of 2.5 per cent, and advance income tax (AIT), and a 1 per cent administrative fee levied as a landed charge. An across-the-board infrastructure development surcharge (IDSC) was removed in 2008.

5. Others:

(a) Restricting imports through land borders, partly on grounds of capacity limitation and partly to restrict imports (Table 15.7). The restriction is implemented through the framing of a positive and/or negative list.

Table 15.7 Restrictions on imports via land ports

Land port (tax stations)	Importable Goods	
	Positive list	Negative list
Benapole	All other importable goods	Milk powder and yarn
Jakiganj	Livestock, fries, fresh fruits, plant, seed, wheat, stone and boulders, coal, chemical fertiliser, china clay, wood, timber, onion, chilli, garlic, ginger, quartz, ball clay, dry fish, limestones and those goods that satisfy the rules and regulations of the circular posted by ERD on 19 September 2002, SRO 255-law/2002/1973/tax by maintaining the quality of the good, amount, price and tax classification certified	Fish, yarn, milk powder, sugar, potato (HS code 0701.90.19 and 0701.90.29)
Hilly	All other importable goods	9) Duplex board, newsprint, craft paper, cigarette paper, all kinds of paper and paper board, yarn, milk powder, juice, tobacco
Dorshona	Livestock, fries, fresh fruits, plant, seed, wheat, stone and boulders, coal, chemical fertiliser, china clay, wood, timber, onion, chilli, garlic, ginger, quartz, rice corn, poultry feed, ball clay limestone	Fish, yarn, milk powder, sugar, potato (HS code 0701.90.19 and 0701.90.29)
Shona Mosjid	All other importable goods	Duplex board, newsprint, craft paper, cigarette paper, all kinds of paper and paper board, yarn, milk powder, juice, tobacco

Source: NBR

(b) Customs administration in Bangladesh has some way to go before it is able to take full advantage of available IT capacities. Bangladesh ranks poorly in terms of days taken for import clearance (Ahmed et al. 2010), thanks to procedural inefficiencies or corruption in customs administration, which becomes an NTB.

(c) Inadequate port infrastructure (land and sea ports) could pose serious problems for handling import–export cargo. Lack of warehousing and testing facilities at land ports are problems.

(d) Rules of origin requirements, if made too stringent, could pose as NTBs as well. Together, these conditions, (a–d), could severely impede trade facilitation.

15.4 SAFTA, regional trade and Bangladesh

Post-war developments of the world economy showed the potential of trade as an engine of growth and a catalyst for improving living standards across the globe. With that record before them, South Asian leaders saw the need for stimulating trade in the region as a way to prop up their own growth performance and reduce poverty. When the 1995 preferential trading agreement, SAPTA, failed to stimulate regional trade, SAARC member countries agreed to forge deeper liberalisation of their trade regimes for one another in the hope that this would eventually foster greater intra-regional trade. The signing of SAFTA in 2006 brought about deeper tariff cuts but intra-regional trade still shows no sign of a pickup. In 2009, while the South Asia region recorded total trade volume of US$350 billion, intra-regional trade at US$10.5 billion was barely 3 per cent.

Just as more trade has been good for the world economy and its standards of living, so also is expansion of regional trade expected to accelerate growth in South Asia and reduce poverty. Why is SAFTA not yielding results? What more can be done within or outside the SAFTA regime that will remove barriers to trade further and augment trade volumes in the region?

From the Bangladesh perspective, the key rationale behind its membership of an regional trade agreement (RTA) lies in the opening of markets. The largest market of course is that of India, but other regional markets are no less important to a country whose domestic market is far too limited to create jobs for the millions joining the labour force every year. SAFTA does provide preferential access to these markets but, as we have seen earlier, NTBs and sensitive lists remain major impediments to the smooth access to markets for competitive exports from Bangladesh. Its primary export – RMG – is included on the sensitive list of all SAFTA partners thus robbing it of significant immediate economic benefits from an RTA like SAFTA. It proves the point that preferential arrangements are not enough to open markets if such arrangements are riddled with provisos that render them quite ineffectual.

