

# **NEXT STEPS TO SOUTH ASIAN ECONOMIC UNION**

**A STUDY ON REGIONAL ECONOMIC INTEGRATION (PHASE II)**

**Prepared for South Asian Association for Regional Cooperation (SAARC)**

The views expressed in this report are those of the authors and do not necessarily reflect the views or policies of the SAARC Secretariat and Asian Development Bank, or their Board of Directors, or the governments they represent.





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# Abbreviations

AC	Alternating Current
ACD	Asia Cooperation Dialogue
ACIA	ASEAN Comprehensive Investment Agreement
ACMECS	Ayeyawady–Chao Phraya–Mekong Economic Cooperation Strategy
ADB	Asian Development Bank
ADF	Agriculture Development Fund
AEC	ASEAN Economic Community
AFAS	ASEAN Framework Agreement On Services
AFG	Afghanistan
AFTA	ASEAN Free Trade Area
AHN	Asian Highway Network
APEC	Asia-Pacific Economic Cooperation
APTERR	ASEAN Plus Three Emergency Rice Reserve
ASEAN	Association Of Southeast Asian Nations
ASX–SGX	Australian And Singapore Stock Exchanges
ASYCUDA	Automated System For Customs Data
ATC	Area Transmission Control
ATNF	Apollo Telemedicine Networking Foundation
BCF	Billion Cubic Feet
BCIM	Bangladesh–People’s Republic Of China–India–Myanmar
BCM	Billion Cubic Meters
BEPZA	Bangladesh Export Processing Zones Authority
BGD	Bangladesh
BGMEA	Bangladesh Garment Manufacturers And Exporters Association
BIFT	BGMEA Institute Of Fashion And Technology
BIMPEAGA	Brunei Darussalam–Indonesia–Malaysia–The Philippines East ASEAN Growth Area
BIMSTEC	Bay Of Bengal Initiative For Multi-Sectoral Technical And Economic Cooperation
BITs	Bilateral Investment Treaties
BSE	Bombay Stock Exchange
BSEC	Bangladesh Securities And Exchange Commission

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BSNL	Bharat Sanchar Nigam Limited
BTN	Bhutan
BV	Business Visitor
CAGR	Compound Average Growth Rate
Capex	Capital Expense
CARE	Cooperative For Assistance And Relief Everywhere
CAREC	Central Asian Regional Economic Cooperation Program
CASA	Central Asia–South Asia
CD	Compact Disc
CECA	Comprehensive Economic Cooperation Agreement
CEPA	Comprehensive Economic Partnership Agreement
CEPII	Centre d’Études Prospectives Et d’Informations Internationales
CEPT	Common Effective Preferential Tariff
CES	Consumer Electronics Show
CET	Common External Tariff
CIQ	PRC Entry–Exit Inspection And Quarantine Services
CMDA	Capital Market Development Authority
CMIG	Capital Market Integration Group
CNY	Chinese Yuan
COMESA	Common Market For Eastern And Southern Africa
CRA	Credit Rating Agency
CSE	Colombo Stock Exchange
CSS	Contractual Services Supplier
CTH	Change In Tariff Heading
CV	Coefficient Of Variation
DC	Direct Current
DC-PF	Direct Current Power Flow
DVA	Domestic Value Added
EAP	East Asia And Pacific
e-BRC	Electronic Bank Realization Certificate
ECA	Europe And Central Asia
ECF	Economic Corridors Forum
ECO	Economic Cooperation Organization
ECT	Energy Charter Treaty
ED	Early Decision
EEA	European Economic Area
ENT	Economic Needs Test
EPR	Exempted From Police Reporting
EPZ	Export Processing Zone

ERDF	European Regional Development Fund
ERIA	Economic Research Institute Of ASEAN And East Asia
ESCAP	Economic And Social Commission For Asia And The Pacific
ETF	Economic, Trade And Finance Division
EU	European Union
FAO	Food And Agriculture Organization
FDI	Foreign Direct Investment
FFV	Fresh Fruits And Vegetables
FII	Foreign Institutional Investors
FOB	Free-On-Board
FRO	Foreigner Registration Office
FRRO	Foreigner Regional Registration Office
FTA	Free Trade Agreement
G20	Group Of Twenty
G8	Group Of Eight
GAP	Good Agriculture Practices
GATS	General Agreement On Trade In Services
GDP	Gross Domestic Product
GE	GE healthcare -subsidiary of General Electric
GMM	Generalized Method Of Moments
GMR	Grandhi Mallikarjuna Rao**
GMS	Greater Mekong Subregion
GPRS	General Packet Radio Service
GSP	Generalized Scheme Of Preference
GTAP	Global Trade Analysis Project
GVC	Global Value Chain
GWh	Gigawatt-Hours
HCFC	Hydrochlorofluorocarbons
HDI	Human Development Index
HPMP	Hcfc Phase-Out Management Plan
HS	Harmonized System
HVAC	High-Voltage Alternating Current
HVDC	High-Voltage Direct Current
IAS	International Accounting Standards
ICEGATE	Indian Customs Electronic Commerce/Electronic Data Interchange (EC/EDI) Gateway
ICRA	Information And Credit Rating Agency**
ICRIER	Indian Council For Research On International Economic Relations
ICT	Information And Communications Technology

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IDR	Indian Depository Receipts
IFPRI	International Food Policy Research Institute
IFRS	International Financial Reporting Standards
IIT	Intra-Industry Trade
ILO	International Labour Organization
IMF	International Monetary Fund
IMT-GT	Indonesia–Malaysia–Thailand Growth Triangle
IND	India
IOSCO	International Organization Of Securities Commissions
IP	Independent Professional
IPI	Iran–Pakistan–India
IPO	Initial Public Offering
IPP	Independent Power Producers
IPR	Intellectual Property Rights
ISFTA	India–Sri Lanka Free Trade Agreement
IT	Information Technology
ITC	International Trade Centre
JAAF	Apparel Association Forum
KSE	Karachi Stock Exchange
LAC	Latin America And Caribbean
Lao PDR	Lao People’s Democratic Republic
LDC	Least Developed Countries
LNG	Liquefied Natural Gas
LPI	Logistics Performance Index
M&A	Merger & Acquisition
MERCOSUR	Mercado Común Del Sur
MFA	Multi Fibre Agreement
MFN	Most Favored Nation
MIRAGE	Modeling International Relationships In Applied General Equilibrium
MMCF	Million Cubic Feet
MOU	Multilateral Memorandum Of Understanding
MPM	Marginal Propensity to Import
MPRA	Munich Personal Repec Archive
MRA	Mutual Recognition Agreements
NAFTA	North American Free Trade Agreement
NATGRID	National Intelligence Grid
NCRE	Non-Conventional Renewable Energy
NDMA	Nondiscriminatory Market Access
NEPSE	Nepal Stock Exchange

NES	Not Elsewhere Specified
NGOs	Nongovernment Organizations
NIE	New Institutional Economics
NIT	National Investment Trust
NLDC	Non-Least Developed Countries
NLDC	National Load Dispatch Center
NPL	Nepal
NSE	National Stock Exchange
NTB	Not Otherwise Specified
NTC	Nontariff Trade Cost
NTM	Nontariff Measure
NYSE	New York Stock Exchange
OA	Operating Area
OECD	Organisation For Economic Co-Operation And Development
OPEC	Organization Of The Petroleum Exporting Countries
Opex	Operational Expense
OSBP	One-Stop Border Post
PAK	Pakistan
PIF	Pacific Islands Forum
PNB	Punjab National Bank
PPP	Public-Private Partnership
PRC	People's Republic Of China
PRV	Police Reporting Visa
PSFTA	Pakistan-Sri Lanka Fta
PSI	Pre-Shipment Inspection
PTA	Preferential Trading Agreements
PTC	Power Trade Corporation
R&D	Research And Development
RBI	Reserve Bank Of India
RCA	Revealed Comparative Advantage
RCI	Regional Cooperation And Integration
RFID	Radio Frequency Identification
RMA	Royal Monetary Authority
RMG	Ready-Made Garments
RoO	Rules Of Origin
ROW	Rest Of World
RTA	Regional Trade Agreement
RTC	Regional Transmission Control
RVC	Regional Value Chains

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SA	South Asia
SAARC	South Asian Association For Regional Cooperation
SACEPS	South Asia Centre For Policy Studies
SADF	South Asian Development Fund
SAES	South Asia Economic Summit
SAEU	South Asian Economic Union
SAFE	South Asian Federation Of Exchanges
SAFTA	South Asian Free Trade Area
SAGQ	South Asia Growth Quadrangle
SAIEVAC	South Asia Initiative To End Violence Against Children
SAPTA	SAARC Preferential Trading Arrangement
SARSO	South Asian Regional Standards Organization
SASEC	South Asia Subregional Economic Cooperation
SATIS	SAARC Agreement On Trade In Services
SATRC	South Asian Telecommunication Regulators' Council
SCCI	SAARC Chamber Of Commerce And Industry
SCO	Shanghai Cooperation Organization
SCRA	Special Convertible Rupee Account
SDF	SAARC Development Fund
SEBI	Securities And Exchange Board Of India
SEBON	Securities Board Of Nepal
SEC	Securities And Exchange Commission
SECP	Securities And Exchange Commission Of Pakistan
SECSCA	Subregional Economic Cooperation In South And Central Asia
SEZ	Special Economic Zones
SFB	SAARC Food Bank
SIM	Subscriber Identity Module
SL	Sri Lanka
SLDC	State Load Dispatch Center
SLIA	Sri Lanka Institute Of Architects
SLR	Sri Lanka Rupee
SMC	SAFTA Ministerial Council
SME	Small And Medium-Sized Enterprise
SNC	Snc-Lavalin
SPS	Sanitary And Phytosanitary
SRMTS	SAARC Regional Multimodal Transport Study
STF	Trade Facilitation Among SAFTA Members
STRI	Services Trade Restrictions Index
STS	STS Holdings

TA	Trade Agreement
TAPI	Turkmenistan–Afghanistan–Pakistan–India
TBT	Technical Barrier To Trade
TCF	Trillion Cubic Feet
TEU	Twenty-Foot Equivalent Unit
TIR	Transit International Routier
TQR	Tariff Rate Quotas
TRAINS	Trade Analysis Information System
TRIPS	Trade-Related Aspects Of Intellectual Property Rights
TRQ	Tariff-Rate Quotas
TRS	Time Release Surveys
TSO	Transmission System Operator
UAE	United Arab Emirates
UD	Under Discussion
UN	United Nation
UN Comtrade	United Nations Commodity Trade Statistics Database
UNCTAD	United Nations Conference On Trade And Development
UNCTADSTAT	United Nations Conference On Trade And Development Statistics
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
UNESCAP Pacific	United Nations Economic And Social Commission For Asia And The Pacific
UNNEt	UN Network Of Experts For Paperless Trade
US	United States
USAID	United States Agency For International Development.
USTR	United States Trade Representative
VAT	Value Added Tax
VEPR	Voluntary Export-Price Restraints
WCO	World Customs Organization
WIPO	World Intellectual Property Organization
WITS	World Integrated Trade Solution
WTO	World Trade Organization

## CHAPTER I

# Moving Towards South Asian Economic Union

*Selim Raihan and Cuong Minh Nguyen*

## Introduction

The South Asian Association for Regional Cooperation (SAARC) is striving to integrate more closely the economies of its eight member countries (Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka). Globalization has helped spur progress, and the Agreement on South Asian Free Trade Area (SAFTA), signed in 2004, marks an important milestone in regional cooperation and integration (RCI). However, despite these and other developments, South Asia is one of the least integrated regions in the world. Intraregional trade continues to account for less than 5% of the formal trade of its members.

To date, the results of SAFTA have fallen short of expectations because of complex safeguard measures and nontariff barriers among SAARC member countries. Global, regional, and domestic turbulence has also complicated progress in liberalizing trade, investment, and other dimensions of regional economic cooperation. Nonetheless, there has been progress, and relationships among SAARC countries have improved. Increasingly, their mutual interest lies in accelerating and deepening their economic cooperation and integration.

Accordingly, SAARC leaders have spoken of creating a broad-based South Asian Economic Union (SAEU), building on progress to date and features in the region germane to advancing cooperation. These include the

- (i) large volume of informal trade among countries in South Asia, reflecting a much higher degree of trade interdependence than is normally acknowledged;
- (ii) importance of bilateral trade within the region, notably of Bhutan, Nepal, and Sri Lanka with India, resulting in a “bilateral regionalism”<sup>1</sup> that helps drive greater integration and cooperation;
- (iii) vibrant trade in services, particularly in education, health care, information technology, and construction (the service sector accounts for more than 50% of

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<sup>1</sup> This term is taken from Webster, Timothy (2007), where “bilateral regionalism” refers to Chinese and Japanese approaches to free trade agreement diplomacy, given their preference for bilateral arrangements in the Asia Pacific.

gross domestic product (GDP) in the region, underscoring the importance of a free trade agreement for services);

- (iv) high degree of cooperation in the region among nonstate actors—civil society, academia, and the private sector—which plays a critical role in shaping and advancing the RCI agenda; and
- (v) cultural, linguistic, and historic ties in the region, underscoring the South Asian identity and fostering people-to-people and business-to-business interaction, and ultimately strengthening government-to-government relations.

Collectively, these features support a bottom-up approach to RCI in which people, businesses, and academia can become more involved. While an intergovernmental, top-down approach must determine the ultimate goal and overall process, a great deal can be accomplished by responding to the needs of the business community and the expressed interests of the public.

Although nontariff barriers, infrastructure constraints, and other factors continue to hamper RCI in South Asia, reference by SAARC leaders to an SAEU indicates a willingness to consider bold action. It is time to take a fresh look at RCI in South Asia and to consider the steps needed to achieve an economic union.

## Defining Regional Integration in South Asia

There is no one-size-fits-all approach to economic integration. Depending on the circumstances of the participating countries, RCI can take one or a combination of the following four paths and stages:

**A top-down approach based on binding agreements.** This approach, illustrated by the European Union (EU), is an intergovernmental process supported by legally binding agreements and established voting procedures. It often starts with a preferential trade agreement, followed by a free trade agreement. It then evolves into a common market, a customs union, and finally a monetary and fiscal union. This model worked well until 2008, when the global economic crisis exposed serious flaws.

**A top-down approach based on open regionalism, consensus, and voluntary principles.** The Association of Southeast Asian Nations (ASEAN), Asia-Pacific Economic Cooperation (APEC), SAARC, and many other regional groupings follow this intergovernmental approach. Compared with the EU model, this approach provides greater flexibility for the participating countries. However, these regional groupings are often criticized for being talk shops that make little progress because of their voluntary nature.

**Bottom-up, market-driven approach.** Multinational corporations have spearheaded market-driven integration and globalization by locating manufacturing and assembly units in the most cost- and time-effective locations, facilitated by the information technology revolution and modern transport developments. East Asia has been transformed by global value chains, with intraregional trade accounting for more than 45% of its total trade in the early 2000s. Market-driven forces continue to spur RCI, although “reshoring” has occurred

selectively as some multinational corporations return manufacturing activities to their home countries due to increasing average costs and wages in emerging markets.

**Geographically focused regional cooperation and integration programs and projects.**

Notable examples of this approach include the South Asia Subregional Economic Cooperation (SASEC), Central Asia Regional Economic Cooperation (CAREC), Greater Mekong Subregion (GMS), Indonesia–Malaysia–Thailand Growth Triangle (IMT-GT), and Brunei Darussalam–Indonesia–Malaysia–The Philippines East ASEAN Growth Area (BIMP-EAGA) regional cooperation programs, which have gained prominence in Asia following the slow progress of the top-down intergovernmental approach. By focusing on cross-border connectivity and transboundary initiatives, such as transport and economic corridors, subregional cooperation facilitates greater trade and more general regional economic integration and cooperation.

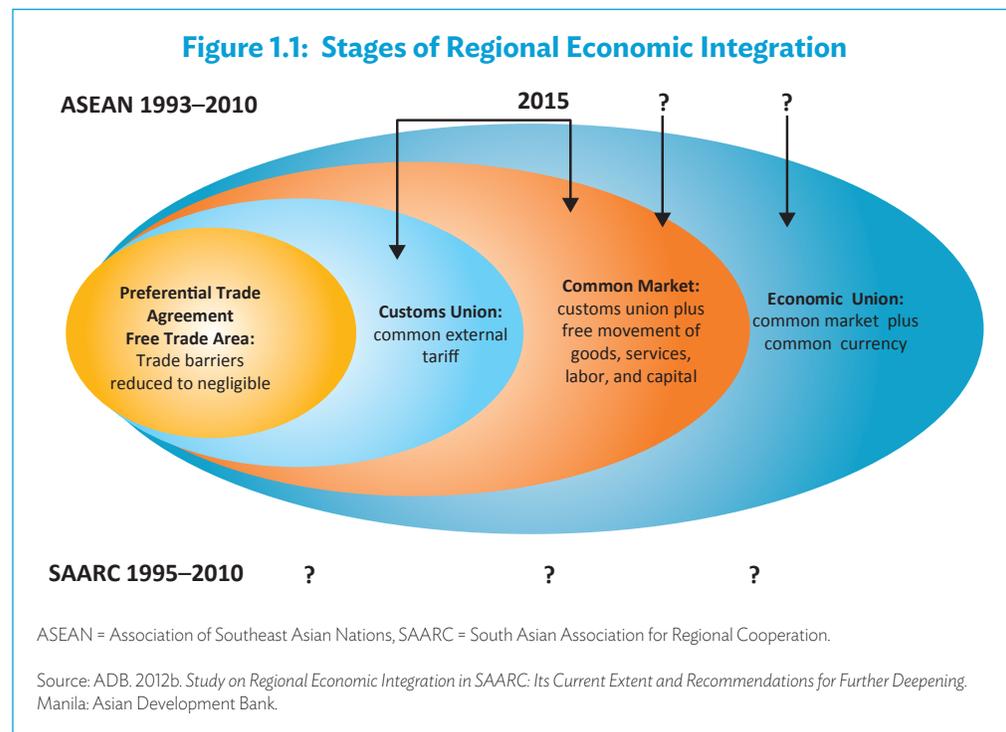
Most regional groupings—including SAARC—have adopted a mixture of the four RCI approaches. Unlike ASEAN and the EU, however, SAARC is an association of areas that used to be integrated but are now politically separate countries. The vision of free movement to recapture lost continuities is part of the motivation for an SAEU. The integration of markets through the liberalization of trade, investment, and capital flows is only a first step toward this goal. Other steps include energy and food security, and cultural connectivity.

Government-to-government RCI initiatives can take many forms, but it is important to simultaneously facilitate business-to-business and person-to-person interaction. As reviewed in the annex to this chapter (p. 9), it is not easy to quantify the gains from trade and regional economic integration, much less the distribution of gains. In the case of South Asia, the reestablishment of regional connectivity is an important way in which SAARC members can rekindle their long-standing economic and social links.<sup>2</sup>

Technically, an economic union involves the free movement of goods, services, capital, and labor among the member states. It also suggests common tariffs and nontariff barriers against commodity and factor movements with the rest of the world. As demonstrated by the EU, to be sustainable, economic and monetary union requires harmonization of fiscal and other macroeconomic policies. Difficulties experienced by the EU since the global financial crisis underscore the need for caution in defining the goal of economic integration. It is timely, therefore, for SAARC member countries to consider not only the mutual benefits of economic integration but also the challenges that the process will raise.

As described by Balassa (1961), regional economic integration evolves through four distinct stages (Figure 1.1). In stage 1, preferential trading agreements (PTAs) and/or free trade agreements (FTAs) are established in which trade barriers (tariffs and nontariff measures) are significantly reduced. Countries then move to stage 2, whereby member countries establish a customs union with common external tariffs. In stage 3, countries advance to

<sup>2</sup> For a review of regionalism in South Asia and the evolution of SAARC, see Bhargava, Bongartz, and Sobhan (1995); Dash (1996); Dash (2008); Gonsalves and Jetley (1999); Mendis (1991); Muni and Muni (1984); Rizvi (1993); among others.



set up a common market, defined as a customs union plus the free movement of goods, services, labor, and capital. Stage 4 involves the creation of an economic union with a common currency.

As noted in Figure 1.1 ASEAN is scheduled to become an economic community by 2015, defined as an FTA-plus, in which barriers to the movement of goods, capital, labor, and services will be reduced as much as possible. Like ASEAN, South Asia is expected to achieve substantial tariff reductions by 2016, facilitating the freer movement of goods and services. ASEAN and SAARC, therefore, are at different stages of regional integration and are expected to move forward in the same direction over the next 5 years.

The ASEAN Vision 2020 for the creation of an ASEAN economic community (AEC) offers a model and road map for SAARC. The AEC Vision calls for ASEAN to act in accordance with the principles of an open, outward-looking, inclusive, and market-driven economy. ASEAN countries have agreed to rules-based systems for effective compliance and implementation of economic commitments. The AEC Vision does not entail a customs union with a common tariff structure, or an economic union with a common currency. Setting aside regional differences, ASEAN's FTA-plus model, therefore, is highly relevant to South Asia.

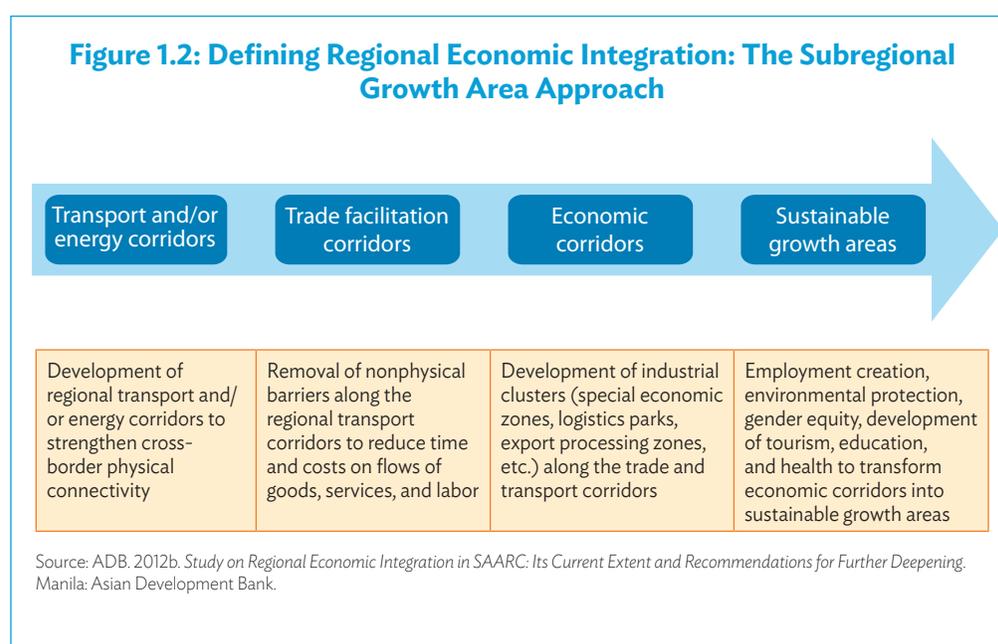
SAARC has passed the stage of a SAARC Preferential Trading Arrangement (SAPTA), and since 2006 has been implementing SAFTA with wide-ranging trade liberalization commitments. More ambitiously, SAARC's Council of Ministers requested the SAARC Finance Committee to study and make recommendations for the eventual realization of an SAEU, including a common currency and monetary unification to reduce economic

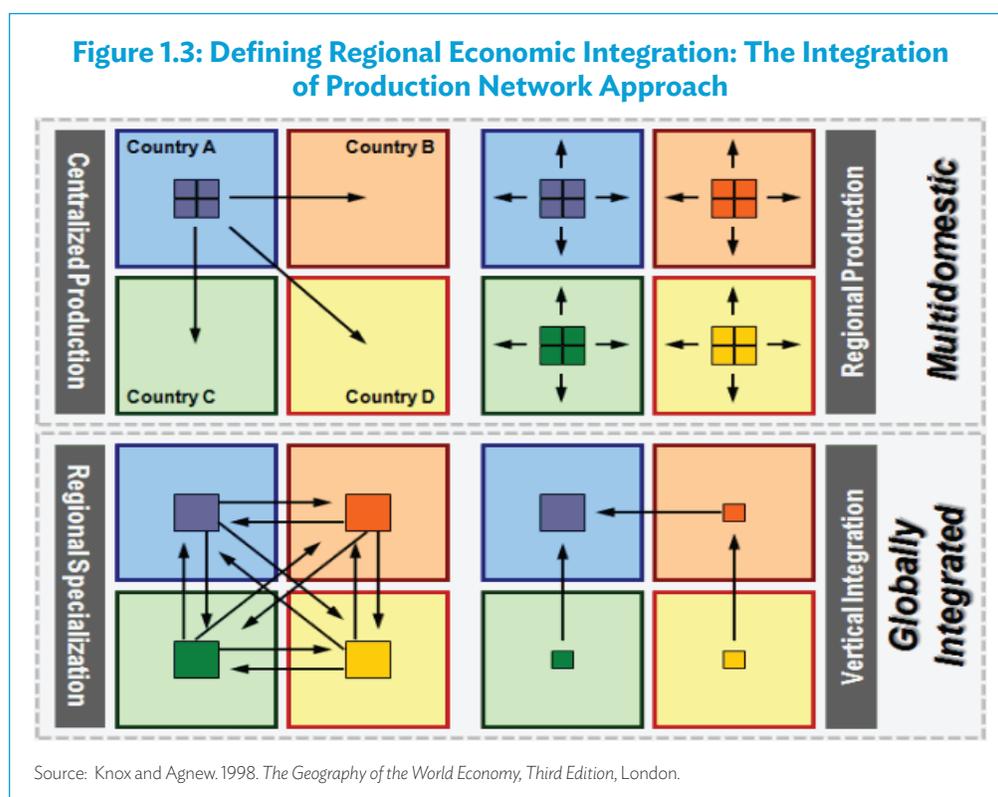
uncertainty and transaction costs caused by exchange rate fluctuations (Neupane 2005). The euro debt crisis, however, has raised serious doubts about an economic union involving a common currency.

The reintegration of South Asia is based both on historic economic links and the processes of globalization and regional integration in the wider Asian context. While an SAEU would require economic policy coordination, SAARC must avoid economic arrangements that may not be sustainable. At this stage, the SAEU can be defined as an FTA-plus arrangement, in a manner similar to the AEC. The first priority for the SAEU would be to complete the ongoing process of economic integration through freer trade and capital flows. A second priority would be to undertake investment in regional infrastructure, especially transport, to strengthen connectivity and facilitate travel. Third, a road map for the SAEU must take account of the inherent structural imbalances among SAARC members, notably the differences in scale between the largest (India) and the smallest (Bhutan).

Designing an SAEU road map is a difficult task. It took ASEAN several years to develop sector road maps, which are integral elements of the AEC Blueprint. As additional input to the blueprint, comprehensive analysis of ASEAN competitiveness was undertaken in 2001. Developing a road map for the SAEU will need to include similar steps. Based on the above discussion on the approaches to RCI, the SAEU will be a combination of three approaches to regional economic integration—government-led, market-driven, and project-based.

The approach to economic integration in South Asia will need to follow elements of the Subregional Growth Area Approach (Figure 1.2) and the Production Network Approach (Figure 1.3). These were introduced earlier in the discussion of the four approaches to RCI.





The SAEU entails four pillars of initiative (Table 1.1). Pillar 1 involves market liberalization (trade liberalization under SAFTA and the SAARC Agreement on Trade in Services (SATIS), including reduction of sensitive lists and nontariff barriers, easing of the rules of origin, and investment facilitation). Pillar 2 entails sector liberalization, whereby priority sectors are identified for fast-track liberalization. Pillar 3 highlights the importance of economic corridors, and integration with global and regional value chains. Pillar 4 addresses regional energy trade (especially electricity and natural gas). Cross-cutting issues include those related to capacity building of regional institutions and financing.

**Table 1.1: Pillars of South Asian Economic Union**

Pillar 1: Market Integration	Pillar 2: Sector-Based Integration	Pillar 3: Economic Corridors	Pillar 4: Regional Energy Trade
Expedite implementation of SAFTA and SATIS	Priority sectors for fast-track liberalization of trade in goods and services	SASEC program Transport infrastructure Global and regional value chains	Export-oriented hydropower development Intraregional electricity and natural gas access
<b>Cross-cutting issues:</b> <ul style="list-style-type: none"> <li>• Building and strengthening institutions, capacity development</li> <li>• financing</li> </ul>			

SAFTA = South Asian Free Trade Area, SASEC = South Asia Subregional Economic Cooperation, SATIS = SAARC Agreement on Trade in Services.

Source: ADB. 2012b. *Study on Regional Economic Integration in SAARC: Its Current Extent and Recommendations for Further Deepening*. Manila: Asian Development Bank.

Table 2 defines the elements of SAEU as a combination of an FTA, a common market, and growth areas supported by efficient regional institutions and funding mechanisms. It does not include a customs union or a common currency.

**Table 1.2: Elements of a South Asian Economic Union**

Elements	South Asia Economic Union
Free flows of goods (FTA)	Yes (SAFTA)
Free flow of services, labor, and capital (Common market)	Yes (Agreements on services liberalization under SATIS; and the Draft Agreement on Investment to be finalized)
Efficient cross border infrastructure (Sub-regional growth area)	Yes (transit and energy agreements)
Integration of regional production network (Sub-regional growth area)	Yes (Transit and energy agreements)
Efficient regional institutions	Yes (SAARC Secretariat, SARSO, etc.)
Sufficient financial resources for regional cooperation initiatives	Yes (SAARC Development Fund)
Common external tariffs (Custom Union)	No
Common currency (Economic Union)	No
Harmonization on economic policies (Economic Union)	Yes (with incremental approach)

SAARC = South Asian Association for Regional Cooperation, SAFTA = South Asian Free Trade Area, SARSO = South Asian Regional Standards Organization, SATIS = SAARC Agreement on Trade in Services.

Source: ADB. 2012b. *Study on Regional Economic Integration in SAARC: Its Current Extent and Recommendations for Further Deepening*. Manila: Asian Development Bank.

## Overview of Chapters

Chapter II provides an analysis of the trade performance and potential in South Asia, including indicators related to overall economic conditions, the sector composition and direction of trade, and tariff and nontariff protection. The pattern of intraregional trade is analyzed and comparisons are made with other regions.

Chapter III provides an overview of the main features of SAFTA, including sensitive lists, rules of origin, treatment of nontariff barriers, and compensation and dispute resolution mechanisms. SAFTA is compared to ASEAN's FTA to identify the policy measures and timing needed for greater progress toward SAEU.

Chapter IV analyzes bilateral trade agreements in South Asia and investigates how these agreements could be harmonized with SAFTA.

Chapter V assesses the importance of informal trade in South Asia. The methodologies for estimating informal trade flows in South Asia are outlined, and their composition and the

reasons for informal rather than formal trade practices are analyzed. The characteristics that differentiate between formal and informal traders are identified.

Chapter VI examines the status of trade in services in South Asia, with a view to understanding the prospects for and challenges of deeper integration of the service sector. Brief overviews of service sector trends in the SAARC member countries and in the region as a whole are provided. The key features and modalities of negotiations under the SAARC Agreement on Trade in Services (SATIS) are outlined, together with the opportunities and challenges of trade liberalization for a representative set of services (energy, telecommunications, tourism, and health).

Chapter VII examines recent developments in labor mobility and remittances in South Asia, and provides a comparative analysis with other regions, leading to policy recommendations for greater integration and harmonization consistent with progress toward the SAEU. Focus is given to facilitating the movement of professionals and skilled workers, as barriers to their movement are easier to remove, or at least reduce, under trade agreements.

Chapter VIII discusses the broad similarities and differences in the foreign direct investment regulatory regimes of SAARC member countries and provides a review on SAARC's perspective on investment cooperation. Recommendations are made regarding the formulation of a road map for investment cooperation under the SAEU.

Chapter IX discusses the key policy and infrastructure priorities for the development of economic corridors in South Asia, and their importance in networking with regional and global value chains.

Chapter X addresses trade facilitation measures consistent with the creation of an SAEU and reviews the performance of SAARC member countries in promoting trade facilitation.

Chapter XI analyzes how regional integration in trade in goods and services and in investment and other areas could help reduce poverty in the South Asia. The chapter includes a theoretical and empirical analysis of the interrelationship between regional integration and poverty reduction.

Chapter XII outlines the methodology for identifying priority products for fast-track trade liberalization in South Asia, focusing on nontariff measures. Export capacity is compared to actual export performance, and nontariff measures are identified in the case of 50 products where bilateral exports are zero despite large export potential.

Chapter XIII quantitatively assesses the implications of full implementation of SAFTA (with and without the sensitive lists) and the impact of deeper levels of regional integration in South Asia. The analysis is based on the use of a global general equilibrium model.

Chapter XIV discusses strategic interventions required at the national and local levels to support regional value chains in South Asia and their link to global value chains. Estimates are made of the untapped potential for regional trade in South Asia are made, based on a gravity model, and sectors suitable for the development of regional value chains are identified.

Chapter XV examines issues related to integration of capital markets in South Asia. It provides cross-regional analysis of the size of capital markets in South Asia and the regulations governing them.

Chapter XVI analyzes energy demand and supply in South Asia and the prospects for cross-border energy trade.

Chapter XVII reviews the development of regional institutions in South Asia and outlines broad recommendations on how to improve the overall institutional architecture for an SAEU.

Finally, Chapter XVIII presents a summary of the report and its main conclusions.

## Annex

### Review of the Literature on Regional Integration in South Asia

There has been considerable debate among policy makers, business leaders, and researchers as to whether South Asian countries stand to gain or lose from the South Asian Free Trade Area (SAFTA). The findings of several qualitative and quantitative studies in this regard have been inconclusive, in part because of differences in the methodologies used to assess the benefits and costs.

In trade theory, the welfare effects of a regional trade agreement (RTA) are analyzed based on two concepts: trade creation and trade diversion. Economic integration is both a policy of protection and a move toward free trade. The protectionist element of integration is called trade diversion, and the effect of the trade liberalization element is called trade creation. The overall effect on welfare for a member country is determined by comparing the trade-creation and trade-diversion effects of the RTA. If trade creation dominates, the formation of the RTA is deemed welfare enhancing; if the trade diversion effect is greater, a welfare loss may occur for the country under consideration.<sup>3</sup>

The evidence indicates that RTAs are predominantly trade-creating (Rodriguez-Delgado 2007). Krugman (1991) concluded that most RTAs are welfare-enhancing, as the negative welfare effects from trade diversion are likely to be marginal, reflecting already significant trade among neighboring countries. Further, RTAs help lock-in reforms by the participating countries, which may not be as politically feasible under multilateralism. Whalley (1996) noted that Mexico's support for the North American Free Trade Agreement negotiations was heavily influenced by its desire to consolidate domestic reforms. Also, failure or stalemate in multilateral trade talks may mean that trade liberalization can only take place through RTAs.

There are, however, some arguments against the formation of RTAs, notably that they undermine the spirit of multilateralism. Widespread development of RTAs could lead to the division of the world into a few protectionist blocs opposed to further multilateral liberalization. As a result, RTAs could be a stumbling block rather than a building block for multilateralism. Given that trade ministries tend to be under-resourced, RTAs may detract from multilateral negotiations. Also, the increasing number of RTAs has generated a complicated "spaghetti bowl" effect of overlapping and contradictory trade provisions.<sup>4</sup> Multiple and overlapping RTAs increase the transaction costs of trade (Feridhanusetyawan 2005). Further, RTAs discriminate against nonmember countries, including less-developed countries, as appears to have been a consequence of the North American Free Trade Agreement; Mexico was favored in the United States market at the expense of Bangladesh (Razzaque 2005). RTAs may also distort resource allocation, favoring regional producers to the potential detriment of local consumers (Rodriguez-Delgado 2007).

Another concern is that tariff reductions under an RTA may not lead to price reductions for goods imported from the South Asian Association for Regional Cooperation (SAARC)

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<sup>3</sup> Note that if member countries are the low-cost producers of the traded good, there will be no trade diversion effect and integration will unambiguously increase welfare.

<sup>4</sup> See Bhagwati and Panagariya (1996).

member countries. This may arise if the exporting SAARC member country dominates the domestic market for a particular good, considered its “captive market,” and is thus able to influence pricing for such good. For example, SAFTA critics allege that Indian exporters may find a captive market for their exports to Bangladesh (World Bank 2006b). Even if Bangladesh reduces the tariffs for Indian products, their prices may not fall in Bangladesh if the Indian products are priced to match or just undercut similar products imported from outside the RTA (with higher tariffs).

Baysan et al. (2006) argued that the economic case for SAFTA is relatively weak because of three important factors. First, most of the economies in South Asia are relatively small, both in terms of gross domestic product (GDP) and trade flows. Heavily populated but with very low per capita incomes, the region accounts for less than one-twentieth of the world GDP—with India accounting for most of the regional share. In this context, it is unlikely that South Asia suppliers are the most efficient source for critical goods and services. Therefore, the probability that the free trade agreement (FTA) is largely trade-diverting is quite high. The second reason relates to the relatively high levels of protection among the SAARC economies. If the country participating in a regional arrangement were itself open, it would not suffer from trade diversion even if it were very small. However, the level of protection within the SAARC region is high in all countries. A third reason why the economic case for SAFTA is weak concerns the political economy of the excluded sectors and the rules of origin. When countries may choose sectors for exclusion from tariff preferences, domestic lobbyists ensure that the sectors in which they are uncompetitive compared with the union partner are excluded. In addition, the rules of origin can be subject to bureaucratic administrative abuse. When imports from the partner threaten an inefficient domestic competitor, bureaucratic discretion may be employed to block their entry.

In contrast to the concerns raised by Baysan et al. (2006), policy makers and many business leaders in South Asia are optimistic about the prospects of SAFTA leading to a significant expansion of trade among the member countries. Informal trade is already substantial, and, combined with formal trade real intraregional trade, is equivalent to 8%–10% of total trade. Although studies indicate limited trade complementarities in the SAARC region, this was also the case in the Association of Southeast Asian Nations (ASEAN) during the mid-1970s; dormant complementarities in the South Asia region could be stimulated by intraregional investment and foreign direct investment.<sup>5</sup> It is also argued that the cost of noncooperation is high (CUTS, 1996 and 2013; RIS, 2004 and 1999; GEP, 1998). While views about SAFTA are far from settled, it is generally acknowledged that there are many gains from regional cooperation beyond the trade impact.

Quantitative assessments of SAFTA and the SAARC Preferential Trading Arrangement (SAPTA) differ in part because of the differing methodologies employed. In general, three methodologies have been used (Baysan et al. 2006): the gravity model, the partial equilibrium model, and a general equilibrium model.

<sup>5</sup> Intraregional trade in ASEAN was close to 6% in the mid-1970s but is now about 23%. ASEAN was characterized by limited complementarities in the 1970s but the situation changed with preferential trading, foreign direct investment, and intraregional investment (South Asia Center for Policy Studies 2002).

Gravity models rely on a set of explanatory variables to predict the impact of the RTAs on bilateral trade flows.<sup>6</sup> Studies that employ the gravity model include Srinivasan and Canonero (1995), Sengupta and Banik (1997), Hassan (2001), Coulibaly (2004), Hirantha (2004), Tumbarello (2006), Rahman (2003), Rahman et al. (2006), and Rodriguez-Delgado (2007). The findings of these studies have been mixed. For example, the studies by Srinivasan and Canonero (1995) and Sengupta and Banik (1997) predicted that the impact of a South Asian FTA on trade flows would be small for India but much larger for the smaller countries. Sengupta and Banik (1997) predicted that official intra-SAARC trade would increase by 30% and by as much as 60% if illegal trade became part of official trade. Coulibaly (2004) determined that SAFTA would lead to net export creation, and Tumbarello (2006) and Hirantha (2004) found that it would lead to net trade creation. Hassan (2001), on the other hand, determined that SAFTA would lead to net trade diversion. Rahman (2003) found the dummy variable for South Asia to be insignificant, indicating that regional integration is unlikely to generate significant trade expansion.

Rahman et al. (2006) used an augmented gravity model to identify trade creation and trade diversion effects originating from the earlier SAPTA. They found that there was significant intra-bloc export creation as a result of SAPTA but also evidence of net export diversion. The study further indicated that Bangladesh, India, and Pakistan were expected to gain from joining the RTA, while the Maldives, Nepal, and Sri Lanka would be negatively affected.

Rodriguez-Delgado (2007) evaluated SAFTA in the global structure of overlapping regional trade agreements, using a modified gravity equation to examine the effects of the Trade Liberalization Program, which started in 2006. The study predicted that SAFTA would have a minor effect on regional trade flows. The gravity model simulation suggested that the SAFTA Trade Liberalization Program would influence regional trade flows mainly by increasing India's exports and its imports from Bangladesh and Nepal.

Gravity model studies of RTAs, however, have a number of methodological flaws. The left-hand side of the gravity equation relates to bilateral trade, not welfare, while the concepts of trade creation and trade diversion directly relate to the welfare of the country in question. Furthermore, gravity models are partial equilibrium analyses and, therefore, fail to take into consideration the inter-sector and interregional linkage effects. As such, gravity models do not estimate the welfare effects of an RTA.

The main partial equilibrium studies on RTA in South Asia include those by Govindan (1994), DeRosa and Govindan (1995), Pursell (2004), the World Bank (2006b), and Raihan (2011). The advantage of these models is that they are generally based on disaggregated data and are flexible enough to facilitate sector-specific study. The major problem with this methodology is that it cannot incorporate general equilibrium interactions, and thus cannot capture the inter-sectoral effects.

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<sup>6</sup> Typically, the exercise involves estimating a bilateral trade flow equation with bilateral trade (imports, exports, or total trade at the aggregate or sector level) as the dependent variable, and country characteristics such as the GDP, population, land area, distance, commonality of language or cultural ties, and existence of preferential trade arrangements as independent variables. Once estimated, the equation can be used to predict the impact of a union between country pairs.

A partial equilibrium model used by Govindan (1994) showed the effect of preferential liberalization of the food sector on intraregional trade in food, indicating welfare gains through increased trade. Analysis by DeRosa and Govindan (1995), however, showed that the welfare gains would be much higher if member countries were to opt for unilateral liberalization on a nondiscriminatory basis. A partial equilibrium analysis of the cement industry by Pursell (2004) suggested that preferential liberalization of trade between Bangladesh and India would lead to substantial gains through increased competition within the industry and regional market.

To explore the potential for a Bangladesh–India FTA, the World Bank (2006b) undertook a comparative assessment of a few industries, including cement, light bulbs, sugar, and ready-made garments. The partial equilibrium analysis indicated that India’s exports of cement, lights bulbs, and sugar to Bangladesh would increase, but exports of these products from Bangladesh to India would not increase. This was mainly because Indian export prices for these products were substantially lower than for similar products in Bangladesh. The simulations for ready-made garments predicted increased Bangladeshi exports to India, but also increased ready-made garment exports from India to Bangladesh. The study found that a bilateral FTA would generate large welfare gains for consumers in Bangladesh provided the infrastructure and administrative capacity at customs borders was sufficiently upgraded. The study cautioned that the benefits for Bangladesh could be erased if the FTA had the effect of blocking access to cheaper third-country imports (i.e., from East Asia). In this case, the trade diversion costs could be substantial. The study suggested that the trade diversion costs could be minimized through unilateral liberalization.

Raihan (2011) applied the WITS/SMART partial equilibrium model to explore the trade effects of SAFTA. The study found that under full implementation of SAFTA, some SAARC member countries would be able to increase their exports within the region quite substantially. India was projected to be the largest gainer, with its exports to member countries increasing by \$858 million. The rise in exports would be about \$169 million for Pakistan, \$122 million for Bangladesh, and \$90 million for Nepal. Sri Lanka’s exports to the region would also increase but, because of the India–Sri Lanka bilateral FTA, its exports to the Indian market would further increase by only a small amount. The study indicated that, except for the Maldives and Sri Lanka, increased exports to India would account for most of the predicted rise in intraregional exports for Afghanistan, Bangladesh, Bhutan, Nepal, and Pakistan. Raihan (2011), however, showed that much of the potential increase in intraregional exports would be limited by the imposition of a stringent sensitive list allowed under SAFTA.

Studies based on computable general equilibrium models provided a wide range of welfare effects of SAFTA, based on variables including production, consumption, and trade flows in all sectors of the economy. Model-based studies of SAFTA were conducted by Pigato et al. (1997), Bandara and Yu (2003), and Raihan and Razzaque (2007). These three studies employed the Global Trade Analysis Project (GTAP) database and model, although they differ in details because of the evolution of the GTAP data.

Pigato et al. (1997) found that SAFTA would produce benefits for member countries but that unilateral trade liberalization would yield larger gains. The study by Bandara and Yu (2003) found that, in terms of real income, SAFTA would lead to gains for India and

Sri Lanka, while Bangladesh would experience losses. The authors endorsed the view that South Asian countries would gain more from unilateral trade liberalization and multilateral liberalization than from SAFTA.

Raihan and Razzaque (2007) also used the GTAP model to explain the welfare effects of SAFTA. The main contribution of their study was to decompose the welfare effects of SAFTA (as calculated from the GTAP simulation results) into trade creation and trade diversion effects for each of the SAARC member countries. It concluded that Bangladesh would incur a net welfare loss from SAFTA implementation. Although Bangladesh would experience a positive trade creation effect, the negative trade diversion effect would be large enough to offset the gain. The study concluded that all other SAARC member countries would gain from SAFTA, with India gaining the most. Raihan and Razzaque (2007) also explored the possible reasons for the larger trade diversion effects for Bangladesh. Under SAFTA, imports from the People's Republic of China and other low-cost sources would decline, while those from India would increase significantly; for Bangladesh, this would mean replacement of low lost-cost import sources by a higher-cost source.

Despite the lowering of tariff rates in SAARC member countries in recent years—especially in India—intraregional trade has not increased significantly. Nontariff barriers have long been identified as a major reason behind the low intraregional trade in South Asia. Reduction in the nontariff barriers would likely lead to significant improvements in intraregional market access.

A study by Taneja (2007) on bilateral trade between India and Pakistan showed that there is a large untapped trade potential between the two countries that is impeded by nontariff barriers and other factors. The study noted complaints by the Government of Pakistan and trade officials about India's imposition of several nontariff barriers on Pakistani imports. In turn, academia, policy makers, and trade representatives in India have noted that Pakistan's positive list approach, where only selected products from India were allowed to be imported, severely limited imports of Indian products. In addition, other barriers included technical barriers such as sanitary and phytosanitary measures, poor trade facilitation and customs procedures, inadequate financial and para-tariff provisions, and difficulties in securing visas.

Hussain (2009) argued that even in the absence of formal tariffs, nontariff barriers could be a major constraint to trade liberalization in South Asia. He noted that although the Group of Eminent Persons had proposed the elimination of nontariff barriers within 7 years of the signing of SAFTA, they continue to be high and inadequately addressed. The agreement merely stipulates that member countries will "inform" the SAARC Secretariat of all "nontariff and para-tariff measures." These are to be reviewed by the SAARC Committee of Experts, and recommendations to reduce such trade restrictions should be taken into consideration by member countries. However, there is no binding commitment within the terms of SAFTA for member countries to eliminate or sharply reduce their nontariff barriers.