That said it is also important to reflect on the fact that the largest potential market – India – has reduced tariffs to internationally competitive levels thus opening up its own market for stiff international competition, particularly in manufacturing. To take advantage of this openness along with SAFTA concessions, Bangladesh has to come up with items of non-traditional exports that are internationally competitive. This is where Bangladesh's own trade regime does not help. First, Bangladesh's manufacturing is dominated by the production of final consumer goods which are produced under high tariff protection not geared to facing stiff international competition. Second, the domestic incentive structure is heavily biased in favour of final consumer goods with little practical support for the intermediate goods industry that is yet to emerge. If the East Asian model of production chain segregation across diffused regional networks is to be emulated, one particular configuration would see a South Asian hub and spoke system taking India (in place of China) as the chief assembler for global markets with SAFTA members supplying inputs, parts and components. This means that for Bangladesh the current dependence on India for manufacturing inputs needs to be reversed, something that will take time. Yet this interpretation of SAFTA market access presents a different perspective as well as a challenge for right positioning of Bangladesh's manufacturing sector to take advantage of regional preferences. This is not to say that Bangladesh should be ignoring further development of a competitive consumer goods sector but that policy needs to be geared to develop backward linkages to the existing manufacturing industries.

15.5 Making SAFTA effective in South Asia

For all its shortcomings, SAFTA is a trading arrangement that can deliver benefits to its members depending on what they put into it. At least five key challenges need to be addressed to make SAFTA yield results:

- *Sensitive lists*. For one, the sensitive list ought to be phased out if trade augmentation is to become reality. Just like the tariff reduction schedule, a phased elimination of sensitive lists should be formally agreed to and made binding upon members. With perhaps the longest sensitive list, Bangladesh has a long way to go. Perhaps this is where Bangladeshi policy-makers face the most formidable political economy challenge. But not dealing with it makes a mockery of the intent to foster regional trade. Bangladesh's sensitive list covers almost all manufactured consumer products assembled in the country. To shield them from regional competition, as is done for RoW, will not make these products competitive in the long run, globally or regionally.
- *Trade diversion costs*. Benefits of SAFTA will depend on whether it is trade creating. If trade diversion costs outweigh any trade creation, negative welfare outcomes will follow. On this score, Bangladesh is in a bind. The existence of high tariffs exacerbate trade diversion costs as preferences are biased in favour of high cost imports from PTA members. Since China and India are the two largest sources of Bangladesh imports, China's exclusion from SAFTA raises the likelihood of high trade diversion costs. These costs can be minimised only through unilateral tariff reductions.
- *Behind-the-border issues*. So far the SAFTA agreement has not focused much attention on several behind-the-border issues that impede if not restrict intra-regional trade. Trade and transport infrastructure – ports, rail and road links,

waterways, transport throughput, connectivity – could facilitate trade and significantly augment trade volumes in the region if managed to create seamless movement of goods within the regional trading arrangement. More attention is needed to improve the payments mechanism for trade in the region. Banking and financing arrangements need to be modernised in order to speed up payment for goods and services in intra-regional trade. This applies to Bangladesh as well as its SAFTA partners.

- *Services and investment*. It has been argued by most researchers on South Asia trade that an important complement to goods trade that is missing under SAFTA is the scope of cross-border investment. Investment regimes in member countries are still riddled with significant restrictions on movement of capital and on sectors open to investment. These restrictions have to be ironed out to make intra-regional investment profitable without limits on profit repatriation. Moreover, as another complement, the focus has to shift beyond trade in goods and on to services – e.g. health, education, finance, tourism.

- *Trade facilitation.* One common problem that South Asia encounters in trade originates from the customs administration which, for all countries, is still geared to the collection of revenue. Trade facilitation is still far from the minds of customs officials whose primary objective is to maximize revenue collection at the border. Such an objective is clearly at odds with the need for trade facilitation that can augment intra-regional trade. It is for this reason that in the component, 'Trading Across Borders', World Bank's Doing Business report shows poor scores for most South Asian countries.[10] Nevertheless, improvements in the time taken for customs clearance are expected as customs administration in all countries move into the electronic environment with post-clearance audits becoming the norm. Bangladesh needs to consider unilateral or joint actions to make a mark on trade facilitation. Steps that may be considered in the future include (a) one-stop border posts with single customs declaration and unified or border crossing processes, (b) harmonisation of transit charges, (c) throughput across borders, with door-to-door delivery of cargo in the offing, regional carriers' licences, and regionally valid insurance, and (d) steps towards greater connectivity via road, rail and air transportation of cargo and people. Finally, there is no question that trade can be amply facilitated with the simplification of visa and travel rules to facilitate the movement of people.

15.6 The way forward

Overall, the regional effort at trade augmentation through the auspices of SAPTA (1995) and SAFTA (2006) has not produced tangible results so far. This chapter has shown that tariff and NTBs are still significant though India has done its part in substantially scaling down its tariffs during the late 2000s. Bangladesh remains a laggard in this respect when it comes to its multilateral tariff stance. Though technically it is in compliance with SAFTA schedules, the existence of para-tariffs in its tariff structure mars the progress made in terms of CD reduction. Yet, perhaps the one factor that hits the SAFTA initiative the hardest is the combined coverage of sensitive lists of all members which, as one estimate shows, preclude some 53 per cent of regional imports from taking advantage of SAFTA concessions. Strong protectionist undercurrents among business leaders and policy-makers alike play a key role in bolstering the political economy or formulating and sustaining large sensitive lists thus undermining efforts at meaningful trade openness for intra-South Asia trade.

Yet all cannot be lost on the regional trade front as globalised production and supply chains take hold across the globe. With regard to tariffs, members should continue bringing down tariff peaks unilaterally, providing impetus to their own trade openness on an MFN basis while embedding regional policies in their overall trade strategy. In modernising customs administration with strong IT capacities, the goal should be to shift the focus of customs from revenue collection to trade facilitation in a co-operative venture among members. This is likely to happen as revenue authorities shift their emphasis from reliance on trade taxes to internal domestic taxes – the way of the future is revenue mobilisation.

Opening up trade in services – banking and finance, tourism, health and education – ought to be made an integral part of the SAFTA trade liberalisation process. The scope in this area is vast, as is the potential for cross-border investment that could be the catalyst for cementing inter-industry linkages within a South Asian framework of 'fragmented agglomeration' of production in the future, something akin to the highly successful inter-industry linkage forged in East Asia. The strategic policy choice needed for this to happen is keeping rules of origin simple and aspirations for investment protocol limited.

Given that the common dominant theme of national policies in the region is to accelerate growth and reduce poverty, boosting intra-regional trade could be an integral part of that strategy, which gives SAFTA the sound basis for more tangible results in the future than has been observed in the past.

Notes

1 This is despite the fact that the much of the tariff-reduction scheme and scaling down of sensitive lists under the TLP has been on track.
2 Sri Lanka was the first among South Asian countries to embark on substantial trade liberalisation at the close of the 1970s.
3 Indeed, a World Bank (2004) study on South Asia trade famously concluded that South Asian countries tended to discriminate against regional neighbours in favor of the RoW.
4 United Nations Commodity Trade Statistics.
5 A joint statement in 2012 had set December 2012 as the date by which Pakistan was to grant MFN status to India. That has not happened as of June 2013.
6 The latest report from Mahbub-Ul-Haq Human Development Center, 'Human Development in South Asia 2009', cites 'high export similarity' as a reason for untapped potential for intra-regional trade in South Asia.
7 Athukorala and Yamashita (2007); Feenstra (1998); Dobson and Yeu (1997).
8 World Bank (2004).
9 'Structure of Tariffs and Rationalization' (2010), unpublished report, NBR.
10 Bangladesh ranks 119 among 184 countries in the latest Doing Business Report 2013.

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