A 2010 Asian Development Bank–Federation of Indian Chambers of Commerce and Industry study highlighted that although SAARC member countries had made steady progress toward liberalizing the intraregional trade regime through continuously lowering

their tariff rates, this progress was undermined by the high degree of protectionism afforded by nontariff barriers and regulatory policy instruments. As tariff and quantitative restrictions on trade have been progressively reduced, trade costs arising from regulatory burdens, inadequate infrastructure, and inefficient customs procedures and logistics have become much more significant. The study suggested that inadequate infrastructure and the cumbersome regulatory environment would impose substantially higher trade costs than those presented by tariff barriers.

Rahman (2010) highlighted that while SAFTA has made some headway in moving toward duty-free access for tradable goods, nontariff barrier issues have not been adequately addressed. He emphasized that regional cooperation needed to be deepened through vertical integration and the promotion of cross-border supply chains. He concluded that nontariff barriers pose the next major challenge to strengthening regional economic and trade cooperation in South Asia.

Raihan (2011), in his economic corridors study for South Asia, showed that such corridors would result in significant increases in intraregional trade among the four eastern South Asian countries. The study concluded that the reduction in trade transaction costs from the establishment of economic corridors would be much bigger than the gains from tariff liberalization. The study emphasized the importance of removing nontariff trade barriers.

De, Raihan, and Kathuria (2012), in their study on bilateral trade between Bangladesh and India, identified several nontariff barriers in both countries. They highlighted that a bilateral FTA would increase bilateral trade significantly if nontariff barriers were reduced along with other transaction costs. The trade potential between the two countries is severely restricted by the presence of nontariff barriers in both countries.

Raihan and De (2013) and De, Raihan, and Ghani (2013), in their analysis of bilateral trade between India and Pakistan, identified several nontariff barriers. These studies suggested that, in addition to rationalizing their import duties, India and Pakistan should eliminate quantitative restrictions, regulatory duties, and para-tariffs, and address several other measures that restrict their bilateral trade. Despite the reduction in tariffs, nontariff barriers heavily restrict bilateral trade between India and Pakistan and have been the major stumbling block to promoting trade between the two countries. Deeper cooperation could result in significant reductions in these barriers.



## CHAPTER II

# Trade Performance and Potential in South Asia

*Selim Raihan, Farazi Binti Ferdous, and Md. Abdur Rahim*

## Introduction

South Asian countries have become increasingly trade-oriented in recent decades, with substantial potential for further trade gains – both intraregionally and globally. This chapter assesses the trade performance and potential of the members of the South Asian Association for Regional Cooperation (SAARC).

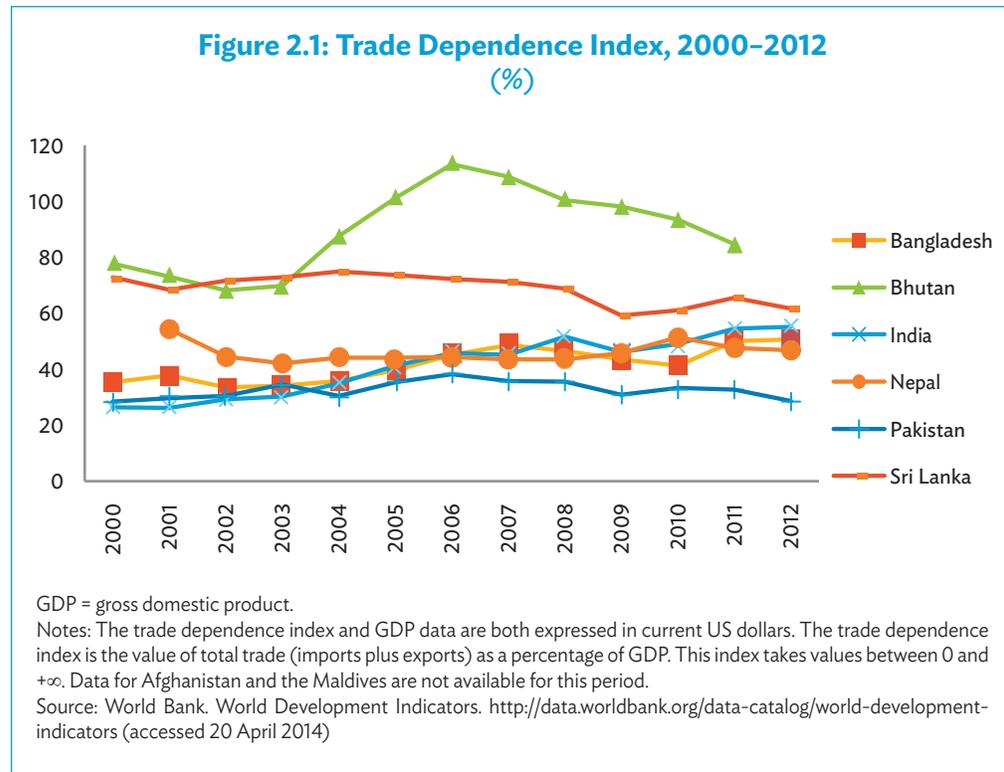
## Economic Importance of Trade in South Asia

The economic importance of trade for countries in South Asia is analyzed based on the following indicators: trade dependence (openness), import penetration, export propensity, and the marginal propensity to import.

### Trade Dependence Index

The trade dependence index (also referred to as the openness index) is a measure of the importance of trade in the overall economy, expressed as total trade (imports plus exports) as a percentage of gross domestic product (GDP). It provides an indication – subject to limitations – of the degree to which an economy is open to trade (Mikic and Gilbert 2007).

Figure 2.1 presents the trade dependence indices for the SAARC economies from 2000 to 2012. There is considerable variation in the degree of openness among these economies, with Bhutan much more dependent on trade than other SAARC countries. Bhutan's trade openness reached high levels in 2006, after which it started to decline to more balanced levels. In comparison, Pakistan is shown to have minimum but stable degree of trade dependency. Bangladesh and India have experienced increasing trade dependency since 2000, while Sri Lanka and Nepal have experienced decreasing trade dependency.



### Import Penetration Index

The import penetration index shows to what degree domestic demand (the difference between GDP and net exports) is satisfied by imports. Calculated at the sectoral level, it is termed the self-sufficiency ratio and may be used as the basis for specific policy objectives targeting self-sufficiency. It may also provide an indication of the degree of vulnerability to external shocks (Mikic and Gilbert 2007).

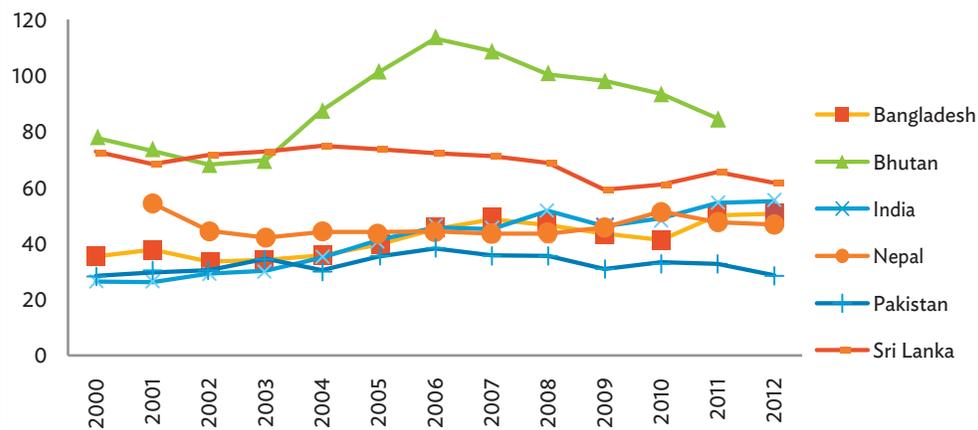
As shown in Figure 2.2, Bhutan has a high import dependency while Bangladesh and Pakistan have relatively low levels of import dependency. Bangladesh and India are indicated as having increasing import dependency since 2000; in contrast, Nepal, Pakistan and Sri Lanka have had quite stable levels of import penetration.

### Export Propensity Index

Figure 2.3 shows the export propensity index for SAARC countries from 2000 to 2012. The index measures the overall degree of reliance of domestic producers on foreign markets (Mikic and Gilbert 2007). It is similar to the trade dependence index, but may provide a better indicator of vulnerability to certain types of external shocks (e.g., falls in export prices or changes in exchange rates).

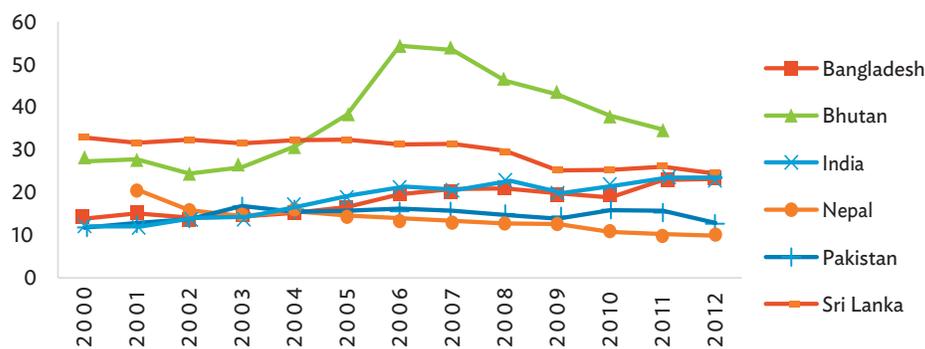
As shown in the figure, Bangladesh, Bhutan, India, and Pakistan have experienced an increasing degree of reliance by domestic producers on foreign markets, while Nepal and Sri Lanka have experienced the reverse.

**Figure 2.2: Import Penetration Index, 2000–2012**  
(%)



Notes: The import penetration rate is the ratio of total imports to domestic demand, as a percentage. The index ranges from 0 (with no imports) to 100 percent when all domestic demand is satisfied by imports only (no domestic production). Data for Afghanistan and the Maldives are not available for this period.  
Source: World Bank. World Development Indicators. <http://data.worldbank.org/data-catalog/world-development-indicators> (accessed 20 April 2014).

**Figure 2.3: Export Propensity Index, 2000–2012**  
(%)



Notes: Export propensity index is the ratio of exports to GDP, defined as a percentage. The index ratio is expressed as a percentage and ranges from zero (with no exports) to 100 (with all domestic production exported). Data for Afghanistan and the Maldives are not available for this period.  
Source: World Bank. World Development Indicators. <http://data.worldbank.org/data-catalog/world-development-indicators> (accessed 20 April 2014).

### Marginal Propensity to Import

The marginal propensity to import (MPM) is a measure of the extent to which imports are induced by a change in incomes. Its relevance for policymakers depends on the cycle of the economy. With a relatively high MPM, a significant fall in imports can be expected during an economic downturn and fall in GDP; in contrast, with a relatively low MPM, the drop in imports is likely to be less significant (Mikic and Gilbert 2007).

Table 2.1 tracks MPM year by year for SAARC countries. Substantial decreases in their respective MPMs are shown, especially in the case of Nepal and Sri Lanka.

**Table 2.1: Marginal Propensity to Import, 2001–2012**

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Bangladesh	0.46	(0.58)	0.27	0.33	0.66	0.63	0.64	(0.09)	(0.12)	0.03	0.98	0.33
Bhutan	(0.17)	0.30	0.43	2.78	1.49	0.02	0.36	0.27	0.70	0.58	(0.16)	...
India	0.09	0.44	0.27	0.45	0.64	0.51	0.25	1.43	(0.07)	0.40	0.87	0.43
Nepal	7.36	(42.21)	0.00	0.50	0.57	0.57	0.26	0.41	0.86	1.95	(0.56)	0.26
Pakistan	0.18	0.16	0.38	(0.20)	0.79	0.59	(0.18)	0.69	(1.17)	0.46	(0.01)	(0.15)
Sri Lanka	2.47	1.04	0.74	0.68	0.18	0.37	0.23	0.27	(1.06)	0.54	0.86	0.03

( ) = negative, ... = not available.

Notes: The marginal propensity to import is the ratio of the change in total imports to the change in GDP over a defined period (typically one year). In macroeconomic theory, MPM ranges between 0 (with no share of increased GDP spent on additional imports) and 1 (the whole of increased GDP is spent on imports). Data for Afghanistan and the Maldives are not available for this period.

Source: World Bank. World Development Indicators. <http://data.worldbank.org/data-catalog/world-development-indicators> (accessed 20 April 2014).

## Trade Performance

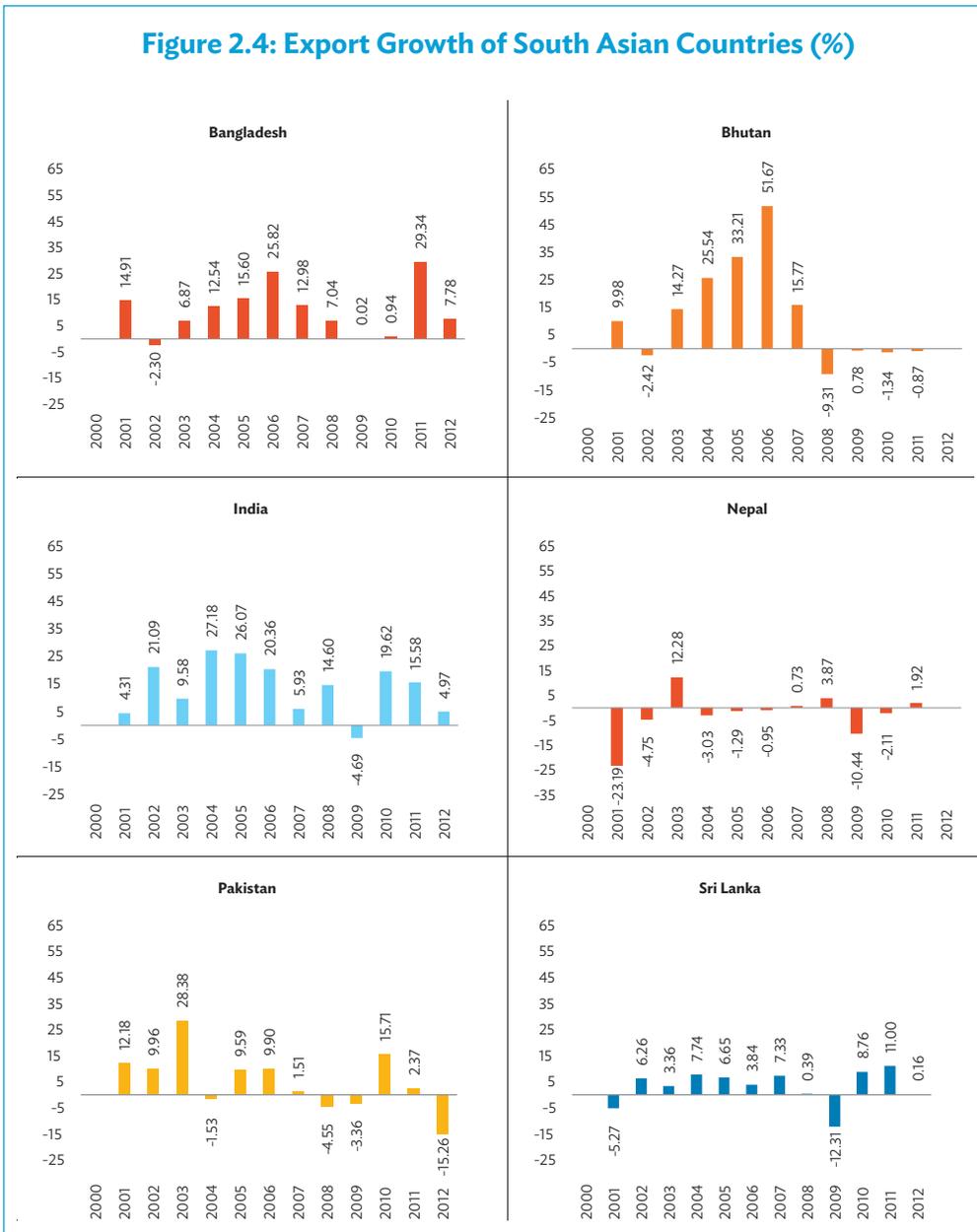
This section includes information on the growth rate of exports, the normalized trade balance, and export–import ratios, which serve as trade performance indicators of an economy or region.

### Growth Rate of Exports

The growth rate of exports is one of the most common indicators used when assessing the progress in any area of economic activity. Often the rate is calculated at the sector level to identify ‘dynamic sectors’. Comparison of such indicators over many countries could be of interest to producer or exporter associations, investors, policymakers, and trade negotiators (Mikic and Gilbert 2007).

Figure 2.4 indicates the annual growth rates of exports for SAARC countries. Decreasing trends are shown for the period 2004 and 2008, particularly strongly so for Bangladesh, Bhutan, India, and Pakistan. In part, this may reflect the impact of the global financial crisis. Overall, however, the region is very dynamic, with average growth rates over the decade of 11 percent for Bangladesh, 13.7 percent for India, and 5.4 percent for Pakistan.

Figure 2.4: Export Growth of South Asian Countries (%)



Notes: The growth rate is the annual compound percentage change in the value of exports between two periods. The growth rate is a percentage and can take a value between -100 per cent (if exports cease) and  $+\infty$ . A growth rate of zero indicates that the value of exports has remained constant. Data for Afghanistan and the Maldives are not available for this period.

Source: World Bank. World Development Indicators. <http://data.worldbank.org/data-catalog/world-development-indicators> (accessed 20 April 2014).

### Normalized Trade Balance

The normalized trade balance represents a record of a country's trade transactions with the rest of the world. In general, economists expect that the trade balance will be zero in the long run, thus imports are financed by exports, but it may vary considerably over shorter periods (Mikic and Gilbert 2007).

Table 2.2 indicates the normalized trade balance for SAARC countries from 2000 to 2012. Negative figures indicate a trade deficit, observed for Bangladesh, Bhutan, India, Nepal, Pakistan, and Sri Lanka.

**Table 2.2: Normalized Trade Balance, 2000–2012**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Bangladesh	(0.22)	(0.20)	(0.15)	(0.16)	(0.15)	(0.16)	(0.13)	(0.15)	(0.10)	(0.09)	(0.09)	(0.09)	(0.09)
Bhutan	(0.30)	(0.24)	(0.28)	(0.26)	(0.30)	(0.24)	(0.04)	(0.02)	(0.08)	(0.13)	(0.19)	(0.18)	...
India	(0.09)	(0.08)	(0.04)	(0.06)	(0.04)	(0.07)	(0.07)	(0.09)	(0.12)	(0.14)	(0.12)	(0.14)	(0.15)
Nepal	(0.24)	(0.29)	(0.31)	(0.29)	(0.34)	(0.37)	(0.39)	(0.42)	(0.45)	(0.58)	(0.57)	(0.58)	...
Pakistan	(0.17)	(0.13)	(0.09)	(0.02)	0.01	(0.11)	(0.15)	(0.12)	(0.17)	(0.10)	(0.05)	(0.04)	(0.10)
Sri Lanka	(0.10)	(0.08)	(0.10)	(0.13)	(0.14)	(0.12)	(0.14)	(0.12)	(0.14)	(0.15)	(0.17)	(0.21)	(0.21)

( ) = negative, ... = not available.

Notes: The normalized trade balance (total exports less total imports) as a fraction of total trade (exports plus imports). The index range is between -1 and +1, which allows unbiased comparisons across time, countries, and sectors. A value of zero indicates a trade balance. Data for Afghanistan and the Maldives are not available for this period.

Source: World Bank. World Development Indicators. <http://data.worldbank.org/data-catalog/world-development-indicators> (accessed 20 April 2014).

### Export-Import Coverage

This is an alternative to the normalized trade balance. It indicates whether a country's imports are fully offset by exports in a given year (Mikic and Gilbert 2007).

From Table 2.3, it appears that in recent years Nepal had the least coverage of imports by exports among the SAARC countries. Bangladesh and Bhutan show increasing trends, indicating increasing exports relative to imports. On the other hand, India, Nepal, and Sri Lanka have decreasing coverage, indicating that imports have been increasing more rapidly than exports.

**Table 2.3: Export-Import Coverage, 2000–2012**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Bangladesh	0.64	0.67	0.73	0.73	0.74	0.72	0.77	0.75	0.82	0.84	0.84	0.84	0.84
Bhutan	0.54	0.61	0.56	0.59	0.54	0.61	0.92	0.96	0.85	0.78	0.68	0.69	...
India	0.84	0.85	0.92	0.88	0.92	0.88	0.87	0.83	0.78	0.76	0.78	0.75	0.74
Nepal	...	0.61	0.55	0.53	0.55	0.49	0.46	0.44	0.41	0.38	0.26	0.27	0.27
Pakistan	0.71	0.77	0.83	0.95	1.03	0.80	0.74	0.79	0.71	0.81	0.90	0.93	0.81
Sri Lanka	0.82	0.86	0.82	0.76	0.75	0.78	0.76	0.79	0.76	0.74	0.71	0.66	0.66

... = not available.

Notes: The export-import coverage is the ratio of total exports to total imports. The values for this index range from 0 when there are no exports to  $+\infty$  when there are no imports. A ratio of 1 signals full coverage of imports by exports (trade balance). Data for Afghanistan and the Maldives are not available for this period.

Source: World Bank. World Development Indicators. <http://data.worldbank.org/data-catalog/world-development-indicators> (accessed 20 April 2014).

## Direction of Trade

This section includes the following indicators: export/import/trade shares, regional market shares, trade intensity, size adjusted regional export share, and the Regional Hirschmann and Trade entropy index. These indicators help track the regional pattern and direction of trade.

### South Asia: Export, Import, and Trade Shares

Export shares indicate how particular export sectors are performing relative to the overall export profile of an economy. Import shares indicate imports from the region of interest (the source) as a percent of total imports to the region under study (the destination). Trade shares indicate the importance of total trade (imports and exports) between source region and the destination region (Mikic and Gilbert 2007).

The results of export, import, and trade shares show low percentage values, as shown in Table 2.4. This reflects the marginal importance of regional trade partners for most SAARC countries.

**Table 2.4: SAARC Intraregional Export, Import, and Trade Shares (%)**

Particulars	Index
Export share	5.35
Import share	3.43
Trade share	4.18

Note: The export, import, and trade shares take a value between 0% and 100%, with higher values indicating greater importance of selected trading partners.

Source: World Bank. World Integrated Trade Solution (WITS) Data. <http://wits.worldbank.org> (accessed 20 April 2014).

### Regional Market Share

Regional market shares represent the relative importance of each SAARC member country in the intraregional trade bloc; the larger the share, the greater the importance of the country in question (Mikic and Gilbert 2007).

Table 2.5 records regional exports as a percentage of a country's total exports. The shares vary widely, from 82% in the case of Bhutan to only 2% Bangladesh and 4 percent for India. Like Bhutan, intraregional exports account for 67 and 71%, respectively, of Afghanistan's and Nepal's total exports. Similar to exports, there are wide variations in the relative importance of intraregional imports for SAARC countries. Approximately 50% of Afghanistan imports and 44% of Nepal's imports are from SAARC countries. In sharp contrast, only 1% of India's imports are from other SAARC member countries; Low intraregional dependency is also evident in Pakistan, where imports from other SAARC member countries account for only 5% of total imports.

Table 2.5: Intra-regional Trade and Regional Market Share in South Asia, 2011

From \ To	(\$ million)											Regional exports as % of country's total exports	Exports as % of total regional exports
	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	Total Intra-regional Export	Export to rest of the world	Total exports		
Afghanistan	0	0	0	70	0	0	181	0	251	125	376	67	1
Bangladesh	1	0	4	579	1	19	83	24	711	32387	33098	2	4
Bhutan	0	26	0	343	0	2	0	0	371	82	453	82	2
India	505	3406	219	0	118	2560	1678	4452	12938	288546	301483	4	65
Maldives	0	0	0	2	0	0	0	10	12	72	83	14	0
Nepal	0	26	3	614	0	0	3	0	647	261	908	71	3
Pakistan	2656	947	0	272	5	1	0	348	4230	20910	25140	17	21
Sri Lanka	3	46	0	521	55	1	75	0	702	9309	10011	7	4
Total exports									19861	351692	371553	5	
Total intra-regional imports	3165	4451	226	2402	180	2583	2019	4834	19861				
Imports from rest of the world	3225	34739	826	460000	1232	3333	41523	14862	559740				
Total imports	6390	39190	1052	462403	1412	5916	43542	19696	579601				
Regional import as % of country's total imports	50	11	21	1	13	44	5	25	3				
Import as % of total regional imports	16	22	1	12	1	13	10	24					

Note: The regional export and import shares take values between 0 and 100 per cent, with higher values indicating greater importance of the economy within the regional trading bloc.

Source: World Bank. World Integrated Trade Solution (WITS) Data. <http://wits.worldbank.org> (accessed 20 April 2014).

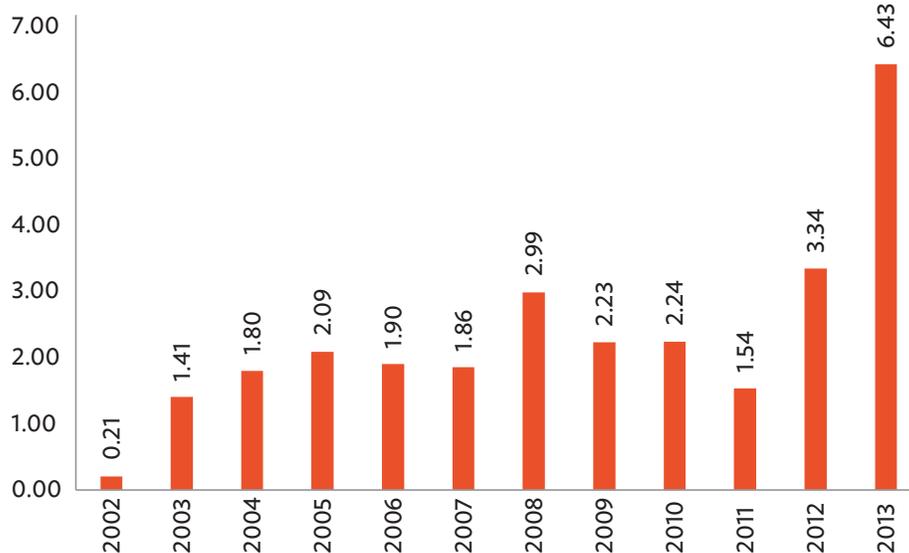
Total exports of a SAARC member country—as a percentage of total exports of all eight SAARC member countries is a measure of their relative trade openness and size. India accounts for 65% of the region's total exports. Pakistan accounts for 21% while Afghanistan and the Maldives together account for only about 1%. In terms of imports, Sri Lanka accounts for 24% of total intra-regional imports, followed closely by Bangladesh at 22%. Bhutan and the Maldives account for only 1% of total imports by SAARC member countries.

### Trade Intensity Index

The trade intensity index indicates whether a region exports more or less (as a percentage) to a given destination as compared to the world average (Mikic and Gilbert 2007).

As shown in Figure 2.5, SAARC member countries have increasing trade intensity as compared to the world average, rising from 1.41 in 2003 to 6.43 in 2013. An index number greater than 1 reflects that SAARC countries trade more intensively with the region compared to the world average. During the global financial crisis, the index values weakened.

**Figure 2.5: Trade Intensity Index of SAARC Members, 2002–2013**



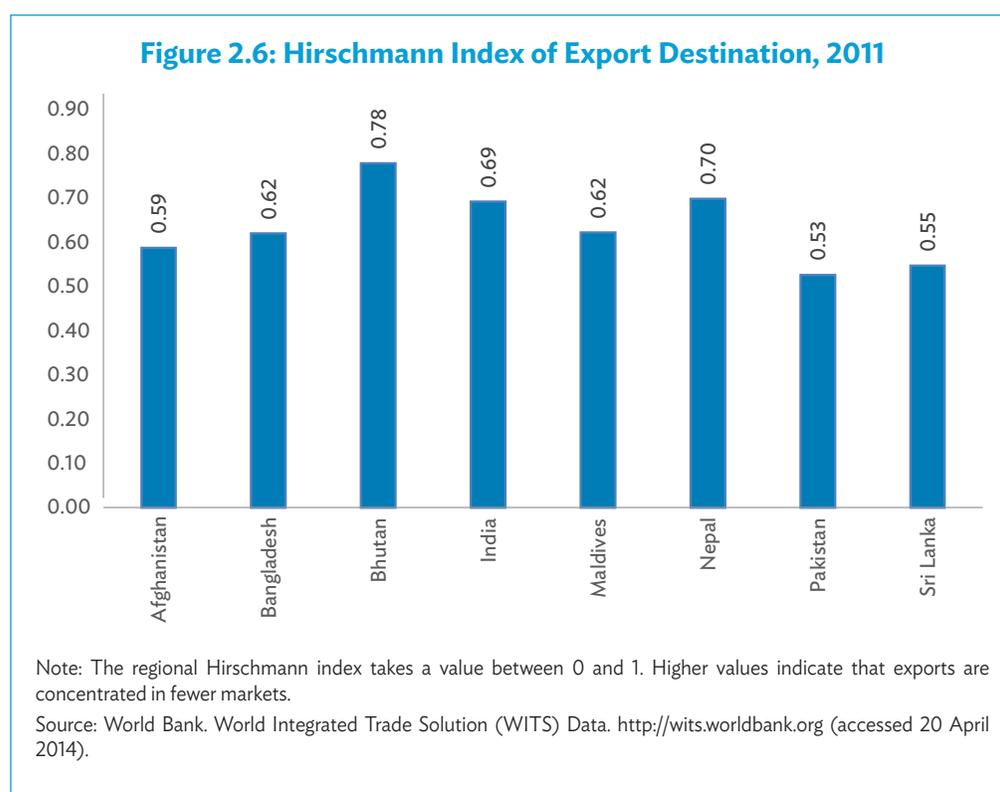
Note: The trade intensity index takes a value between 0 and  $+\infty$ . Values greater than 1 indicate an 'intense' trade relationship.

Source: World Bank. World Integrated Trade Solution (WITS) Data. <http://wits.worldbank.org> (accessed 20 April 2014).

### Hirschmann Index of Export Destination

The Hirschmann index of export destination is a measure of the geographical concentration of exports. It indicates the degree to which a region's or country's exports are distributed across different destinations. High concentration levels are sometimes interpreted as an indication of vulnerability to economic changes in a small number of export markets (Mikic and Gilbert 2007).

From the Hirschmann index values in Figure 2.6, it is apparent that exports by SAARC member countries, especially in the case of Bhutan, are directed to relatively few markets. It should be noted, however, that the Hirschmann index is subject to an aggregation bias—the more disaggregated the data from which it is calculated the better.



## Sectoral Structure of Trade

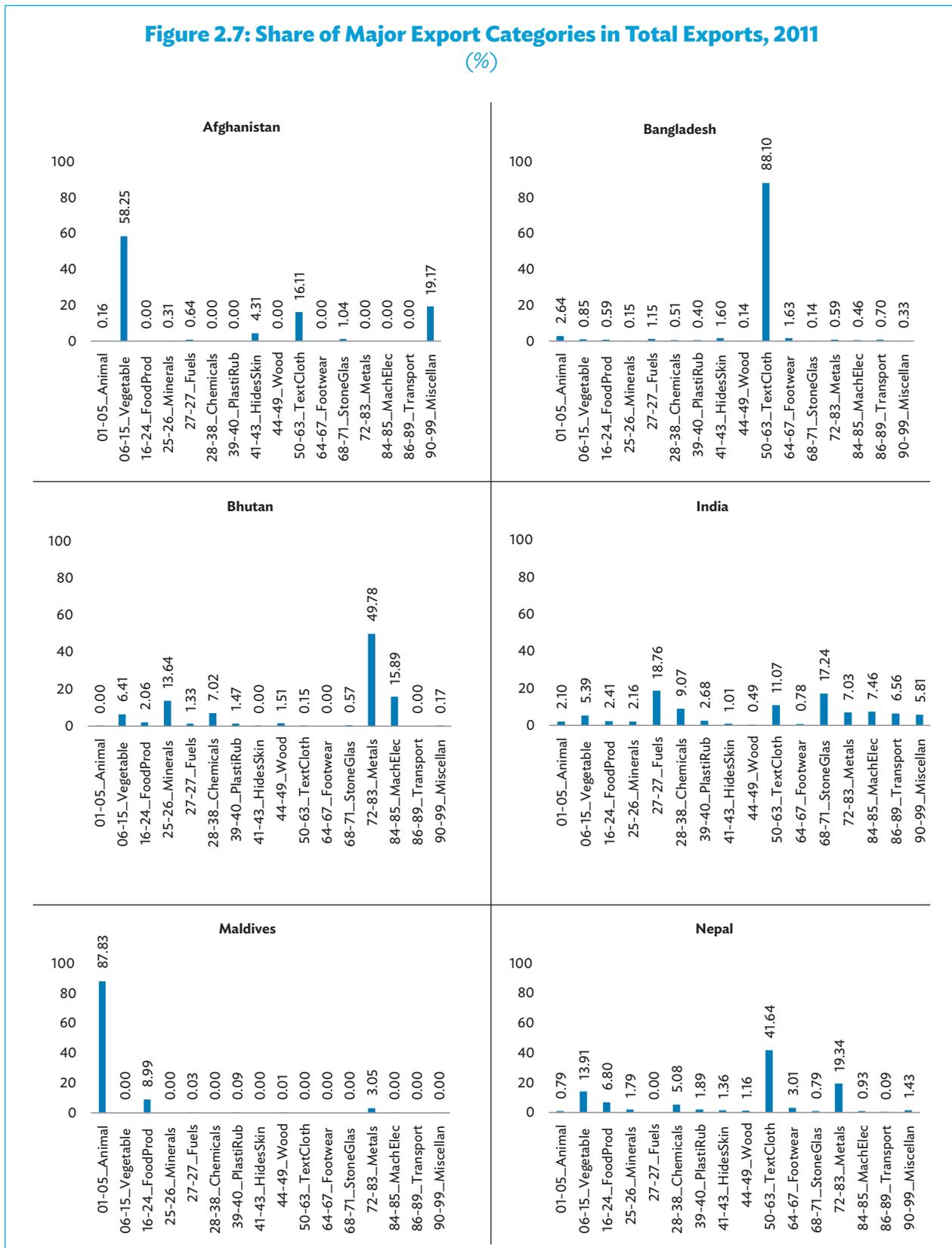
Indicators tracking changes in the commodity structure of trade of SAARC countries are useful for trade negotiations. They are also relevant to the formulation of development strategies, as they reflect the competitiveness of a country's or region's economic sectors. The indices covered in this section are (i) major export category, (ii) sectoral Hirschmann, (iii) export concentration, (iv) revealed comparative advantage, (v) Michelaye, (vi) regional orientation, (vii) complementarity, (viii) export similarity, (ix) sectoral intra-industry trade, and (x) trade overlap.

### Major Export Category Index

The major export category index is simply a measure of the extent of diversification of exports across sectoral categories. To identify the major export sectors of a country, the value of exports of each commodity is expressed as a percentage of total country's exports; the shares are then ranked in order of magnitude. If no single category accounts for 50% or more of total exports, the economy is classified as diversified. Identification of the dominate products of a country's trade is valuable for both trade policy and adjustment management (Mikic and Gilbert 2007). As shown in Figure 2.7, Bhutan, India, Nepal, and Sri Lanka could be considered as diversified economies. Afghanistan is heavily dependent on exports of vegetables, Bangladesh and Pakistan on exports of textiles and clothing, and the Maldives is on exports of animal products.

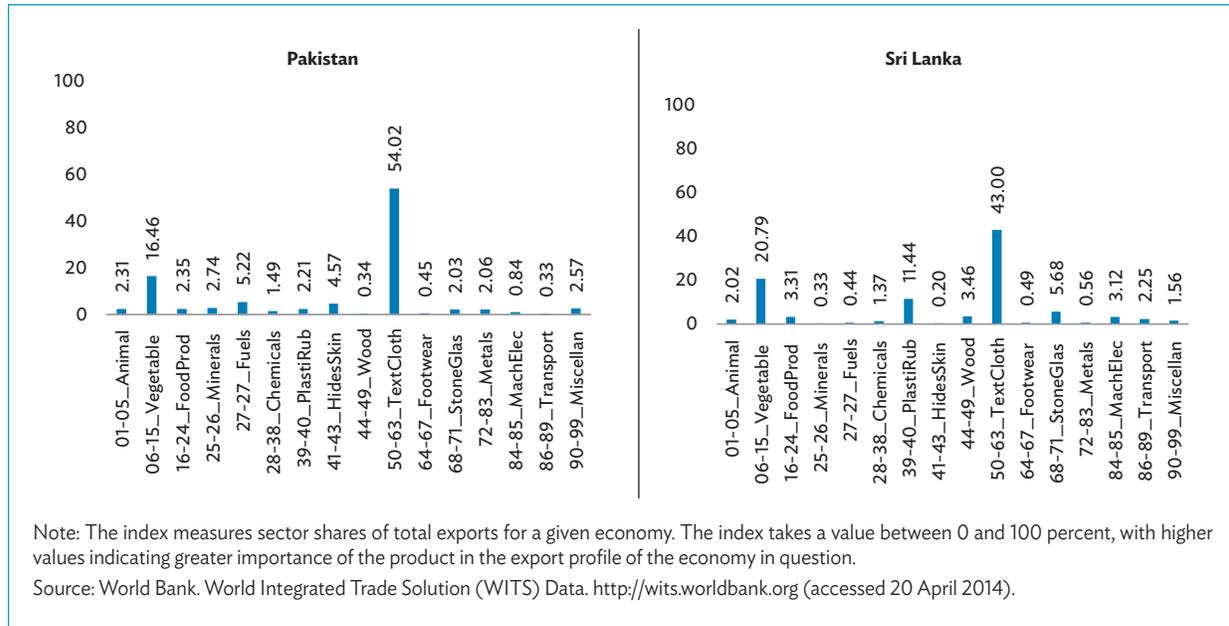
Figure 2.7: Share of Major Export Categories in Total Exports, 2011

(%)



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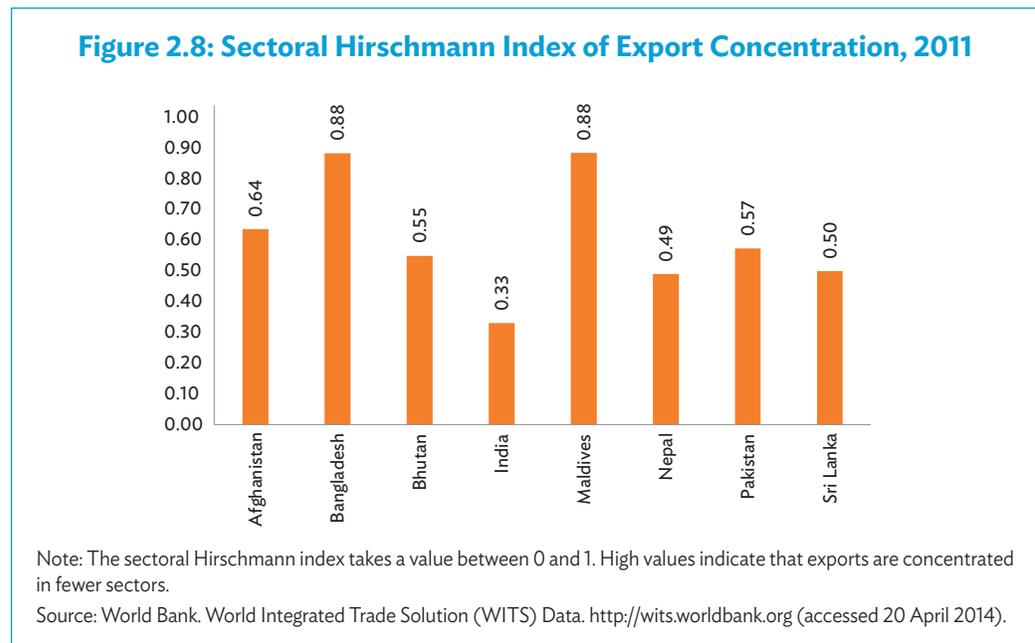
Figure 2.7 continued



### Sectoral Hirschmann Index for Export Concentration

The sectoral Hirschmann index measures the sectoral concentration of a region’s exports. It indicates the degree to which a region’s or country’s exports are dispersed across different economic activities. High concentration levels are sometimes interpreted as an indication of vulnerability to economic changes in the key product markets (Mikic and Gilbert 2007).

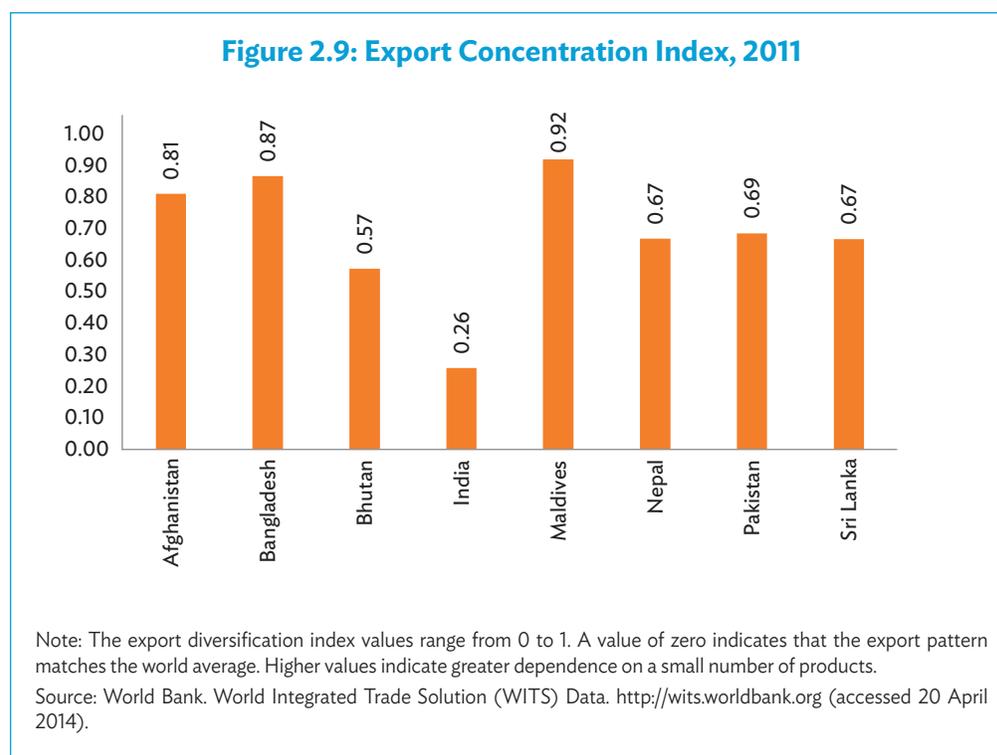
The sectoral Hirschmann index results in Figure 2.8 for 2011 provide comparisons of the degree of export diversification among SAARC countries. India is shown as relatively diversified while Afghanistan, Bangladesh, the Maldives, and Pakistan are indicated as relatively little export diversification.



### Export Concentration Index

The export concentration index is another measure of sectoral concentration, indicating the degree to which a region or country's exports are dispersed across different economic activities. Unlike the Hirschmann index, it normalizes the export diversification pattern by comparing it to the world average (Mikic and Gilbert 2007).

Figure 2.9 indicates that the export pattern of India matches closely with the world average. High dispersal values of other SAARC countries (especially for the Maldives, Bangladesh, and Afghanistan) indicate greater dependence on a small number of products.

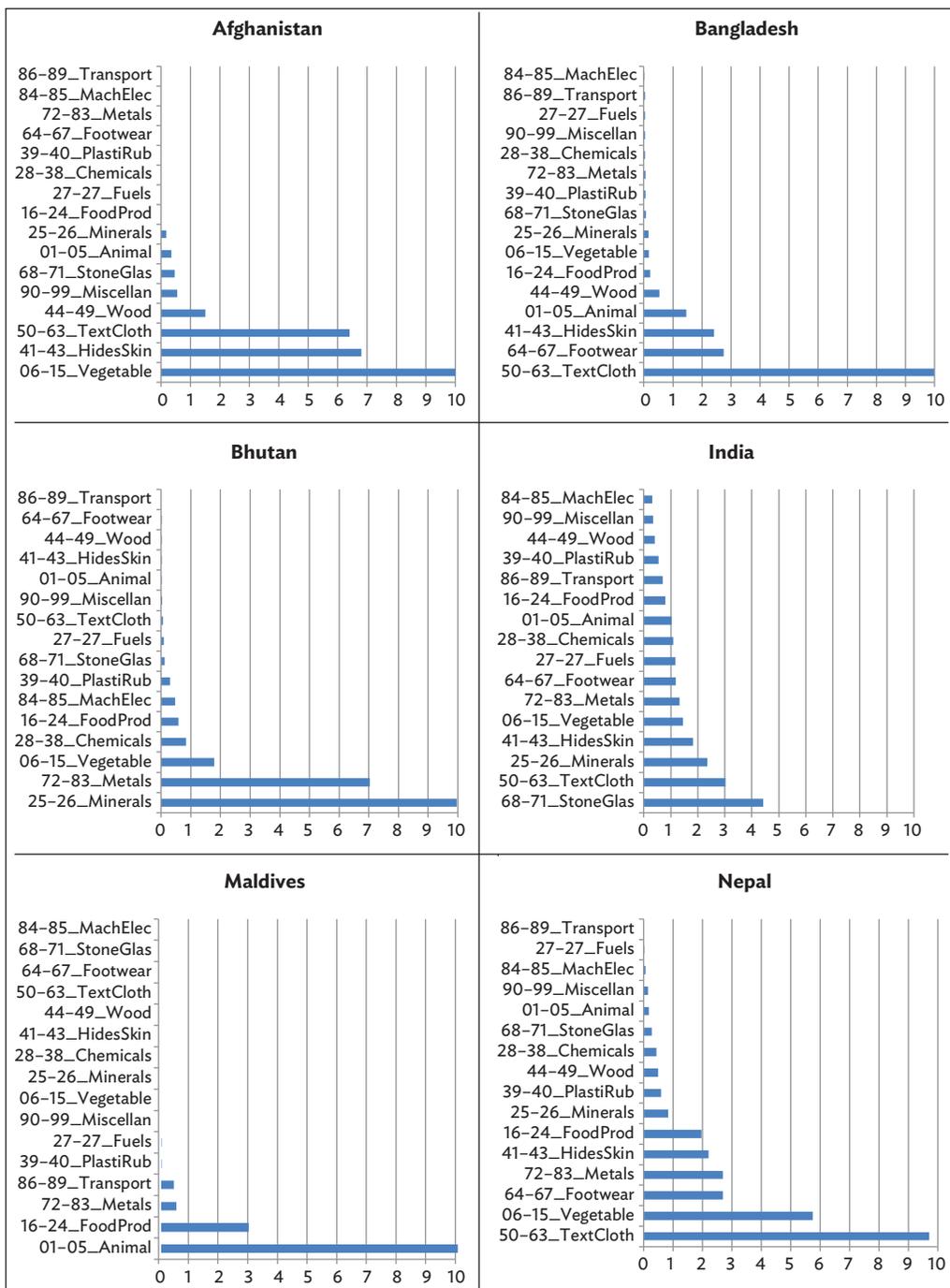


### Revealed Comparative Advantage

Comparative advantage underlies economists' explanations for the observed pattern of inter-industry trade. By comparing a country's trade profile to world averages, revealed comparative advantage (RCA) help identify sectors of comparative advantage (Mikic and Gilbert 2007).

In Figure 2.10 and Figure 2.11, Afghanistan, Bangladesh, Nepal, Pakistan, and Sri Lanka have a high revealed comparative advantage in textile and clothing; India in fuel products; and the Maldives in animal products. Except for Bangladesh and the Maldives, all other SAARC countries have revealed comparative advantages in food products. Bhutan's revealed comparative advantage in mineral products is higher than that of India and Pakistan.

**Figure 2.10: Revealed Comparative Advantage of SAARC Countries, 2010**



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Figure 2.10 continued

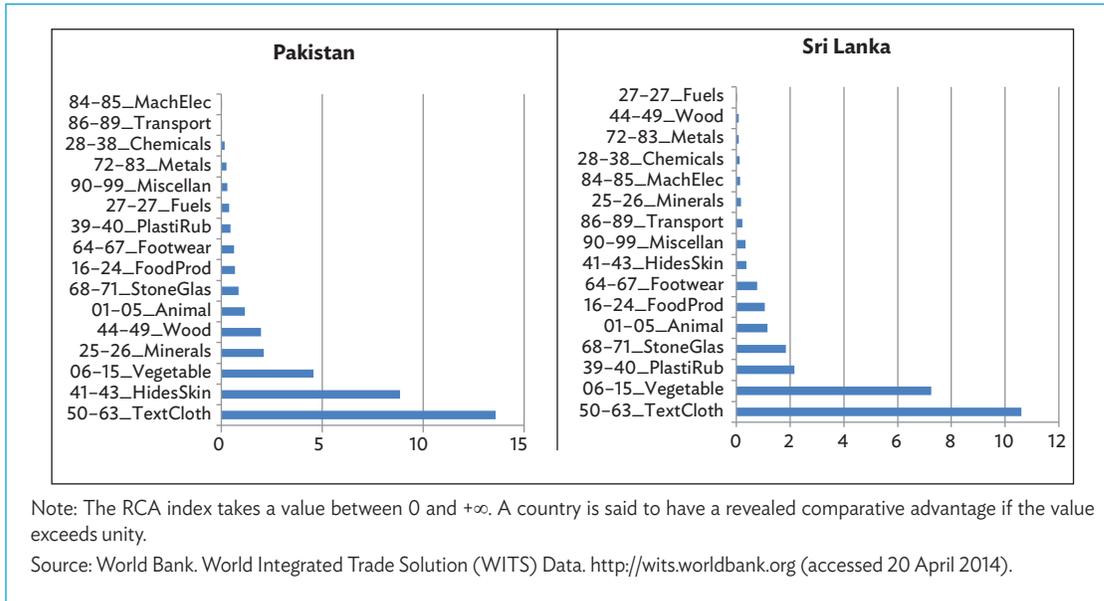
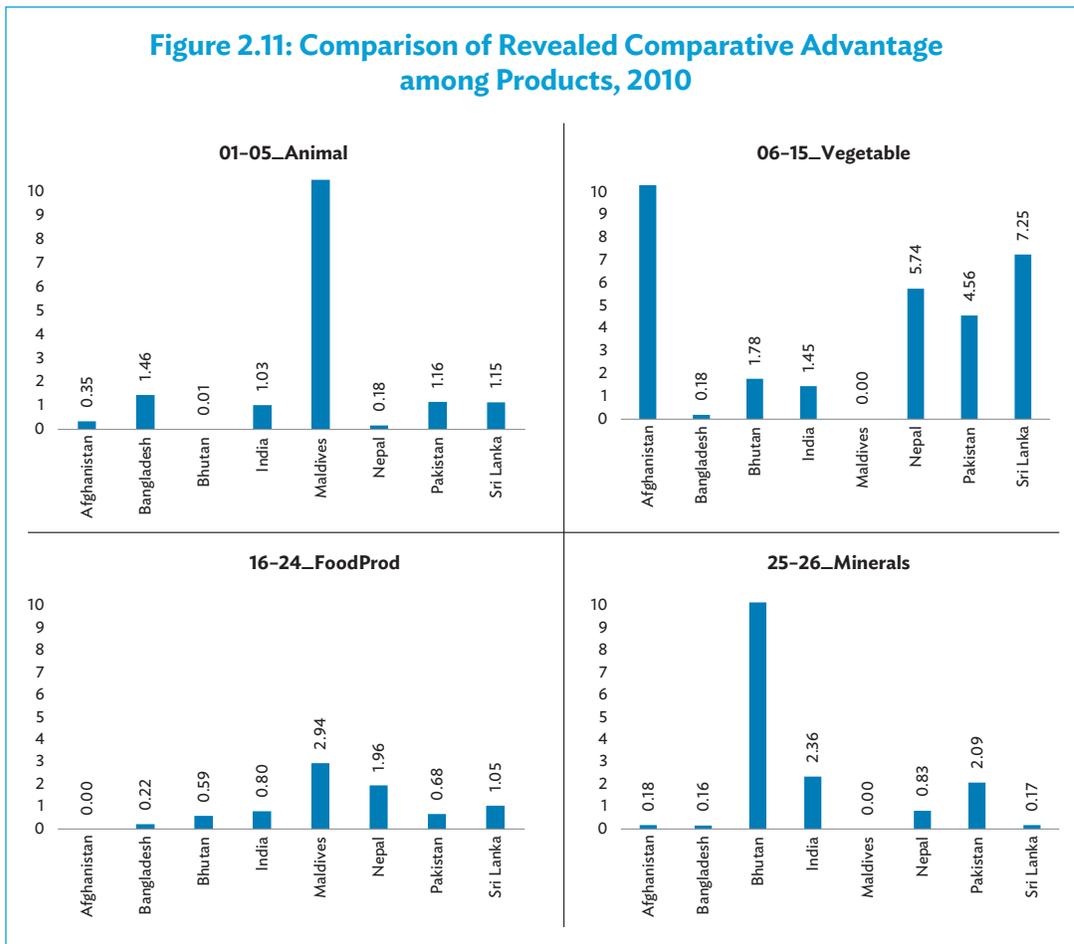
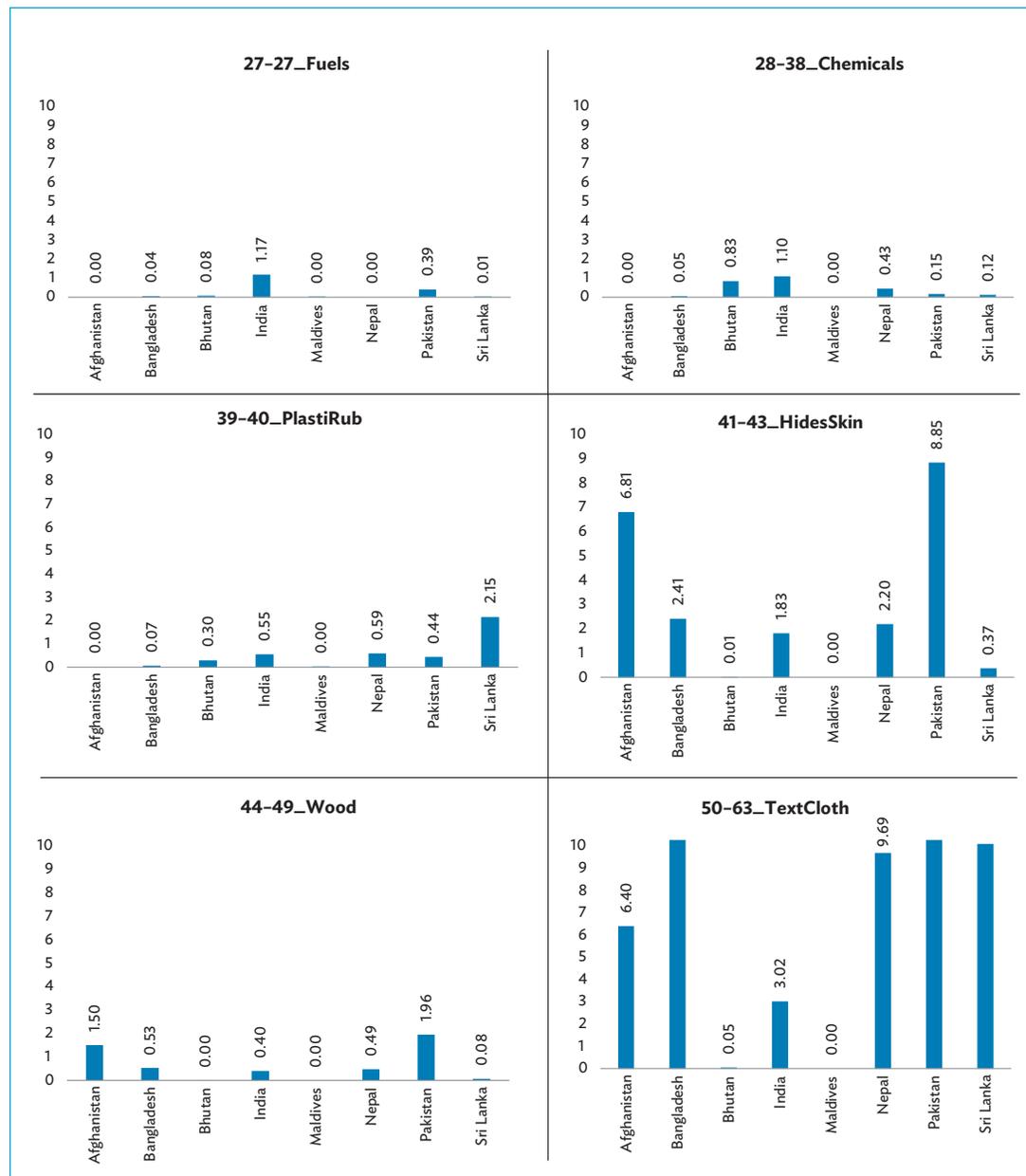


Figure 2.11: Comparison of Revealed Comparative Advantage among Products, 2010



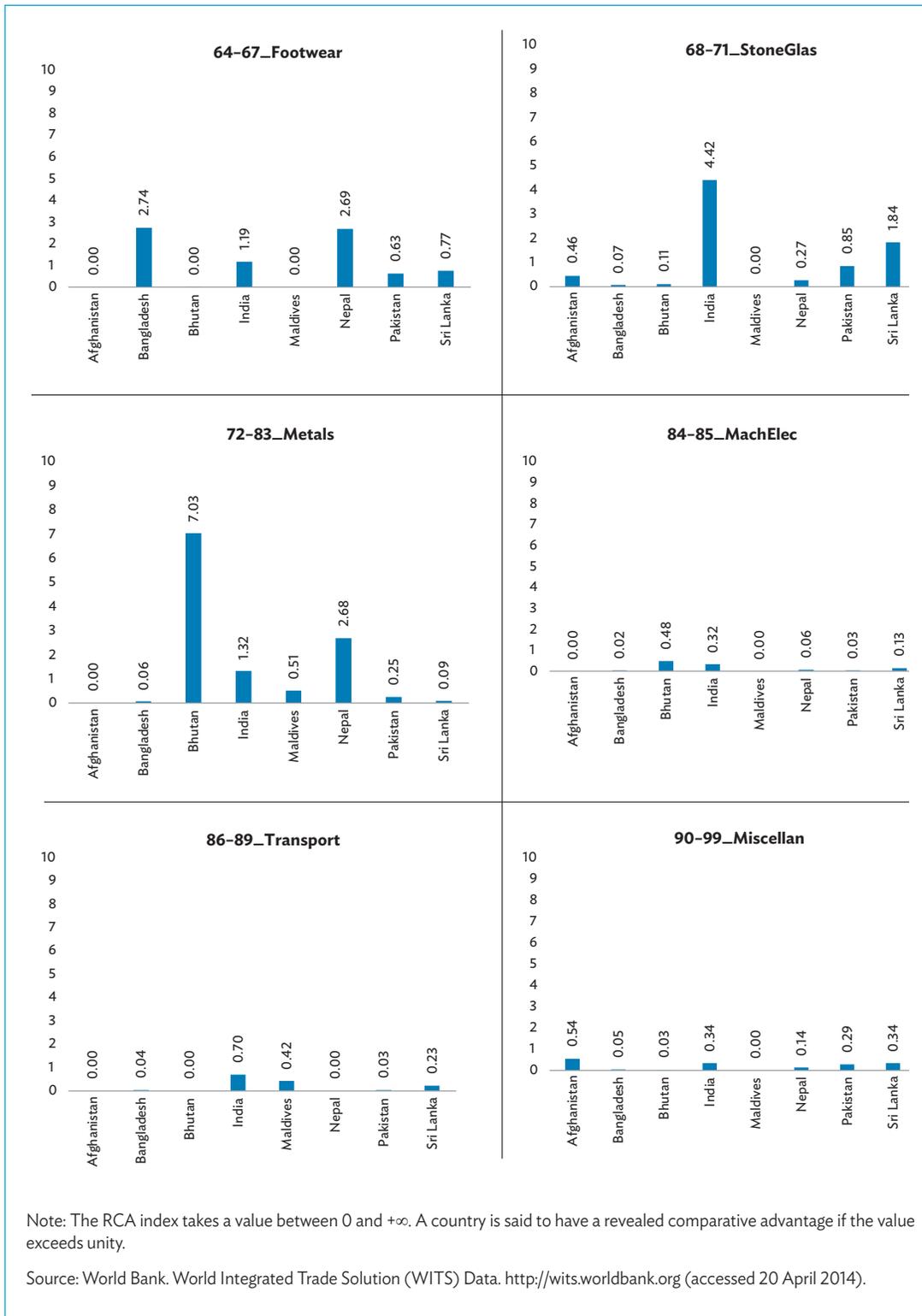
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Figure 2.11 continued



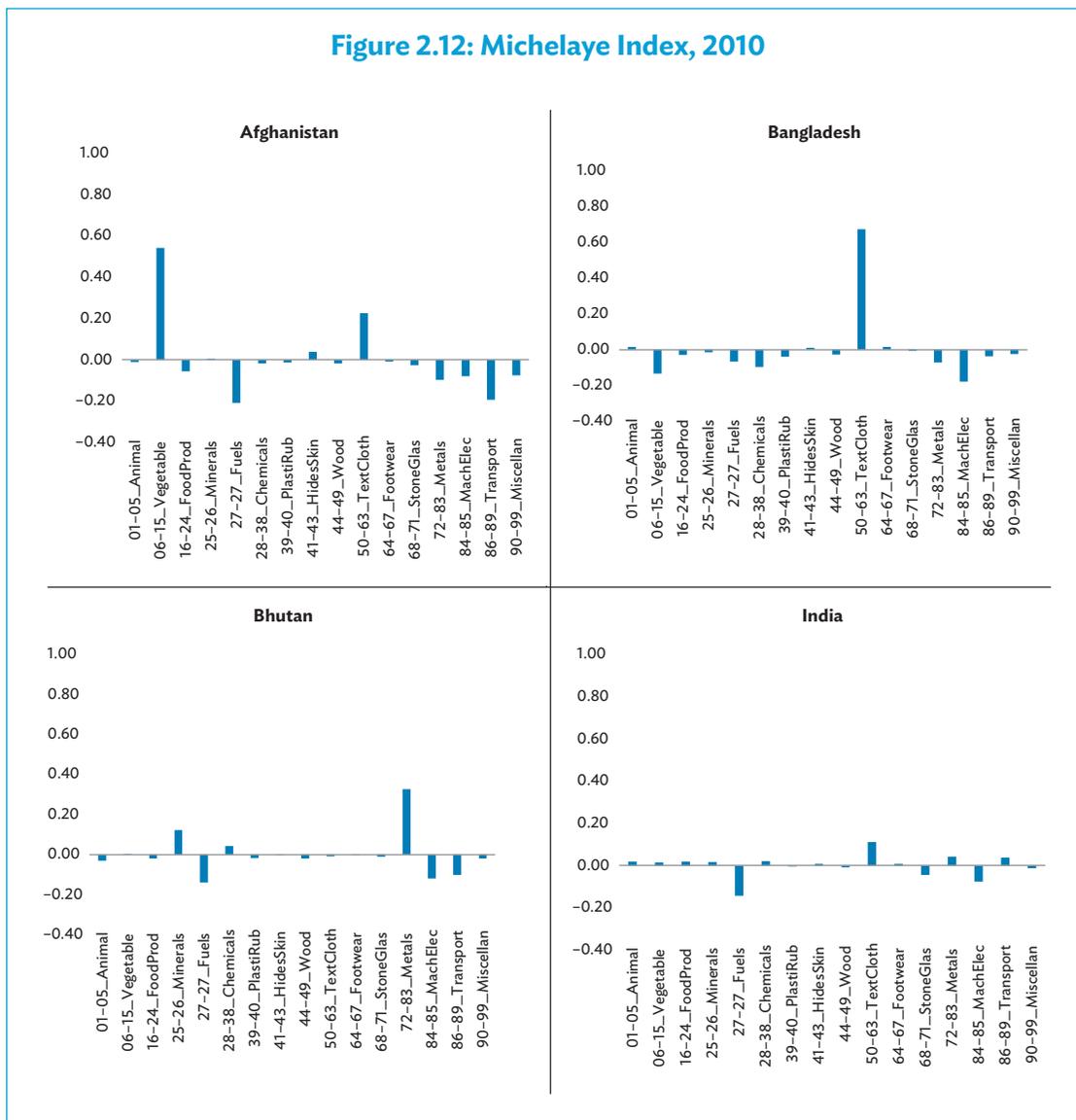
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Figure 2.11 continued



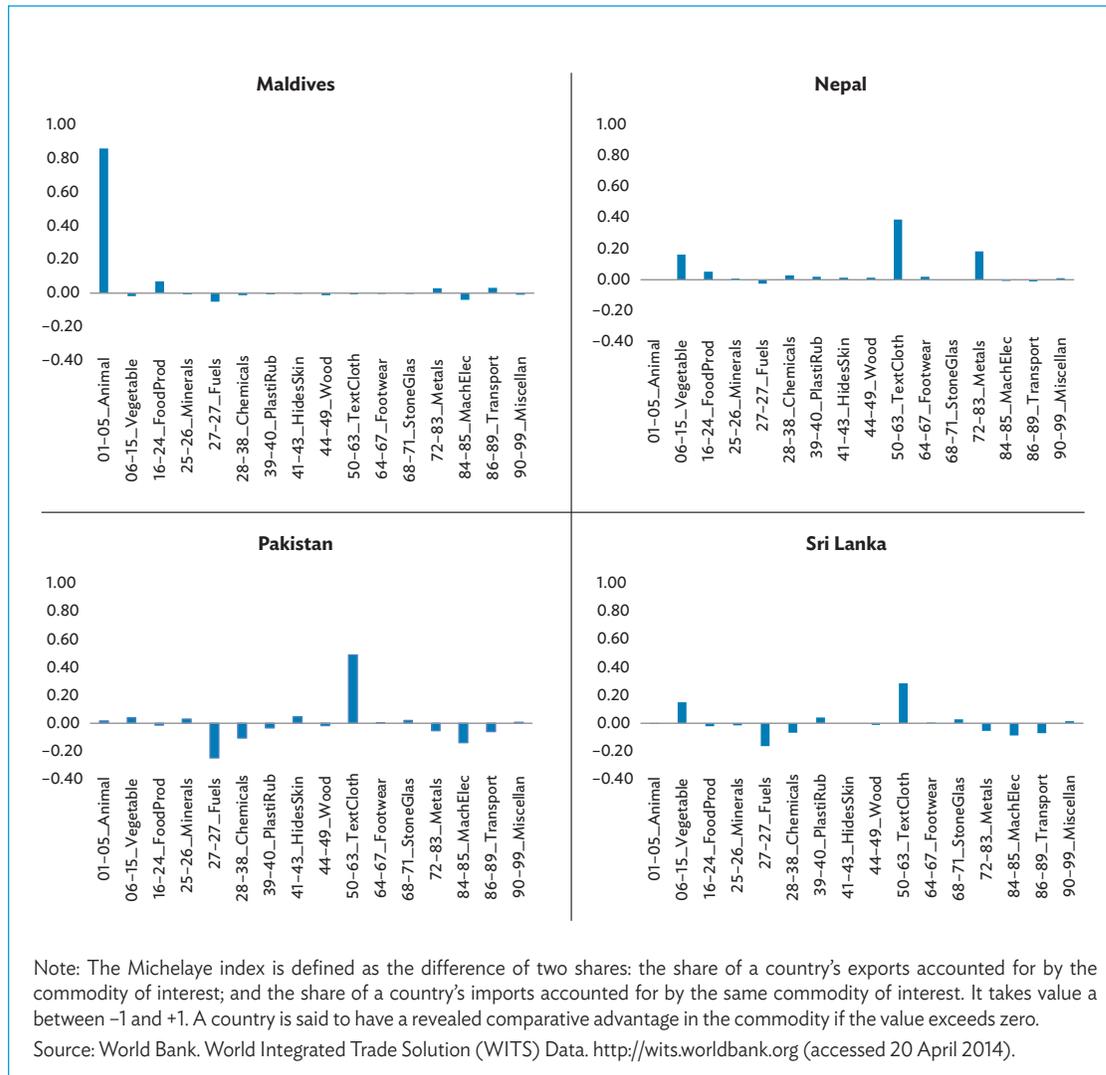
### Michelaye Index

The Michelaye index is also used to identify sectors in which an economy has a comparative advantage (Mikic and Gilbert 2007). Figure 2.12 indicates that Bangladesh, Bhutan, India, Nepal, Pakistan, and Sri Lanka had revealed comparative advantage in 2010 in the textile and clothing industry. Similarly, Afghanistan had a revealed comparative advantage in vegetables, Bhutan in the metal industry, and the Maldives in animal products.



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Figure 2.12 continued

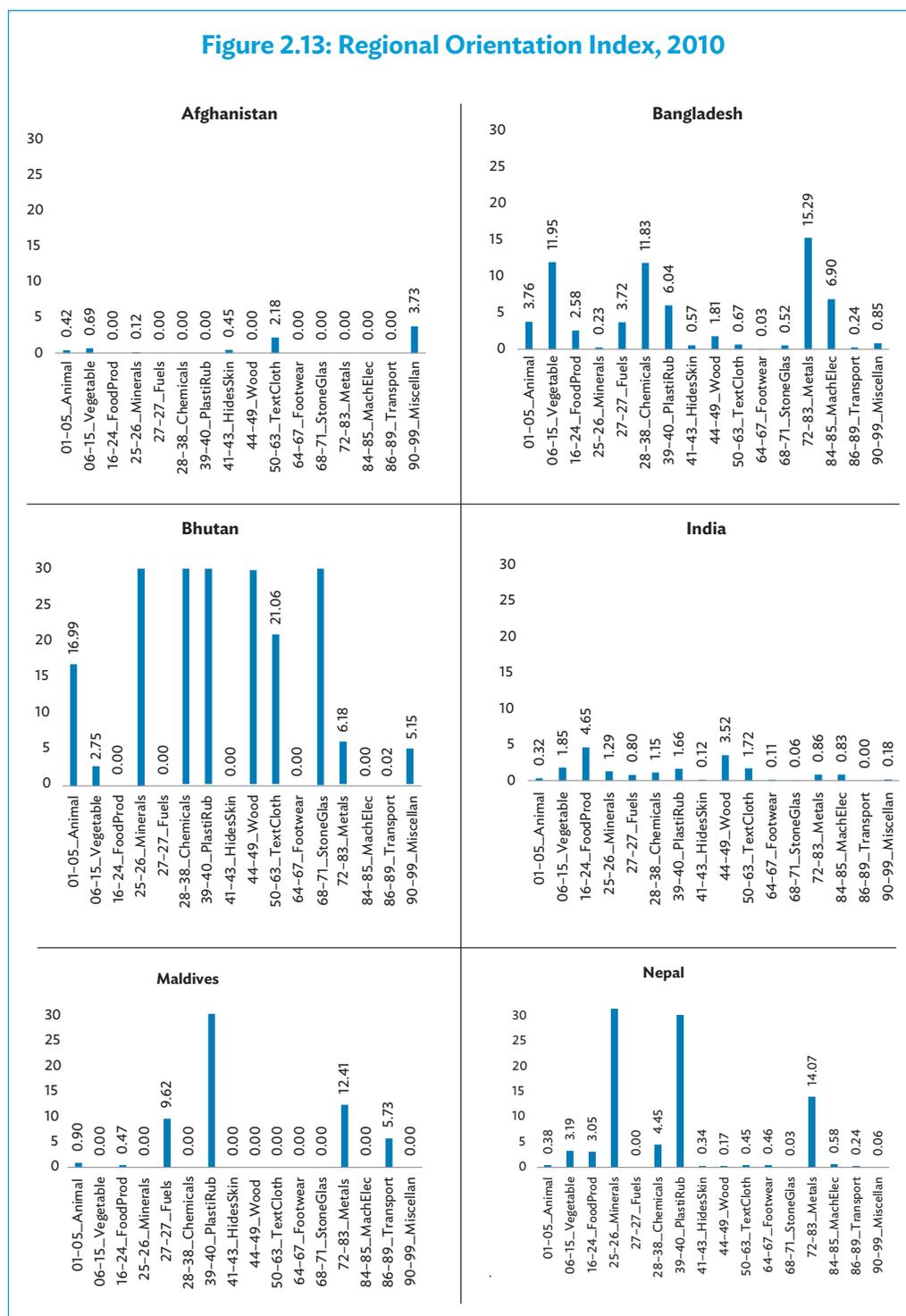


### Regional Orientation Index

The regional orientation index indicates whether exports of a particular product from the region under study to a given destination are greater than exports of the same product to other destinations (Mikic and Gilbert, 2007). For purposes of this study, it measures the importance of intraregional exports relative to extra-regional exports.

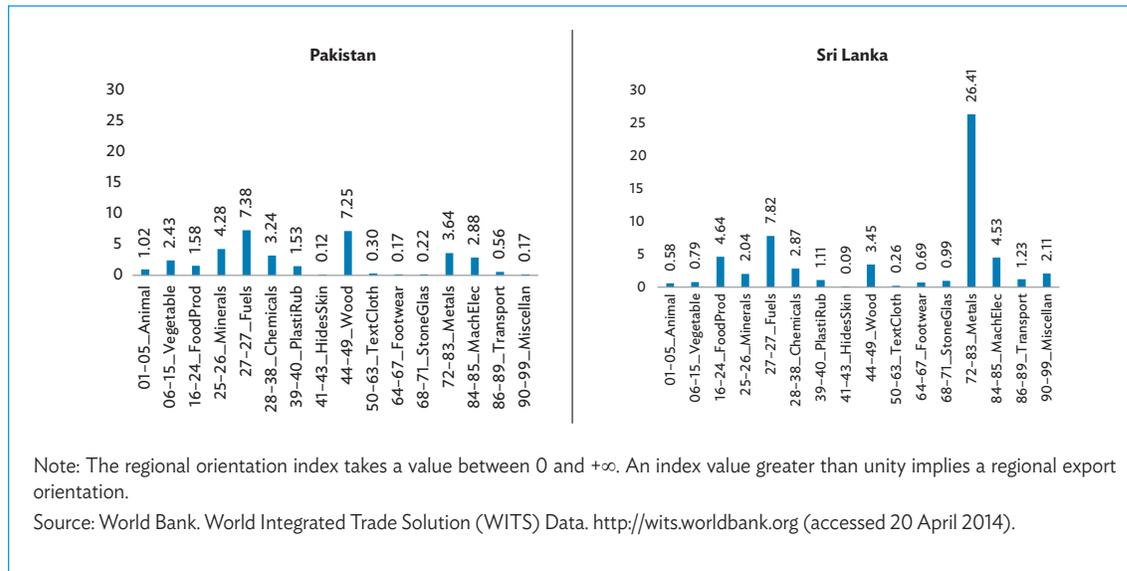
Figure 2.13 shows the regional orientation of SAARC exports in 2010. An index value greater than unity implies a regional bias in exports. The index results show that Bangladesh, Bhutan, Pakistan, and Sri Lanka have a strong regional orientation for several of their export products, especially relative to that of Afghanistan, India, the Maldives, and Nepal. The data also show that Bangladesh, Bhutan, the Maldives, and Nepal have a strong regional orientation for their exports of plastic and rubber products; and India, Pakistan, and Sri Lanka for food products, wood products and metals respectively.

Figure 2.13: Regional Orientation Index, 2010



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Figure 2.13 continued



## Complementarity Index

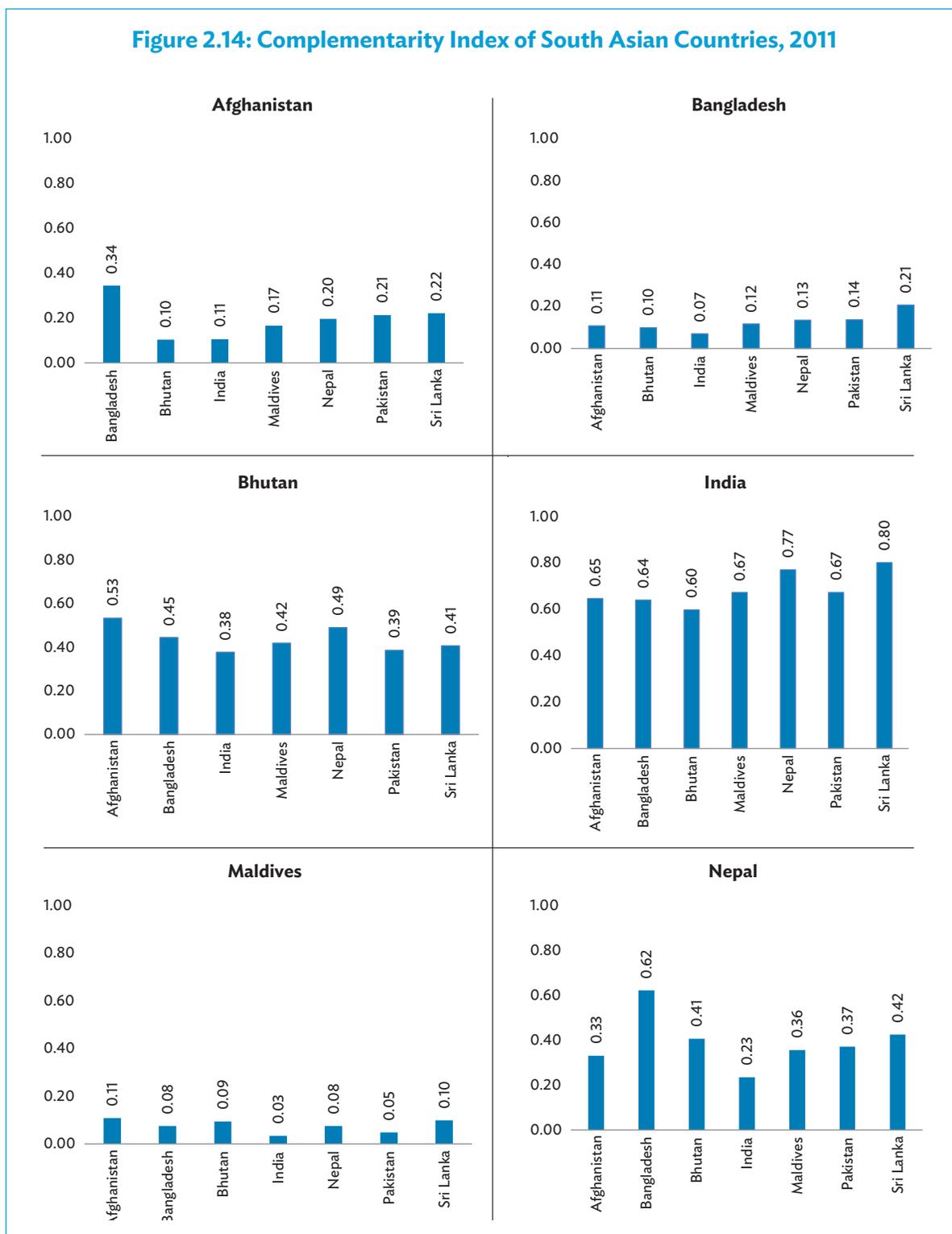
The complementarity index is a form of overlap index. It measures the degree to which the export pattern of one country matches the import pattern of another. A high degree of complementarity is assumed to indicate more favorable prospects for a successful trade arrangement (Mikic and Gilbert 2007).

Figure 2.14 presents the complementarity index results for 2011 among SAARC economies. The exports of India are quite complementary with the imports of other SAARC economies, but the converse is not true. India's highest complementarity index value is 0.80 for Sri Lanka and the lowest is 0.60 for Bhutan. In contrast, the Maldives' export pattern is not complementary with other SAARC countries, as the index shows the highest value of only 0.11 with Afghanistan and the lowest value of 0.03 with India.

Afghanistan's export complementary index was 0.34 with Bangladesh, high relative to the index with other SAARC countries. Bangladesh's export pattern is relatively complementary with Sri Lanka (0.21), but not so with India (0.07). Bhutan's complementarity index with other SAARC countries varies between 0.39 and 0.53.

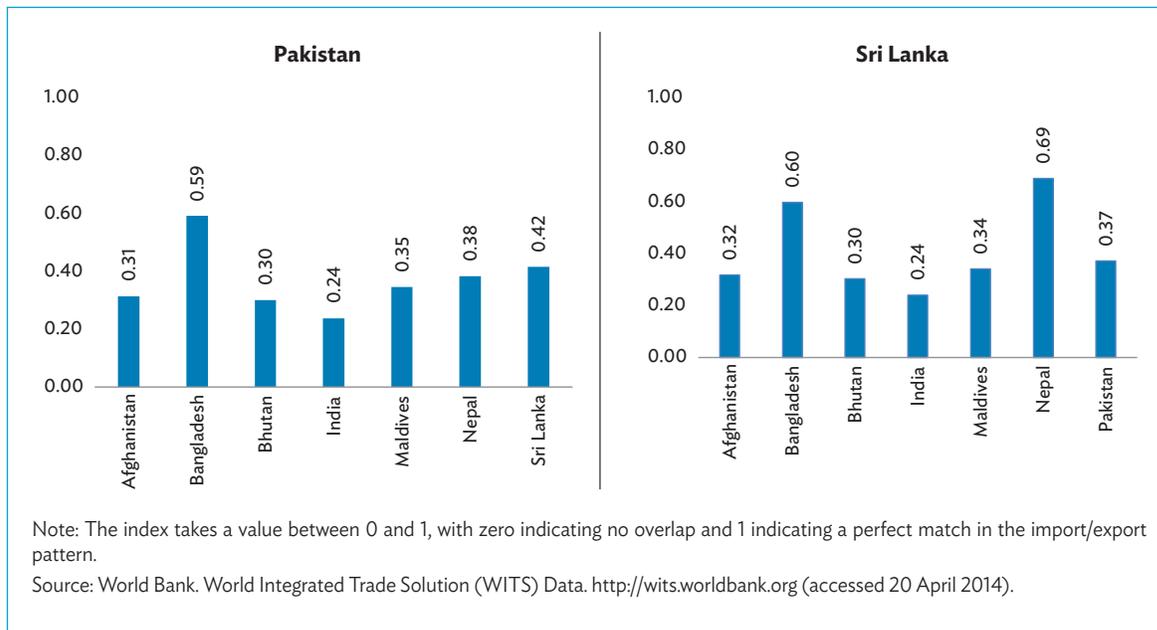
Nepal's complementarity index is highest with Bangladesh (0.62) and lowest with India (0.23). Pakistan's export pattern is highly complementary (0.59) to Bangladesh's import pattern but less than half this value for its exports to India (0.24). Sri Lankan data indicate that its export pattern matches well with the import pattern of Nepal (0.69) and that of Bangladesh (0.60) but much less so with India's import pattern (0.24).

Figure 2.14: Complementarity Index of South Asian Countries, 2011



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Figure 2.13 continued



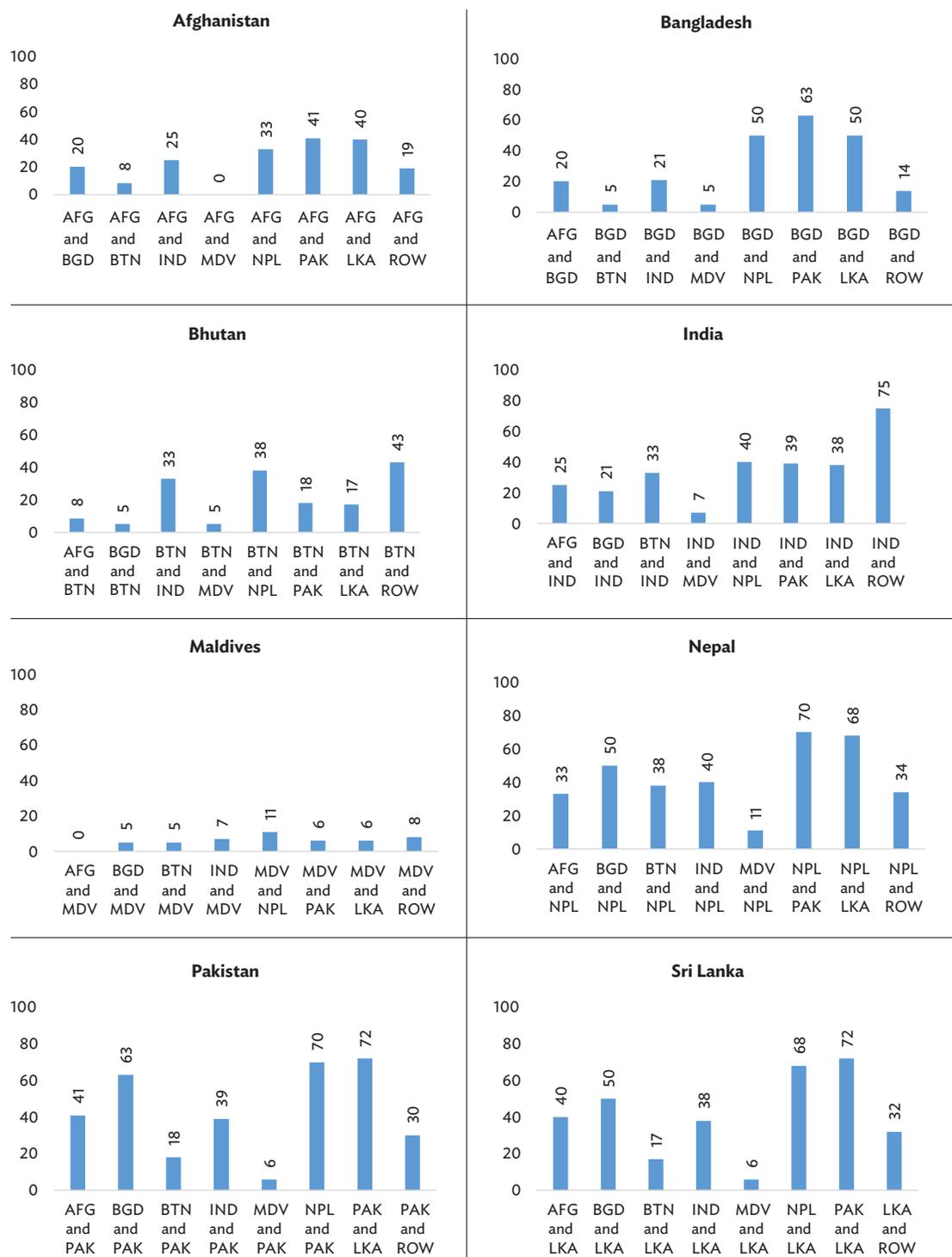
### Export Similarity Index

The export similarity index is another overlap index. It is designed to measure the degree of similarity between the export profiles of two economies. The more similar the export profiles, the more likely that the economies are competitors in global markets. High similarity indices may also indicate limited potential for inter-industry trade within a regional trading arrangement (Mikic and Gilbert 2007).

Figure 2.15 shows that the export patterns of India, Nepal, Pakistan, and Sri Lanka in 2011 had similarities with other SAARC countries. In contrast, Afghanistan, Bangladesh, Bhutan, and the Maldives' had export profiles that were less similar to those of other SAARC countries. India's export pattern is reasonably similar to that of rest of the world, along with Nepal, Pakistan, and Sri Lanka.

The data in Figure 2.15 indicate that the Maldives' export pattern is not comparable to that of other SAARC countries. In contrast, Nepal's export pattern is comparable to that of Pakistan, Sri Lanka, Bangladesh, and India. Pakistan's export pattern is similar to that of Sri Lanka, Nepal, Bangladesh and Afghanistan. Finally, Sri Lanka's export pattern is mostly comparable to the export pattern of Pakistan, Nepal and Bangladesh.

Figure 2.15: Export Similarity Index, 2011



AFG = Afghanistan, BGD = Bangladesh, BTN = Bhutan, IND = India, LKA = Sri Lanka, MDV = Maldives, NPL = Nepal, PAK = Pakistan, ROW = rest of world.

Note: The export similarity index takes a value between 0% and 100%. A value of 0% indicates no overlap in the export profiles (the countries are not competitors), a value of 100% indicates perfect overlap.

Source: World Bank. World Integrated Trade Solution (WITS) Data. <http://wits.worldbank.org> (accessed 20 April 2014).

### Sectoral Intra-Industry Trade

The sectoral intra-industry trade (IIT) is a measure of the degree to which trade in a particular sector represents intra-industry trade (based on scale economies and/or market structure). By engaging in IIT, a country can reduce the number of similar goods it produces, and benefit from scale economies. High IIT ratios suggest that these sources of gains are being exploited (Mikic and Gilbert 2007).

Figure 2.16 depicts the sectoral intra-industry trade index for selected product categories in SAARC countries. In general, IIT index levels are higher for manufactured products than for primary products in Bangladesh, Bhutan, India, Nepal, and Sri Lanka; this reflects the greater role of economies of scale in the production of those products. For Afghanistan, the Maldives, and Pakistan, trade is more primary-product oriented.

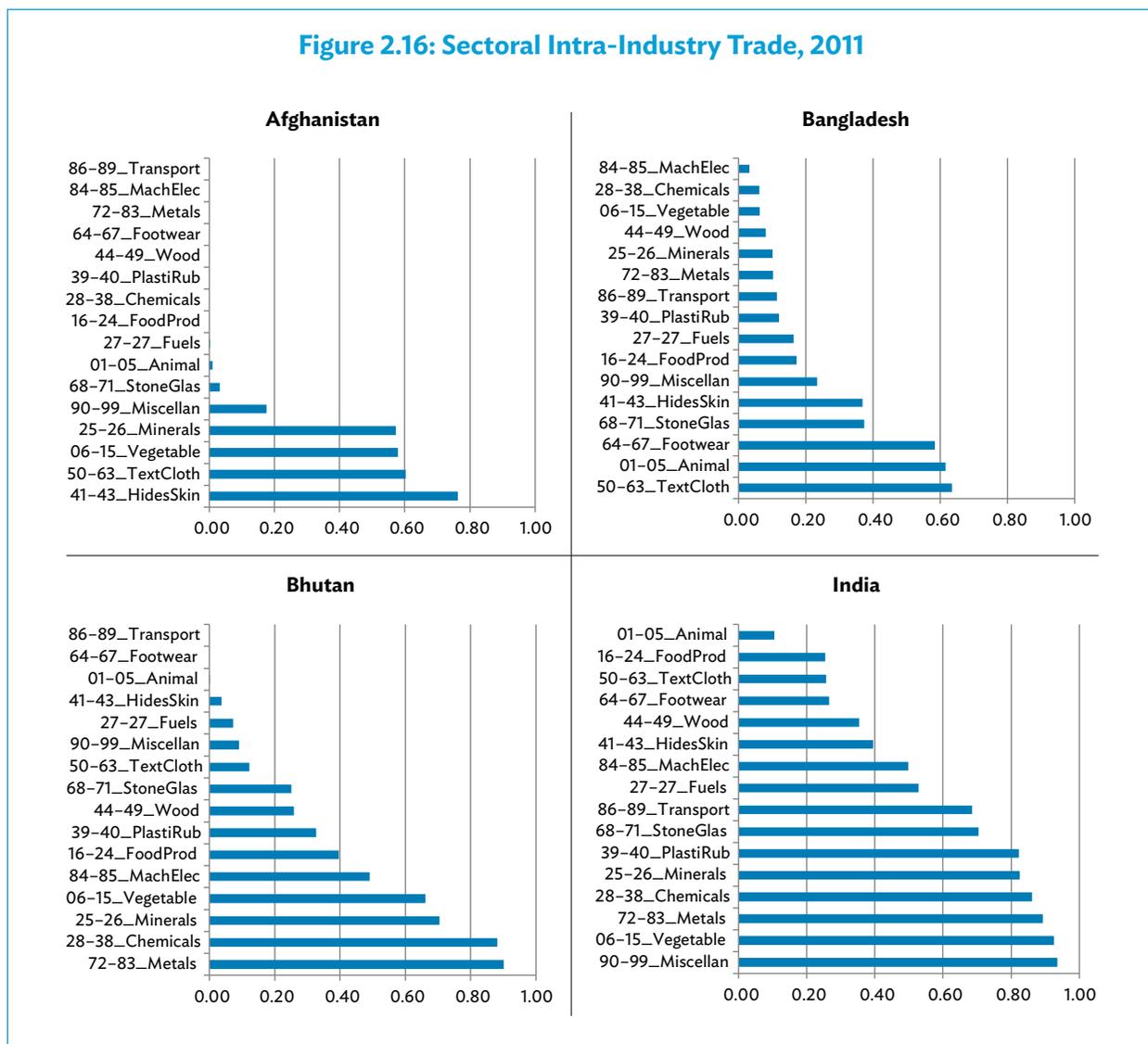
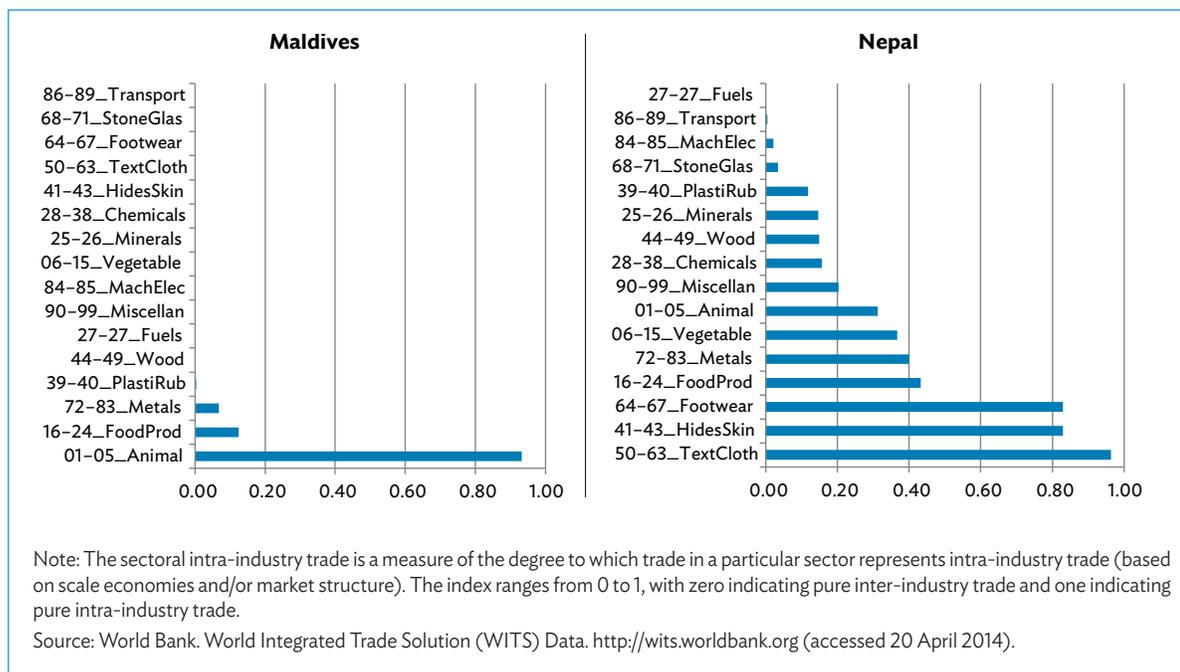
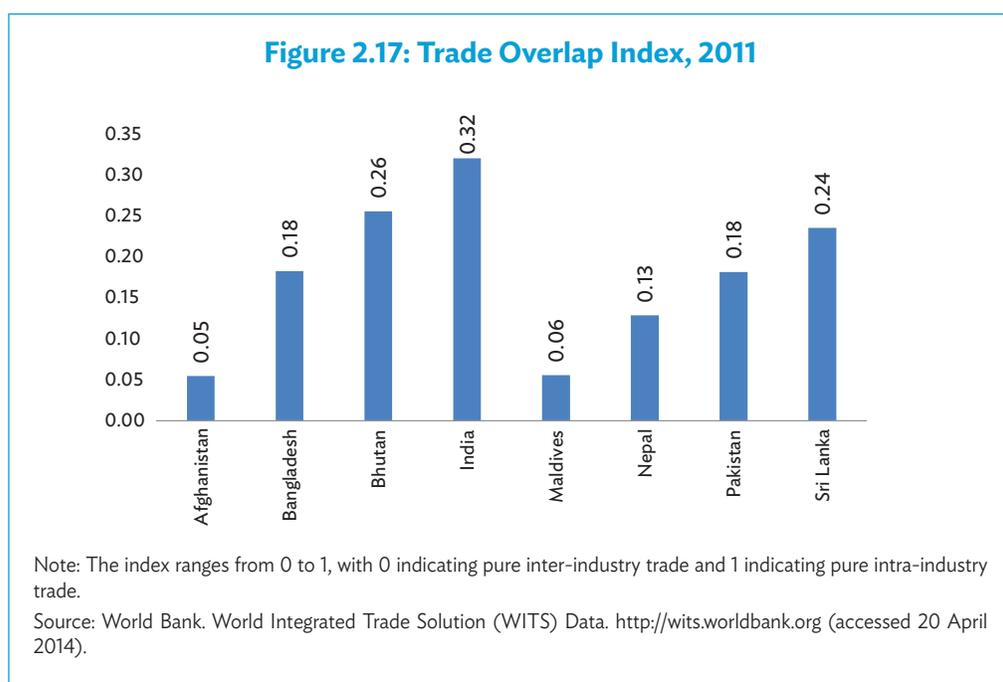


Figure 2.16 continued



### Trade Overlap Index

The trade overlap index is an alternative to the aggregate IIT index. It indicates the overall significance of intra-industry trade relative to inter-industry trade. Figure 2.17 shows that in 2011, intra-industry trade was comparatively significant for India, Bhutan, and Sri Lanka, while Afghanistan, and Maldives' trade pattern was more orientated to inter-industry trade (Mikic and Gilbert 2007).



## Tariff Protection in South Asia

This section describes the level of tariff rates in the South Asian markets using the (simple) average tariff and weighted average tariff. The *(simple) average tariff* is a measure of the overall degree of protection in the tariff schedule. It is a useful overall measure but can disguise very high protection levels in some sectors. The *weighted average tariff* takes into account the importance of each product in the import profile of the economy in question by using the import share to weight the components of the tariff average. In contrast to the simple average tariff, it tends to understate the level of protection because highly protected sectors have a low weight (since the high protection level restricts the volume of imports in that sector).

### Average Tariff Rate

As shown in Table 2.6, in South Asia, the simple average tariff is highest for Bhutan (21.9%) and lowest for Afghanistan (5.9%). In the case of weighted average tariff, the Maldives has the highest rate (20.4%) and Sri Lanka has the lowest (6.6%).

**Table 2.6: Aggregate Simple Average Tariff and Weighted Average Tariff in SAARC Countries (%)**

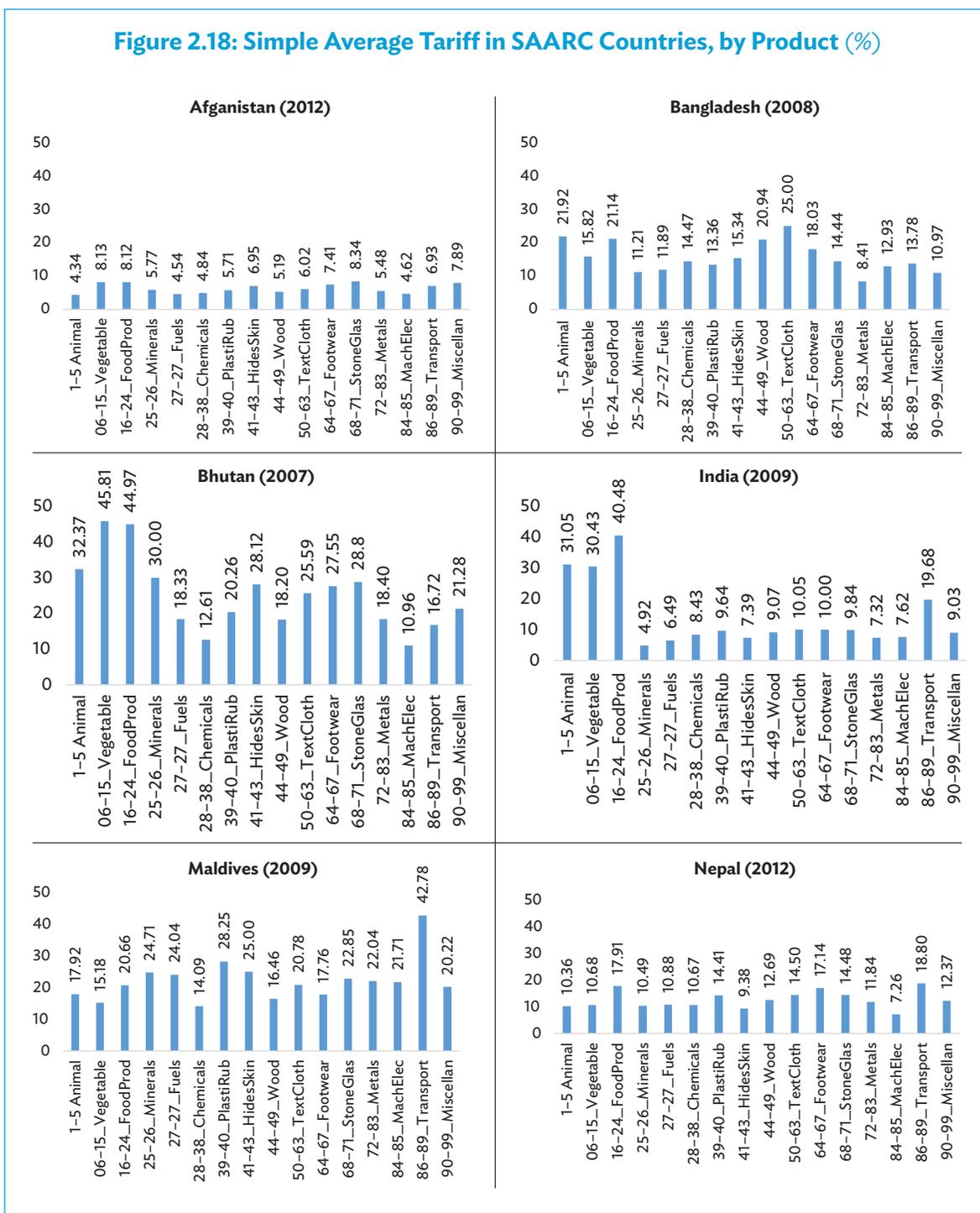
Country	Simple average	Weighted average
Afghanistan (2012)	5.9	7.0
Bangladesh (2008)	14.8	13.1
Bhutan (2007)	21.9	16.5
India (2009)	12.4	7.7
Maldives (2009)	20.4	20.4
Nepal (2012)	11.9	11.6
Pakistan (2009)	13.9	9.6
Sri Lanka (2012)	9.4	6.6

Note: Simple average tariff is the average value of tariffs in a country or region's full tariff schedule, or a part of the schedule. The simple average tariff and the weighted average tariff are defined as a percentage, so the average can range from 0 to  $+\infty$  (import ban).

Source: World Bank. World Integrated Trade Solution (WITS) Data. <http://wits.worldbank.org> (accessed 20 April 2014).

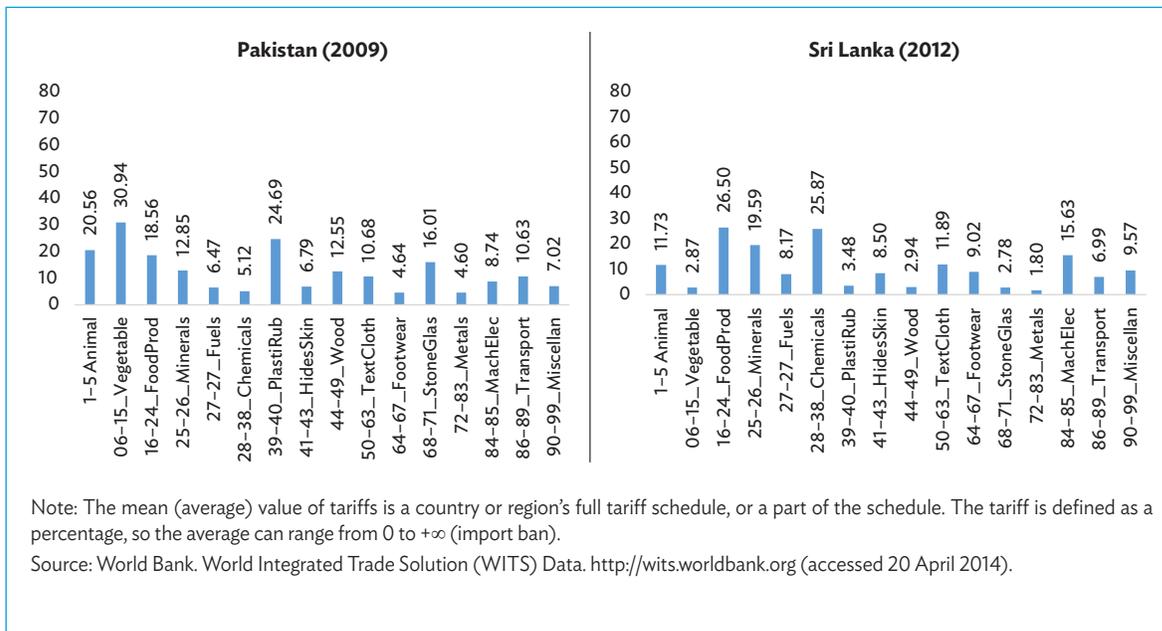
As shown in Figure 2.18, Afghanistan appears to apply less protection for its economy since tariff rates are below 10% for all products imported from the region. Data for Bangladesh, Bhutan, and the Maldives indicate highly protective economies. India applies high tariffs for selected categories: food products, vegetable, animal, and transport, compared to other product categories. Nepal's lowest average tariff (7.26%) is for mechanical and electronic products, whereas its highest average tariff (18.80%) is for transport products. For Pakistan and Sri Lanka, their lowest average tariff is for fuels (5.4) and highest average tariff is for food products (29.6).

**Figure 2.18: Simple Average Tariff in SAARC Countries, by Product (%)**



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Figure 2.18 continued



### Weighted Average Tariff

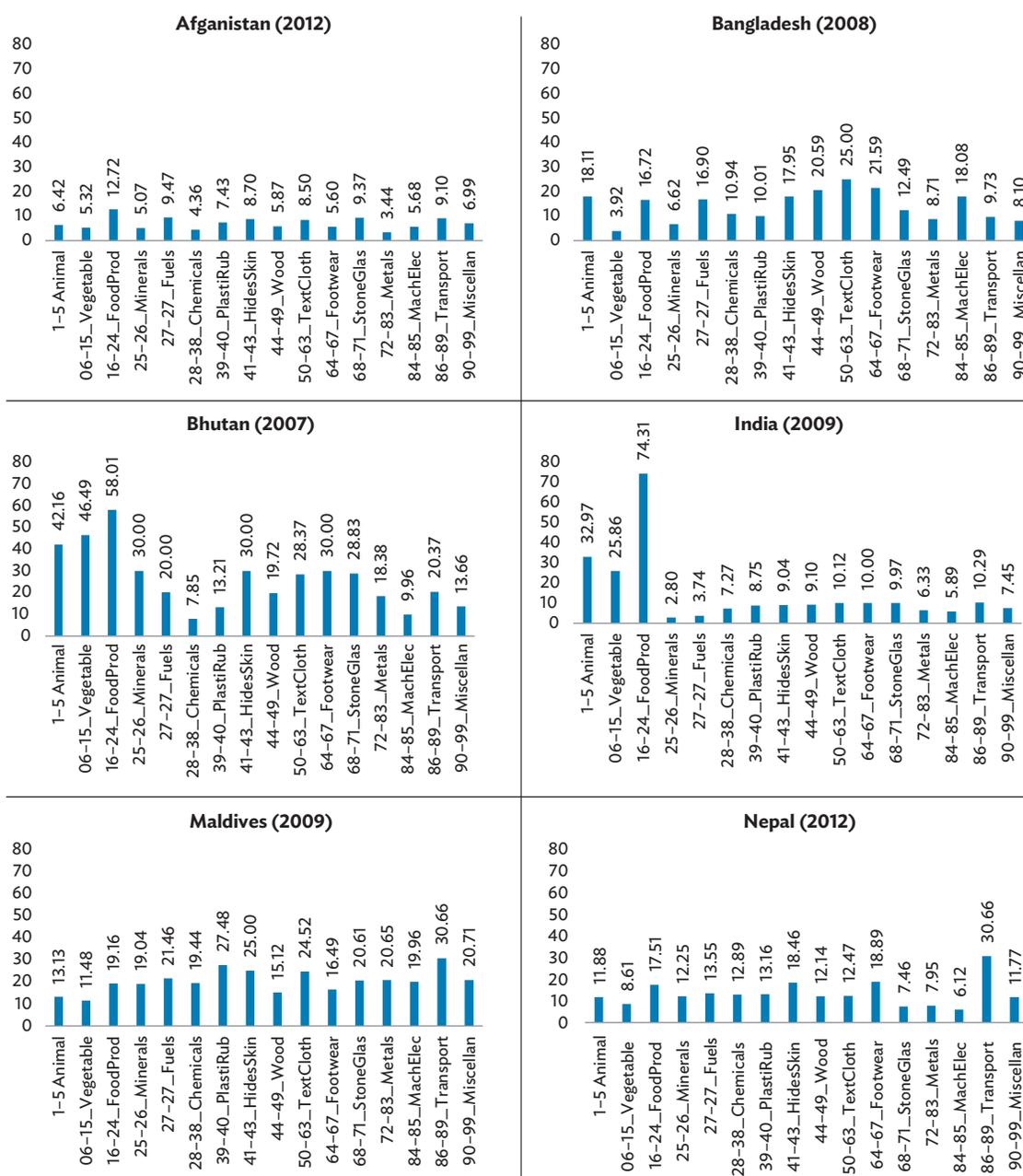
As shown in Figure 2.19, the weighted average tariff data for India indicate its highest tariff rates are for food products (more than 74%) and animal products (33%). For Afghanistan, the weighted average tariff rates are below 10% for most of the categories, except for food products, reflecting that Afghanistan is a relatively open economy. In contrast, Nepal's weighted average tariff rates are all above 10% except for metals, machines, stone, and vegetable goods.

Bangladesh's weighted average tariffs are very high, although less so for vegetables, minerals, metals, and transport products. Similarly, Bhutan's weighted average tariffs are quite high for all categories except for chemical products. In contrast, India's weighted average tariffs are relatively low for most products - but for food products, animals, and vegetables. The Maldives weighted average tariffs are higher than 10% for all products.

Pakistan's weighted average tariffs are moderately high for vegetables, plastic and rubber, and animal products. Finally, Sri Lanka's weighted average tariffs are below 5% for metals, stone, vegetables, wood, and plastic products.

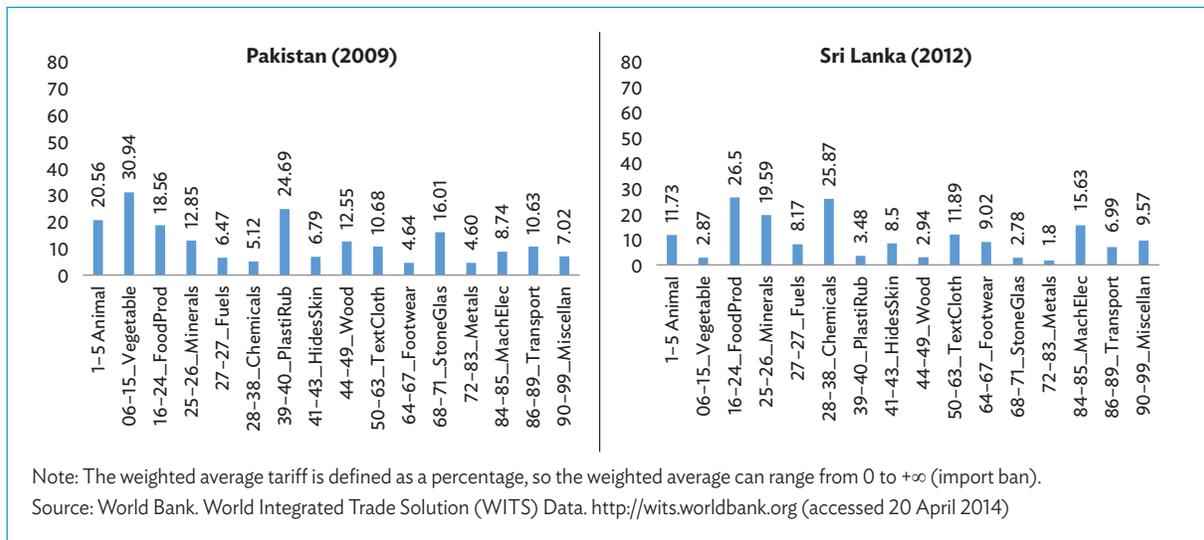
High tariff rates among SAARC countries have long been identified as one of the major reasons behind the low level of intraregional trade. South Asia has highest average tariff rates than in any other region the world. Reduction in the tariff barriers could have important implications in terms of improved market access among SAARC countries. However, this is yet to be seen. (Raihan, Khan, and Quoreshi, 2014).

Figure 2.19: Weighted Average Tariff in SAARC Countries, by Product (%)



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Figure 2.19 continued



## Intraregional Trade: Comparison with Other Regions

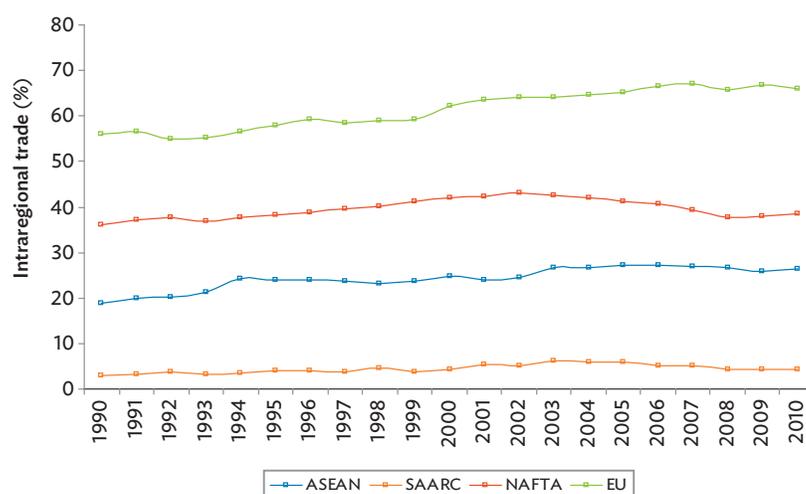
With the impact of globalization and growing concerns about competitiveness, SAARC countries are gradually realizing the importance of regional cooperation and economic integration. The concepts and necessities of economic integration, regional cooperation, global competition, and open markets are actively being considered, planned, and influenced by the respective policymakers, consumers, business communities, and development partners.

Regional integration in South Asia gained momentum in 1995 when the SAARC Preferential Trading Arrangement (SAPTA) was signed. In early 2004, the SAARC member countries agreed to form a South Asian Free Trade Area (SAFTA), which has become a parallel initiative to the multilateral trade liberalization commitments of the SAARC member countries. SAFTA has been gradually implemented since July 2006, with the aim of boosting intraregional trade among the SAARC member countries.

There have been strong arguments for regional economic integration in South Asia, as integration is expected to generate significant intraregional trade and welfare gains for SAARC member countries. Policy makers and business communities in these countries have referred to the positive impacts of SAFTA. It is expected that the SAFTA mechanism, when fully implemented, will provide the member countries improved market access in the region, help boost their exports to the region, and improve intraregional trade. SAFTA is expected to enhance the existing trade—the so-called static gains. The dynamic gains could be even, due to possible expansion in operations through access to the markets of the larger member countries.

Intraregional trade among the South Asian countries was in the double-digit range until 1951, but then began to decline. By 1967, as South Asia became more closed and the political difficulties between India and Pakistan intensified, intraregional trade fell to just 2% of the region's total trade. The share began to recover during the 1990s and by 2002 it had increased to 4.4% (Baysan et al., 2006). It reached a peak of 6.2% in 2004 and then declined to 4.8% in 2008. This decrease in intraregional trade intensity was due to South Asia's increasing trade with rest of the world. While South Asia's outward trade is a healthy sign, the distribution of intraregional trade is highly skewed in terms of countries participating. Further, compared to other regions such as NAFTA, ASEAN, and EU, intraregional trade in South Asia is abysmal (Figure 2.20).

**Figure 2.20: Intraregional Trade: SAARC vis-à-vis Other Regions**



Source: De, Raihan, and Kathuria (2012).

## Conclusions

This chapter has provided an overview of the trade and economic situation of SAARC member countries, using different trade indicators. The major observations are:

There is considerable variation in the degree of openness among the SAARC countries, with Bhutan much more dependent on trade (or open) than other SAARC economies. However, India and Bangladesh data indicate increasing import dependency during 2000–2012, while Nepal, Pakistan, and Sri Lanka have had quite stable levels of import penetration. Indices of export propensity from 2000 to 2012 show an increasing trend for Bangladesh, Bhutan, India, and Pakistan, indicating that the degree of reliance of domestic producers on foreign markets has been increasing. The reverse trend is evident for Nepal and Sri Lanka. The marginal propensity to import (MPM) with changes in incomes has

fallen since 2000 for most of the SAARC member countries, significantly so in the case of Nepal and Sri Lanka. In terms of the growth rate of exports, it was decreasing during the 2004–2007 period, particularly for Bangladesh, Bhutan, India and Pakistan. The global financial crisis of 2007 and 2008 also impacted export growth. Nonetheless, the region is dynamic, with average export growth rates during 2000–2010 of 11% for Bangladesh, 13.7% for India, and 5.4% for Pakistan. During 2000–2012, there were trade deficits for Bangladesh, Bhutan, India, Nepal, Pakistan, and Sri Lanka.

Regional exports as a percentage of a country's total exports in South Asia varied widely, ranging from a high of 82% for Bhutan to a low of 2% for Bangladesh. Regional imports as a percentage of a country's total imports also vary widely, from a high of 50% for Afghanistan, followed by Nepal (44%). India and Pakistan import very little from the region, accounting for only 1% and 5%, respectively, of their total imports.

Although India exports relatively little to other SAARC member countries, it nonetheless accounts for 65% of total intraregional export trade. Pakistan accounts for 21% of total intraregional export trade while Afghanistan and the Maldives each account for less than 1%. As noted earlier, Sri Lanka is the highest intraregional importer (24%) and Bangladesh the second highest (22%). Bhutan and Maldives account for only 1% of intraregional imports.

SAARC member countries have experienced increasing trade intensity over the past decade. The trade intensity index started at 1.4 in 2003 and increased to as high as 6.3 in 2013 before tapering off as a result of the global financial crisis. High regional Hirschmann index values indicate that the exports of SAARC countries are concentrated on relatively few export markets, especially for Bhutan, India, and Nepal.

Indicators of the commodity structure of trade by SAARC countries suggest that Bhutan, India, Nepal, and Sri Lanka have relatively diversified economies. In contrast, Afghanistan is heavily dependent on exports of vegetables, Bangladesh and Pakistan on exports of textiles and clothing, and the Maldives on exports of animal products.

According to data for 2010, all SAARC countries, except the Maldives, have revealed comparative advantage in the textile and clothing sector. The Maldives has a high revealed comparative advantage in animal products and Bhutan in mineral products. Only India has revealed comparative advantage in fuel products. Except for Bangladesh and the Maldives, all SAARC countries have revealed comparative advantage in vegetable products.

The complementarity indexes for SAARC economies in 2011 show that India's exports were quite complementary with the imports of other economies in the region, but the converse is not true. Data for 2011 show that the export patterns of India, Nepal, Pakistan, and Sri Lanka were relatively similar to those of other SAARC countries. In contrast, Afghanistan, Bangladesh, Bhutan, and the Maldives had quite different export profiles.

The sectoral intra-industry trade (IIT) index for selected product categories is higher for manufactured products than for primary products, especially in the case of Bangladesh, Bhutan, India, Nepal, and Sri Lanka. Afghanistan, the Maldives, and Pakistan are more primary-product oriented in their trade. In 2011, intra-industry trade was comparatively

significant for India, Bhutan, and Sri Lanka, while the trade pattern for Afghanistan and the Maldives was more inter-industry.

Protection indicators suggest that Afghanistan applies relatively low levels of protection for all products. In contrast, Bangladesh, Bhutan, and the Maldives have highly protected economies. India has high tariffs for selected categories, especially for food products and transport products. Nepal's lowest average tariff is for mechanical and electronic products, whereas the highest average tariff is for transport products. For Pakistan and Sri Lanka, the lowest average tariff is for fuels and the highest average tariff is for food products.

## Annex 2

Under World Integrated Trade Solution standard product group list, the 16 product groups are based on 2-digit HS code:

01-05_Animal	- Animal
06-15_Vegetable	- Vegetable
16-24_FoodProd	- Food Products
25-26_Minerals	- Minerals
27-27_Fuels	- Fuels
28-38_Chemicals	- Chemicals
39-40_PlastiRub	- Plastic or Rubber
41-43_HidesSkin	- Hides and Skins
44-49_Wood	- Wood
50-63_TextCloth	- Textiles and Clothing
64-67_Footwear	- Footwear
68-71_StoneGlas	- Stone and Glass
72-83_Metals	- Metals
84-85_MachElec	- Machineries and Electricals
86-89_Transport	- Transportation
90-99_Miscellan	- Miscellaneous

## CHAPTER III

# SAFTA: Progress, Challenges, and Prospects

*Ather Maqsood Ahmed and Robina Ather Ahmed*

## Introduction

Although the South Asian Association for Regional Cooperation (SAARC) was established in 1985, it was not until 1995 that intraregional trade was promoted through the signing of the South Asian Preferential Trading Arrangement (SAPTA). This was replaced by the South Asian Free Trade Area (SAFTA) in January 2006, designed to more proactively promote and facilitate intraregional trade among the eight SAARC members. The tariff reduction arrangements stipulate that by 2012, India and Pakistan will have completed tariff reductions to 0%–5% on all items other than those in their sensitive lists; Sri Lanka is expected to do the same by 2013, and Bangladesh, Bhutan, the Maldives, and Nepal will have followed suit by 2016. However, unlike many other regional integration arrangements elsewhere in the world, SAARC has made little progress in expanding intraregional trade. Even though the region has experienced strong growth rates in its external trade from 2004 to 2013, intraregional trade still accounts for only 4%–5% of the members' total trade.

Many factors have contributed to the slow progress in integrating South Asia, including limitations on the influence of civil society, which reflects weaknesses in the democratic process in some countries; political problems between India and Pakistan; security concerns; and the wide disparities in size of SAARC member countries (e.g., India versus Bhutan). Additional factors include (i) failure to fully recognize the economic benefits of integration and to delink trade from political and security issues, (ii) protectionist trade and investment regimes, (iii) maintenance of large sensitive lists, (iv) extensive use of nontariff measures, and (v) lack of an effective dispute resolution mechanism.

Faced with the challenges of globalization, a growing engagement in bilateral and multilateral arrangements within and beyond the region, and tariff reductions by most South Asian countries, SAARC members must now more seriously undertake to meet the goals of SAFTA. Not only must sensitive lists be cut and tariffs reduced, but also nontariff barriers must be reduced and customs procedures and standards harmonized.

Despite its limitations, SAARC provides an opportunity for policy makers, administrators, and experts to meet regularly and hold formal and informal discussions on trade and other issues central to economic integration (e.g., transport and social development).

Gradual reduction in SAFTA sensitive lists, ratification of the SAARC Agreement on Trade in Services in 2012, and, more recently, positive bilateral trade talks between India and Pakistan have generated optimism about the relevance of SAARC in promoting regional economic cooperation in South Asia. They have provided a new hope for SAARC member countries to resolve their disputes through dialogue and to move economic integration forward, thereby helping to bring prosperity and peace to the region. It is time for member states to take tariff liberalization seriously, identify the key problem areas, build consensus within their constituencies, and liberalize their intraregional trade and investment regimes.

## Overview of SAFTA Agreement

SAFTA was signed in January 2004 and implemented in January 2006. The agreement was motivated by the “commitment to strengthen intra-SAARC economic cooperation to maximize the realization of the region’s potential for trade and development for the benefit of their people.” The agreement has various provisions to deal with trade liberalization, including institutional arrangements, RoO, safeguard measures, and compensation and dispute settlement mechanisms. The following subsections provide an assessment of these provisions.

### Tariff Liberalization under SAFTA

The first tariff reduction under the Trade Liberalization Program went into effect on 1 July 2006. There are separate tariff reduction programs for the non-least developed countries (NLDCs), which included India, Pakistan, and Sri Lanka, and the least developed countries (LDCs), which included Bangladesh, Bhutan, the Maldives, Nepal, and Afghanistan (which became an SAARC member in April 2007).

The NLDCs were to reduce their tariffs on intraregional trade with fellow NLDCs in two phases: under Phase 1 (2006–2008), existing tariff rates above 20% were to be reduced to 20% within 2 years, tariffs below 20% were to be reduced on a margin of preference basis by 10% per year. Under Phase 2 (2008–2013), tariffs on intraregional trade were to be reduced to 0%–5% within 5 years.

LDCs were also to reduce their tariffs on intraregional trade with SAARC members in two phases: under Phase 1 (2006–2008), tariff rates above 30% were to be reduced to 30% within 2 years, and tariffs below 30% were to be reduced on a margin of preference basis by 5% per year. Under Phase 2 (2008–2016), tariffs on intraregional trade were to be reduced to 0%–5% within 8 years.

All products, except those on the sensitive lists, will have their tariffs reduced to 0%–5% by the end of the Trade Liberalization Program in 2015. For products that meet the 0%–5% tariff rule, 30% of the product lines are expected to have a customs duty of 0%. While all SAARC members have reduced their tariff rates from 2004 to 2013, tariffs in the region are still among the highest in developing countries.

India and Pakistan have completed the tariff liberalization program and have reduced their tariffs to the 0%–5% range applicable to all intraregionally traded products other than those on sensitive lists. Under SAFTA, India has reduced its duty to zero for five Least

Developed Member Countries of SAARC for all products except 25 which include whiskey, beer, and tobacco. Pakistan and Sri Lanka have also reduced their duty to 0–5% for five Least Developed Member Countries of SAARC for all products outside their sensitive lists. However, it is often argued that the tariff liberalization process under SAFTA is too slow. By the time SAFTA achieves its goal of 0%–5% tariffs by 2016, tariffs in general may be reduced to even lower levels through World Trade Organization (WTO) and regional or bilateral trade agreements (Dubey 2007).

An analysis by Bouët et al. (2010), using the 2004 MacMap HS6 database and MIRAGE model, concluded that even though the LDCs were given special and differential treatment, by the end of the tariff liberalization program they will face relatively higher tariffs than the NLDCs. For instance, Pakistan will have lowered its tariffs for India and Sri Lanka by 56%, whereas for the rest of South Asia its tariffs will be reduced by only 37% (Table 3.1). Similarly, the average applied tariff by Sri Lanka to the rest of South Asia—8%—will be twice as high as that applied to India and Pakistan.

**Table 3.1: Average Tariff Rates Applied at the End of Each Phase of SAFTA, 2006–2016 (%)**

Importers	2006					2008					2016				
	Bangladesh	India	Pakistan	Sri Lanka	Rest of South Asia	Bangladesh	India	Pakistan	Sri Lanka	Rest of South Asia	Bangladesh	India	Pakistan	Sri Lanka	Rest of South Asia
Bangladesh		19	24	18	21		19	23	17	20		9	9	8	12
India	21		20	22	12	14		18	20	10	10		12	14	9
Pakistan	15	18		16	19	11	17		14	14	8	8		7	12
Sri Lanka	6	6	6		11	3	6	5		9	2	3	4		8
Rest of South Asia	18	15	13	11		17	14	12	11	10	8	5	4	5	7

Source: Bouët, A., S. Mevel, and M. Thomas. 2010. *Is SAFTA Trade Creating or Trade Diverting?* IFPRI Discussion Paper 00950, Washington, DC: International Food Policy Research Institute (IFPRI).

### SAFTA Sensitive Lists

As identified by Taneja and Sawhney (2007), sensitive lists under SAFTA are a critical barrier to intraregional trade. The authors determined that almost 53% of total intraregionally traded products are on sensitive lists. Sri Lanka has the largest sensitive list among the NLDCs, covering 52% of all intraregionally traded products; in the case of India, 38% of intraregionally traded products are included in the sensitive list, while for Pakistan only about 17% are listed. Weerakoon and Thennakoon (2006) noted that the SAFTA provisions for sensitive lists are incompatible with meaningful regional trade liberalization. The sensitive list provision was limited to 20% of tariff lines, but the expectation was that only 10% of tariff lines would be listed. In addition, the sensitive lists of India and Pakistan had a greater percentage of exports of the member countries (57% for India and 34% for Pakistan) compared to other member countries' percentage of imports placed on their sensitive lists.

Raihan (2008) highlighted that a major flaw of SAFTA is the lack of categorical provisions for phasing out negative lists, or in prescribing timelines for doing so. The only provision is for the negative list to be reviewed every 4 years, with a view to reducing the number of items.<sup>1</sup>

Nonetheless, sensitive lists have been revised under SAFTA (Phase II). The Working Group on Reduction in the Sensitive Lists under SAFTA completed its task with a 20% reduction. India reduced its sensitive list for LDC members from 480 tariff lines to only 25 (a 95% reduction), while the Maldives reduced its sensitive list from 681 tariff lines to 152 (a 78% reduction). Table 3.2 presents the number of products included in SAFTA members' sensitive lists.

**Table 3.2: Number of Products in SAFTA Members' Sensitive Lists**

Countries	Original Number of 6-Digit Tariff Lines	Revised Number of 6-Digit Tariff Lines
Afghanistan	1,072	858
Bangladesh	1,233 (LDCs) 1,241 (NLDCs)	987 (LDCs) 993 (NLDCs)
Bhutan	150	156
India	480 (LDCs) 868 (NLDCs)	25 (LDCs) 614 (NLDCs)
Maldives	681	154
Nepal	1,257 (LDCs) 1,295 (NLDCs)	998 (LDCs) 1,036 (NLDCs)
Pakistan	1,169	936
Sri Lanka	1,042	837 (LDCs) 963 (NLDCs)

LDC = least-developed country, NLDC = non-least developed country.

Source: South Asian Association for Regional Cooperation Secretariat.

Despite the reductions in the number of products in the sensitive lists, the lists are still very restrictive. Raihan (2014) reviewed the coverage of the revised sensitive lists and found, for example, that Bangladesh's revised list still includes about 48% of its total imports from India (Table 3.3).

<sup>1</sup> There are concerns about the excessive size of the negative lists. This is at odds with Article XXIV of the General Agreement on Tariffs and Trade, which states that a free trade area should cover substantially all trade.

**Table 3.3: Coverage of Revised Sensitive List under SAFTA:  
Imports of Sensitive Products in Total Imports (%)**

Imported by	Source of Imports					
	Bangladesh	India	Nepal	Pakistan	Sri Lanka	Rest of SA
Bangladesh		47.72	97.56	52.93	40.18	52.38
India	0.01		0.00	17.13	11.25	0.06
Nepal	...	45.40		9.67	45.95	...
Pakistan	5.16	9.54	20.81		46.81	8.89
Sri Lanka	18.35	31.56	0.00	12.82		72.39
Rest of SA	63.48	52.63	71.88	80.34	54.23	

... = not available, SA = South Asia

Source: Raihan, S. 2014. *South Asian Economic Union: Challenges and Tasks Ahead*. 7th South Asia Economic Summit, New Delhi. November. 5-7.

## Rules of Origin

Rules of origin (RoO) play a key role in determining whether a product originates from a partner country. With the development of global value chains and outsourcing of materials or inputs, RoO have gained additional significance in free trade areas. SAFTA RoO stipulate 40% value addition for NLDCs and 30% value addition for LDCs. Further, the RoO include product-specific rules and certification procedures. The rules apply to products wholly produced in the exporting country as well as those not wholly produced there. Products not wholly produced in the exporting country need to meet three conditions: (i) the final product must be classified with a 4-digit Harmonized System (HS) code that is different from the HS heading under which all the nonoriginating inputs are classified, (ii) the value-addition criteria must be met, and (iii) manufacturing must take place in the exporting country. Regional accumulation is allowed provided that (i) the inputs are acquired from the member states, (ii) the combined value of inputs from other member states and the domestic addition is greater than 50% of the free-on-board value, (iii) the domestic value addition is more than 20%, and (iv) the final product fulfills the change in tariff heading (CTH) conditions.<sup>2</sup>

Structural and administrative issues surrounding SAFTA's RoO include (i) the dual criteria are restrictive, e.g., to qualify for the origin status, there is a requirement to have 40% local content and change-in-value-head fulfillment; (ii) accumulation is allowed but subject to meeting a regional value content of 50% and a domestic value content of 20%; (iii) origin certificates are issued exclusively by government authorities (except for Nepal), and the authorizing signatures must match those of issuing authorities; (iv) there is a lack of reporting on the use of certificates of origin; and (v) a proper mechanism to determine origin in the case of a dispute is lacking.

<sup>2</sup> "Change in tariff heading criteria" means the criteria according to which substantial transformation is deemed to have occurred when all the materials used in the production of a product are classified in a heading other than that of the product.

Raihan (2008) observed that the RoO under SAFTA should be consistent with those in force in various bilateral trade agreements within the SAARC region; however, the RoO of bilateral trade agreements are more liberal than the prevailing SAFTA rules. Further, gradual convergence of the external tariffs of member countries is essential. A free trade area needs a strict system of proof of origin, mainly for preventing trade deflection.<sup>3</sup> Given that trade deflections occur when there are wide differences in the members' external tariffs, it is important to reduce the absolute levels of the members' external tariffs and to narrow intercountry differences in tariff rates. Wide differences in members' external tariffs make the RoO difficult to implement.

### **Nontariff Barriers**

Nontariff barriers are a critical factor in liberalizing trade in South Asia. Despite tariff reforms and liberalization of the economy in recent years, SAARC members' nontariff barriers severely restrict intraregional trade. As recognized by Gourdon and Nicita (2012), instead of nontariff measures being a substitute trade policy instrument to tariffs, the two appear to be reinforcing. The authors' analysis indicates the high correlation between tariffs and nontariff barriers on various products. They concluded that a high nontariff barrier incidence and high tariffs are driven by the support for trade protection by the political economy.

Nontariff barriers, including licensing, quantity restrictions, price controls, state trading, and restrictive visa policies, are major impediments to trade in the region. The World Bank's trade restrictiveness index, which measures the effectiveness of trade protection, indicates that inclusion of nontariff barriers in the index sharply increases the overall level of trade restrictiveness for India and Bangladesh, much more so than tariffs alone (Table 3.4).<sup>4</sup>

Analysis of nontariff barriers included in the United Nations Conference on Trade and Development TRAINS database for SAARC members indicates that most barriers fall under the category of price and quantity control measures, which includes such practices as nonautomatic licensing, price setting, and interventions in food and commodity markets. Clearly, the higher the number of nontariff barriers the more challenging it is for exporters to engage in intraregional trade.

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<sup>3</sup> When two or more countries form a free trade area, they do not have tariffs that are homogeneous with respect to the rest of the world. Consequently, it is possible for one country to import all of a certain good that the other country previously imported, only to turn around and trade it to another country in its free trade area. This lowers the amount of government revenue in the consuming country and can lead to decreases in surplus.

<sup>4</sup> The index is based on the United Nations Conference on Trade and Development TRAINS data that takes nontariff measures into account and includes four types of policy barriers: quantity restrictions, voluntary export restraint, enforcement of decreased prices, and tariff quotas.

Table 3.4: Trade Restrictiveness Indexes for South Asia, 2006–2009

Country	Tariff Trade Restrictiveness Index (Applied Tariff, Including Preferences)			Overall Trade Restrictiveness Index (Most Favored Nation Applied Tariff + Nontariff Measures)		
	All Goods	Agricultural Goods	Non- Agricultural Goods	All Goods	Agricultural Goods	Non- Agricultural Goods
Bangladesh	10.61	7.93	11.00	20.40	42.17	17.14
India	12.00	28.00	11.00	18.00	39.00	17.00
Nepal	16.40	11.30	17.50	...	...	...
Pakistan	12.20	7.90	12.50	...	...	...
Sri Lanka	6.22	16.19	4.88	6.84	16.66	5.53
South Asia trade weighted average	11.74	23.97	10.97	17.63	38.15	16.47
World trade weighted average	2.97	8.85	2.47	10.68	43.84	7.52

... = not available.

Source: World Bank. Overall Trade Restrictiveness Indices and Import Demand Elasticities. <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:22574446~pagePK:64214825~piPK:64214943~theSitePK:469382,00.html> (accessed 1 March 2014)

For agriculture products, SAARC members rely extensively on restrictive measures, such as additional duties, nonautomatic licenses, price controls, quantitative restrictions, quotas, and state trading, for imports and exports. Table 3.5 summarizes some of the most frequently targeted products and measures.

Table 3.5: South Asia Most Frequently Targeted Products and Measures

Country	Measure	Import or Export	Product
Bangladesh	Other duties and charges	Imports	Mineral water, fruit juice, alcohol
	Quantitative restrictions	Imports	Chicks, salt
	Nonautomatic licenses	Imports	Salt, alcohol
	Price controls	Both	Salt, sugar, red lentil, onion, soybean oil Minimum export prices specified for jute
	Export certification	Exports	Frozen fish, products of plant origin, tea, jute, live animals
India	Export certification	Exports	Fish and fish products, dairy, egg, and meat products
	Price controls	Both	In place for 25 major agricultural commodities

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Table 3.5 continued

Country	Measure	Import or Export	Product
India	Quantitative restrictions	Imports	TQRs <sup>1a</sup> : milk powder, maize, sunflower seed, safflower oil, rape, mustard, and colza oil Bilateral deal with Sri Lanka permits TQRs for tea  Other import restrictions: fats, margarines, chicks, eggs, feathers, pig meat  Sensitive products monitored and subject to ad hoc restrictions include: edible oil, cotton, silk, milk, cereals, fruit and vegetables, spices, tea, coffee, alcoholic beverages, and other products produced by small scale industry  Quotas in place for wheat, grain, barley, lentils, beans, and flour
	Quantitative restrictions	Exports	Export restrictions issued on an ad hoc basis including wheat, pulses, sugar, and onions
	State trading	Both	Onions may be exported through 13 designated state trading enterprises.  Import side: wheat, rye, oats, maize, rice, grain sorghum, buckwheat, millet, and other cereals, copra, coconut oil, etc.
Pakistan	Price controls	Both	Beef, mutton, and various other essential commodities
	Quotas	Imports	Ad hoc import bans permitted if in the public interest.
	Quantitative restrictions	Both	Wheat flour exports banned in 2007 due to domestic supply shortages  Vegetable ghee and cooking oil exports are permitted so long as there is a minimum value addition of 15% for edible uses (50% for nonedible uses)
	Other duties and charges	Exports	35% duties applied on pulses due to domestic shortages

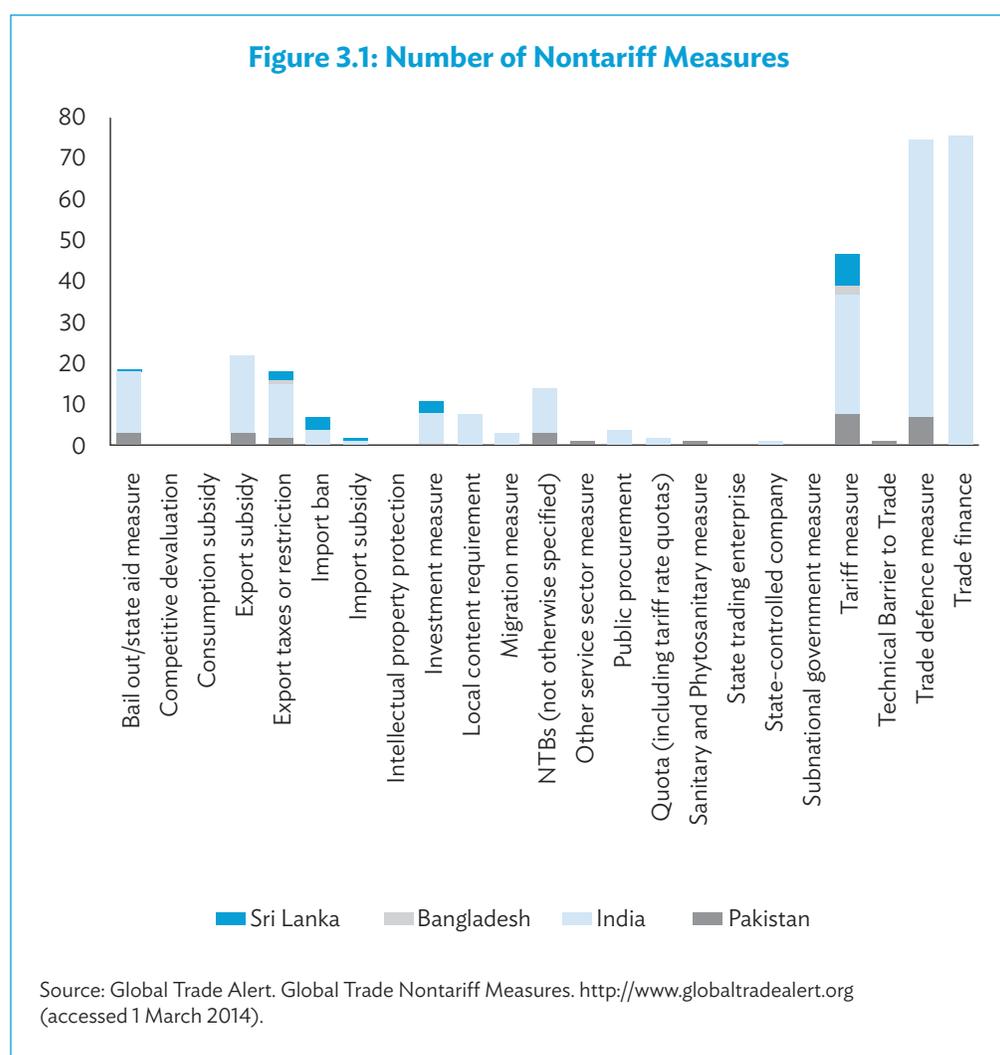
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Table 3.5 continued

Country	Measure	Import or Export	Product
Maldives	Price controls or state trading	Both	Retail prices of staple foods (rice, sugar, and wheat flour) are capped  The presence of state trading is to ensure sufficient domestic supplies of staples, and accounts for about 25% of all imports into the Maldives.
	Quantitative restrictions	Both	Trade in timber is controlled. Exports of certain marine species are prohibited.
Sri Lanka	Price controls	Both	Any item or good may be specified as an essential commodity and therefore requires ministerial approval related to domestic, import, and export sale prices.  Products currently subject to these price regulations include: chicken meat, dairy products, rice wheat flour, white sugar, dried chillies, onion, dal, canned fish.  Tea board has the authority to regulate price of green leaf paid by factories.
	Nonautomatic licenses	Both	Nonautomatic licensing in place covering a total of 512 items at the 8-digit level, including grains
	Other duties and charges	Both	Special commodity levy introduced in 2007 on 11 essential food stuffs, including milk powder, dhal, sugar, potatoes, and onions Rates are adjusted to reflect price, and supply and demand development. Adjustments may be general or limited to some products.  An export tax levied on cashew nuts, rubber, and coconut products to discourage exports in raw form and ensure local supplies

<sup>a</sup> TQRs are tariff rate quotas when quantities inside a quota are charged lower import duty rates than those outside (which can be high).

Source: UNCTAD. Nontariff measures Database. <http://www.unctad.info/en/Trade-Analysis-Branch/Key-Areas/NTM/> (accessed 1 March 2014).



Another source of information on nontariff measures is provided by Global Trade Alert. Global Trade Alert categorizes measures into red (most discriminatory), amber (may entail discrimination), or green (nondiscriminatory). In the four major South Asian economies, the number of measures categorized as red or amber was 245 for India, 22 for Pakistan, 18 for Sri Lanka, and 2 for Bangladesh. Figure 3.1 suggests that the use of trade defence measures, including antidumping, countervailing and safeguard measures, and trade finance is most prevalent in India (68, 76). Export subsidies and export restrictions are present in India (19, 13), Pakistan (3, 2), Sri Lanka (0, 2), and Bangladesh (0, 1). Import bans are common in India and Sri Lanka.

A study by Raihan et al. (2014) developed an inventory of nontariff measures for each SAARC country. The significant nontariff measures identified by the study include para tariffs, port restrictions, sanitary and phytosanitary measures, technical barriers to trade, quantitative restrictions, licensing requirements, certification requirements, and fluctuating standards and procedures (in the case of India and Pakistan). The study also identified

country-specific lists of products for which the country had export capacity but no or limited exports to major trading partners within SAARC, due to possible reasons related to nontariff measures. The study designed a monitoring and reporting template for nontariff measures, which would require implementation through the help of an active network of institutions in each SAARC country. NTM Desks are now operating in all member states except Maldives, with support mobilized by the SAARC Trade Promotion Network.

### Dispute Resolution Mechanism

To make SAFTA more effective, it is important that the dispute resolution mechanism is effective. Article 10 of SAFTA outlines the dispute resolution mechanism. Disputes arising from the interpretation and application of SAFTA can be brought for settlement under this mechanism. A committee of experts is the primary dispute-settlement body; the SAFTA Ministerial Council is the appellate body. Although it represents a big improvement over the earlier mechanism under SAPTA, the mechanism is hampered by many jurisdictional and procedural issues.

The scope and jurisdiction of the mechanism are not clearly defined. Also undefined are procedures for the Committee of Experts and criteria for selecting members qualified to deal with trade-related issues. Currently, mid-career officers working in the commerce ministries of SAARC member countries are serving on the committee. Lack of expertise over the past 10 years has seriously impeded the committee's work. Experts from the private or business sector are not included in the committee. The business community is only consulted for suggestions and recommendations but it is not part of the committee's decision-making process. The mechanism provides for the assistance of specialists, but again there are no criteria defined for their selection. The ASEAN Protocol, in contrast, has well-defined criteria for the selection of specialists.

The appellate review procedure is also faulty, as there is no well-defined distinction between the legal and the substantive matters reviewed by the Committee of Experts. An important ambiguity in the SAFTA appellate provision is whether this is the only way of remedying violations in the agreement, or whether the contracting states can simultaneously approach other dispute settlement bodies such as the World Trade Organization (WTO). In contrast, the ASEAN dispute resolution mechanism has jurisdictional flexibility. Before bringing a dispute to the ASEAN dispute resolution mechanism, member states can use other dispute resolution forums. Given the size discrepancies between the SAARC members, inclusion of such provisions in SAFTA would help allay the concerns of smaller members, such as Nepal, and build confidence in the dispute resolution mechanism.

Given the lack of defined procedures and rules governing their deliberations, the Committee of Experts has the discretion to employ any process or method it deems suitable. There are no guidelines on how the affected parties may present evidence to the committee, whether written or oral. The procedures for review of committee recommendations by the SAFTA Ministerial Council are also vaguely defined.

## Comparison with ASEAN and the ASEAN Free Trade Area

ASEAN is emerging as an effective hub and a complementary modality of regional integration. India, Pakistan, and Sri Lanka trade extensively with members of the ASEAN Free Trade Area (AFTA). In contrast to SAFTA, intraregional trade among AFTA members accounts for more than 30% of their total trade. It is useful to learn how ASEAN has achieved this success and how ASEAN member countries are managing the integration process through better policies and institutions.

AFTA was formed in 1993 by the founding members of ASEAN—Indonesia, Malaysia, Philippines, Singapore, Thailand—and Brunei Darussalam,<sup>5</sup> and was subsequently joined by Cambodia, the Lao People's Democratic Republic, Myanmar, and Viet Nam. ASEAN and AFTA are different from SAARC and SAFTA in many ways.

First, although SAARC was established in 1985, it still lacks strong guidance and leadership for implementing the vision envisaged by the member states. As a major economy, India should contribute to leadership by addressing openly the challenges of trust and security among SAARC members. As the largest country in Southeast Asia, Indonesia has played a leadership role in ASEAN by recognizing the contributions of the smaller states.

Second, SAARC has not fully recognized the economic benefits of regional cooperation. The experience of successful regional integration organizations confirms that economic interests and threats are important factors favoring integration. In the case of ASEAN, initially it was the threat of communism and the domino theory that catalyzed greater economic cooperation and integration. Later, the Asian financial crisis of 1997–1998 further motivated countries in Southeast Asia to continue down this path. Moreover, ASEAN has been successful in keeping political issues separate from economic interests of the region. SAARC, in contrast, has yet to delink political and economic issues and to resolve border and other disputes through peaceful dialogue and consultation. Neither has it been successful in drawing on public opinion, the media, and business and academic communities to moderate, if not resolve, these political and security controversies.

Third, South Asia suffers from the lack of strong political will among member states to work together to create a prosperous and peaceful region. The limited role of public opinion combined with the strong influence of business and political lobbyists in decision making, notably in protecting vested interests, have—together with other factors—resulted in South Asian countries failing to significantly liberalize their trade policies. SAARC members are not fully supportive of institutional mechanisms crucial for close coordination and integration. The SAARC Secretariat lacks sufficient funds and expertise to provide the necessary support.

Last but not least, ASEAN integration has been achieved by a multipronged process and following a multilateral approach. The ASEAN member countries have signed a series of multilateral agreements on trade, services, and investment. SAARC has been slow to implement the SAFTA provisions, and even slower in liberalizing the service sector and

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<sup>5</sup> ASEAN was founded in 1967; Brunei Darussalam joined in 1984.

investment.<sup>6</sup> Bilateral agreements in South Asia appear to be stumbling blocks rather than building blocks for regional integration.

There are five major areas where SAFTA can learn from AFTA and improve performance:

**Trade liberalization.** Tariffs have been reduced substantially under AFTA. Under AFTA's Common Effective Preferential Tariff (CEPT), the six original ASEAN members have placed 99% of products at zero duty. Under SAFTA, only India and Pakistan have reduced tariffs to 0%–5% on 75%–80% of their products.

**Bilateral agreements.** The South Asia region has several bilateral agreements. For example, India has bilateral agreements with Afghanistan, Bangladesh, Bhutan, the Maldives, Nepal, and Sri Lanka. Pakistan has a bilateral agreement with Sri Lanka. Most of these agreements provide advanced liberalization in terms of faster tariff reduction, more liberal RoO, and more restricted use of nontariff barriers compared to SAFTA, making SAFTA somewhat irrelevant.<sup>7</sup> ASEAN, on the other hand, has adopted a multilateral Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area (CEPT–AFTA). More than 98% of products have been incorporated in the CEPT inclusion list, and tariffs on these products have been reduced to 0%–5%.<sup>8</sup>

**Sensitive lists.** Sensitive lists under SAFTA include more than 20% of the trade of member states. As most of the trade potential rests with the items included in the sensitive lists, this not only has denied market access but also shifted exports to illegal and informal channels. Article 7(3) (b) of SAFTA provides for review of these lists every 4 years. So far, only a 20% reduction in the sensitive lists has been agreed upon by all member states. AFTA, in contrast, has provision for only a limited sensitive list, which includes a tariff liberalization program for the listed items.

**Nontariff barriers.** Nontariff barriers are restricting trade in South Asia. SAFTA has limited legal and institutional capacity to handle this issue. Article 7(4) of SAFTA provides for notification of nontariff barriers to the Committee of Experts and for their resolution and/or elimination. However, it has not provided any mechanism for compilation, evaluation, and monitoring of nontariff barriers. In contrast, AFTA has achieved significant progress in eliminating nontariff barriers. It has provided for a notification procedure and an effective surveillance mechanism.

**Dispute settlement mechanism.** Article 20 of SAFTA provides a framework for dispute settlement, first with the Committee of Experts and second with the SAARC Ministerial Council as the appellate body. However, the scope and jurisdiction of the dispute resolution mechanism are not defined, and it is not clear whether member states can also approach the WTO for dispute resolution. The ASEAN framework provides jurisdictional flexibility by allowing member states to use other dispute settlement mechanisms. Moreover, whereas the SAFTA mechanism is more a negotiation-based approach, ASEAN follows a rules-based approach, which is more transparent and consistent.

<sup>6</sup> The SAARC Agreement on Trade in Services has been ratified but not yet implemented.

<sup>7</sup> These aspects have been discussed in more detail in the section on impediments to trade.

<sup>8</sup> See Agreement on the Common Effective Preferential Tariff (CEPT) Scheme for the ASEAN Free Trade Area (AFTA). <http://www.asean.org/communities/asean-economic-community/item/agreement-on-the-common-effective-preferential-tariff-cept-scheme-for-the-asean-free-trade-area-afta> (accessed 1 March 2014).

## Recommendations and Road Map for Further Tariff Liberalization and Reduction of Nontariff Barriers

### Tariff Liberalization and Reduction in SAFTA Sensitive Lists

To liberalize trade, SAARC members must be more ambitious in their tariff liberalization program. More effective negotiation is required to reduce the number of tariff lines in sensitive lists, in addition to the number of sectors protected under the sensitive lists. Further, as in the case of AFTA, there should be tariff reduction provisions for products included in the sensitive lists. Article 7 (3) (b) of SAFTA, which stipulates revision after 4 years or earlier, is not mandatory. The first 20% reduction in sensitive lists took nearly 4 years to complete. The next round of discussions for a further reduction has just begun. The member states have agreed to reduce the sensitive lists but have not yet agreed on the percentage reduction or sectors to which it will apply.

Given that there is very substantial trade potential for products included in the sensitive lists of the member states, the following two options are suggested:

- (i) **Reduction based on priority sectors.** Based on trade potential, 29 priority sectors have been identified, which are included in the sensitive lists of Bangladesh, India, Pakistan, and Sri Lanka (Table 3.6). The highest number of tariff lines protected under sensitive lists relate to textiles, electronic equipment, iron and steel, and plastic and rubber products. Following further analysis, it is recommended that member countries agree on annual reduction in tariff lines in priority sectors by non-least developed countries (NLDCs) and least developed countries (LDCs) by 20% and 10% respectively by 2016, and having not more than 100 tariff lines in the Sensitive List by NLDCs and LDCs by 2020 and 2025, respectively.
- (ii) **Reduction based on tariff structures.** In the identified priority sectors, tariffs range from 5% to 50%, with the highest applied by India on edible fruits. In some cases, the tariff is 0% but products are nonetheless placed in the sensitive list (e.g., articles of leather and precious stones by Sri Lanka). Following further analysis, it is recommended that member countries adopt Tariff Liberalization Programs for Sensitive Lists whereby, by 2016, peak tariff will be reduced to 30%, and by 2020, peak tariff will be reduced to 20% with some flexibility for highly sensitive products.

The recent negotiations between India and Pakistan leading to an agreed road map for trade normalization are very promising. If the road map is implemented, India would reduce its SAFTA sensitive list for trade with Pakistan to 100 items within 5 years; likewise, Pakistan would reduce its SAFTA sensitive list for trade with India to 100 items within 5 years. This would mean that by 2019, India and Pakistan would each have only 100 items in their sensitive lists. This would provide Pakistan with market access to India for a large number of agriculture and textile products, and would in turn provide India with market access to Pakistan for pharmaceutical, auto, and engineering products.

Table 3.6: Sensitive Lists Priority Products, 2012

Sector	Bangladesh		India		Pakistan		Sri Lanka	
	Count of HS-6	Average of Equivalent Ad Valorem Tariff	Count of HS-6	Average of Equivalent Ad Valorem Tariff	Count of HS-6	Average of Equivalent Ad Valorem Tariff	Count of HS-6	Average of Equivalent Ad Valorem Tariff
Articles of apparel, accessories, not knit or crochet	99	24.65	145	20.54	149	25.00		
Electrical, electronic equipment	97	12.15	23	8.50	95	21.28	34	12.60
Machinery, nuclear reactors, boilers, etc.	45	15.30	5	8.80	84	21.58	38	11.01
Articles of iron or steel	53	17.88	52	5.00	83	20.30	43	20.49
Plastics and articles thereof	60	14.62	68	9.80	72	19.78	14	16.36
Vehicles other than railway, tramway	56	16.31	4	10.00	70	39.52	32	18.30
Paper and paperboard, articles of pulp, paper and board	55	21.26	13	10.00	42	21.88	44	18.85
Rubber and articles thereof	7	21.29	27	12.85	33	21.41	68	19.38
Organic chemicals	1	19.80			17	16.55		
Manmade staple fibers	58	22.23	10	12.75	16	15.00		
Footwear, gaiters and the like, parts thereof	13	25.00	17	10.00	15	24.50	25	6.60
Manmade filaments	41	19.73	3	21.23	14	15.00		
Animal, vegetable fats and oils, cleavage products, etc.	6	11.08	21	11.18	13	17.98	37	28.72
Wood and articles of wood, wood charcoal	7	8.33			13	18.08		
Dairy products, eggs, honey, edible animal products	13	25.00	8	33.75	11	24.09		
Miscellaneous articles of base metal	18	24.28			9	21.53	14	23.49
Optical, photo, technical, medical, etc. apparatus	11	14.33	2	7.20	7	24.07	7	17.61
Tools, implements, cutlery, etc. of base metal	19	23.85			7	26.43	22	12.05
Inorganic chemicals, precious metal compounds, isotopes	8	14.38	1	7.10	6	18.47		
Edible fruit, nuts, peel of citrus fruit, melons	13	25.00	4	50.50	4	20.95	47	27.49
Miscellaneous chemical products	19	4.95	2	7.50	4	17.20	3	8.33
Pharmaceutical products	8	5.99	5	9.80	4	16.25		
Vegetable, fruit, nuts, etc. food preparations			9	30.00	4	23.75	43	28.57

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Table 3.6 continued

Sector	Bangladesh		India		Pakistan		Sri Lanka	
	Count of HS-6	Average of Equivalent Ad Valorem Tariff	Count of HS-6	Average of Equivalent Ad Valorem Tariff	Count of HS-6	Average of Equivalent Ad Valorem Tariff	Count of HS-6	Average of Equivalent Ad Valorem Tariff
Stone, plaster, cement, asbestos, mica, etc. articles	3	5.00			2	30.00	14	21.82
Articles of leather, animal gut, harness, travel goods	13	24.00			1	15.00	19	0.00
Edible vegetables and certain roots and tubers	10	16.35	6	38.75	1	25.00	51	27.08
Residues, wastes of food industry, animal fodder			18	21.56			5	17.26
Pearls, precious stones, metals, coins, etc.	1	25.00					3	0.00
Toys, games, sports requisites	1	0.00					1	10.00

Source: Authors' calculation from UN Comtrade Database.

### Elimination of Nontariff Barriers

To liberalize trade and allow free movement of goods in the region, nontariff barriers must be reduced or eliminated where possible. SAFTA provides for annual notification to the SAARC Secretariat of nontariff and para-tariff measures of member states. It also provides for review by the Committee of Experts concerning their compatibility with relevant WTO provisions and for the committee to recommend the elimination of such restrictions to facilitate intraregional trade. However, the committee has not yet reviewed the nontariff and para-tariff restrictions and barriers reported by member states in 2010.

Although most of these measures are identified as possible nontariff barriers, the member states defend them as legitimate measures and not as barriers to trade. Even for measures such as quantity control, SAFTA contains no binding commitments for the removal of what is clearly a nontariff barrier. This indicates that SAFTA's reliance on self-notification and voluntary removal of nontariff barriers by member countries is ineffective. Further, there is no adequate monitoring mechanism for nontariff barriers.

It is recommended, therefore, that a proper reporting, evaluation, and monitoring mechanism for nontariff barriers is developed. As a first step, the SAARC Secretariat should develop a database on nontariff barriers and regulatory measures affecting intraregional trade. Member states should be required to report to the SAARC Secretariat any changes in regulatory measures that have a trade effect, and as notified to the WTO. Information on nontariff barriers provided by Global Trade Alert and various studies should be used to augment the database. The SAARC Secretariat, in coordination with the SAARC Chamber of Commerce and Industry, could also conduct business surveys. Financial support for the database should be sought from the donor community, in the interests of collecting information from exporters and importers concerning their difficulties in trading within the region. The database should be updated regularly and evaluated by a team of experts, including representatives from the private sector.

As a second step, priority nontariff barriers and priority products should be identified. Committees and working groups should examine and suggest measures to eliminate nontariff barriers affecting trade in priority sectors. As documented earlier in this chapter, the most prevalent nontariff barriers in the region are port restrictions, sanitary and phytosanitary technical barriers to trade restrictions, quantitative restrictions, licensing requirements, certification requirements and fluctuating standards and procedures, use of trade-defense measures, export subsidies and restrictions, and import bans. It is recommended that an agreement among the member states is made to reduce annually a certain number of products subject to the above-noted regulations.

Solutions to technical barriers to trade, sanitary, and phytosanitary issues and other similar trade impediments include standards harmonization, conformity assessment improvements, and mutual recognition agreements. It is especially important to identify possible mutual recognition agreements for regulating issues relating to sanitary and phytosanitary technical barriers to trade that hamper intraregional trade in agricultural products. In this context, ongoing work at the South Asian Regional Standards Organization needs to be intensified.

Trade facilitation is another effective way of dealing with customs-related nontariff barriers. The scope of SAFTA needs to be expanded to include trade facilitation at borders. This will help address challenges related to infrastructure, documentation requirements, and border agency coordination.

### **SAARC Blueprint**

On the pattern of the ASEAN Economic Community Blueprint, a comprehensive plan should be developed to deepen and broaden economic integration in the region through initiatives with clear targets and timelines for full implementation. SAARC members must agree on a common agenda to transform the region into a single market and production base. A high-level task force should be constituted to review all the institutional arrangements and factors constraining the free flow of goods and to recommend progressive legal, technical, and administrative changes in SAFTA.

This requires reconsideration not only of issues related to SAFTA sensitive lists and nontariff barriers, but also to the RoO and compensation and dispute resolution mechanisms. The RoO should be liberalized to accommodate the changing business environment and proliferation of bilateral agreements in the region. Consideration should be given to reducing the required degree of value addition, and regional accumulation provisions should be relaxed. Value-addition requirements and the issuance of origin certificates should be facilitated through better use of technology. The dispute resolution mechanism needs to be strengthened by clarifying its scope and jurisdiction, specifying the procedures of operation of the Committee of Experts and the qualifications of its members, and streamlining the appellate review process. A clear and comprehensive dispute settlement mechanism would help reduce political impediments to regional integration and encourage otherwise reluctant states to accept their responsibilities under SAFTA. Table 3.7 provides a suggested schedule for trade liberalization, reduction in the sensitive lists, removal of nontariff barriers, and simplifying of RoO under SAFTA.

**Table 3.7: Suggested Schedule for Trade Liberalization, Reduction of Sensitive Lists, Removal of Nontariff Barriers, and Simplifying of Rules of Origin**

Strategic Action	2014–2016	2017–2020	2021–2025
SAARC Blueprint	Set up a high-level task force to prepare SAARC Blueprint. SAARC Blueprint adopted at the SAARC Summit	SAARC Blueprint implemented	
Tariff liberalization	Reduce tariff on all products except for those on sensitive list to 0%–5% by LDC. Reduce tariff on all products except those on sensitive list to 0% by NLDC.	Reduce tariff on all products except those in sensitive list to 0% by LDC.	
Reduction in sensitive lists: Option 1: Reduction in number of tariff lines	20% annual reduction in tariff lines in priority sectors by NLDC  10% annual reduction in tariff lines in priority sectors by LDC	Not more than 100 tariff lines by NLDC  10% annual reduction in tariff lines in other sectors by LDC	Not more than 100 tariff lines by LDC
Reduction in sensitive lists: Option 2: Reduction in tariff	Reduce peak tariff to 30%.	Reduce peak tariff to 20% with some flexibility for highly sensitive products.	
Elimination of nontariff barriers: Database and monitoring	Set up reporting, evaluation, and monitoring mechanism. Enhance transparency by adhering to notification requirement.		
Elimination of nontariff barriers: Reduce nontariff barriers by 50% in priority sectors	By NLDC	By LDC	
Elimination of nontariff barriers: Full elimination of nontariff barriers:			By LDC and NLDC with flexibility for some products
Rules of origin	Review all bilateral RoO in the region and explore possible cumulation mechanism. Reform RoO to respond to changes in global production process to develop value chains in the region. Simplify procedure for certification through ED.		

LDC = least-developed country, NLDC = non-least developed country, RoO = rules of origin.

Source: Authors.

## CHAPTER IV

# How Can SAFTA Embrace Bilateral Trade Agreements in South Asia?

*Selim Raihan and Farazi Binti Ferdous*

During the 12 years between the establishment of the SAARC Preferential Trading Arrangement (SAPTA) in 1995 and of the South Asian Free Trade Area (SAFTA) in 2006, regional trade liberalization was largely achieved through unilateral and bilateral trade initiatives. While Sri Lanka was a relatively liberalized economy as early as the 1970s, other South Asian countries, such as Bangladesh, India, Nepal, and Pakistan, commenced their trade liberalization process in the early 1990s. The trade liberalization process of individual countries was instrumental in facilitating regional trade and investment expansion as well as the establishment of subsequent multilateral and bilateral agreements. However, there are concerns that bilateral trade agreements in South Asia, especially the bilateral free trade agreements (FTAs), are more attractive than SAFTA. SAFTA needs to be consistent with these bilateral trade agreements in South Asia.

## Existing Bilateral Trade Agreements in South Asia

This section reviews the bilateral FTAs among members of the SAARC as summarized in Table 4.1.

**Table 4.1: Bilateral Trade Agreements in South Asia**

Country	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Afghanistan		-	-	PTA (2003)	-	-	FTA (2010)	-
Bangladesh	-		FTA (2009)	TA (2006)	-	-	FTA (UD)	FTA (UD)
Bhutan	-	FTA (2009)		FTA (2006)	-	-	-	-
India	PTA (2003)	TA (2006)	FTA (2006)		TA (1981)	Treaty (1991)		FTA (1998)
Maldives	-	-	-	TA (1981)				
Nepal	-	-	-	Treaty (1991)	-		FTA (UD)	
Pakistan	FTA (2010)	FTA (UD)	-	-	-	FTA (UD)		FTA (2005)
Sri Lanka	-	FTA (UD)	-	FTA (1998)	-	-	FTA (2005)	

- = none, FTA = free trade agreement, PTA = preferential trade agreement, TA = trade agreement, UD = under discussion.

Note: The year denotes year of signing the agreement.

Source: ADB. 2012b. *Study on Regional Economic Integration in SAARC: Its Current Extent and Recommendations for Further Deepening*. Manila: Asian Development Bank.

### India–Sri Lanka Free Trade Agreement

The India–Sri Lanka Free Trade Agreement (ISFTA) was India's first bilateral FTA and was among the first attempts to promote trade liberalization in South Asia. It was signed in December 1998 and resulted in substantial growth in trade between the two countries after it became operational in March 2000. Trade between the two countries surged after March 2003 when 100% tariff reductions translated into complete free trade for 2,797 items. Sri Lanka's exports enjoyed an increase of 107% from \$245 million in 2003 to \$506 million in 2006. However, 77% of the surge in exports stemmed primarily from light processing of a few imported goods, including animal fats, vegetable oils, copper and aluminum products, and pharmaceuticals. (Kelegama and Karunaratne 2013).

Table 4.2 provides a measure of the impact of the ISFTA on Sri Lanka's top exports to India. Data were compiled for 1999 (the year preceding implementation of the agreement), 2005 (2 years after India implemented full liberalization), and 2011 (the year for which the latest data were available). In 2005, vegetable fats and oils were the prime exports, followed by copper products and pharmaceutical goods. Kelegama and Karunaratne (2013) suggest that the high quantity of exports of vanaspati (a type of vegetable oil), for which tariff concessions were made under the ISFTA, might explain why vegetable oils were such a key export in 2005.

**Table 4.2: Sri Lanka's Top Five Exports to India, 1999–2011 (SLRs billion)**

1999		2005		2011	
Product	Value	Product	Value	Product	Value
Whole pepper	0.7	Vegetable fats and oils	12.0	Animal feed	5.2
Areca nuts	0.4	Refined copper and copper alloys	7.9	Insulated wires and cables	4.7
Scrap iron	0.3	Copper wire	4.1	Cloves	3.8
Dried fruit	0.2	Aluminum wire	3.1	Waste and scrap paper	3.2
Cloves	0.2	Antibiotics	2.2	Garments	3.2

SLRs = Sri Lanka rupees.

Source: Kelegama, S, and C. Karunaratne. 2013. *Experiences of Sri Lanka in the Sri Lanka - India FTA and the Sri Lanka - Pakistan FTA*. Background Paper No RVC-10, Geneva: United Nations Conference on Trade and Development.

Table 4.3 shows Sri Lanka's top five imports from India during the same period. The data show that, following implementation of the agreement, petroleum products and motor vehicles became two of the top imports to Sri Lanka in 2005 and 2011. Again, Kelegama and Karunaratne (2013) reason this may be due to the tariff concessions made in the ISFTA that facilitated the import of these items.

Trade under the ISFTA increased substantially from \$634.0 million in 2000 to \$3,674.1 million in 2010, with a substantial improvement in the trade balance in the early years of the agreement. In 2000, the ratio of India's exports to imports was 15:1; in 2004 the trade balance improved considerably in Sri Lanka's favor to 4:1, and in 2010 it was 6:1. The improvement in Sri Lanka's trade balance in relation to India was largely due to the export

of two items—copper and vanaspati. However, trade in these items was largely a result of tariff arbitrage as there was a large tariff differential in the most favored nation (MFN) rates prevailing in India and Sri Lanka on the raw material required to manufacture these products (Kelegama and Karunaratne 2013). Consequently, this encouraged manufacturers to under-invoice the import of raw material to meet rules-of-origin (RoO) criteria.

**Table 4.3: Sri Lanka's Top Five Imports from India, 1999–2011 (SLRs billion)**

1999		2005		2011	
Product	Value	Product	Value	Product	Value
Lentils	2.1	Refined petroleum oil	16.0	Gas oil and diesel	47.0
Ayurvedic medicine	1.4	Motorcycles	8.0	White cane sugar	35.0
Motor cars	1.3	Motor cars	6.3	Petrol	32.0
Milled rice	1.3	Medicaments	5.3	Motorcycles	19.0
Pepper	1.2	Crude petroleum oil	4.1	Auto-trishaws	18.8

SLRs = Sri Lanka rupees.

Source: Kelegama, S, and C. Karunaratne. 2013. *Experiences of Sri Lanka in the Sri Lanka - India FTA and the Sri Lanka - Pakistan FTA*. Background Paper No RVC-10, Geneva: United Nations Conference on Trade and Development.

India's sensitive list under ISFTA consisted initially of 431 items; it imposed tariff quotas under the ISFTA on garments (8 million pieces) and tea (15 million kilograms), and specified ports of entry for these items to qualify for the preferential tariffs. Furthermore, India added the condition that the fabric of 6 million of these 8 million apparel articles to be manufactured in Sri Lanka had to be sourced from India. In 2008, India allowed duty-free import of 216 garment items (up to a limit of 8 million pieces), thereby reducing the operational sensitive list to 215 items. Moreover, India gradually removed port restrictions on tea in June 2007 and on garments in April 2008, and allowed duty-free import of garments without any restriction on sourcing of fabric from India up to a limit of 3 million pieces (Kelegama and Karunaratne 2013). In contrast, Sri Lanka's sensitive list under the ISFTA covers 1,180 tariff lines.

For RoO, the ISFTA uses a combination of domestic value added (DVA) and change in tariff heading (CTH). For products that include inputs that originate from countries other than the contracting parties (i.e., India and Sri Lanka), the minimum DVA is 35% of the value of the product. If some inputs originate within the contracting parties, then the DVA requirement is 25% of the value of the product, provided that the combined value addition of the two parties is at least 35% of the value of the product. In addition to fulfilling the DVA criteria, the final product being exported must have a different classification from all of its constituent inputs, according to the Harmonized Commodity Description and Coding System (HS code) at the four-digit level.

### Pakistan–Sri Lanka Free Trade Agreement

Sri Lanka was keen to enter into an FTA with Pakistan because it is Sri Lanka's second-largest trading partner in the SAARC region. Sri Lanka was particularly enthusiastic about the Pakistan–Sri Lanka FTA (PSFTA) in light of the significant market access it gained

with India following the signing of the ISFTA. Pakistan and Sri Lanka signed the PSFTA in Colombo in August 2002. Following implementation of the PSFTA in June 2005, both parties agreed to remove all nontariff barriers on goods and services, stop any increase in existing para tariffs, and prevent the introduction of new para tariffs without mutual consent. There has been interest by both countries to expand trade and investment to cover more sectors in agriculture and industry. Taking into account the economic asymmetries between the two countries, the PSFTA allows Sri Lanka to offer only 102 items on a duty-free basis, while Pakistan can offer 206 items. Sri Lanka's negative list consists of 697 items while that of Pakistan consists of 540 items (Kelegama and Karunaratne 2013).

Table 4.4 shows the top five exports of Sri Lanka to Pakistan during 2003–2011. The data show little change in the primary products before and after the agreement was implemented in 2005. In both 2003 and 2007, copra was the largest export, with negligible difference in export receipts earned. The value of Sri Lanka's exports from trade with Pakistan increased after both countries fully liberalized their bilateral trade, but the change was not dramatic.

**Table 4.4: Sri Lanka's Top Five Exports to Pakistan, 2003–2011 (SLRs billion)**

2003		2007		2011	
Product	Value	Product	Value	Product	Value
Copra	1.1	Copra	1.2	Rubber sheets	2.1
Fermented black tea	0.6	Rubber sheets	1.1	Vegetable products	0.7
Rubber sheets	0.6	Rubber latex	0.5	Fermented black tea	0.5
Vegetable products	0.3	Vegetable products	0.5	Desiccated coconut	0.5
Natural rubber	0.2	Desiccated coconut	0.5	Rubber latex	0.5

SLRs = Sri Lanka rupees.

Source: Kelegama, S, and C. Karunaratne. 2013. *Experiences of Sri Lanka in the Sri Lanka - India FTA and the Sri Lanka - Pakistan FTA*. Background Paper No RVC-10, Geneva: United Nations Conference on Trade and Development.

Correspondingly, Sri Lanka's top five imports from Pakistan remained similar throughout the pre- and post-implementation period (Table 4.5). For example, woven cotton fabric continued to be among the top two imports during 2003–2011. Other heavily imported products, including potatoes and milled rice, also remained among the top five imports.

Under the PSFTA, the value of Sri Lanka's exports to Pakistan did not grow considerably during 2006–2010. The value of exports to Pakistan as a percentage of Sri Lanka's total exports remained almost stable throughout the 5-year period and failed to rise above 1%, indicating that Pakistan is not a significant destination for Sri Lankan exports (Kelegama and Karunaratne 2013).

It appears that the PSFTA surpasses SAFTA in terms of the depth of free trade, time span of progress, and RoO. The PSFTA came into force within 3 years of signing of the agreement in July 2002, indicating that bilateral agreements are more time-effective than regional or multilateral agreements. The ISFTA was operational even more expeditiously—within 15 months of signing in 1998.

**Table 4.5: Sri Lanka's Top Five Imports from Pakistan, 2003–2011 (SLRs billion)**

2003		2007		2011	
Product	Value	Product	Value	Product	Value
Woven cotton fabric	2.0	Woven cotton fabric	5.2	Wheat grain	4.2
Dried fish	0.6	Potatoes	1.6	Woven cotton fabric	3.5
Potatoes	0.4	Milled rice	1.2	Welded iron/steel tubing	2.3
Milled rice	0.4	Welded iron/steel tubing	0.9	Onions	2.1
Medicaments	0.4	Dried fish	0.7	Portland cement	1.9

SLRs = Sri Lanka rupees.

Source: Kelegama, S, and C. Karunaratne. 2013. *Experiences of Sri Lanka in the Sri Lanka - India FTA and the Sri Lanka - Pakistan FTA*. Background Paper No RVC-10, Geneva: United Nations Conference on Trade and Development.

On implementation of their FTAs with Sri Lanka, both India and Pakistan have agreed on achieving zero tariffs for a range of tradable products and a time frame for phasing out tariffs for the remaining items. In both cases, the agreements granted more favorable conditions and longer gestation periods for Sri Lanka than to India or Pakistan. Sri Lanka was also entitled to a lengthier sensitive list than India or Pakistan. Accordingly, although it was reasonable to anticipate greater trade performance toward the end of the decade with the completion of the tariff liberalization process, Sri Lanka has not shown a significant change in its bilateral trade with Pakistan. It is, however, worth noting that the last few years during 2000 to 2010 were marked by adverse effects of external shocks—including the United States financial crisis and the European Union (EU) sovereign debt crisis—on trade performance in the SAARC region (Kelegama and Karunaratne 2013).

### India–Nepal Trade and Transit Agreement

The India–Nepal Preferential Trade Agreement was signed in 1996 and renewed in 2002, 2007, and 2009. The 1996 treaty allowed for (i) exemption of primary products from import duties and quantitative restrictions on a reciprocal basis; (ii) duty-free access for Nepalese manufactures to India on the basis of nonreciprocity, largely without quantitative restrictions, except for sensitive items; and (iii) preferential access for Indian manufactured exports without quantitative restrictions.<sup>1</sup> The renewed treaty of March 2002 introduced more stringent RoO, tariff-rate quotas, and safeguard clauses. New provisions for RoO cover value-added requirements of 30% of ex-factory prices (from March 2003) and CTH at the four-digit level of the HS code (ADB 2012b).

For Nepalese manufactured exports that do not meet the CTH criteria, the new provision requires products to have undergone a “sufficient manufacturing process within Nepal,” which is determined on a case-by-case basis to qualify for preferential access. Under the amended clause of the renewed treaty, India imposes the following fixed annual tariff-rate quotas on Nepal’s exports: 100,000 tons for vegetable ghee, 10,000 tons for acrylic

<sup>1</sup> The margin of preference provided by Nepal to Indian manufacturing products is 5% for goods with customs duty of less than 30% and 7% for those with customs duty above that level.

yarn, 10,000 tons for copper, and 2,500 tons for zinc oxide. If exports exceed the quotas, which are lower than recent export levels, they are subject to MFN treatment. In addition, exporters of vegetable ghee must channel their products through India's state trading company and pay a service charge. The new treaty also provides safeguards against damage to domestic producers from an export surge. Nepal's exports to India are subject to a countervailing duty that makes the prices of these exports comparable to those of Indian counterparts. Trade transactions are in local currencies. Nepal, however, permits imports of a few intermediate inputs or machinery for local industry from India against payment in a convertible currency (ADB 2012b).

The renewed 2009 treaty agreed to (i) calculate value addition on a free-on-board (FOB) basis for preferential access of Nepalese manufactured products to India; (ii) undertake measures to reduce or eliminate nontariff, para-tariff, and other barriers to bilateral trade; (iii) address the problem of lack of mutual recognition of standards and testing; (iv) facilitate cross-border trade flows through simplification, standardization, and harmonization of customs, transport, and other trade-related procedures, and development of border infrastructure; and (v) end the duty refund procedure—a process of refunding excise duty levied in India for Indian manufactured goods exported to Nepal—allowing Nepal to collect excise duty at the customs point. Recently, India has also agreed to remove the 4% additional customs duty imposed on 162 Nepali items (ADB 2012b).<sup>2</sup>

Under the India–Nepal Trade Treaty, the MFN list of articles not allowed of preferential entry from Nepal to India are (i) alcoholic liquors and beverages and their concentrates except industrial spirits, (ii) perfumes and cosmetics with non-Nepalese and non-Indian brand names, and (iii) cigarettes and tobacco. However, the Government of India may, in consultation with the Government of Nepal, modify this list (Raihan 2008).

Given that value additions of most of Nepal's export products are very low, a 30% value-addition requirement under SAFTA and the India–Nepal Trade Treaty is a significant barrier for Nepal's exports. This is also true for other least developed countries (LDCs) in South Asia. Therefore, the RoO problem will need to be resolved, taking into account the low manufacturing and processing capability of the LDCs (Raihan 2008).

### India and Pakistan Trade Negotiations

South Asia remains one of the world's least-integrated regions. India and Pakistan account for almost 92% of South Asia's gross domestic product, 85% of its population, and 80% of its surface area, but only 20% of intraregional trade (Raihan and De 2013). India and Pakistan do not have a trade agreement and have not had normal trade relations for many years. In the period following the partition of India and Pakistan in 1947 until the formation of the World Trade Organization (WTO) in 1995, the two countries traded in a limited number of items. In 1996, India accorded MFN status to Pakistan. Pakistan continued to follow the positive-list approach for imports from India. Since 2000, Pakistan has been gradually increasing the positive list, from 600 items in 2000 to 1,934 items in 2009. Pakistan took the initiative to extend MFN status to India in 2012 and replaced the restricted positive list with a negative list in February of the same year (De, Raihan, and Ghani 2013).

<sup>2</sup> India imposed an additional customs duty on 331 Nepali exportable items in 2006. Although India waived the duty on 169 items in 2008, it continued to impose duty on 162 items. India subsequently issued a notification of waiver, but it came into effect only from March 2012.

In the context of SAFTA, India offered tariff concessions to SAFTA members in line with those offered to the non-least developed countries (NLDCs). Pakistan offered preferential tariffs for items that were on the positive list. India abides by its responsibilities under SAFTA, hence Pakistan can avail of tariff concessions offered by India to the NLDCs. India maintains a sensitive list of 868 items with Pakistan, while Pakistan has one sensitive list of 1,183 items that is applicable to all member countries.

According to Nag (2014), India–Pakistan trade has a chequered history. India offered MFN status to Pakistan immediately in 1996, whereas Pakistan allowed imports from India on the basis of a positive list which consisted of only 1,946 items until 2011. In November 2011, Pakistan decided to accord MFN status to India, and it shifted to a negative list in March 2012, which includes 1,209 items. However, only 137 items are declared as importable from India through the Wagah land border crossing. Total trade between the two countries reached \$2.4 billion in 2013, indicating an increase of Pakistan’s exports to India by 28% and that of India to Pakistan by 19%.

According to Taneja (2006), India–Pakistan bilateral trade is constrained by several barriers such as a large sensitive list, limited positive list, MFN status, and nontariff measures.<sup>3</sup> As there is great potential for trade between India and Pakistan,<sup>4</sup> these trade barriers have led to a high level of informal trade. In some instances, trade has been diverted to third countries. For example, items that are not on Pakistan’s positive list are exported from India to Dubai, from where goods enter into the Pakistani market after passing through Iran and Afghanistan or directly to Karachi by sea. Using the indirect route has meant much higher transport costs for traders. Costs of transport on the indirect Mumbai–Dubai–Karachi route are 1.4 to 1.7 times more than on the direct Mumbai–Karachi route.

Nag (2014) compared SAFTA to MFN duties and concluded that only 14% of products (54 products) have duties of 5% or less under SAFTA, which India can take advantage of. All other products are still under SAFTA’s sensitive list, which protects domestic producers in Pakistan from competition with India. Nag examined the products for which India has a competitive advantage and concluded that while India clearly has a strong competitive advantage in many products, the fear that India could destroy Pakistan’s domestic industries is largely unfounded.

Greater trade with India offers an immediate and rich possibility of economic growth for Pakistan, and India would also benefit as it is a positive-sum game (Husain 2013). The composition of exports from India to Pakistan has been primarily limited to about 15 commodities, which accounted for about 64% of the total Indian exports to Pakistan in 2000 but increased to about 80% by 2010. The composition of official exports from Pakistan to India has also been limited to very few commodities.

<sup>3</sup> Ahmed (2012) has identified nontariff barriers faced by Pakistan while exporting to India, including (i) arbitrary customs valuation in India, (ii) no clear mapping between HS 8 codes of the two countries thus raising classification issues, (iii) mandatory pre-shipment inspection (PSI) for textile and clothing, and (iv) standards for textiles (1131 etc.).

<sup>4</sup> Ahmed (2012) has reviewed the empirical literature, which indicates the high trade potential between the two countries. For example, a study carried out by Ahmed and Rehman (2012), commissioned by the Ministry of Commerce, Pakistan shows that if both India and Pakistan trade on an MFN basis and make SAFTA operational, their trade would increase to \$10 billion–\$11 billion.

Trade between India and Pakistan is restricted by closed trade regimes. Trade is uncompetitive when channeled through Dubai because of the rising transport costs. Normal and MFN trade at land border points between India and Pakistan is tightly restricted. While both countries have adopted a negative list of trade, they maintain a positive list for trade through land borders, which is inconsistent with the principles of the General Agreement on Tariffs and Trade.

The results of a study by De, Raihan, and Ghani (2013) indicate that allowing MFN status for India by Pakistan, together with enhanced trade facilitation, would lead to large welfare gains for both countries, especially Pakistan. A SAFTA scenario was considered with a full elimination of bilateral tariffs where there would be no sensitive list. Using the Global Trade Analysis Project (GTAP) model, the SAFTA scenario was examined with and without the MFN provision, then the SAFTA scenario plus MFN provision was analyzed for the entire South Asian regional trade area. The GTAP simulation results suggest that the SAFTA scenario with the MFN provision would lead to higher welfare gains for Pakistan and India than a scenario of SAFTA without the MFN provision. However, when a South Asian trade facilitation scenario is added, the gains become much larger. The results of study's general equilibrium simulation indicate that Pakistan's granting of MFN status to India would generate larger benefits if it is supported by improved connectivity and trade facilitation measures; in their absence, the gains from trade would be small. Conceptually, trade facilitation is simple; it consists of implementing measures to reduce the cost of trading across borders by improving infrastructure, institutions, services, policies, procedures, and market-oriented regulatory systems. Most importantly, the dividends of trade facilitation can be shared by all.

Pakistan has offered India nondiscriminatory market access (NDMA) if India gives access to 250–300 of items at lowered duties. The Government of Pakistan has provided the Government of India with the list of items for which it is seeking lower tariffs. These items are on the sensitive list of SAFTA. Textiles and chemicals, which form the bulk of these products, are currently subject to higher duties by India (Nag 2014). The offer to allow NDMA was made during trade talks in 2014. The NDMA has been suggested as a new name for MFN, in an attempt to reduce the political implications. The move, if implemented, would abolish Pakistan's negative list of 1,209 items.

### **Bangladesh–India Trade Negotiations**

Despite bonds of culture and a shared history, as well as proximity, economic ties between Bangladesh and India are well below potential. Bangladesh could export far more to India's vast market, and Indian firms could invest in Bangladesh, benefiting from abundant and relatively inexpensive labor to produce exports to India as well as other countries. Both face innumerable barriers to trade, and the loss to industry and consumers in general is considerable (De, Raihan, and Kathuria 2012).

While tariff concessions have been offered under SAPTA and SAFTA, there would be greater benefit in addressing nontariff and para-tariff barriers in both countries. Some examples of nontariff and para-tariff barriers in both countries are discussed in the following paragraphs.

First, India requires permitted risk analysis of agricultural imports in biosecurity and sanitary and phytosanitary categories, and this has become a complex process lacking in

transparency. It covers about 600 items with the aim of protecting human, animal, and plant life and health. Nearly all livestock, agricultural, and food imports require sanitary or phytosanitary certificates and import permits from India's Ministry of Agriculture.

Second, the Indian Prevention of Food Adulteration Act, 1954 requires the shelf life of processed foods to be not less than 60% of the original shelf life at the time of import. While this objective is fine, the process of determining shelf life is often arbitrary and nontransparent. India's Prevention of Food Adulteration Rules, 1955 are complicated. For instance, one rule—number 32—has 30 provisions with further subprovisions. It also cross-references to other rules prescribing content, size, and design of labels, display-panel specifications, details of colors and flavors, trade names, and so on. No certificate from the country of origin is accepted. The results of laboratory tests cannot be challenged. Separate regulations exist for various food types.

Third, for exports of textiles and textile products to India, exporters must obtain a pre-shipment inspection (PSI) certificate from a textile testing laboratory accredited to the National Accreditation Agency of the country of origin. Nonavailability of the certificate requires testing by the notified agencies in India for every consignment. In some cases, even certificates issued by European Union-accredited labs have been rejected by Indian customs authorities, and the consignments have been subject to repeat tests in India. In addition, the Textiles (Consumer Protection) Regulation, 1988 imposes strict marking requirements for yarns, fibers, and fabrics imported into India.

Fourth, exporters of jute products to India must have certificates from the exporting country stating the product does not contain more than 3%, by weight, of non-homogenate hydrocarbon (jute batching oil). Jute bags or sacks require special labeling, and each bag or sack must carry machine-stitched marking of the country of origin.

Bangladesh also imposes several nontariff barriers and supplementary duties on Indian exports. For example, Bangladesh has imposed over 60% supplementary duty on imports of plastics from India. Furthermore, Bangladesh continues to have 225 items in its sensitive list with respect to trade with India, covering items such as machinery, pharmaceuticals, and textiles. Other issues raised during the commerce secretary discussions held in March 2012 include port restrictions in both countries. Not all Indian ports can accept cargoes from Bangladesh. Port restrictions are also imposed by Bangladesh on Indian exports; for example, port restrictions exist in Bangladesh on export of vulcanized rubber thread through the Akhaura land customs station. Similarly, exports of yarn, milk powder, fish, sugar, and potatoes from India (particularly from the northeastern states and West Bengal) face port restrictions in Bangladesh.

Finally, the commerce secretary discussions noted that heavy restrictions limit professional exchanges and cooperation. Moreover, Indian companies and professionals face difficulties in sending remittances back to India. Indian exporters can remit dollars converted from taka only as royalty, consultancy, and "other charges," and there is a ceiling on the repatriable amount (for example, under "royalty," only 6% of the sale proceeds in Bangladesh can be repatriated). This creates problems for knowledge-intensive sectors such as software, information technology and telecommunication, and architecture. (De, Raihan, and Kathuria 2012).

Nontariff measures such as standards, certification, regulations, labeling, documentation, public procurement, licensing, countervailing measures, tariff quotas, and antidumping measures are all matters of contention between Bangladesh and India. Nontariff barriers are the most problematic and undermine the trade potential of both countries. Sanitary and phytosanitary and technical barriers to trade and related measures have been found to account for 86% of all barriers across South Asia. Other hurdles, such as stringent visa regimes, inadequate physical connectivity, restrictions in opening bank branches, lack of testing facilities at the border, and non-honoring of irrevocable letters of credit, have been faced by exporters and importers in both countries (De, Raihan, and Kathuria 2012).

Gravity modeling analysis of Bangladesh–India bilateral trade by De, Raihan, and Kathuria (2012) suggests that bilateral trade would be highly responsive to improvements in transaction efficiencies. The analysis showed that a 10% reduction in trade-related documentation could result in a 7.3% increase in bilateral trade. Similarly, a 10% improvement in the efficiency of clearance processes by border control agencies, including customs, could lead to a 4% increase in bilateral trade. A 10% improvement in the quality of trade and transport-related infrastructure could lead to a 2.3% increase in bilateral trade. Further trade liberalization (a 10% cut in tariffs) would lead to an additional increase in bilateral trade of almost 8%. The study shows that regional transit trade in South Asia is extremely important, and transit facilitation would substantially increase Bangladesh's exports to South Asia. Improved trade facilitation (as defined by the trade facilitation index) would have the strongest effect for Bangladesh's bilateral trade; a 1% improvement in trade facilitation would result in an almost 4% increase in Bangladesh's exports. These results indicate that the gravity model with the trade facilitation index could also be used to evaluate the effectiveness of initiatives to improve logistics.

It is important to reduce the transaction costs of trade between Bangladesh and India in the larger context of regional transit trade in South Asia. To gain the full benefits of regional transit trade, transport network integration should be a priority objective of South Asian cooperation. In short, increased trade between Bangladesh and India requires measures that go beyond tariffs. This would require India to follow up the significant changes in the tariff situation. This would require India to follow up the significant changes in the tariff situation, as India now offers a free trade regime to Bangladesh for all except 25 products, with reductions in nontariff measures/barriers. Bangladesh would also gain from reducing its tariffs and para tariffs as well as nontariff measures/barriers in its trade with India, given that this will help expand its overall production capability and exploit dynamic gains from trade.

Bangladesh–India cooperation offers a win–win prospect for both countries and for the South Asia region as a whole. For India, closer economic cooperation would help to reduce the economic isolation of its northeastern states. A bilateral FTA between the two countries could create scope for resolving some of these critical issues while reducing nontariff barriers.

As described by ADB (2012b), Bangladesh and India signed a series of new trade and transit agreements in January 2010 to address some of the barriers to bilateral trade:

- **Greater market access for Bangladesh.** India has extended duty-free access beyond its SAFTA commitments, broadening the scope of goods with duty-free access to India, with the aim of narrowing the large trade gap.

- **Promotion of transit links between Bangladesh and India.** India agreed on transit rights for goods from India's northeastern state of Tripura to Chittagong, including a new rail link. The links will benefit both countries by reducing transport costs for Indian exporters in the border regions and by gaining greater revenues for Bangladesh from transit and port fees.
- **Regional trade facilitation.** India agreed to a long-pending request from Bangladesh to allow rail transit from Bangladesh to Bhutan and Nepal, thereby benefiting all three of India's regional trade partners. The provisions also provide greater access to India's underused port facilities and services, enabling landlocked regions in Bangladesh, Bhutan, and Nepal to gain greater market access for their exports.

## Other Trade Agreements

### *Afghanistan–Pakistan*

Pakistan has a transit treaty with landlocked Afghanistan. Until recently, Afghan transit goods through Pakistan were transported under the Afghan Transit Trade Agreement, which was signed by the two countries in 1965. Under the agreement, five transit routes are available for transit trade through Pakistan: Peshawar–Torkham and vice versa, Chaman–Spin Boldak and vice versa, Ghulam Khan Kelli, Port Qasim, and Karachi Port. India has used the road route through Wagah to import goods from Afghanistan since 1948. However, Pakistan has not given any transit rights to India to access the Afghanistan market for its exports.

In July 2010, Afghanistan and Pakistan signed the Afghanistan–Pakistan Transit Trade Agreement, which, once ratified by the two governments, will represent a major overhaul of the 1965 agreement. The 2010 agreement updates and improves the joint transit system to reflect current economic conditions, infrastructure, technology, and transport practices. The new transit regime increases the number of transport routes available to trucks from both countries, lowering the cost of imports and making exports more competitive in the global market (ADB 2012b).

### *Bhutan–India Trade, Commerce, and Transit Agreement*

Bhutan and India first signed an agreement on trade and commerce in 1972.<sup>5</sup> It has been renewed regularly, most recently in 2006. The current agreement is valid until 2016, and has the following benefits, among other things:

- (i) There is free trade and commerce between the two countries.
- (ii) Bhutan can impose nontariff restrictions on imports of certain goods of Indian origin for protection of its industries.
- (iii) Both countries can impose nontariff restrictions on entry into their territories of goods of third country origin.
- (iv) All exports and imports of Bhutan to and from countries other than India will be free from trade restrictions and custom duties of the Government of India.
- (v) India provides 16 entry/exit points for Bhutan's trade with it and other countries.

<sup>5</sup> ADB (2012b), Bhandari (2011).

- (vi) All trade-related transactions are conducted by the two countries in their national currencies.
- (vii) There is refund of excise duties on one country's exports to the other.

#### *Bangladesh and Bhutan Agreements on Trade and Transit*

Two agreements<sup>6</sup> were signed in 1980, the first one on trade and the second on transit. The trade agreement was last renewed in 2009.<sup>7</sup> Among other things, the trade agreement aims to

- (i) promote, diversify, expand, and facilitate bilateral trade between the two countries;
- (ii) grant MFN status to each other;
- (iii) negotiate tariff concessions through mutual consultations;
- (iv) provide trade facilitation services and support speedy movement of trade cargo; and
- (v) provide eight entry and exit points by Bangladesh to Bhutan for its bilateral trade.

Despite provision in the agreement for conducting trade on an MFN basis, Bhutan does not levy tariffs on imports from Bangladesh. Likewise, Bangladesh accords duty-free entry to 18 major commodities of export interest for Bhutan. While Bhutan has consistently experienced a balance of trade surplus with Bangladesh, this has not been the case with any other country in the region.

## Comparison of SAFTA with Bilateral Trade Agreements in South Asia

### Tariff Liberalization Program

The tariff liberalization programs under the India–Sri Lanka and Pakistan–Sri Lanka bilateral FTAs are more aggressive than that under SAFTA (Tables 4.6, 4.7, and 4.8).

**Table 4.6: Tariff Phasing-Out Period for SAARC Countries Under SAFTA**

Tariff Phasing-Out List	Period (years)	Tariff Reduction
NLDC to NLDC	3	0%–5%
Sri Lanka	6	0%–5%
LDC to all contracting states	8	0%–5%
NLDC to LDC	3	0%–5%

LDC = least-developed country, NLDC = non-least developed country.

Source: Secretariat of the South Asian Association for Regional Cooperation.

<sup>6</sup> ADB (2012b), Bhandari (2011)

<sup>7</sup> Bangladesh is reluctant to renew the lapsed bilateral transit agreement with Bhutan because Bangladesh wants to replace the agreement with a broader regional agreement to facilitate transit with India and Nepal.

**Table 4.7: Tariff Phasing-Out Period for India–Sri Lanka Free Trade Agreement**

Tariff Phasing-Out List	Period (years)	Duty Concession	
India	3	100% in March 2003	
Sri Lanka	8	70% in March 2006	100% in March 2008

Source: Board of Investment of Sri Lanka.

**Table 4.8: Tariff Phasing-Out Period for Pakistan–Sri Lanka Free Trade Agreement**

Tariff Phasing-Out List	Period (years)	Duty Concession
Pakistan	3	0%–5% by 2013
Sri Lanka	5	0%–5% by 2014

Source: Board of Investment of Sri Lanka.

### Rules of Origin

Preferential tariffs are accompanied by rules of origin (RoO) that must be complied with by the exporter to enjoy lower tariffs. If RoO are too lax, trade deflection will occur by encouraging nonmembers to transship goods through the country with the lowest external tariffs and thereby defeat the purpose of increasing trade integration among members. Table 4.9 summarizes the general RoO in the regional and bilateral trade agreements of South Asia. The agreements all use a combination of value-added and change-in-tariff classification approaches in designing their respective RoO. Under the value-added rule, the higher the percentage of free on board (FOB) required, the more difficult it is to comply. For a change-of-tariff classification, there are three rules by which a non-originating good acquires origin: a change in chapter, a change in tariff heading (CTH), and a change in tariff subheading. Generally, a change in chapter is more difficult to comply with than a CTH, which in turn is more difficult to comply with than a change in tariff subheading. This follows because the transformation required at the chapter level is greater than that at the heading level, which in turn is more difficult than that at the subheading level.

The proliferation of bilateral and regional FTAs has necessarily been accompanied by overlapping RoO. The main reason for the existence of RoO in FTAs is to prevent trade deflection, which would mean that the country with the lowest external tariff acts as port of entry for the entire bloc's imports, depriving partners of tariff revenue. However, the proliferation of RoO can lead to what Bhagwati termed the "spaghetti bowl effect." Complex RoO increases administrative, compliance, and business costs, particularly for small and medium-sized enterprises, which have limited capacity to deal with them. Furthermore, the demands of negotiating multiple RoO increasingly strains the scarce trade negotiation resources of many South Asian countries, particularly in the least developed countries.

Multiple RoO (e.g., value-added rules or changes in customs classification) arising from overlapping agreements among South Asian countries under SAFTA and different bilateral FTAs have significant implications for trade and welfare in the region. Depending upon how

Table 4.9: Rules of Origin in the Regional and Bilateral Trade Agreements

Regional or Bilateral Trade Agreement	Value Addition Requirement	Change in Tariff Heads	Regional Cumulation
South Asian Free Trade Area	30% for LDCs, 35% for Sri Lanka, and 40% for India and Pakistan	Change in tariff head at the four-digit HS code	Value of inputs from other members plus domestic value addition is not less than 50% of FOB value. Domestic value content must not be less than 20% of the FOB value.
India–Sri Lanka Bilateral Free Trade Agreement	35%	Change in tariff head at the four-digit HS code	Value of inputs from other member plus domestic value addition is not less than 35% of FOB value. Domestic value content must not be less than 25% of the FOB value.
India–Nepal Trade Treaty	30% for Nepal. But, India does not enjoy any preference. Therefore, India–Nepal Trade Treaty is silent about RoO (value addition) requirement for India's exports to Nepal. In actual practice, India's exports to Nepal have never been subjected to RoO requirements.	Change in tariff head at the four-digit HS code	No mention
Pakistan–Sri Lanka Bilateral Free Trade Agreement	35%	Change in tariff head at the six-digit HS code	Value of inputs from other member plus domestic value addition is not less than 35% of FOB value. Domestic value content must not be less than 25% of the FOB value.
BIMSTEC	Proposed: 35%–40% for the developing countries and 30% for LDCs	Proposed: change in tariff head to be included in the RoO, but not yet decided	Not yet decided
ASEAN	ASEAN content of 40% or higher	Change in tariff head at the four-digit HS code	The final process of manufacture is performed within the territory of the exporting member state and local content must be higher than 40%.

ASEAN = Association of Southeast Asian Nations, BIMSTEC = Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation, FOB = free on board, HS = Harmonized Commodity Description and Coding System, LDC = least developed country, RoO = rules of origin.

Sources: Raihan, S. 2008. *Rules of Origin and Sensitive List under SAFTA and Bilateral FTAs among South Asian Countries: Quantitative Assessments of Potential Implications for Nepal*. MPRA Paper No 37893, Munich: Munich University Library;

they are specified, RoO under South Asian bilateral FTAs and those under SAFTA can— to varying degrees—restrict trade, misdirect investment, inhibit productivity growth, and reduce welfare from levels otherwise attainable. SAFTA would be relatively less attractive to South Asian countries if its RoO are more restrictive and costly than those under bilateral FTAs. If this were to be the case, potential trade and welfare benefits under SAFTA would be diluted by bilateral FTAs. Consequently, SAFTA would lose its relevance.

In addition to the RoO issue, bilateral and regional FTA agreements allow the member countries to maintain sensitive lists of products outside of the trade liberalization program. Under SAFTA, the sensitive lists maintained by the NLDCs, especially by India, prevent the least developed members from expanding their exports significantly.

### Settlement of Disputes

The dispute settlement provisions under SAFTA are more stringent than those of the India–Sri Lanka and Pakistan–Sri Lanka bilateral FTAs (Table 4.10).

**Table 4.10: Settlement of Disputes**

Agreement	Major features in the treaty
South Asian Free Trade Area	<ol style="list-style-type: none"> <li>1. Any dispute that may arise among the Contracting States regarding the interpretation and application of the provisions of this Agreement or any instrument adopted within its framework concerning the rights and obligations of the Contracting States will be amicably settled among the parties concerned through a process initiated by a request for bilateral consultations.</li> <li>2. Any Contracting State may request consultations with other Contracting State in writing stating the reasons for the request including identification of the measures at issue. All such requests should be notified to the Committee of Experts, through the SAARC Secretariat with an indication of the legal basis for the complaint.</li> <li>3. If a request for consultations is made pursuant to this treaty, the Contracting State to which the request is made shall, unless otherwise mutually agreed, reply to the request within 15 days after the date of its receipt and shall enter into consultations in good faith within a period of no more than 30 days after the date of receipt of the request, with a view to reaching a mutually satisfactory solution.</li> <li>4. If the Contracting State does not respond within 15 days after the date of receipt of the request, or does not enter into consultations within a period of no more than 30 days, or a period otherwise mutually agreed, after the date of receipt of the request, then the Contracting State that requested the holding of consultations may proceed to request the Committee of Experts to settle the dispute in accordance with working procedures to be drawn up by the Committee.</li> <li>5. Consultations shall be confidential, and without prejudice to the rights of any Contracting State in any further proceedings.</li> <li>6. If the consultations fail to settle a dispute within 30 days after the date of receipt of the request for consultations, to be extended by a further period of 30 days through mutual consent, the complaining Contracting State may request the Committee of Experts to settle the dispute. The complaining Contracting State may request the Committee of Experts to settle the dispute during the 60-day period if the consulting Contracting States jointly consider that consultations have failed to settle the dispute.</li> <li>7. The Committee of Experts shall promptly investigate the matter referred to it and make recommendations on the matter within 60 days from the date of referral.</li> </ol>

*continued on next page*

Table 4.10 continued

Agreement	Major features in the treaty
South Asian Free Trade Area	<ol style="list-style-type: none"> <li>8. The Committee of Experts may request a specialist from a Contracting State not party to the dispute selected from a panel of specialists to be established by the Committee within one year from the date of entry into force of the Agreement for peer review of the matter referred to it. Such review shall be submitted to the Committee within 30 days from the date of referral of the matter to the specialist.</li> <li>9. Any Contracting State, which is a party to the dispute, may appeal the recommendations of the Committee of Experts to the SMC. The SMC shall review the matter within 60 days from date of submission of request for appeal. The SMC may uphold, modify, or reverse the recommendations of the Committee of Experts.</li> <li>10. Where the Committee of Experts or SMC concludes that the measure subject to dispute is inconsistent with any of the provisions of this Agreement, it shall recommend that the Contracting State concerned bring the measure into conformity with this Agreement. In addition to its recommendations, the Committee of Experts or SMC may suggest ways in which the Contracting State concerned could implement the recommendations.</li> <li>11. The Contracting State to which the Committee's or SMC's recommendations are addressed shall, within 30 days from the date of adoption of the recommendations by the Committee or SMC, inform the Committee of Experts of its intentions regarding implementation of the recommendations. Should the said Contracting State fail to implement the recommendations within 90 days from the date of adoption of the recommendations by the Committee, the Committee of Experts may authorize other interested Contracting States to withdraw concessions having trade effects equivalent to those of the measure in dispute.</li> </ol>
India–Sri Lanka Free Trade Agreement	<ol style="list-style-type: none"> <li>1. Any dispute that may arise between commercial entities of the Contracting Parties shall be referred for amicable settlement to the nodal apex chambers. Such references shall, as far as possible, be settled through mutual consultations by the Chambers. In the event of an amicable solution not being found, the matter shall be referred to an Arbitral Tribunal for a binding decision. The Tribunal shall be constituted by the Joint Committee in consultation with the relevant Arbitration Bodies in the two countries.</li> <li>2. Any dispute between the Contracting Parties regarding the interpretation and application of the provisions of this Agreement or any instrument adopted within its framework shall be amicably settled through negotiations failing which a notification may be made to the Committee by any one of the Contracting Parties.</li> </ol>
Pakistan–Sri Lanka Free Trade Agreement	<ol style="list-style-type: none"> <li>1. Any dispute that may arise between commercial entities of the Contracting Parties shall be referred for amicable settlement to the nodal Chambers. Such references shall, as far as possible, be settled through mutual consultations by the Chambers. In the event of an amicable solution not being found, the matter shall be referred to an Arbitration Tribunal for a binding decision. The Tribunal shall be constituted by the Joint Committee.</li> <li>2. Any dispute between the Contracting Parties regarding the interpretation and application of this Agreement or any instrument adopted within its framework shall be amicably settled through negotiations failing which a notification may be made to the Committee by any one of the Contracting Parties for settlement of the dispute.</li> </ol>

SAARC = South Asian Association for Regional Cooperation, SMC = SAFTA Ministerial Council

Source: SAARC. Agreement on SAFTA. <http://www.saarc-sec.org/userfiles/saftaagreement.pdf> (accessed 1 April 2014).

## Sensitive Lists

The sensitive list acts as a major hindrance to trade expansion in South Asia. Baysan et al. (2006) analyzed the political economy of the selection of excluded sectors and RoO. When countries are allowed to choose sectors that can be excluded from tariff references in an FTA, domestic lobbyists ensure that the sectors in which they may not be able to withstand competition from the union partner are the ones that get excluded. The RoO can also be abused by the bureaucracy administering them. In cases where imports from the partner may be threatening an inefficient domestic competitor, bureaucratic discretion may be employed to block entry of the imports.

### *Sensitive List under SAFTA*

SAFTA provides scope for maintaining sensitive lists, which are not subject to the tariff reduction program. Although the agreement maintains that sensitive lists shall be different for LDCs and non-LDCs, only four countries—Bangladesh, India, Nepal, and Sri Lanka—maintain different sensitive lists for LDCs and non-LDCs. The LDCs maintain longer sensitive lists than the non-LDCs.

The Working Group on Reduction in the Sensitive Lists under SAFTA has completed its task of reducing the sensitive lists by 20%. The Maldives has reduced its sensitive list from 681 tariff lines to 152 (78% reduction), and India has reduced its sensitive list for LDC members from 480 tariff lines to only 25 (95% reduction). The number of products covered in the sensitive lists before and after the 20% or more reduction is shown in Table 4.11.

**Table 4.11: Sensitive Lists of SAFTA Members Before and After the 20% or More Reduction**

Member	Number of Products in the Earlier Sensitive Lists	Number of Products in the Revised Sensitive Lists (Phase-II) Effective 1 January 2012
Afghanistan	1,072	858
Bangladesh	1,233 (LDCs), 1,241 (NLDCs)	987 (LDCs), 993 (NLDCs)
Bhutan	150	156
India	480 (LDCs), 868 (NLDCs)	25 (LDCs), 614 (NLDCs)
Maldives	681	154
Nepal	1,257 (LDCs), 1,295 (NLDCs)	998 (LDCs), 1,036 (NLDCs)
Pakistan	1,169	936
Sri Lanka	1,042	837 (LDCs), 963 (NLDCs)

LDC = least developed country, NLDC = non-least developed country.

Source: South Asian Association for Regional Cooperation Secretariat. Revised Sensitive Lists Under SAFTA (Phase-II) [http://saarc-sec.org/areaofcooperation/detail.php?activity\\_id=35](http://saarc-sec.org/areaofcooperation/detail.php?activity_id=35)

However, a major flaw of the SAFTA treaty is that it does not subscribe categorically to phasing out the negative list or eliminating nontariff barriers, let alone prescribing time limits for doing so. It only provides that the negative list shall be reviewed after every 4 years with a view to reducing the number of items further.

#### *Sensitive Lists Under Different Bilateral Free Trade Agreements in South Asia*

Among the regional and bilateral FTAs, the India–Nepal Trade Treaty appears to have the shortest negative list for Nepal as far as the Indian market is concerned. Under this treaty, only three categories of products are specified in the Indian negative list, whereas under SAFTA, as an LDC, Nepal is supposed to receive no concessions on exports of 744 items at the four-digit HS code to the Indian market. Compared with other bilateral FTAs (e.g., India–Sri Lanka and Pakistan–Sri Lanka), the negative lists of the SAFTA members appear to be too long (Table 4.12).

SAARC leaders, the SAFTA Ministerial Council, and meetings of SAARC finance ministers have been urging further reductions in the number of products on the sensitive lists, especially the elimination of those that are actively traded or have the potential to be traded under SAFTA. The reduction should focus on products that are of export interest to members.

**Table 4.12: Comparison of Sensitive Lists under Different Bilateral Free Trade Agreements and Trade Treaties in South Asia**

Treaty or Agreement	Negative List	
India–Sri Lanka FTA	India: 429 items	Sri Lanka: 1,220 items
India–Nepal Trade Treaty	India: 3 categories	
Pakistan–Sri Lanka FTA	Pakistan: 540 HS tariff lines (products) at six-digit level	Sri Lanka: 697 HS tariff lines (products) at six-digit level

FTA = Free Trade Agreement, HS = Harmonized Commodity Description and Coding System.

Sources: Department of Commerce. Government of India. [http://commerce.nic.in/india\\_rta.htm](http://commerce.nic.in/india_rta.htm) (accessed 1 March 2014); Department of Commerce. Government of Sri Lanka. [www.doc.gov.lk](http://www.doc.gov.lk) (accessed 1 March 2014); Ministry of Commerce. Government of Pakistan. <http://www.commerce.gov.pk/> (accessed 1 March 2014).

#### *How SAFTA Could Embrace Bilateral Free Trade Agreements in South Asia*

Tariff reduction or elimination provisions in the India–Sri Lanka FTA and Pakistan–Sri Lanka bilateral FTAs are broader and deeper than those under SAFTA; the bilateral FTAs have greater product coverage, and the preferences granted are deeper. In 2008, 70%–80% of bilateral trade between India and Sri Lanka was duty free; in 2010, about 80% of duties on Pakistan–Sri Lanka trade were eliminated. By comparison, SAFTA's liberalization achieved a floor rate of 0%–5% with Sri Lanka in 2012 and with Pakistan in 2013, and will achieve this with the LDCs only in 2016. In effect, the concessions Sri Lanka receives from India and Pakistan under the bilateral FTAs are better than those available under SAFTA. A more proactive policy initiative would be for SAFTA to match the deeper tariff cuts of bilateral FTAs by initiating a review of all current commitments, with the objective of accelerating tariff reductions to converge with those provided in the bilateral FTAs. As preferential tariffs

in SAFTA move closer to those provided in bilateral FTAs, the schedule of commitments will become similar and will eventually be identical.

SAFTA's RoO must be revised in view of the difficulties LDCs face meeting the 30% value addition requirement. In addition, the change in tariff head criteria should be made consistent with those that are in force in the bilateral FTAs, which are more liberal than the SAFTA rules. For example, the Pakistan–Sri Lanka FTA has a relatively flexible rule in this regard. Strict proof of origin is mainly necessary to prevent trade deflection, which is potentially most serious when there are wide differences in the members' external tariffs. SAFTA should therefore seek to reduce both the absolute level of external tariffs and the intercountry differences in tariff rates.

Given that preferences in bilateral FTAs are deeper, SAFTA could compensate or correct the situation by easing the RoO. It could do this by (i) introducing a “de minimis” rule—a leniency feature where a specified maximum percentage of non-originating materials is allowed without affecting the determination of origin; and (ii) lowering the regional cumulation rule to an aggregate minimum content closer to 35%—the rate offered in bilateral FTAs. It would be easier to introduce more lenient RoO than it would be to lower tariffs to match those granted in bilateral FTAs because the change would not be perceived as losing a price advantage as a result of lower tariffs.



## CHAPTER V

# Informal Trade in South Asia

*Nisha Taneja and Radhika Saini*

## Introduction

Informal trade in South Asia is substantial, and it is important to better understand its magnitude and the institutional factors that facilitate or promote this trade. A better understanding of its magnitude, together with official data on formal trade, will provide a stronger basis for formulating trade policies for the South Asian Association for Regional Cooperation (SAARC). In turn, a better understanding of the institutional factors that facilitate or promote informal trade includes answers to a series of questions. What is the transactional environment for informal trade? What motivates such trade and how does it differ from formal trade? And what are the implications for regional trade agreements?

Informal trade is motivated by the incentive of evading high tariffs. Moreover, if there are wide tariff differentials between countries, then there will be an incentive for the country with the lower tariff to import from a third country and reexport informally. Other incentives include quantitative restrictions. For example, informal trade between India and Pakistan is conducted in part through Dubai, as a way of circumventing restrictions on imports imposed by both countries.

Stringent rules of origin (RoO) can be another stimulus for informal trade. The numerous bilateral free trade agreements and other trade arrangements in South Asia have necessitated rules of origin (RoO) in each case, to ensure that goods from third countries passing through a country that is a member of the agreement meet domestic content requirements and are therefore eligible for duty-free entry. Rules of origin (RoO) can be complex and nontransparent, and are sometimes used as an excuse to block official trade, making informal trade an attractive option.

Informal trade could also be prompted by domestic policy distortions. For instance, a trader may have an incentive to buy subsidized commodities (e.g., rice) from the public distribution system and transport it informally to a neighboring country where the prices are higher. The dual pricing policy followed by India makes some essential goods and agricultural commodities cheaper than those sold in the open markets. Stocks of essential

commodities, such as food grains, fuel, kerosene, cement, rice, and sugar, are maintained at border points and are subsequently exported informally to Bangladesh and Nepal.

Noneconomic and institutional factors may further prompt informal trade. Efficient institutional arrangements may support informal trade, such as a better payments mechanism or a good marketing distribution network. These factors would attract traders to the informal channel.

The official machinery for formal trade may be very cumbersome, causing delays and higher costs. Moreover, rent-seeking by various authorities may dissuade traders from using official channels. Inadequate transit and transport systems in South Asia may prompt traders to seek informal channels (Taneja 1999). Other factors supporting informal trade include strong ethnic links, which help ensure payments are made, and the low education levels of many traders, hence their difficulty in dealing with official requirements (e.g., documentation).

Although substantial, informal trade in South Asia has not been extensively researched. Except for a few recent studies, estimates of informal trade date from the mid-1990s when limited tariff concessions were introduced under the SAARC Preferential Trade Arrangement (SAPTA). Since the signing of the South Asian Free Trade Area (SAFTA) in 2006, India has provided duty-free access to the less-developed countries of SAARC. Another major development has been the process of normalizing trade relations between India and Pakistan, and Pakistan's shift from a positive to a negative list.<sup>1</sup> Quantitative restrictions have been eased but have been replaced to some extent by the more rigorous application of product standards, with the result of continuing to encourage informal trade. These developments are likely to have an impact on the magnitude, composition, and direction of informal trade in the region. More recently, SAARC member countries have endorsed the World Trade Organization (WTO) Trade Facilitation Agreement, under which formal trade will be facilitated, potentially lessening the degree of informal trade.

Thus, the context for informal trade has changed considerably since earlier studies were completed, leaving a gap in the literature for South Asia. The literature on informal trade in Africa, Central Asia, and other regions of the world, however, can help provide a framework for studies on informal trade in South Asia.

## A Framework for Analysis

Pohit and Taneja (2000, 2002, and 2003), Taneja et al. (2005), and Taneja and Pohit (2002) concluded that the thriving informal trade in South Asia indicated the presence of supportive institutional mechanisms. They drew further insights from the literature on new institutional economics (NIE), which questions two fundamental assumptions of neoclassical economics—costless transactions and perfect information. Rather, NIE emphasizes the role of institutions in reducing transaction costs, providing a predictable

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<sup>1</sup> Pakistan now allows India to export all products to Pakistan, except a negative list of 1,200 items, allowing Pakistan to import over 6,800 items from India under the new policy. Previously, Pakistan traded with India under a positive list structure that allowed imports of fewer than 2,000 items.

framework for trade and helping to overcome imperfect information (Assaad 1993, Bardhan 1989). The acceptance of costs associated with acquiring market information and concluding market transactions differentiates NIE from neoclassical economic theory. Institutions are intermediaries through which information and costs are transacted (Harriss, Hunter, and Lewis 1995). Landa (1994) added the role of ethnic trading networks in developing societies as an alternative to contract law in more developed societies. Ethnic trading networks, such as those of Chinese traders in Southeast Asia, function as an institution helping traders reduce their transaction costs. Likewise, MacGaffey and Bazenguissa-Ganga (2000) highlighted the ethnic, kinship, religious, and friendship networks of Congolese traders' networks. Pohit and Taneja (2000), Taneja and Pohit (2002), and Taneja et al. (2005) concluded that formal institutional arrangements may be more costly to organize, maintain, and enforce than institutional arrangements for informal trade.

Under formal trading arrangements, recourse to law defines contracts between contracting parties, ensuring that goods move across borders and payments are made. Informal traders cannot resort to law, and hence they have developed alternative institutional mechanisms for contract enforcement and dispute settlement, as well as for information and risk management.

If transaction costs of informal trade are lower than that of formal trade, informal and formal trade may coexist. Pohit and Taneja (2000), Taneja and Pohit (2002), and Taneja et al. (2005) explored this possibility through having formal and informal institutions perform similar cross-border trade transactions to (i) understand how informal trading markets function compared to formal trading arrangements, (ii) analyze the relative importance of institutional factors compared to trade and domestic policy distortions, and (iii) see whether informal trading arrangements provided better institutional solutions than formal ones.

How informal trade is defined clearly affects estimates of its magnitude. Earlier studies equated informal trade with smuggling and therefore considered all such exchanges to be illegal. More recent literature broadens the definition of informal trade to include trade flows that escape state procedures. Most studies of South Asia have defined informal trade flows as unrecorded trade that should be included in the national income statistics. Such trade could pass through formal channels designated as official points of trading, or goods could move across permeable borders but escape the state procedures.

Lesser and Leeman (2009) reviewed a number of studies on informal trade in selected sub-Saharan African countries. This involved goods traded by formal and informal firms that were unrecorded officially and thus avoided customs controls and payment of duties and charges. Such practices could include under-invoicing, misclassification, failure to make a declaration, or bribery of customs officials. The Lesser and Leeman study sought to identify trade facilitation measures that had the potential to encourage traders to switch from informal to formal trade.

Kaminiski and Mitra (2011) examined bazaar-facilitated border trade in Central Asia, particularly in terms of employment and income generation in border areas. The study noted the significant welfare and employment gains accruing from bazaar trade. It advised

against imposing regulatory or fiscal burdens that would hamper legitimate bazaar activity, beyond the minimum necessary for health, consumer protection, security, and public order. This view was reinforced by the finding that the bazaars meet five important requisites of effective markets: high levels of trust, security of property, information about available goods and their quality, limited side effects for third parties, and open competition.

## Methodologies for Estimating Informal Trade Flows

Estimates of informal trade are based on primary and secondary data. Secondary data have been used to make partner country data comparisons in South Asia and Central Asia. The common method used to quantify informal trade in South Asia has been primary surveys. While some of the studies used a single-round survey, others processed multiple rounds of surveys using the Delphi technique. Such estimates were largely based on the perceptions of the respondents rather than referenced data. A more comprehensive framework for quantifying informal trade has been adopted in African and Central Asian countries. It involves three techniques for collecting primary information applied individually or in combination: border monitoring, tracking, and stocktaking.

### Partner Country Data Comparisons

Empirical studies based on secondary data using partner country data comparisons have been undertaken by Bhagwati (1964) in Turkey, Naya and Morgan (1969) in Southeast Asia, Simkin (1970) in Indonesia, and Nayak (1977) to detect informal trade. The gap between reported export and import data of partner countries is indicative of false or fake invoicing and thus informal trade. However, as recognized by Yeats (1995), there may be a number of legitimate reasons for this gap, the most important being the discrepancy between the reporting practices for exports (usually free on board) and imports (reported with cost, insurance, and freight values). Other discrepancies in data could be caused by the differences in classification or time lags between reports of exports and imports. Recognizing these limitations in the context of South Asia, Chaudhari (1995), Sarvananthan (2001), and Taneja et al. (2002) attempted to detect the extent of false or fake invoicing for India–Bangladesh, India–Sri Lanka, and India–Nepal trade. In the case of India–Bangladesh trade, Chaudhari (1995) found that export and import values varied considerably, indicating misclassification and false or fake invoicing in both countries. While the study estimated the level of informal trade between the two countries based on partner country data, the statistical errors owing to misclassification and false or fake invoicing did not allow for a realistic estimation of the extent of such trade. Sarvananthan (2001) pointed out that there was no single pattern of false invoicing, and that it is a two-way pervasive process. Taneja (2001) found that a comparison of the national statistics of India and Nepal shows a considerable extent of over-invoicing of exports and imports. It is difficult, therefore, to assess the level of misdeclaration by comparing partner country trade data. Another complication is that International Monetary Fund (IMF) data indicate that misdeclaration is limited, which would seem contradictory to the finding that trade is frequently not recorded at either end.

Despite these difficulties, a large part of the literature on informal trade in Central Asia has relied on partner country data comparisons. Kaminiski and Mitra (2011) analyzed the discrepancy between the reported value of exports from the People’s Republic of China

(PRC) to the Kyrgyz Republic and the value of imports from the PRC officially reported by the Kyrgyz Republic. The data indicated that exports to the Kyrgyz Republic from the PRC were far higher than the value of reported imports. The study noted that it would have been impossible for the Kyrgyz Republic to consume these unreported imported goods domestically, as it lacked the resources to finance such a large trade deficit. The authors suggested that these goods were reexported to neighboring Central Asian economies through the intermediation of the bazaars. However, Mogilevskii (2012) questioned the reliability of the PRC data, indicating that while Central Asian sources underestimate trade flows, the PRC sources overestimate them. The author observed that since customs clearance is done on the basis of weight of consignments rather than value, the weight data are likely to be more reliable. He compared mirror data on the weight of the commodities traded rather than export and import data. His analysis shows that the discrepancy in mirror data based on weight is much lower than the discrepancy estimated by Kaminisky and Mitra (2011).

## Primary Surveys

### *Single Round of Perception Surveys*

Primary surveys were used in several studies to estimate informal trade flows between pairs of countries in South Asia. The World Bank (2006b) surveyed India–Bangladesh informal trade, distinguishing between bootleg and technical smuggling. Bootleg smuggling was defined as involving large numbers of people individually transporting small quantities, whereas technical smuggling was defined as trade in larger quantities involving illegal practices such as under-invoicing, bribery, and misclassification. Interviews were conducted with Indian customs agents and officials in Benapole and Chittagong, as well as with Bangladesh Customs intelligence inspectors, to estimate the degree of technical smuggling.

Sarvananthan (1994) estimated India–Sri Lanka informal trade based on interviews conducted at the official and grassroots level. To estimate informal trade between India and Pakistan, limited surveys were undertaken by the Government of Pakistan (1996) and Nabi and Nasim (2001), followed by a more systematic survey conducted by Khan et al. (2005). Primary data for the Khan et al. study were collected through wide-ranging interviews with formal and informal importers and exporters, retailers, members of the chambers of commerce and industry, forwarding agents, customs officials, border rangers, security officials, wholesalers, and transporters. Estimates for Bhutan and Myanmar based on a primary survey are available in Rao et al. (1997). More recent estimates of bilateral informal trade also used single rounds of perception surveys, but their scope and coverage were limited. Karmacharya (2010) used a primary survey to estimate two-way informal trade between India and Nepal in agricultural commodities, and Ahmed et al. (2014) used this approach to quantify the magnitude of one-way informal exports from India to Pakistan.

### *Multiple Rounds of Perception Surveys: Delphi Technique*

The Delphi technique is essentially a set of procedures for eliciting and refining the opinions of a group of respondents over successive rounds of interviews. The responses obtained in successive rounds are based on feedback provided to the group from previous rounds. The iterations continue until a consensus emerges or until reasons for a lack of consensus are documented. The Delphi technique was used in several studies to estimate informal trade in South Asia. Chaudhari (1995), Rahman and Razaque (1998), and Taneja et al. (2004)

used the Delphi technique to estimate informal trade between India and Bangladesh, Nepal, and Sri Lanka.

Chaudhari (1995) modified the Delhi technique for estimating informal trade between India and Bangladesh through informal discussion with the participants and by limiting the discussions to two rounds. The survey responses were corroborated through a third round of interviews with customs officials, economic analysts, trader association executives, and divisional commissioners and/or district magistrates. Another important study on estimating India–Bangladesh informal trade was conducted by Rahman and Razzaque (1998). A questionnaire was discussed with key informants, and 15–20 knowledgeable people identified were able to respond to the questionnaire. Two or three rounds of follow-up were made with the respondents to resolve inconsistencies. To gain a more in-depth estimate of smuggling operations, a separate questionnaire was reviewed with field officers. Their field diaries were a useful source of information.

Taneja et al. (2004) also used a modified Delphi approach to quantify India's informal trade with Nepal and Sri Lanka. Further, estimates were prepared by local experts in India, Nepal, and Sri Lanka, enabling cross-comparisons and providing possible magnitudes of the degree of informal trade. In another modification of the Delphi approach, several broad categories of respondents were defined rather than a single group. For example, estimates of seaborne informal trade between India and Sri Lanka were obtained by identifying traders, government officials, and experts knowledgeable of the two-way trade.

### **Border Monitoring, Tracking, and Stock-Taking**

Border monitoring involves selecting popular border sites where enumerators can observe and estimate the volume of trade that is not officially cleared or recorded by customs authorities. Monitoring is usually for a limited number of days or weeks, and the data are extrapolated to get monthly or annual estimates. The accuracy of the estimates may be improved by monitoring on both sides of the border. A tracking technique is often used in combination with the border-monitoring approach. For example, an unrecorded container of vehicles and trucks may be traced to gather information regarding mode of movement, origin, destination, and value of goods transported. The information gathered through this method is then cross-checked against official customs declaration papers at relevant points of entry or exit.

A stock-taking approach has been recommended for open-border markets. This technique requires recording the volume of goods brought to the market by traders, amounts purchased, and carryover stocks that would be treated as beginning stocks for the next market day. This technique involves observation of traders and a survey of warehouses at the border areas to compare the observed trade data with that reported by customs. Kaminiski and Mitra (2011) used partner country data as a first step in assessing informal trade in Central Asia, and then complemented the analysis with a survey of the bazaars through stock taking.

### Estimates of Informal Trade

The estimates provided by the studies cited are summarized in Table 5.1 for 1992–2005. All estimates are point estimates and refer to the periods indicated. For India–Bangladesh, India–Pakistan, and India–Sri Lanka, multiple estimates are available. For India–Nepal and India–Sri Lanka, estimates were made separately for the same year in the partner countries. For Bhutan and Myanmar, only one estimate is available. For India–Bangladesh, estimates of total informal trade during 1992–1993 and 2002–2003 ranged from \$215 million to \$500 million. Estimates for India–Pakistan informal trade ranged from \$100 million to \$2 billion.

**Table 5.1: Estimates of India’s Informal Trade with South Asian Partners**  
(\$ million)

Country Pair	Authors	Year	Exports	Imports	Trade Balance	Total Trade
India–Bangladesh	Chaudhari	FY1993	299	14	285	313
	Rahman and Razzaque (1998)	FY1998	177	38	139	215
	World Bank (2006b)	FY2003	500	...	...	...
India–Pakistan	The Economist	1996	...	...	...	2,000
	Government of Pakistan	1996	50	50	0	100
	Nabi and Nasim	2001	...	...	...	100–500
	Khan et al. (2005)	2005	593	166	427	759
India–Sri Lanka	Sarvananthan (1994)	1992	131	111	20	242
	Taneja et al.(2004) (India)	FY2001	185	23	162	208
	Taneja et al.(2004) (Sri Lanka)	FY2001	190	15	175	215
India–Nepal	Taneja et al.(2004) (India)	FY2001	180	228	48	408
	Taneja et al.(2004) (Nepal)	FY2001	211	157	54	368
India–Bhutan	Rao et al.(1997)	FY1994	31	1	30	33
India–Myanmar	Rao et al.(1997)	FY1994	26	48	22	74

... = data not available, FY = financial year.

Source: Authors’ compilation.

Tables 5.2 and 5.3 provide a representative estimate of informal trade for each country pair, along with the value of their formal trade in the corresponding years. From these studies, some interesting features of the magnitude of informal trade can be discerned. Total informal trade in South Asia was about \$1.5 billion annually during the early 1990s to the early 2000s, or equivalent to about 50% of the value of formal trade. India’s informal trade with Nepal equaled its formal trade, with Pakistan it approximated 90% of formal trade, with Sri Lanka it was almost one-third, with Myanmar it was about one-half, and with Bhutan it was almost three times. India’s informal trade with Bangladesh in 1998 was only

about 20% the amount of formal trade. It is notable that almost half of the \$545 million of India's informal trade with Pakistan was traded officially first to Dubai and then unofficially to Pakistan via Iran and Afghanistan. Another notable feature is that India had a surplus in informal trade with Bangladesh, Bhutan, Pakistan, and Sri Lanka but a deficit in informal trade with Myanmar; two-way informal trade with Nepal was approximately balanced.

**Table 5.2: Selected Estimates of India's Informal Trade with South Asian Partners (\$ million)**

Country	Year	Exports	Imports	Trade Balance	Total Trade
Bangladesh	1998	177.0	38.3	138.7	215.3
Sri Lanka <sup>a</sup>	FY2001	185.0	23.0	162.0	208.0
Pakistan	2005	534.5	10.4	524.1	544.9
Nepal	FY2001	180.0	228.0	(48.0)	408.0
Bhutan	FY1994	31.3	1.2	30.1	32.6
Myanmar	1994	25.7	47.8	(22.1)	73.5
Total		1,133.5	348.7	784.8	1,482.3

(-) = negative, FY = financial year.

Note: Numbers may not sum precisely because of rounding.

<sup>a</sup> The data were calculated using estimates in the Indian territory as estimates for seaborne trade were not available in Sri Lanka.

Sources: Rahman and Razzaque 1998 (India-Bangladesh), Taneja et al. 2004 (India-Sri Lanka and India-Nepal), Khan et al. 2005 (India-Pakistan), and Rao et al. 1997 (India-Bhutan and India-Myanmar).

**Table 5.3: India's Formal Trade with South Asian Economies (\$ million)**

Country	Year	Exports	Imports	Trade Balance	Total Trade
Bangladesh	1998	995.2	62.4	932.8	1,057.6
Sri Lanka	FY2001	640.0	45.0	595.0	685.0
Pakistan	2005	593.0	165.9	427.1	758.9
Nepal	FY2001	141.0	255.0	(114.0)	396.0
Bhutan	FY1994	9.9	2.9	6.9	12.9
Myanmar	1994	24.0	120.0	(96.0)	144.0
Total		2,403.1	651.2	1,751.8	3,054.5

(-) = negative, FY = financial year.

Note: Numbers may not sum precisely because of rounding.

Source: United Nations. UNCOMTRADE Database. <http://comtrade.un.org> (accessed 15 March 2014).

## Composition of Informal Trade

The studies cited were based on aggregations of commodity-wide estimates. Commodity shares of the top 5 informally traded items provided in these studies are shown in Tables 5.4 and 5.5.

Textiles and food items were India's top traded informal exports to other South Asian countries. India's informal exports of textiles were especially important for Bhutan, Pakistan, and Sri Lanka, accounting for more than one-third of India's total informal trade. For each country pair, however, the relative importance of different commodities varied. For Bangladesh, live animals were the largest category; for Myanmar, medicines and diamonds were the most important items. The composition of informal exports from India to Pakistan was governed in large part by Pakistan's positive list during this time. A large number of textile items (such as ready-made garments and made-up items) were not included in the positive list for Pakistan, explaining the substantial informal trade in this category. Cosmetics (such as creams and soaps) and many electrical and mechanical items were also excluded in Pakistan's positive list.

The pattern of informal imports to India was more diversified, although textiles were again a substantial item of trade. Close to 90% of India's informal imports from Pakistan was in this category, and textiles were among the top five traded items with Bangladesh, Myanmar, and Nepal. Another significant set of informal imports to India was cigarettes and liquor, especially from Bhutan and Myanmar. Spices, electronics, and gold were also important.

**Table 5.4: Indian Informal Exports: Top Exports in Total Informal Exports (%)**

Commodities	Harmonized System 2-Digit Code	Bangladesh (FY1997)	Sri Lanka (FY2001)	Nepal (FY2001)	Pakistan (2005)	Bhutan (1995)	Myanmar (1995)
Textiles/cloth including ready-made suits and sarees	50–63	24.7	57.2	17.4	35.7	38.5	
Food (processed/unprocessed)	6–24	19.5	3.8	29.7		43.0	
Livestock/poultry/fish	1–5	41.0			6.2	2.2	
Transport parts	86–89	7.5		8.1	14.7		
Cosmetics and toiletries	33–34	1.9			11.9		
Electrical and mechanical items	84–85		20.9	4.6	14.0	3.7	7.4
Utensils	73–76, 82		11.7			9.1	
Medicines	30		1.1				35.4
Cement	25			11.5			
Diamonds	71						35.2
Paint	32						15.2
Urea (fertilizer)	31						1.7

FY = financial year.

Sources: Rahman & Razzaque 1998 (India–Bangladesh), Taneja et al. 2004 (India–Sri Lanka and India–Nepal), Khan et al. 2005 (India–Pakistan), and Rao et al. 1997 (India–Bhutan and India–Myanmar).

**Table 5.5: Indian Informal Imports: Top Imports in Total Informal Imports**  
(%)

Commodities	Harmonized System 2-Digit Code	Bangladesh (FY1997)	Sri Lanka (FY2001)	Nepal (FY2001)	Pakistan (2005)	Bhutan (1995)	Myanmar (1995)
Gold	71	38.7					7.9
Hilsa fish	3	20.8					
Copper, brass, and bell metal	74, 83	18.8					
Textiles	50–63	17.0		34.5	89.0		6.1
Spices	9		37.0	5.4			
Electronics	85		29.8	35.3		5.1	
Cosmetics	33–34		21.3				
Cigarettes and liquor	22, 24		10.7		1.0	85.7	51.8
Bags and suitcases	42			7.3			
Ball bearings	84			5.1			
Dry fruit	8				4.1		
Footwear	64				0.5	4.0	
Prayer mats	57				0.5		
Video games/CDs	85				0.9		
Kerosene oil	27					2.8	
Oranges	8					2.2	
Livestock	1–5						7.8
Stones and pearls	71						6.3

FY = financial year.

Sources: Rahman–Razzaque 1998 (India–Bangladesh), Taneja et al.2004 (India–Sri Lanka and India–Nepal), Khan et al.2005 (India–Pakistan), and Rao et al. 1997 (India–Bhutan and India–Myanmar).

## Reasons for Informal Trade in South Asia

Based on the analytical framework provided by Pohit and Taneja (2000, 2002, and 2003) and Taneja et al. (2005), the factors determining informal trade flows can be classified into two broad categories: (i) those related to trade policy barriers and domestic policy distortions, and (ii) institutional and other factors. Drawing from this framework, a survey canvassed responses on informal trading between India and Nepal, Bangladesh, and Sri Lanka. The factors considered included presence of high duties in official channels, quantitative restrictions, imports from a third country, leakage of administered priced goods, absence or shortage of storage or warehousing facilities, local production across the border, presence of haats (bazaar), lower transport costs, less time to reach destination for perishable and/or nonperishable commodities, absence of trading routes, lack of procedural delays, absence of paperwork, quick realization of payments, lower bribes, nexus between enforcement agencies and traders, and ethnic ties. Table 5.6 identifies the five most important reasons for informal trade between India and Bangladesh, Nepal, and Sri Lanka.

**Table 5.6: Reasons for Informal Trade: Top Five Factors for Each Economy**

Factors	India–Bangladesh		India–Sri Lanka		India–Nepal		India–Pakistan
	India to Bangladesh	Bangladesh to India	India to Sri Lanka	Sri Lanka to India	India to Nepal	Nepal to India	
Factors of Informal Trade							
Low transport costs	√	√			√	√	√
Lower time to reach the destination	√		√	√			
Imported from third country				√		√	
Absence of paperwork	√	√	√		√	√	√
Lack of procedural delays	√	√	√	√	√		√
Lower bribes					√	√	√
Quick realization of payments	√	√	√	√	√	√	
Ethnic ties across the border	√		√	√			
High duties in the official channel		√					√
Granting of MFN status							√
Items banned from formal trade							√

MFN = most favored nation.

Sources: Pohit and Taneja 2000 (India–Bangladesh), Taneja et al. 2005 (India–Sri Lanka), Pohit and Taneja 2000 (India–Nepal), and Khan et al. (2005).

Quick realization of payment, absence of paperwork, and lack of procedural delays were among the top five factors prompting informal trade. Traders noted that payments could be realized within a day, and that no formal banking channel could compare with the efficiency of informal banking channels. Informal traders are not equipped to handle the time-consuming and complex procedures of the formal channels.

Lower transport costs were an important reason for trading informally in Bangladesh, India, Nepal, and Pakistan, circumventing the inadequate transport systems and high transport costs in the four countries. The survey identified the following transit bottlenecks: port congestion, excessive documentation, delays, slow movement of goods, transshipment, and other indirect costs.

Shorter time to reach the market was cited by respondents in India trading informally with Bangladesh, and by respondents engaged in India–Sri Lanka exports and imports. Respondents stated they could deliver goods much faster than through formal channels; traders indicated that it was possible to meet an order on one day's notice through informal channels.

Strong ethnic ties were cited as facilitating informal trade between India and Bangladesh and between India and Sri Lanka. Lower bribes were cited by respondents engaged in India–Nepal and India–Pakistan informal trade.

For traders exporting goods from Nepal to India, third-country goods figured prominently in informal trade. These goods were first shipped to Nepal owing to lower tariffs than those in India, and then reexported to India. Because these goods fail to meet the rules of origin, they are traded informally. Similarly, for traders engaged in exporting goods informally from

Sri Lanka to India, trading in third-country goods was substantial. High duties were cited by Indian respondents as one of the main reasons for conducting trade informally between India and Bangladesh.

Khan et al. (2005) noted that one of the primary reasons for informal trade between India and Pakistan was the restricted list of commodities that could be exchanged between the two countries. This provided a strong incentive for goods to be traded informally from India to Pakistan, largely through third countries. The study also found that high tariffs in the formal channel provided an incentive for informal trade. The study concluded that granting of most favored nation (MFN) status by Pakistan to India would not be a sufficient condition for strengthening the formal channels of trade; the liberalization process would have to be complemented by a reduction in tariffs and easing of procedural impediments.

## Transacting Environment of Informal Traders

The modalities of informal trade vary with border characteristics. Informal trade could be carried out by land, sea, and/or air. India shares long and porous borders with Bangladesh, Nepal, and Pakistan. Before the 1990s, a large part of informal trade between India and Nepal was carried out by air travelers. However, profit margins declined over time and the movement of goods by air passengers became unprofitable, leading to a shift to the land route. The main centers for informal trading are Raxaul–Birgunj and Naxalbari–Kakarbitta on the India–Nepal border.

As Bangladesh is sandwiched between the Northeastern region and West Bengal borders of India, informal trade takes place along both borders. Chaudhari's (1995) study of the major smuggling and trading centers in the states of Assam, Tripura, and West Bengal revealed that West Bengal accounted for about 96% of illegal exports from the three states, while the balance was shared by Assam (3%) and Tripura (1%).

Informal trade between India and Sri Lanka is conducted mainly by air passengers, with a small proportion being carried out by sea. Historically, the sea route between the coastal areas of Jaffna (in Sri Lanka) and Tamil Nadu (in India) was the most important passage for informal trade. However, the civil war in Sri Lanka and subsequent naval patrols made it difficult to trade informally by sea. Taneja et al. (2004) found that Chennai was the largest center for informal trade flows between India and Sri Lanka.

The India–Pakistan trade modalities are complex, as a large part of informal trade between the two countries takes place via third countries, reflecting the limited number of items permitted to be imported into Pakistan from India. Goods are exported officially from India to Dubai, and then shipped to Bandar Abbas in Iran, from where they are moved informally via a land route across Afghanistan into Pakistan. A small amount is traded by sea to Karachi from Dubai. Informal trade via the land route is carried out through the Amritsar–Lahore (two sides of Punjab) and Sind–Rajasthan border areas. On the Lahore route, informal trade mainly takes place through passengers travelling on the Samjhauta Express (the only rail link between India and Pakistan); on the Sind route, it is conducted along the land border.

Khan et al. (2005) identified five major routes for informal trade between India and Pakistan: (i) Dubai–Bandar Abbas–Herat–Kabul–Jalalabad–Bara, (ii) Dubai–Bandar Abbas–Herat–Kandahar–Wesh–Chaman, (iii) Dubai–Bandar Abbas–Herat–Kandahar–Wesh–Noshki–Chaman–Quetta, (iv) Sindh cross-border, and (v) India–Dubai–Karachi. The study also identified some minor routes of informal trade between the two countries: Delhi–Amritsar–Lahore; Mumbai–Karachi; India–Singapore–Karachi; India–Hong Kong, China–Karachi; Mumbai–Kabul–Bara; and Afghan transit trade (Karachi–Chaman–Afghanistan or Karachi–Peshawar–Afghanistan).

Critical to informal trading are the institutional mechanisms that facilitate it. The smooth functioning of such markets demonstrates that traders have developed efficient mechanisms for obtaining information on goods and quantities to be traded and for mitigating risks that might arise in the trading environment. Key features of the institutional mechanisms for informal traders can be discerned from answers to the following questions: How do they gather information on goods and quantities to be traded in the absence of a formal market? What are the risks in conducting informal transactions and how do traders mitigate such risks? What are the transaction costs and how do traders finance such trade? This section examines these questions.

### Entry Characteristics

In the absence of formal contracts among trading partners, informal trading arrangements in South Asia are often characterized by person-to-person transactions. Most survey respondents indicated that they entered informal trading through friends. Some three-quarters of respondents surveyed in Bangladesh and India entered informal trade through a friend or relative (Table 5.7). For trade between India and Nepal, 65% of Nepalese traders entered through family members or relatives, while the corresponding number for Indian traders was 58%. Similar analysis with regard to India and Sri Lanka showed that 68% of respondents in India and 90% in Sri Lanka entered informal trading in this way. Informal trading channels were also found to be characterized by low rates of entry and exit, consequently a large part of such trade is undertaken by established firms.

**Table 5.7: Entry Mechanisms of Informal Traders**  
(%)

Country	Friend	Relative	Own Initiative
<b>India–Nepal</b>			
India	48	10	42
Nepal	47	18	35
<b>India–Bangladesh</b>			
India	62	12	26
Bangladesh	40	34	26
<b>India–Sri Lanka</b>			
India	41	27	32
Sri Lanka	63	27	10

Sources: Pohit and Taneja (2003), Taneja and Pohit (2002), and Taneja et al. (2005).

### Information Channels

Informal trade hinges on how traders can obtain information on goods and quantities to be traded. Personal trips and informal distribution networks emerged as the most important mediums for sourcing information within South Asia (Table 5.8). Nepali and Sri Lankan traders also relied on formal channels to obtain information on goods and quantities to be traded, while Bangladeshi respondents used enforcement agencies in addition to personal trips and informal networks.

**Table 5.8: Information Channels Used by Informal Traders**  
(%)

Source of Information	India–Sri Lanka		India–Bangladesh		India–Nepal	
	India	Sri Lanka	India	Bangladesh	India	Nepal
Formal channel	44	78	14	28	31	37
Personal trips	73	20	88	80	85	68
Informal distribution network	76	92	72	92	33	34
Official mediums	18	4	18	46	3	0
Enforcement agencies	49	0	10	64	3	0
Trade fairs	5	0	6	14	0	5

Note: Column totals exceed 100% because traders have the option of ticking more than one choice.

Sources: Pohit and Taneja (2003), Taneja and Pohit (2002), and Taneja et al. (2005).

### Risk

Risks associated with informal trading can be critical. Risk-sharing arrangements and risk-mitigation mechanisms are prevalent among trading partners trading informally. Risks for exporters could arise from delays in the delivery of goods, default in payment, and seizure. For importers, risks could arise from goods not conforming to specifications, default in delivery, and delays in the delivery of goods.

One indicator of the extent of risk is the probability of goods being seized by enforcement agencies. Surveys conducted in Bangladesh, India, Nepal, and Sri Lanka found that the probability of seizure was less than 1% for all of the respondents (Table 5.9).

With regard to risk-sharing arrangements between trading partners, most Bangladeshi traders replied that the risk was shared equally if the goods were seized. However, most Indian traders responded that the risk was borne primarily by the sender of goods. Cross-border trading between India and Bangladesh is carried out through a network of agents in both countries, and how the risk of seizure is shared depends on where and when the seizure takes place. At some point in the network, goods are transferred from the sender to the receiver, either in Bangladesh or Indian territory. A number of respondents noted that risk is borne by the sender until the goods are delivered to the receiver. From that point onward, the risk is borne by the receiver. If the goods are seized at the border, risk is shared equally between the trading partners. Equal risk sharing in Bangladesh suggests that its traders may have experienced seizures at the border. In contrast, Indian respondents stated

**Table 5.9: Risk to Informal Traders of Seizure (%)**

Country	Probability of Seizure			
<b>India-Sri Lanka</b>	0	<0.03	0.03–0.06	0.06–0.1
India	55	24	18	3
Sri Lanka	100	0	0	0
<b>India-Bangladesh</b>	<0.05	0.05–0.1	0.1–0.2	>0.2
India	72	26	2	0
Bangladesh	20	58	18	0
<b>India-Nepal</b>	<0.03	0.03–0.05	0.05–0.1	0.1–0.2
India	81	16	3	0
Nepal	74	18	8	0

Sources: Pohit and Taneja (2003), Taneja and Pohit (2002), and Taneja et al. (2005).

that risk was borne primarily by the sender, implying that goods were handed over to the agent of the trading partner in Indian territory.

If the risk of seizure is low, this is clearly because informal traders have developed mechanisms to mitigate risk. As explained earlier, transacting with relatives and acquaintances is an important mechanism for minimizing risk in informal trading. Informal traders also make payments to enforcement agencies to mitigate risk; these payments comprise a small proportion of turnover. Most respondents engaged in India–Bangladesh, India–Sri Lanka, and India–Nepal informal trade paid less than 3% of their turnover to enforcement agencies (Table 5.10). Concerning dispute settlement mechanisms among contracting parties, it was found that traders usually approached informal trading groups to resolve disputes. In several cases, traders reported that they depended on their ethnic ties to resolve conflicts.

**Table 5.10: Percentage of Turnover Paid to Enforcement Agencies (% of informal traders)**

Country	Proportion of Respondents Reporting Payment to Enforcement Agencies			
<b>India-Sri Lanka</b>	<3%	3%–5%	6%–10%	>10%
India	94	6	0	0
Sri Lanka	10	58	32	0
<b>India-Bangladesh</b>	<3%	3%–6%	7%–10%	>10%
India	78	18	4	0
Bangladesh	28	60	12	0
<b>India-Nepal</b>	<3%	3%–6%	7%–10%	>10%
India	59	24	14	3
Nepal	65	25	10	0

Sources: Pohit and Taneja (2003), Taneja and Pohit (2002), and Taneja et al. (2005).

Khan et al. (2005) noted that informal trade between India and Pakistan was facilitated by bribes to enforcement agencies ranging from 1% to 15% of the consignment value, depending on the route for informal trade. While bribes paid for informal trade through Dubai were less than 5% of the consignment value, the rates were higher at the Sindh cross-border (5%–10%) and the Delhi–Lahore route (5%–15%).

### Transaction Costs

Informal traders incur transaction costs in the form of payments made to enforcement agencies as bribes, transport costs, cost of credit, and cost of currency conversion. Transaction costs were found to be less than 20% of turnover for most traders (Table 5.11). Except for a small percentage of the Bangladeshi respondents in the survey, transaction costs did not exceed 30% of turnover. Khan et al. (2005) examined the transaction costs borne by traders along the identified routes of informal trade. The Delhi–Amritsar–Lahore and Sindh cross-border routes were found to have very low transaction costs, therefore the study proposed that informal trade along these routes would likely to continue even if tariffs were slashed to zero because of the procedural requirements and transaction costs associated with formal trade. In contrast, higher transaction costs on the Dubai–Karachi route would probably cause traders to shift to formal channels in the event of tariff reductions.

**Table 5.11: Transaction Costs of Informal Traders**  
(%)

Country	<10%	10%–20%	21%–30%	>30%
<b>India–Sri Lanka</b>				
India	25	75	0	0
Sri Lanka	14	80	6	0
<b>India–Bangladesh</b>				
India	60	38	2	0
Bangladesh	25	50	21	4
<b>India–Nepal</b>				
India	72	25	3	0
Nepal	61	36	3	0

Sources: Pohit and Taneja (2003), Taneja and Pohit (2002), and Taneja et al. (2005).

### Financing Informal Trade

Intrinsic to informal trading is the issue of financing, including the nature of the transacting environment in informal financial markets and the modes for financing such activities. Easy access to black market money has opened avenues for cross-border informal trade in South Asia. Illegal trade is financed by high-value precious metals, such as gold and silver, or by money through a network of unauthorized money lenders. Where gold is used for financing illegal trade, it is smuggled and then converted to the desired currency. However, the risks associated with smuggling gold make it preferable for traders to use illegal money. This system is unique in that there is no physical transfer of currency. Instead, a mechanism

called hawala in India, hundi in Bangladesh and Pakistan, and “chit fund” in Sri Lanka is used for financing. An Indian exporter of goods to Sri Lanka would receive payment through the hawala, an “I owe you” in effect. This is analogous to a cash check under the modern banking system. A huge network of money lenders functions as an unofficial capital market, which is able to finance illegal trade flows among members.

Survey respondents were asked whether they rely on their own finances, or approach friends or relatives, informal money lenders, or banks to finance their informal trade. All respondents engaged in informal trading between India and Bangladesh, India and Sri Lanka, and India and Nepal were found to rely at least to some extent on their own resources. The second most important source of finance in India and Bangladesh was borrowing from informal money lenders. For informal trade between India and Nepal and India and Sri Lanka, traders supplemented their own finances by borrowing from friends and relatives. In the case of India–Pakistan informal trade, Khan et al. (2005) reported that traders raised business capital largely from family members or used their own savings. Further, it was found that carriers of goods, often referred to as khepias, raised finances (i) using their own money; (ii) through the mechanism of hundi, drawing on their close relations with money changers involved in the hundi business; (iii) through Karachi-based shopkeepers who had close relations with wholesalers in Dubai and khepias in Karachi; and (iv) by large khepias financing their smaller counterparts, who earned commissions for acting as carriers.

## Transacting Environment for Formal Traders

Exporting through official channels involves obtaining import–export licenses, and quality control certification, and receiving export remittances through a bank. Importing formally also involves several steps, such as obtaining import licenses, letter-of-credit authorization, finance, and customs clearance. These procedural complexities, along with institutional bottlenecks and lack of transparency, give rise to rent-seeking activities by officials at various stages of trading. Following Coase (1960), these time and/or monetary outlays that exporters and importers incur are referred to as transaction costs.

The main procedural complexities in Bangladesh, India, Nepal, and Sri Lanka arise while obtaining licenses and refunds, dealing with custom authorities, negotiating financing and banking generally, and transporting goods. In surveys reported in Pohit and Taneja (2000, 2003), Taneja and Pohit (2002), and Taneja et al. (2005), time-related transaction costs were determined from information obtained from formal traders, noting how much additional time was taken compared with the ideal time that such transactions should take. The surveys indicated that in South Asia, transactions pertaining to customs, banks, and transport cost an additional 1–10 days (Table 5.12). Most Indian and Nepali traders engaged in India–Nepal trade, and Indian traders engaged in India–Bangladesh trade spent more than 20 additional days obtaining licenses.

**Table 5.12: Additional Days Required for Transactions by Formal Traders**  
(% of formal traders)

India–Sri Lanka						
Transaction	India			Sri Lanka		
	1–10 days	11–20 days	>20 days	1–10 days	11–20 days	>20 days
Licenses	54	10	36	0	0	0
Customs	100	0	0	100	0	0
Banks	88	5	7	82	0	0
Transport	98	2	0	82	0	0
India–Bangladesh						
	India			Bangladesh		
	1–10 days	11–20 days	>20 days	1–10 days	11–20 days	>20 days
Licenses	21	37	42	67	24	9
Refunds	40	35	25	24	27	49
Customs	100	0	0	100	0	0
Banks	74	14	12	100	0	0
Transport	96	4	0	100	0	0
India–Nepal						
	India			Nepal		
	1–10 days	11–20 days	>20	1–10 days	11–20 days	>20 days
Licenses	25	25	50	30	9	61
Customs	100	0	0	100	0	0
Banks	100	0	0	93	7	0
Transport	100	0	0	92	8	0

Sources: Pohit and Taneja (2003), Taneja and Pohit (2002), and Taneja et al. (2005).

The surveys also elicited information from formal traders on the transaction costs incurred in (i) payments to officials as bribes at various stages, (ii) transport costs (including insurance costs), and (iii) cost of credit. Transaction costs amounted to more than 30% of turnover for most Bangladeshi traders engaged in India–Bangladesh trade and Indian traders engaged in India–Nepal trade. Most other respondents in Bangladesh, India, Nepal, and Sri Lanka incurred transaction costs of 10%–20% of their turnover (Table 5.13).

Khan et al. (2005) found that transaction costs were much higher in formal trade channels compared with informal channels. The main complaint of formal exporters regarding transaction costs was with customs procedures. Most respondents also reported that bribes were demanded to expedite formal consignments. While these bribes were usually low and did not significantly affect profit margins, nonpayment resulted in retaliation by the officials in the form of slowing the clearing processes.

**Table 5.13: Transaction Costs of Formal Traders**  
(% of formal traders)

Country	Transaction Cost as % of Turnover			
	<10%	10%–20%	21–30%	>30%
<b>India–Sri Lanka</b>				
India	24	50	26	15
Sri Lanka	25	48	25	2
<b>India–Bangladesh</b>				
India	24	40	36	0
Bangladesh	22	0	20	58
<b>India–Nepal</b>				
India	33	13	18	36
Nepal	18	42	24	16

Sources: Pohit and Taneja (2003), Taneja and Pohit (2002), and Taneja et al. (2005).

Understandably, the formal conduct of business requires compliance with laws and regulations. To comply, entrepreneurs must deal with government bureaucracies and the courts. If government agencies and the courts lack adequate financial and technical resources and skilled personnel, their capacity to administer and enforce laws quickly and correctly is diminished even if laws are clear and coherent. If it takes months to have a contract dispute adjudicated, the cost is high in terms of forgone opportunities. Entrepreneurs may choose to reduce such costs by operating informally instead of dealing with government bureaucracies and the courts.

As highlighted by the survey respondents, when contracts were not honored, formal traders preferred not to take recourse to the law and court proceedings. Rather, formal traders preferred to settle disputes mutually or approached traders or business associations for dispute settlement. Some respondents relied on ethnic ties to resolve disputes, indicating that formal traders use similar mechanisms as informal traders to deal with institutional barriers to trade.

## Differentiating Characteristics between Formal and Informal Traders

While the transacting environments for formal and informal traders differ in many respects, Pohit and Taneja (2000, 2003), Taneja and Pohit (2002), and Taneja et al. (2005) evaluated several differences between the two types of traders using the statistical method outlined in the box.

One of the key hypotheses in the analysis was to test whether informal trade flourished because of lower transaction costs. The survey instrument was used to determine the transaction costs that traders incur in informal and formal channels. The signed rank test

### Statistical Steps for Differentiating Characteristics

#### Between Formal and Informal Traders

The significance of differences between the two types of traders was evaluated using a univariate statistical criterion, the nonparametric Wilcoxon signed-rank test. This paired difference test is used when comparing two related samples, matched samples, or repeated measurements on a single sample to assess whether their population mean ranks differ. Because many of the variables considered are qualitative in nature, they can be classified or ranked but not measured accurately, making nonparametric tests more appropriate for the analysis. The advantage of using a nonparametric test is that it is free of specific assumptions about the form of the distribution of the variable, which is appropriate in this case. The tests were performed separately for each territory for each pair: India–Bangladesh, India–Nepal, and India–Sri Lanka. In the context of informal trade between India and Bangladesh, the database for the test consisted of 50 pairs of traders for India and 46 pairs for Bangladesh. Similarly, for India’s informal trade with Sri Lanka, the database consisted of 55 pairs of traders for India and 50 pairs for Sri Lanka; and for India’s informal trade with Nepal, the database consisted of 39 pairs of traders for India and 38 pairs for Nepal.

The main parameters for differentiating formal and informal traders in India and Bangladesh were transaction costs, education levels, awareness of the South Asian Free Trade Area, ethnic ties, trade in perishable commodities, number of commodities traded, trading in the same commodities, time taken for a first trade deal, time taken for subsequent trade deals, margin fluctuations, risks, number of transactions, financing, value of trade per transaction, rate of entry and exit, trading period, presence in the domestic market, profit, and border price differentials. In the case of Nepal, third-country imports, local area trade, and turnover were included, while trade in perishable commodities, number of commodities traded, trading in same commodities, financing, and margin fluctuations were dropped. For Sri Lanka, the time taken at various stages of the trading process and age of enterprises were added, while trade in perishable commodities was dropped.

Sources: Pohit and Taneja (2003), Taneja and Pohit (2002), and Taneja et al. (2005).

suggested that transaction costs of formal trade between India and Bangladesh and Sri Lanka and Nepal were significantly higher than the informal counterpart. The test results also indicated that a lower level of education among informal traders acted as a deterrent to using formal channels. Informal traders in all four countries were revealed to have lower levels of education than formal traders. Further, informal traders were found to be less aware of the SAFTA provisions.

Another factor contributing to informal trade was the presence of ethnic ties among SAARC member countries. While the presence of ethnic ties was found to be a significant contributing factor to India’s informal trade with Nepal and Sri Lanka, this was not the case for Bangladesh. Ethnic ties among informal traders not only help to ensure that payments are made, but also contribute to reducing risks and other transaction costs.

The studies included an analysis of the information channels of informal trade. The efficiency of information channels for informal trading arrangements was judged by the time taken for (i) a first trade deal between two parties, and (ii) the current trade deals. The analysis showed that in both cases the information channels for informal trade between India and Bangladesh were better than for formal trade. For Indian traders dealing with Sri Lanka, there was no significant difference between formal and informal traders in the time taken to finalize a first trade deal. In Sri Lanka, however, formal traders were found to

take significantly more time than informal traders to finalize a first trade deal. For current trade deals, the time taken to finalize them was significantly higher for formal than for informal traders in both India and Sri Lanka. With regard to trade between India and Nepal, countries informal trading arrangements for both countries take less time for subsequent trade deals than the formal counterpart.

The traders operating through the informal channel occasionally face the risk of goods seizure. As a result, informal traders have to bear this risk in addition to the risks of goods not conforming to specification, and default or delay in delivery, both of which are faced by formal traders. The analysis assessed the combined risk (goods not conforming to specification and incidence of default or delay in delivery) that traders face in carrying out their transactions. The statistical evidence indicates that informal traders in both Bangladesh and India bear higher risk than formal traders; this was also the case for informal trade between India and Sri Lanka. However, for unrecorded traders in India and Nepal, no significant difference in risk was found between the two channels. This is expected, as a thriving informal trade indicates that government is failing to enforce its laws and regulations. Moreover, the survey suggests that informal traders make payments to officials to mitigate the risk of seizures.

## Current Context of Informal and Formal Trade

### Recent Estimates of Informal Trade

As discussed in earlier, the only recent estimates of informal trade pertain to informal trade in agricultural commodities between India and Nepal and informal exports from India to Pakistan. Tables 5.14 and 5.15 present estimates of informal trade and the corresponding values of formal trade. Informal trade in agricultural commodities between India and Nepal was more than five times the total value of formal trade in 2010; India had a trade surplus with Nepal in both formal and informal trade. In the case of Indian exports to Pakistan, the informal value is also larger than its formal counterpart.

**Table 5.14: India's Informal Trade with Nepal and Pakistan**  
(\$ billion)

Country Pair	Year	Exports	Imports	Trade Balance	Total Trade
India–Nepal (only agricultural products)	2010	0.84	0.16	0.68	1.0
India–Pakistan	2012	1.78	...	...	...

... = not available.

Note: To estimate the total trade in agricultural products between India and Nepal, a weighted average of the estimates for different response groups was calculated. The weights were assigned on the basis of number of respondents in each category.

Sources: Based on Karmacharya (2010), and Ahmed et al. (2014).

**Table 5.15: India's Formal Trade with Nepal and Pakistan**  
(\$ billion)

Country Pair	Year	Exports	Imports	Trade Balance	Total Trade
India–Nepal (only agricultural products)	2010	0.13	0.06	0.07	0.19
India–Pakistan	2012	1.63	0.50	1.13	2.13

Source: United Nations. UNCOMTRADE Database. <http://comtrade.un.org> (accessed 15 March 2014).

Karmacharya (2010) estimated informal trade in agricultural products between India and Nepal using a primary survey. For the estimation of unrecorded trade, five major border towns—Birgunj, Bhairahawa, Biratnagar, Kakkadvitta, and Nepalgunj—were chosen for the survey. These towns accounted for about 90% of total formal trade between the two countries. A total of 150 respondents were surveyed, distributed equally among the five towns. The respondent groups included 28 informal traders, 56 carriers, 25 government officials, and 41 knowledgeable individuals. The survey estimated the informal imports of agricultural goods from India to Nepal to be \$841.6 million and the total informal exports in agricultural goods from Nepal to India to be \$159.3 million. Birgunj appeared to be the largest center of informal imports between India and Nepal, while Biratnagar was the major center of informal exports.

The study identified paddy as the major agricultural item exported informally from India to Nepal, accounting for about one-quarter of Nepal's total informal agricultural imports from India (Table 5.16). This was followed by informal exports of rice (21%–22%), sugar (12%), and edible oils (8%–9%). Fish, poultry, powder milk, and oilseeds were other items informally exported from India to Nepal. The study also analyzed the gap between the formal and informal trade of these commodities. The largest disparity for Indian exports was that for paddy, where the total informal imports by Nepal were more than 600 times that of formal imports.

**Table 5.16: Shares of Top Five Exports and Imports in Total Informal Trade between India and Nepal (%)**

Commodity	Exports from India to Nepal	Imports from Nepal to India
Paddy	25–27	0
Rice	21–22	0
Sugar	12	0
Edible oils	8–9	0
Oilseeds	3–4	0
Betel nuts	0	47–52
Hides and skins	0	18–21
Apples	0	11–12
Garlic	0	11–12
Ginger	0	5–6

Source: Karmacharya (2010).

Table 5.16 indicates that betel nuts were the top commodity imported from Nepal to India, comprising approximately 50% of total agricultural exports. Hides and skins (18%–21%), apples (11%–12%), and garlic (11%–12%) were the other important import items from Nepal to India. A notable finding of the survey was that some of the agricultural commodities imported informally from Nepal were goods of third-country origin, such as betel nuts, apples, and garlic. The largest gap between formal and informal imports was that for apples, where the informally traded volume was 3,000 times that of formal trade.

While total informal trade between Nepal and India in 2001, as estimated by Taneja et al. (2004), was almost balanced, the more recent study by Karmacharya (2010) indicates a large trade deficit in agricultural trade between the two countries. A possible explanation for this disparity could be the large informal exports of paddy and rice from India to Nepal. Restrictions on the export of basmati and non-basmati rice were imposed in India in March 2008, at which time exports of these rice varieties were subject to minimum export prices and were only allowed through the ports of Kandla, Kakinada, Kolkata, and Jawaharlal Nehru Port Trust in Mumbai. These restrictions were eased for Bangladesh and Nepal in 2012, when non-basmati rice exports to these countries were allowed through land customs stations. Further, the minimum export price for basmati rice was also removed. As a result, rice was being exported informally in large quantities across the border to Nepal during the interim years, which included the period when this survey was conducted. A reassessment of informal trade relations between the two countries may now show a more balanced trend, which may include a lower total value of informal trade.

While the estimates provided by Khan et al. (2005) provided important insights into informal trading relations between India and Pakistan, the formal trading environment between the two countries has changed significantly. The most notable development has been Pakistan's transition from a positive list approach for India to a small negative list of 1,209 items. India also took several steps to address nontariff barriers. Subsequently, India and Pakistan pruned their sensitive lists under SAFTA.

Ahmed et al. (2014) studied informal trade between India and Pakistan in this changed context. However, the study only analyzed India's informal exports to Pakistan. Moreover, the estimates were based on a survey conducted in January 2013—just a few months after Pakistan moved to a negative list. As such, the study could not cover the impact of the trade normalization process. The survey included 135 respondents covering importers, exporters, retailers, wholesalers, transporters, customs and clearing agents, and rangers and security personnel. The study estimated that the total volume of informal inflows from India to Pakistan amounted to approximately \$1.7 billion. The main items that were informally exported from India to Pakistan included textiles, cosmetics, tobacco, spices, herbal products, jewelry, pharmaceuticals, and auto parts. Textiles were the largest commodity informally exported from India to Pakistan, accounting for three-quarters of the total estimated informal inflows. This was followed by imports of auto parts and tires (9.8%), jewelry items (4.3%), and pharmaceuticals (3.3%). This pattern of trade can be explained in part by examining the commodity composition of Pakistan's sensitive list. The greatest number of tariff lines in the sensitive list fall under the category of textile items (24%), providing the incentive to trade informally in this category (Table 5.17). Other important informally traded items such as pharmaceuticals, vehicle parts, and cosmetics appear either in the negative or sensitive lists (Table 5.18). However, there were items that

were not on the sensitive or negative lists and were subject to low tariffs. This indicates that factors other than those related to trade policy are at play in influencing informal trade flows. Similar to the findings of Khan et al.(2005), this study noted the large magnitude of informal trade that occurs through third-country channels, such as Dubai.

**Table 5.17: Share of Commodity Groups in Pakistan's Sensitive List (%)**

Harmonized System Chapter	Product	Distribution of items under Pakistan's Sensitive List (share of tariff lines %)
7	Plastics, rubbers	11.2
11	Textiles and textile articles	24.0
15	Base metals	12.4
16	Machinery and mechanical appliances, electrical equipment, parts thereof	19.0
17	Vehicles, aircraft, vessels, and associated transport equipment	7.5
	All other items	25.9
	Total items on sensitive list	100.0

Source: Authors' compilation.

**Table 5.18: Presence of Informally Exported Items on Pakistan's Sensitive and Negative Lists, 2012**

Commodities <sup>a</sup>	Value (\$ million)	Sensitive List	Negative List	Tariff (%)
Fruits and vegetables	5.4	√		0-30
<b>Textiles</b>				
Saris	204.4	√		25
Bridal wear and other fancy dress	1,152.0	√		25
<b>Spices and herbs</b>				
Spices	8.4			5-15
Tea	1.2	√		10
<b>Tobacco items</b>				
Ghutka	4.8		√	-
Betel leaves	39.6			200/kg
<b>Automobile sector</b>				
Spare parts	5.7	√	√	
Tires	170.0			5-25
<b>Cosmetics</b>				
Soap, cream, shampoo, hair oil, etc.	48.0	√	√	30
Pharmaceuticals	59.4	√	√	
<b>Jewelry items</b>				

continued on next page

Table 5.18 continued

Commodities <sup>a</sup>	Value (\$ million)	Sensitive List	Negative List	Tariff (%)
Bridal sets	27.4		√	5
Bangles	16.4		√	5
Locketts	32.9		√	5
<b>Low-grade artificial jewelry</b>				
Locketts	2.2			10
Bangles	9.1			10
<b>Herbal products</b>				
Feminine creams	0.2			30
Hair oil	0.2			30
Herbal beauty creams	0.2			10
Herbal soaps	0.1	√		30
<b>Others</b>				
Paper	0.30	√	√	5–25
Crockery	0.20	√	√	30

<sup>a</sup> Commodities exported informally from India to Pakistan in 2012.

Source: Authors' compilation based on Ahmad et al. (2014).

Taneja et al. (2013) provided insights on informal trade between India and Pakistan, based on a survey conducted in Amritsar, Delhi, and Dubai in December 2012. For many years, Dubai has played the role of a trade facilitator between India and Pakistan, bringing together buyers and sellers. Dubai has also acted as a risk guarantor, ensuring goods reach their destination and payments are made. The study concluded that trade normalization and a reduction in tariff and nontariff barriers would lower informal trade between India and Pakistan. However, trade through third countries, such as Dubai, would shift to formal channels only if there were active channels of information networking buyers and suppliers so that trade could be conducted directly rather than through third parties. Elimination of the negative list would also allow the export of many items that had to be routed via Dubai and other informal trade channels. Until all such measures are fully implemented, informal and formal trade between India and Pakistan are likely to coexist.

### Recent Changes in Transacting Environment for Formal Trade

Recognizing the importance of lowering transaction costs to facilitate trade, South Asian countries have undertaken various trade facilitation measures as part of their reform agenda. Taneja and Dayal (2013) discussed these measures, which are largely related to “soft infrastructure” (cross-border transport agreements, use of information and communication technology in customs, international customs convention, etc.). The extent to which these measures have been adopted varies significantly, reflecting differences in the level of development, availability of resources, and priority given to trade facilitation.

Steps have been taken to expedite and simplify the release and clearance of goods, facilitated by the introduction of electronic bank realization certificate (e-BRC) systems for pre-arrival processing, facilities for electronic payment of application fees, risk-management systems, and publication of average release times measured by the dwell

time at ports. To reduce transaction and handling costs, a single-window system has been introduced to facilitate the export of perishable agricultural produce.

However, challenges remain. A major problem area for the trading community in India is the lack of coordination between customs and port authorities, resulting in delays in clearing goods. Lack of adequate infrastructure, such as testing laboratories, further creates border delays. With respect to formalities and documentation requirements, there continues to be a trail of hard copy, even though India is electronically linking the documents of different agencies. Moreover, introducing risk management systems facilities in all ports and making all border customs electronically functional remain a challenge given that India has 461 customs locations. Similarly, making available information on release times for goods may not be possible at all ports. Although the establishment of single enquiry points is pending, single-window clearance systems for general commodities are resource-intensive and technologically challenging for a big country like India.

Pakistan's National Trade Facilitation Strategy, 2012 sets out a timeline for undertaking various reforms during 2012–2015. A major advance in the country's customs procedures was the implementation of the Pakistan Customs Computerized System in 2005, which was designed to maintain electronic records, minimize customs clearance and dwell times, and adopt a risk-based clearance system. However, since not all features of the computerized system have yet been implemented, hard copies of documents will continue to be submitted.

Bangladesh has introduced several trade facilitation measures. The efficiency of Chittagong Port has improved considerably. There have been improvements during recent years in trade facilitation, including reduction in the physical inspection of goods, the number of signatures required, and export clearance time. However, there is still a great need for electronic and single-window processes and general procedures to expedite shipments and goods clearance.

While SAARC member countries are streamlining their procedures to reduce clearance times and improve transparency, there are significant differences in the application of these measures among the land ports that connect South Asian countries. Most informal trade takes place through land borders, and this will continue until effective trade facilitation measures are adopted. For instance, even though an electronic data interchange system has been installed at Petrapole on the India–Bangladesh border and at Raxaul on the Indo–Nepal border, they do not function properly and manual processing is still required. At the India–Pakistan border, there is no provision for such facilities. Moreover, there is a conspicuous absence of risk management systems at land ports. As a result, there is excessive checking of goods at land borders, which is far less efficient than the procedures and systems in place for sea and air ports. Thus, even though South Asian countries have succeeded in reducing clearance times at major sea and air ports, the systems in place at land ports lag far behind, constituting a critical weakness for intraregional trade. Efficiency at border crossings could be further improved by greater cooperation between customs authorities and the establishment of one-stop joint inspection facilities between trading countries.

Another aspect that needs to be highlighted is weak and inadequate transport protocols, which obstruct the seamless transport of goods across borders. Requiring transshipment of goods at land borders raises transaction costs considerably. Even at borders where seamless transport is allowed (e.g., at the India–Nepal border), transshipment occurs because the protocols do not operate in practice. Restrictions on the movement of containerized cargo further raise the transaction costs. Poor infrastructure and lack of warehousing facilities at land borders in South Asia are other impediments that continue to remain largely unaddressed (Taneja et al. 2013).

As recent studies testify, the transacting environment for cross-border trade is not very conducive, and informal trade will continue substantially.

## Policy Lessons from Other Regions

As an input to the World Trade Organization (WTO) Trade Facilitation Agreement negotiations, Lesser and Leeman (2009) discussed several trade facilitation measures that would help formalize trade in sub-Saharan Africa. Many of these policy lessons are relevant to formalizing trade in South Asia. Several steps fall under Articles VIII and X of the General Agreement on Tariffs and Trade.

Simplification or reduction of documentation requirements and formalities for imports and exports would significantly reduce transaction costs (especially for smaller traders), thus incentivizing formal trade. For small or low-value consignments, the cost of complying with the complex formal procedures is disproportionate to the transaction value. Lesser and Leeman (2009) therefore suggested simplifying documentation requirements and submission procedures. This could be complemented with a single-window or one-stop shop for lodging all trade-related documents, helping to reduce the direct transaction costs of compliance with document requirements and the indirect costs related to long customs clearance times. The single window would also link the information networks of various agencies and help speed-up data transmission among them. Another important suggestion in the context of reducing formal procedures and paperwork is harmonization of documentation requirements and formalities for import clearances across all member states of a regional trade agreement. This has been adopted by the Southern African Customs Union and the Southern African Development Community, which use a single clearance document for trade among them. The Common Market for Eastern and Southern Africa has designed a single form for customs declaration, and 15 countries can trade using this document. Given that avoidance of excessive paperwork is one of the primary reasons for informal trade in South Asia, simplification and harmonization of documentation is one of the major requirements for the formalization of informal trade.

The second set of policy lessons is the need for lower and more transparent fee schedules for formal trade. Authorities must provide a clear legal basis for demanding fees, and the charges must be set and disclosed in a transparent manner. Moreover, the fee structure should be periodically reviewed, consolidated, and ultimately simplified. The lowering of fees in South Asia would reduce the transaction costs of formal trade and ultimately lower informal trade.

A further important initiative would be faster clearances and release of goods by customs. Speedy clearances are particularly important for perishable commodities; time delays may mean that exporters of such items would not trade formally. A suggestion could be the separation of release from the clearance of goods, and before the payment of duties and taxes subject to the deposit of a financial guarantee. Another possible measure is to grant pre-arrival clearances. Traders would be able to submit clearance data to the customs administration for advance processing and goods would be released to them immediately upon arrival at the border crossing. The study suggests that customs authorities regularly measure and publish average release and clearance times, as well as inform all traders of the possible delays they might incur to ensure transparency and predictability. An automated system to handle customs data and declarations at all border crossing points would further help to shorten clearance times. The United Nations Conference on Trade and Development has developed an automated system for customs data that handles manifests, customs declarations, accounting procedures, and transit and suspense procedures. This system is being installed in more than 90 developing countries and regions.

Information on trade regulations and laws must be improved, particularly with regard to its transparency and predictability. Publication of information regarding trade conditions and the application of trade-related regulations would help to considerably reduce the transaction costs of formal trade. Information should be made available from enquiry bureaus throughout the country, drawing from a centralized information bureau. Information could also be disseminated through a common website that publishes all regulatory requirements. Businesses should further be alerted through notifications in official journals or websites regarding any changes in the regulations. Traders' lack of awareness of the formal procedures and their entitlements is another factor prompting informal trade in South Asia.

The study further suggests strengthening in-country coordination among border agencies to reduce the costs associated with duplicative formalities and controls, compliance costs, risks of error, and delays. National border agencies should cooperate in exchanging information among customs authorities. Further, steps are needed to strengthen the degree of interaction and trust between border agencies and the private sector. Suggestions by the private sector on how to facilitate formal trade must be taken into consideration. This can be achieved through regular consultations and the establishment of a private sector resource unit on customs.

Traders need to be better informed about import-export requirements and formalities. Lack of information, education, tax literacy, and skills to comply with trade-related regulations are common to informal traders in South Asia. Technical assistance and capacity-building measures for traders are an important way to facilitate formal trade. This assistance could be funded by government or business associations. Traders must also be introduced to the benefits that would accrue to them from formalizing their trade transactions. Organizing information campaigns in this regard could help nudge informal traders into formal trade.

The common practice of demanding bribes in Africa and South Asia underscores the importance of enhancing the integrity of customs administrations. A code of good conduct for officials would be helpful. This would set the standards of behavior, and rights and

obligations in the exercise for their public duties. Disciplinary measures in the case of noncompliance with the code must be specified. A higher level of integrity could help reduce corruption and arbitrary application of trade-related regulations, again contributing to a more favorable context for formal trade.

Kaminiski and Mitra (2011) demonstrated that one of the major obstacles to formal trade in Central and South Asia is the restrictions on cross-border mobility of vehicles, goods, and individuals. Simplifying visa requirements, facilitating vehicles crossings in border areas, removing restrictions on vehicle sizes, reducing fee payments, and eliminating bribes would all contribute toward removing the barriers to formal trade. Similar complexities in visa, customs, and clearance procedures in South Asia make these policy recommendations highly relevant.

## Policy Recommendations

Formalizing trade that takes place through informal or quasi-formal channels has the potential to benefit traders and the economies of South Asia more generally. The following recommendations are designed to promote and facilitate formal trade.

### Trade and Tariff Policies

While tariffs have been substantially reduced with the implementation of SAFTA, SAARC member countries continue to maintain large sensitive lists, and the rules of origin compound the difficulties of formal trade.

Significantly, India and Pakistan have agreed to normalize trade relations, with Pakistan shifting from a positive list to a negative list. While these changes will have an impact on informal trade and quasi-formal trade through third countries, several institutional changes are needed for such trade to shift to formal channels.

Nontariff barriers continue to be a major impediment to formal trade. While quantitative restrictions on imports have been reduced, nontariff measures related to product standards have been increasing and very often are applied in a trade-restrictive manner. Countries should set up monitoring mechanisms so that that appropriate measures can be taken.

The imposition of export restrictions in recent years by some SAARC member countries has encouraged informal trade flows. India and other countries should relax these restrictions for SAARC member countries, particularly with respect to food items. This would help in reducing informal trade.

### Reducing Barriers to Formal Trade

The absence of appropriate transport and transit facilities, cumbersome customs procedures, excessive paperwork, and lack of infrastructure at border areas have all been identified as incentives for traders to use informal trading routes instead of formal channels. In recent years, all South Asian countries have undertaken trade facilitation measures to reduce the transaction costs of trading. However, much remains to be done, especially at land customs stations. Customs procedures need to be simplified, and the paperwork required for cross-border trade should be made less tedious. Another important aspect

of strengthening formal trading ties among countries is better connectivity. This should include improvement of cross-border physical infrastructure and transport protocols that encourage seamless multimodal transport of goods across land borders. In addition, streamlined visa processes, cellular services, and courier facilities are needed.

### **Increasing Awareness and Trade-Related Education for Traders**

An important step toward improved trade-related information and education would be to increase communication among traders throughout the region. Increased dialogue among traders would result in a more active and amenable business environment, and would fill in gaps of information about trade regulations and procedures. Online portals for discussion on trade, trade fairs, exhibitions, and multilevel dialogues are some possible ways to increase awareness of intraregional trade policies.

### **Strengthening Border Institutions**

While border security measures are of utmost importance, border security officials tend to view even legitimate trade suspiciously. Security checks, payment of bribes, and harassment by border officials are disincentives for trading through official channels. Training border personnel in trade and security matters would be a step toward tackling this problem. Information about legitimately traded goods, routes, correct standards, and bona fide trading partners is needed to help border security officials differentiate legitimate trade from informal or illegal trade.

### **Cross-Border Banking to Facilitate Faster Payments for Goods**

One of the important advantages of informal trade over formal trade is faster payment through informal mechanisms. Under formal channels of trade, payment may take many days and require standing in line and filling out cumbersome paperwork. Cross-border banking facilities would be an important step toward faster payments for traders. Further, easier access to formal credit and banking systems would encourage traders to use formal channels of trade.

In sum, informal trade is unlikely to be eliminated. Ethnic trading networks continue to facilitate such trade by reducing transactions costs by minimizing risk, providing market information, and reducing search costs. Nevertheless, further reduction of tariffs, improvements in the transaction environment for formal trade, strengthened awareness and education, and better dissemination of information would contribute to reducing informal trade in favor of formal trade.

## CHAPTER VI

# Services Trade Liberalization in South Asia

*Rupa Chanda*

In April 2007, the South Asian Association for Regional Cooperation (SAARC) Summit Declaration stated the need to integrate services into the South Asian Free Trade Area (SAFTA) and called for the early conclusion of a services agreement for the region. The August 2008 SAARC Summit Declaration stated that “Extending SAFTA to include services would considerably broaden its scope and impact and boost competitiveness in key emerging sectors such as banking, communications, and aviation.” The declaration further highlighted the need for regional cooperation on domestic regulations, data, and standards to complement efforts toward regional services integration. The SAARC Agreement on Trade in Services (SATIS) was signed during the 16th SAARC Summit in 2010. The agreement aims to progressively liberalize services in line with national policy objectives and the level of economic development of the SAARC members. However, thus far, the outcomes of SATIS negotiations are not encouraging.

Against this backdrop, it is important to examine the status of services integration in South Asia and the prospects and challenges for deeper integration. Based on this assessment, there is a need to identify feasible modalities and steps that could be adopted to facilitate services integration in the region and to pave the way for eventual South Asian economic union. This chapter provides a brief overview of trends in the service sector in each of the SAARC member countries and in the region, and reviews the status of the SATIS negotiations and the preparedness of the member countries to regionally integrate their service sectors. Opportunities and challenges for integrating a representative set of services (energy, telecommunications, tourism, and health) are outlined and cross-cutting challenges are summarized. The chapter concludes with a discussion of modalities for regional integration in services and outlines a possible road map for a South Asian economic union.

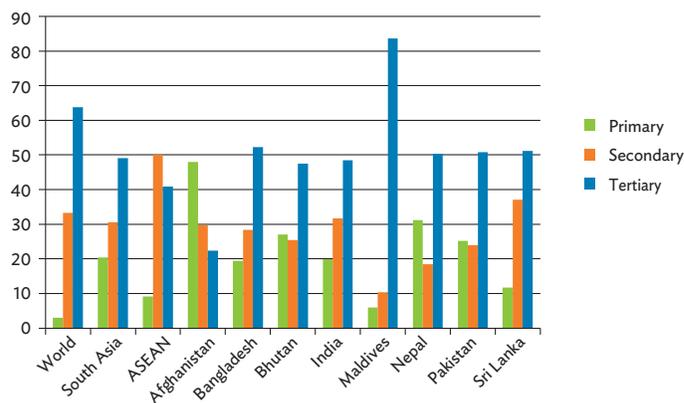
## Overview of Services Performance in South Asia

The service sector in South Asia has achieved more rapid and more consistent average growth than other sectors in the region. Services have also increased in importance in the region’s trade and investment flows. This section highlights trends in services output, trade, competitiveness, and foreign direct investment (FDI) in South Asia.

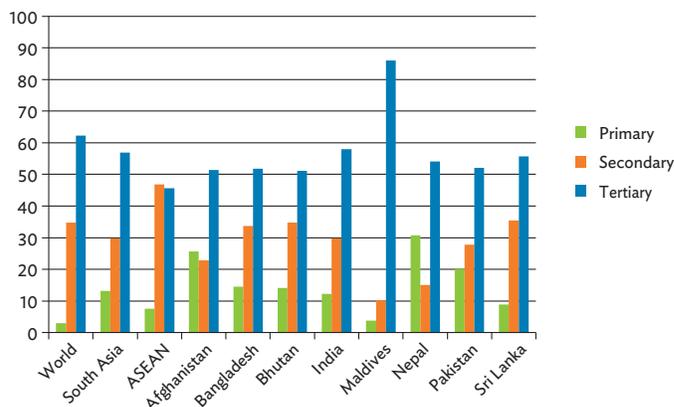
### Services Output

Services output registered an average annual growth of more than 8% during 2010–2012. This regional picture also holds true at the country level, although the relative performance of the sector varies across the region. Services have been growing faster than the rest of the economy in all SAARC countries, thereby helping to raise the overall growth rate of gross domestic product (GDP).<sup>1</sup> Today, services account for at least half of GDP in all countries in South Asia—higher than in other developing regions such as the Association of Southeast Asian Nations (ASEAN). In the Maldives, services contribute more than 80% of GDP, reflecting the country’s reliance on tourism. Figures 6.1 and 6.2 highlight the shift in sector composition toward services from 2000 to 2012.

**Figure 6.1: Composition of Gross Domestic Product by Sector, 2000 (%)**



**Figure 6.2: Composition of Gross Domestic Product by Sector, 2012 (%)**



ASEAN = Association of Southeast Asian Nations.

Source: United Nations. National Accounts Main Aggregates Database. <http://unstats.un.org/unsd/snaama/dnList.asp> (accessed 19 December 2013).

<sup>1</sup> Author’s calculations from United Nations. National Accounts Main Aggregates Database. <http://unstats.un.org/unsd/snaama/dnList.asp> (accessed 19 December 2013).

Services such as construction, wholesale and retail trade and distribution, communications, and transport are the most significant contributors to the service sector in South Asia (Chanda 2011). One exception is the Maldives, where tourism services dominate, contributing over one-third of GDP. Communication services exhibit the highest growth, registering growth rates of more than 10% in most SAARC countries. Financial services have also grown rapidly in several countries.

The trends in the GDP contribution and growth of the subsectors reflect the importance of various factors in shaping the service sector's performance in South Asia. These include (i) deregulation and policy reforms in areas such as telecommunications and financial services, (ii) the role of rising incomes and domestic demand in driving growth in segments such as trade and distribution services, (iii) incentives given to promote certain services such as tourism or information technology (IT), and (iv) lack of diversification in the smaller economies such as the Maldives. In short, the general growth dynamics of rising incomes and consumption, liberalization, and reform measures appear to have played an important role in shaping intraregional trade, investment, and collaboration in services within South Asia.<sup>2</sup>

### Services Trade in South Asia

The share of trade in services in South Asia's GDP increased from about 3% in the early 1990s to more than 10% in 2010. Both exports and imports of services have experienced high growth rates during 2010–2012. South Asia's exports of services registered a compound annual growth rate of more than 20% during 2001–2012, which is higher than the average growth rates of services exports for the ASEAN region, and also higher than the average for goods exports in the South Asian region (Table 6.1). A similar trend is visible

**Table 6.1: Growth in Goods and Services Exports, 2000–2012 (%)**

Area/Country	Services			Goods	
	Average Annual Growth Rate			CAGR	CAGR
	2000–2004	2005–2009	2010–2012	2000–2012	2000–2012
Afghanistan	...	...	16.6	...	16.6
Bangladesh	8.6	13.1	1.2	9.4	13.8
Bhutan	17.7	17.3	17.3	14.0	17.2
India	25.2	20.9	8.5	21.0	19.0
Maldives	1.0	32.5	33.8	17.0	10.0
Nepal	(6.5)	11.1	7.1	7.6	1.9
Pakistan	20.2	8.6	16.4	14.6	9.3
Sri Lanka	9.3	4.6	18.2	9.8	6.2
World	10.5	9.5	3.5	10.2	10.4
South Asia	22.3	19.7	10.9	20.6	16.8
ASEAN	11.2	10.5	7.6	12.6	11.3

( ) = negative, ... = not available, ASEAN = Association of Southeast Asian Nations, CAGR = compound annual growth rate. Source: United Nations Conference on Trade and Development. UNCTADSTAT. <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx> (accessed 19 December 2013 and 26 February 2014 for ASEAN).

<sup>2</sup> The service sector's contribution to employment, however, remains relatively low in South Asia (except in the Maldives) accounting for less than one-third of employment in most South Asian countries. This is because of the higher growth in services such as communications and financial services, which have mostly grown on the basis of productivity gains rather than factor absorption.

for the import of services (Table 6.2). However, there is considerable asymmetry in the performance of trade in services among SAARC members and the regional trend, largely reflecting India's performance. With the exception of India, all South Asian countries are net importers of services. The regional trend largely captures India's performance over this period.

**Table 6.2: Growth in Goods and Services Imports, 2000–2012 (%)**

Area/Country	Services			Goods	
	Average Annual Growth Rate		CAGR	CAGR	
	2000–2004	2005–2009	2010–2012	2000–2012	2000–2012
Afghanistan	...	...	14.5	...	11.3
Bangladesh	8.5	12.7	10.1	11.8	12.9
Bhutan	27.9	2.1	12.9	11.6	17.2
India	19.1	18.6	11.5	18.3	23.0
Maldives	12.9	20.9	13.6	16.4	13.3
Nepal	13.6	17.9	1.7	13.9	13.7
Pakistan	25.7	7.1	(2.4)	12.1	14.3
Sri Lanka	7.0	6.5	11.8	8.9	11.2
World	9.8	9.4	3.6	9.7	10.1
South Asia	18.5	16.8	13.9	18.5	20.2
ASEAN	10.8	9.1	7.8	11.9	12.1

( ) = negative, ... = not available, ASEAN = Association of Southeast Asian Nations, CAGR = compound annual growth rate. Source: United Nations Conference on Trade and Development. UNCTADSTAT. <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx> (accessed 19 December 2013 and 26 February 2014 for ASEAN).

Services have grown in importance in the region's export basket. Their share in total exports rose from 24% in 2000 to 33% in 2012—higher than the averages for world and ASEAN (Table 6.3). The largest increases have been experienced by the Maldives, India, and Nepal, while other SAARC members' share has increased only marginally or remained stagnant. The overall trend for South Asia again captures India's performance, given its dominance in the export of services.

These trends in trade in services indicate that some countries in the region are highly export-oriented in their service sector and that this orientation has increased over time. The relatively lower growth rates for services imports further indicates that the region may be less open to service imports and that the service sector may be less liberalized than in other regions, such as ASEAN. Overall, South Asia's share of the world export of services increased from 1.4% in 2000 to 3.5% in 2012, but this was mainly due to India, whose share in the world export of services rose from 1.1% to 3.2% during this period. All other SAARC countries account for less than 0.2% of the world export of services.<sup>3</sup> Similar trends can be observed for the region's imports of services, which are again dominated by India. Further,

<sup>3</sup> UNCTAD. Online statistics database for ASEAN. <http://unctadstat.unctad.org/> (accessed 19 December 2013 and 26 February 2014).

**Table 6.3: Contribution of Services to Exports and Imports, Selected Years (%)**

Area/Country	Services Exports			Services Imports		
	2000	2005	2012	2000	2005	2012
Bangladesh	11.3	11.8	7.5	15.4	13.7	13.2
Bhutan	16.2	14.1	14.4	20.9	24.9	11.6
India	28.3	34.5	32.4	27.1	24.9	20.8
Maldives	76.2	66.6	86.4	22.0	22.2	27.3
Nepal	38.6	30.6	50.4	11.3	16.0	12.9
Pakistan	13.3	18.6	21.1	17.2	22.8	15.6
Sri Lanka	14.7	19.5	28.8	20.5	19.1	18.9
World	19.1	19.7	19.4	18.6	18.7	18.8
South Asia	24.3	31.0	26.9	22.9	23.4	20.5
ASEAN	13.8	15.4	16.9	18.8	18.7	18.68

ASEAN = Association of Southeast Asian Nations.

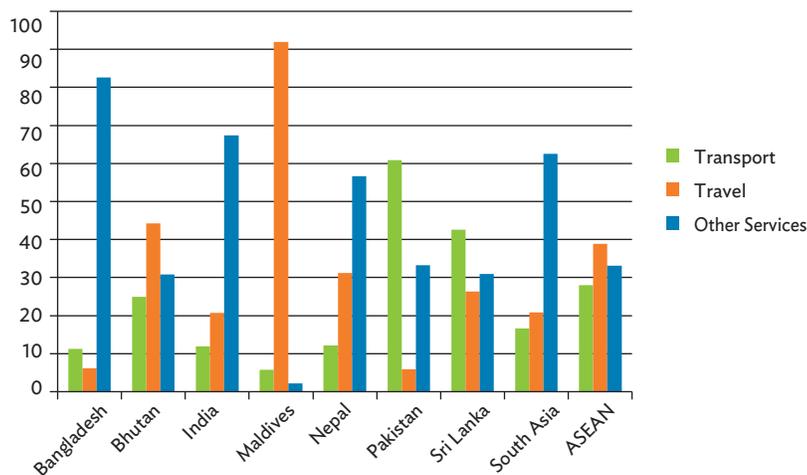
Source: United Nations Conference on Trade and Development. UNCTADSTAT. <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx> (accessed 19 December 2013 and 26 February 2014 for ASEAN).

the degree of integration in the world import of services is less than that for goods imports, possibly reflecting higher levels of restriction in the service sector as opposed to goods.

The trends in trade indicate that the dynamics for services integration would need to be provided by India, given its higher degree of services integration and its relative size. There are also likely to be subgroups within the region where progress in liberalizing services trade may be more likely than for the regional group as a whole, given that there are differences between countries in trade performance and contribution of services to the trade basket.

An examination of subsector trends in the composition of services trade reveals areas of common strength and complementarities, which could be leveraged to promote regional integration in services. There is a general trend toward “other services” and away from traditional service exports such as travel and transport (Figures 6.3 and 6.4). Although commercial services constitute more than 90% of service exports for Bhutan, India, the Maldives, and Sri Lanka, noncommercial services (i.e., government services) constitute 20% or more of total service exports for Bangladesh, Nepal, and Pakistan. Hence, there is a lack of commercial orientation in services exports for some SAARC member countries. A common feature across several countries is the growing importance of exports of computer and information services. This indicates that the subsector is of common interest and competition, reflecting the countries’ comparative advantage based on the availability of low cost, skilled labor, and government policies to boost exports of software services.

**Figure 6.3: Trends in Subsector Composition of Service Exports from SAARC Countries, 2000 (%)**

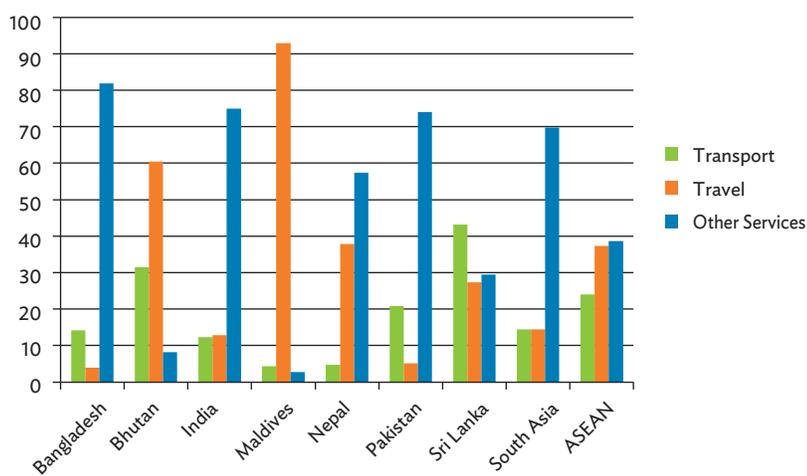


ASEAN = Association of Southeast Asian Nations.

Note: Bhutan data are for 2006, the earliest year for which subsector breakdown is available for its services exports

Source: United Nations Conference on Trade and Development. UNCTADSTAT. <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx> (accessed 24 December 2013).

**Figure 6.4: Trends in Subsector Composition of Service Exports from SAARC Countries, 2012 (%)**

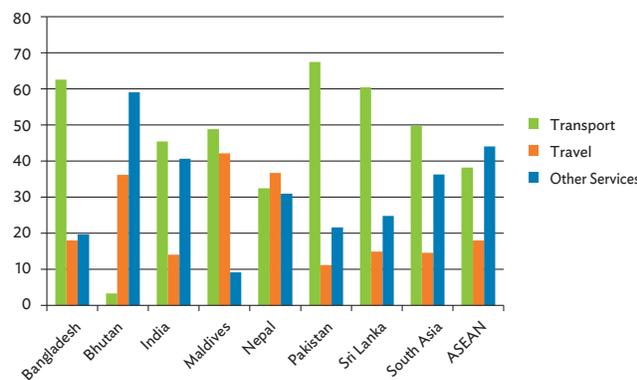


ASEAN = Association of Southeast Asian Nations.

Source: United Nations Conference on Trade and Development. UNCTADSTAT. <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx> (accessed 24 December 2013).

The composition of service imports has not changed as much as for service exports. Figures 6.5 and 6.6 show the trends and considerable variation in the composition of service imports for SAARC members. For some countries, “other services” have grown in relative importance but in others this category has declined considerably. Travel services also show considerable variability, increasing in importance in some countries and declining in relative importance in others. The most consistent feature across all the countries is the importance of transport services, accounting for 30% or more of service imports for all countries and constituting nearly half of the region’s services imports. This reflects the importance of trade in transport and logistics services for the region.

**Figure 6.5: Trends in Subsector Composition of Service Imports from SAARC Countries, 2000 (%)**

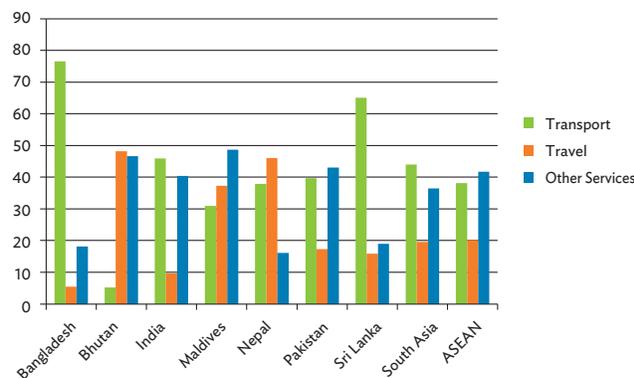


ASEAN = Association of Southeast Asian Nations.

Note: Bhutan data are for 2006, the earliest year for which subsector breakdown is available for its services imports

Source: United Nations Conference on Trade and Development. UNCTADSTAT. <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx> (accessed 24 December 2013).

**Figure 6.6: Trends in Subsector Composition of Service Imports from SAARC Countries, 2012 (%)**



ASEAN = Association of Southeast Asian Nations.

Source: United Nations Conference on Trade and Development. UNCTADSTAT. <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx> (accessed 24 December 2013).

### Competitiveness in Services

The overall trends in service exports and imports are indicative of the sources of strength and weaknesses in the sector for South Asia and the asymmetries in competitiveness among the countries. Table 6.4 shows that South Asia has consistently been more competitive in services than in goods, with revealed comparative advantage (RCA) indexes exceeding 1 and rising during 2001–2012.

**Table 6.4: Trends in Revealed Comparative Advantage Indexes for Goods and Services, Selected Years**

Area/Country	2000		2005		2012	
	Goods	Services	Goods	Services	Goods	Services
Bangladesh	1.10	0.59	1.10	0.60	1.15	0.38
Bhutan	1.04	0.85	1.07	0.72	1.06	0.74
India	0.89	1.48	0.81	1.76	0.84	1.67
Maldives	0.29	3.99	0.42	3.39	0.17	4.45
Nepal	0.76	2.02	0.86	1.56	0.62	2.60
Pakistan	1.07	0.69	1.01	0.95	0.98	1.09
Sri Lanka	1.05	0.77	1.00	0.99	0.88	1.48
South Asia	0.94	1.27	0.86	1.58	0.84	1.66
ASEAN	1.07	0.72	1.05	0.78	1.03	0.87

ASEAN = Association of Southeast Asian Nations.

Note: The revealed comparative advantage (RCA) Index is calculated as the share of a country's exports of an item in its total exports divided by the share of the world's exports of that item to the world's total exports. It is 0 or greater. The higher the RCA index, the greater the RCA of a country in an item. In this case, RCAs have been calculated for all goods and all services.

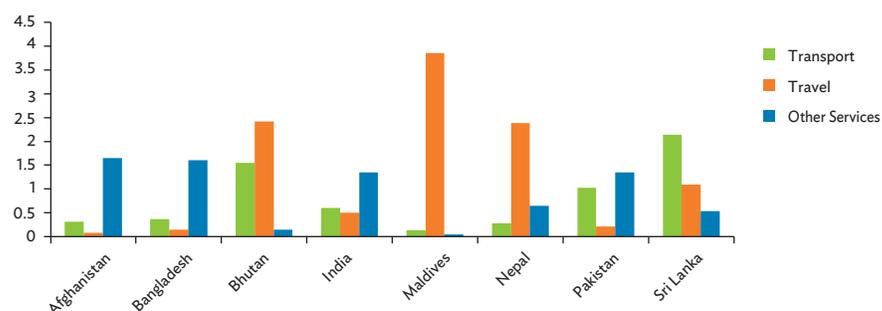
Source: United Nations Conference on Trade and Development. UNCTADSTAT. <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx> (accessed 19 December 2013 and 26 February 2014 for ASEAN).

However, this competitiveness is not broad-based. The RCA indexes for South Asia and the individual countries are higher for “other services,” and within this segment, “other business services” is generally the highest, especially computer and information services. Smaller countries in the region—Bhutan, the Maldives, and Nepal—are competitive ( $RCA > 1$ ) in travel and tourism services. Only Sri Lanka, Bhutan, and Pakistan have RCAs exceeding 1 for transport services. For the region as a whole, both transport and travel services are not competitive.

In summary, the region has performed strongly in growth and trade in services, mainly led by India. Most countries in the region exhibit niche-based rather than generalized competitiveness. A common area of competitiveness among the countries is labor-based services. This observation is corroborated by statistics on migration and remittances, which in part capture the region's exports of labor services. South Asian countries rank among the leading source countries for international migration. Remittances as a share of GDP are significant, exceeding 10% for several countries (Bangladesh, Nepal, and Sri Lanka) and dwarfing foreign direct investment (FDI) inflows and official development assistance.<sup>4</sup> Clearly, labor mobility and market access are of common interest for SAARC members, as well as being an area of competition and sensitivity in their engagement within the region.

<sup>4</sup> World Bank. Annual Remittances Data - Inflows and Outflows. <http://econ.worldbank.org> (accessed 20 October 2013).

**Figure 6.7: Broad Subsector Revealed Comparative Advantage Indexes in Services for South Asian Countries, 2009 or 2012**



Notes: The RCA Index is calculated as the share of a country's exports of an item in its total exports divided by the share of the world's exports of that item to the world's total exports. It is 0 or greater. The higher is the RCA index, the greater the revealed comparative advantage of a country in an item. In this case, RCAs have been calculated for three broad subsectors of services. Data are for 2009 for Afghanistan, Bangladesh, Maldives, Nepal and 2012 for the other countries.

Source: United Nations Conference on Trade and Development. UNCTADSTAT. <http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx> (accessed 24 December 2013).

### Trends in Services Foreign Direct Investment

There has been a considerable degree of opening up and deregulation of the service sector in South Asia. Several important services have been fully or partially liberalized. This has enabled the service sector to attract a growing share of FDI in the region. The services accounted for 72% of total FDI inflows into South Asia in 2009, with India accounting for over 80% of FDI inflows in services and 85% of total FDI inflows (World Bank 2013b).

**Table 6.5: Foreign Investment Regime (Indexes) in Selected Services in South Asia, 2010**

Region/ Economy	Light Manufacturing	Telecom	Electricity	Banking	Insurance	Transport	Media	Construction, Tourism, and Retail	Health care & Waste Management
South Asia	96.3	94.8	94.3	87.2	75.4	79.8	68.0	96.7	100.0
Afghanistan	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Bangladesh	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
India	81.5	74.0	100.0	87.0	26.0	59.6	63.0	83.7	100.0
Pakistan	100.0	100.0	100.0	49.0	51.0	79.6	37.0	100.0	100.0
Sri Lanka	100.0	100.0	71.4	100.0	100.0	...	40.0	100.0	100.0

... = not available.

Notes: This table reports statutory restrictions on foreign ownership of equity in new investment projects (greenfield foreign direct investment) and on the acquisition of shares in existing companies (mergers and acquisitions). It also shows foreign equity ownership indexes (where 100 = full foreign ownership allowed) for 11 sector groups, which can be disaggregated into 33 sectors.

Source: World Bank. Investing across Borders. <http://iab.worldbank.org/Data/Explore%20Topics/Investing-across-sectors> (accessed 27 June 2012).

However, South Asia registered the lowest level of FDI inflows as a share of GDP, among all developing regions. During 2000–2011, FDI inflows averaged less than 2% of GDP and the region’s average annual FDI inflow was only \$18.3 billion (World Bank 2013b). The same holds for FDI in services, which was only 1.8% of South Asia’s GDP, compared with the developing country average of more than 3%. The region has experienced rising outward FDI flows, which totaled \$85.2 billion during 2005–2010, making South Asia the fourth-largest FDI investor among developing regions. This outflow was mainly due to India, and most of these outflows were to manufacturing, natural resources, and strategic technology or distribution network-related sectors and not services. There was outward investment from the region in some services, such as tourism, IT and business process outsourcing, health, and energy, again mainly by Indian companies. Overall, as with trade in services, the level and extent of integration with other markets through inward and outward service-related FDI varies across the countries, reflecting differences in geography, market size, levels of development, availability of basic infrastructure, and the regulatory frameworks for FDI.

## Status of Service Negotiations in South Asia

Several studies have concluded that considerable benefits could be gained from broadening SAFTA to include services.<sup>5</sup> The following discussion highlights the status of negotiations under SATIS and what they reveal about the preparedness of the South Asian countries for regional integration in the service sector.<sup>6</sup>

### Concessions under SATIS

SATIS resembles the General Agreement on Trade in Services (GATS) in its architecture, with similar provisions, carve-outs, and scheduling modalities.<sup>7</sup> It aims at the progressive liberalization of services using a positive list approach and request-offer-based negotiations.<sup>8</sup> The general guidelines and principles call for SAARC members to make initial offers “in addition to their levels of multilateral commitments, with substantial sector and modal improvements over those commitments.” Thus far, initial offers and requests have been made to and received from one or more regional partners by all SAARC. Afghanistan, Bangladesh, Bhutan, India and Nepal are ready with their Final Offer Lists and are ready for tabling of these Final Offers.

The requests put forward by the member countries are quite extensive. Most countries have received requests that cover a large number of services. Construction and engineering,

<sup>5</sup> See Chanda (2011).

<sup>6</sup> Some of the discussion in this section is based on the author’s contribution to a forthcoming World Bank report on South Asia.

<sup>7</sup> All services are covered except those supplied in the exercise of governmental authority; transport and nontransport air services; domestic and international air transportation services and related services other than aircraft repair and maintenance; sales and marketing; and computerized reservation services. There are also carve-outs, i.e. what is not covered by the GATS commitments, with respect to measures affecting individuals seeking access to the employment market or to citizenship, residence, and permanent employment, and with respect to regulations on the entry of natural persons, provided these do not impair benefits to other parties granted under specific commitments.

<sup>8</sup> Since 2000, services have been under negotiation through what is termed a request-offer approach. WTO member countries place requests to WTO members nations to open up the latter’s services sectors. The recipient countries then make offers to the demandeur countries to further open up their services sectors.

business, financial, education, transport, and tourism services are common inclusions in the request lists, indicating potential commonality of interest among SAARC members. India's requests are the most extensive, with separate lists for least-developed country (LDC) and non-LDC members of SAARC; computer and related services as well as professional services are the subsectors of most interest. The offers, however, are quite minimal compared to the requests received. They are also subject to conditions such as foreign equity ceilings, minimum capital requirements, preferential treatment of domestic service providers, and economic needs tests. Table 6.6 highlights the limited scope and depth of the offers made by SAARC members.

**Table 6.6: Status of SATIS Offers by SAARC Members**

Sector	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Business Services							
Professional		X	X	X	X	X	
Computer and related		X	X	X	X	X	
Other			X		X	X	
Communication	X		X		X	X	X
Construction and related engineering			X		X	X	
Distribution					X	X	
Education					X	X	
Environmental		X			X	X	
Financial					X	X	X
Health and related social					X	X	
Recreational, cultural, sporting					X		
Tourism and travel-related	X	X	X		X		
Transport					X		
Remarks, conditions	Network services only by government operators, foreign employees in management/specialized jobs	Unbound subsidies, minimum investment requirement, FDI cap of 51%, intra-corporate transferees at management level, foreign exchange payments as per Central Bank guidelines	Differential taxation and/or subsidies, numerical ceiling on motion pictures, ICT	No conditions	Maximum foreign equity of 80%, local incorporation required, no subsidies for foreign companies, ICT at managerial level, no transactions in real estate by foreigners	No subsidies for foreigners, ICT at managerial level, ENT, residency requirement	Subsector carve out, FDI ceiling of 40%

ENT = economic needs test, FDI = foreign direct investment, ICT = information and communication technology.

Note: X indicates the services offered in that country. A blank means no offer of services has been made.

Source: Pandey, P. R. 2012. *SAARC Agreement on Trade in Services (SATIS): Status of Request and Offer*. Regional Seminar on Emerging Issues on Trade, Climate Change and Food Security: Way Forward for South Asia, Colombo. May-June. 31-1.

It is evident that most SAARC members are not willing to offer a large range of services for negotiation and for market access commitments under SATIS. Except for Nepal and Pakistan, the countries have offered less than 50% of possible services for negotiation. Even within services that are offered, there are numerous subsector carve-outs and only specific segments have been offered for market access negotiations. For instance, offers in health services are limited to hospitals, offers in tourism and travel services are limited to hotels, and offers in construction services are limited to general construction work for civil engineering. Segments such as tour and travel operators or health professionals have not been offered. Several important services that are critical for regional connectivity and development, such as transport and health services, have not been scheduled for the most part. Even India, given its size and significant share of the region's services sector, has offered only four service subsectors. The conditions are also quite restrictive and include FDI caps, necessity tests, and information and communications technology (ICT)-related conditions on the temporary movement of service providers in this sector.

Employment-related considerations appear to be important, as segments where market access could have adverse implications on the labor market are either left out altogether or mode 4 conditions are cited to ensure that access is restricted. There is a lack of willingness to liberalize mobility for independent professionals and contractual service suppliers, indicating the overlapping and competing interests of SAARC members in this mode. Considerations surrounding foreign investment are also important, which involve restricting the degree of foreign versus local participation, regulation of these providers, and stressing the role of state operators in some infrastructure services.

Thus, meaningful market access has not been offered so far under SATIS, notably not from India, which is the most competitive country in services and which dominates the region in service exports and FDI. This illustrates the challenges faced by an ambitious and comprehensive approach to services integration in South Asia.

### **Comparing SATIS with other SAARC Country Commitments in Services**

Compared with the GATS commitments made by these countries, the SATIS offers are GATS-minus, although the SATIS guidelines call for GATS-plus commitments.<sup>9</sup> Many services that have been scheduled under the GATS have not been offered under SATIS. This is not an encouraging sign for regional integration, as it reflects a general unwillingness to undertake meaningful services liberalization among SAARC members.<sup>10</sup>

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<sup>9</sup> GATS minus offers means that the offers placed under SATIS are less liberal than those made by these same countries under their GATS commitments in the WTO.

<sup>10</sup> The GATS commitments made by the SAARC countries are limited in scope and depth. On a scale of 0 to 100 where 100 represents a completely liberal commitment, SAARC countries score very poorly in most services, both on market access and national treatment. Many services have either not even been scheduled or commitments in these services have been left unbound (as indicated by a score of 0). For almost all services, the index value is less than 50%. The commitments are largely unbound and partial for key modes of delivery, such as modes 1 and 3. Detailed Hoekman indexes disaggregated across the four modes and across market access and national treatment commitments in individual services highlight the extremely low levels of bindings on both market access and national treatment across the services scheduled, with a score of 20 or less out of possible maximum scores of 620. The levels of binding on modal commitments are very low, with a score of 10 or 20 out of possible maximum scores of 310.

The lack of regional prioritization in services commitments is also evident from an examination of the commitments made by India under its extraregional agreements. India has made GATS-plus commitments in these other agreements with Japan, the Republic of Korea, and Malaysia, in contrast to its significantly narrower set of offers under SATIS. This may be indicative of the lower priority India has given to the South Asian market, in contrast to its signed agreements with other countries in Southeast and East Asia. Discussions with experts on South Asia confirm this inference. Even SAFTA is not necessarily seen as the agreement through which they can best secure their interests. Bilateral agreements among SAARC members (India–Sri Lanka, India–Nepal, Pakistan–Sri Lanka), as well as the presence of other plurilateral agreements such as the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) which involve several countries in the region, has reduced the focus on SAFTA. These alternate agreements are seen as more effective ways for the countries to meet their market access interests than under SATIS. Furthermore, relations between India and Pakistan have slowed down SATIS negotiations considerably. Overall, there appears to be a lack of prioritization, interest, and preparedness in binding services liberalization under SATIS.

There has also been little or no progress under SATIS concerning issues critical for services integration in the region. These include (i) visa facilitation to enable mobility; (ii) financial services liberalization and integration to facilitate capital flows among member countries; (iii) entry into mutual recognition agreements to facilitate skilled and professional mobility within the region; (iv) cooperation on infrastructure development, especially with regard to IT and transport connectivity; and (v) investment facilitation and related tax and other regulations. To date, there are only references to such issues or informal platforms, where they have been discussed by industry or regulators in South Asia. In the absence of a road map, South Asia is lagging in the development of institutional and regulatory frameworks needed to underpin services liberalization in the region.

## Prospects and Challenges: Case of Selected Services

This section uses the examples of energy, telecommunications, tourism, and health services to highlight both the opportunities for regional services integration and the wide range of regulatory, institutional, and business environment related constraints in SAARC member countries that pose a challenge to this process. The selected examples were chosen because of their recognized potential for intraregional collaboration and commercial engagement, but also because cooperation efforts in these areas have been impeded by regulatory, infrastructure, and institutional bottlenecks.<sup>11</sup>

### Cooperation in Energy Services

There is a general recognition among member governments in the region that energy cooperation and trade can play an important role in addressing the energy security interests

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<sup>11</sup> The sector discussion is in large part based on the author's contribution to a forthcoming World Bank publication and work by the author in Chanda (2011).

of SAARC members. Many studies<sup>12</sup> have highlighted the scope for mutual benefit from exports of power generation surpluses from Bangladesh, Bhutan, and Nepal to meet the huge energy deficits in India, and the scope to structure this power generation mix in a way that meets regional needs and makes possible lower electricity prices for all countries concerned. For example, effective development of the huge hydropower potential of Bhutan and Nepal could serve regional electricity needs while also addressing those countries' trade deficits with India and other partner countries. The estimated direct benefits from energy cooperation in the region are considerable. These benefits relate to investments in energy supply and demand technologies as well as environmental outcomes. This benefit is projected to be as large as \$359 billion over 2010–2030, or an equivalent of almost 1% of the region's GDP (IIMA 2000). There are also indirect benefits from regional cooperation in energy, related to the development of water markets, infrastructure, and agricultural productivity from better irrigation. The cost of not cooperating in the energy sector is high. Tables 6.7 and 6.8 highlight the potential for cross-border energy trade in the eastern and western parts of SAARC.

Energy cooperation within SAARC has progressed mainly at the bilateral level and is mostly limited at present to the hydropower segment. There are some subregional initiatives. Since post-2000, with the liberalization of the energy market in South Asia, there has been a growing interest from private companies (mainly from India) to participate in energy generation, transmission, and distribution in the regional market. Indian companies have submitted proposals for energy-related investments in the region, and the Government of Nepal has awarded the 200-megawatt Upper Karnali Hydroelectric Project to India-based GMR Group. Several Indian entities have expressed interest in investing in Bangladesh's power sector. Bangladesh expects about 25%–30% of its investment requirements (including for transmission and generation) in the power sector to come from India. In turn, Bangladesh

**Table 6.7: Overview of Trade Prospects in the Eastern and Northern SAARC Region**

Exporting Countries	Importing Countries				
	Bangladesh	Bhutan	India	Nepal	Sri Lanka
<b>Bangladesh</b>		Small amounts of thermal power and gas connection possible via India	Natural gas and power exports possible	Small amounts of thermal power and gas connection possible via India	Not likely due to distance
<b>Bhutan</b>	Some hydropower potential via India		Large quantities of hydropower exports possible	Unlikely due to similar resources and seasonal shortages	Not likely due to distance
<b>India</b>	Sharing reserves, electricity swaps	Dry season support		Dry season and thermal power support	Dry season and thermal power support
<b>Nepal</b>	Some hydropower potential via India	Unlikely due to similar resources and seasonal shortages	Large quantities of hydropower exports possible		Not likely due to distance
<b>Sri Lanka</b>	No scope	No scope	Could provide peak power support	No scope	

Note: Dark blue denotes that trade prospects are significant, and are being exploited, or could be exploited in the short to medium term. Pink denotes that trade prospects could materialize in the medium term. Light blue denotes that prospects may be limited and may materialize only in the medium to long term. Gray denotes that prospects are weak or unlikely.

Source: World Bank. 2008. *Potential and Prospects for Regional Energy Trade in the South Asia Region*. Washington, DC: World Bank.

<sup>12</sup> Parts of this discussion were drawn upon Das (2009), De (2009b), Dhungel (2008), and Siddiqui (2008).

**Table 6.8: Overview of Trade Prospects in the Western SAARC Region**

Exporting Countries Inside and Outside SAARC	Importing Countries	
	India	Pakistan
Afghanistan	Possibility of transit of gas	Possibility of transit of gas
India		Short term trading in power and mutual support possible
Iran	Significant potential for gas exports and transit via Pakistan	Significant potential for gas export, cross-border electricity trade could grow
Pakistan	Short-term trading in power and mutual support possible	

Note: Blue denotes that trade prospects are significant. Gray denotes possibilities in the medium to long term. Pink denotes prospects related to developments in other countries

Source: World Bank. 2008. *Potential and Prospects for Regional Energy Trade in the South Asia Region*. Washington, DC: World Bank.

is looking to participate in hydropower projects in the northeastern states of India (Hindu Business Line 2012). The opening up of the energy sector to international competitive bidding has facilitated cross-border private sector participation within the region.

### Challenges

Energy cooperation in South Asia has been fraught with challenges. Foremost among these is the political and security situation in the region. Political instability in Bangladesh, Nepal, and Sri Lanka has deterred energy sector investment in these countries, thus limiting the scope for energy trade. Implementation of important treaties has been delayed because of political sensitivities between some governments, such as India and Nepal. The possible export of surplus power from independent power producers in Pakistan to India failed because of political uncertainties and concern about possible supply disruptions. One of the flagship hydropower projects by the GMR Group in Nepal could not proceed because of political problems. Hence, although the Foreign Investment and Technology Transfer Agreement in Nepal permits foreign investment in most services and the legal framework is quite liberal, the investment climate does not support foreign investment. Likewise, political factors led to the failure of a proposal for gas and power exports from Bangladesh to India by Indian and international investors. The absence of good political relations between key players in the region and the lack of political stability in several of the countries have made the investment climate unattractive for bilateral and intraregional cooperation in the energy sector.

Another constraining factor is the inadequate institutional capacity for power development, planning, and implementation in the region. Joint development and utilization of power is impeded by the absence of a regional network of focal institutions in each country to work out power purchase agreements and the procedural and legal issues involved. There is also an absence of regional power trading frameworks setting out basic principles of power trading and the rights and obligations of participants, including the procedures for full cost recovery and elements for the equitable sharing of benefits. There is lack of clarity on how to integrate and expand the region's electricity grids. The absence of such frameworks

complicates drafting of intergovernmental agreements on energy. There is also inadequate technical and planning capability in several South Asian countries and a lack of willingness to cooperate with countries, such as India, which have this technical capacity.

In addition, there are infrastructure and resource-specific challenges. Cross-border electricity trading is constrained by the absence of a transmission grid with enough capacity to transmit hydropower from Bhutan and Nepal to India. According to some studies by ADB (2008), Siddiqui (2008), USAID (2005, 2006, 2008a,b,c), and the World Bank (2008) given the dynamics of energy demand in India, together with the unpredictability of river flows and the high cost of hydropower development, regional transmission lines may be difficult to build. Large-scale development to serve regional demand therefore remains unlikely at present. Hence, the likely scenario according to these studies is isolated projects with dedicated supplies to load centers in India rather than a regional transmission grid.

The ownership and financing structure of the energy sector in SAARC member countries is another constraint. Although reforms have made possible an increased role for the private sector, created multiple buyers and sellers, and led to the establishment of regulatory bodies, the public sector still predominates. The poor operational and financial performance of electricity utilities in South Asia, on account of uneconomic pricing and misuse of power, constrains energy trade and investment in the region. Financing constraints, in turn, make it difficult for the region's power utilities to fulfill contractual obligations with independent power producers and to engage in power trade arrangements. Regional electricity trade would require that power is made available at competitive prices for export to neighboring countries, which in turn would require regulatory cooperation among the concerned countries.

#### *Possible Steps Forward*

Several steps could be taken to foster regional cooperation in energy development and supply. First and foremost, political will and agreement are needed on some basic principles, based on an understanding of the implications of the current regulatory and policy environment for regional energy cooperation. An agreement would also require assessment of the technical and economic feasibility of an integrated electricity network in the region and of the contractual obligations. Given the complexities of energy sector cooperation, it would be best to take a gradual approach, selecting pilot projects, starting on a smaller scale, and then moving to larger initiatives.

Second, institutional frameworks are needed for regional energy cooperation. One possibility would be to set up an apex regional body composed of state-owned and leading private sector companies engaged in energy exploration, production, and sales in the region. So far, institutional cooperation in the region has mainly occurred among government officials at various SAARC Summits and under the aegis of the SAARC Energy Centre. However, there is a need for dialogue among energy companies, both public and private, operating in the region. Regional cooperation in energy will involve joint ventures, build-own-operate-transfer investments, and public-private partnership arrangements. The concept of a SAARC regional power trading corporation has been proposed to provide a market mechanism for energy trade, and provide information on a broad range of energy-

related matters. An institution of this type could help in the development of a bidding system for power generation projects in the region and facilitate joint initiatives on research and development, renewable energy, and capacity building. With the growing role of private investors in the energy sector, an apex body that includes leading private companies in the region would be important.

Third, as energy trade requires costly infrastructure, a legally binding instrument, such as a charter or treaty, is required covering issues of investment, trade, transit, safeguards for investors, and dispute resolution. The energy charter or treaty in South Asia could provide such a framework of rules, reducing the risks associated with energy cooperation, trade, and investment. It would be important for all SAARC members to be active participants in such a treaty. Underlying this agreement would be cooperation on the legal and regulatory framework and harmonization of energy policies, including investment policies, tariff-setting principles, and issues of standards and specifications.

Fourth, energy cooperation will need to be backed by reforms in the energy sector of the individual SAARC member countries. It will require reforms of the service energy balance systems through more competitive retail pricing of electricity, more commercial discipline, and less political interference in the functioning of these boards if regional investments and cross-border sales of electricity are to be viable.

Finally, energy cooperation in the region will require looking at new areas of common interest. One such area is clean and alternative energy, in response to the region's growing energy requirements, heavy dependence on fossil fuels, and associated environmental concerns. The potential for wind energy in South Asia remains largely unexplored. India produces modern, cost-effective wind power technologies, but, because Pakistan does not permit the payment of technology fees to India, it imports higher-cost technologies from the West. Nonetheless, joint feasibility studies and development projects should be possible in the region. Current institutional arrangements, such as the Regional Secretariat on Renewable Energy and Energy Efficiency Program and the USAID's South Asia Regional Initiative on Energy, need to be leveraged to initiate regional projects.<sup>13</sup> Effort should also be made to leverage financial resources for private companies engaged in renewable and clean energy projects, including from the South Asia Clean Energy Fund (a private equity fund), which is dedicated to promoting clean energy in South Asia.<sup>14</sup>

In summary, the constraints are wide-ranging, spanning political, institutional, technical, infrastructure, and commercial factors. Hence, the approach to fostering energy cooperation needs to be multidimensional. The spin-offs in terms of reduced power costs, enhanced manufacturing competitiveness, and improved balance of payments could be significant.

<sup>13</sup> See, USAID (2008a, b,c), (2006), (2005), and (2000) for discussion of regional opportunities in alternative and conventional segments.

<sup>14</sup> [http://www.opic.gov/sites/default/files/docs/south\\_asia\\_clean\\_energy\\_fund\\_nc.pdf](http://www.opic.gov/sites/default/files/docs/south_asia_clean_energy_fund_nc.pdf)

### Cooperation in Telecommunication Services

The telecommunication sector has been the frequent subject of regional discussions in intergovernmental and industry forums. As ICT is designated as a priority sector for cooperation under the South Asia Subregional Economic Cooperation (SASEC) Program, a working group on telecoms and ICT has been established to address constraints arising from lack of connections among member countries, lack of strong infrastructure, and the poor human resource capacity in telecom services. The working group has identified five focus areas: (i) enhancing regional connectivity, (ii) promoting information sharing and human resources development, (iii) establishing community information centers, (iv) strengthening and harmonizing regulations and standards, and (v) developing common software tools to enhance the content on the internet.

The South Asian Telecommunication Regulators' Council (SATRC), established in 1998, helps coordinate regulatory issues of common interest to telecommunication regulators in South Asia, such as licensing, service quality, universal service and access obligations, tariff rebalancing, interconnections, number plans and portability, network access, and broadband technology. It also serves as a forum for mutual learning, sharing of experiences, and harmonization of regulations.<sup>15</sup> There is an SATRC plan to (i) lower telecom tariffs within the SAARC region; (ii) introduce special rates for transiting regional traffic; (iii) promote intercountry direct services, calling cards, cellular roaming, liberalized leased lines, and use of either direct links or hubs to facilitate intraregional communications; and (iv) advance regulatory cooperation. The common priority areas under this plan are universal access, development of rural services, optimal sharing of available resources, enhanced cooperation in technology transfer, and standardization.

There are some industry-led initiatives. For example, an annual meeting of SAARC industry leaders in the telecom industry has discussed issues such as lowering of tariffs, introduction of lower cost roaming facilities and high speed services, sharing of regulatory best practices, building of knowledge and capacity on latest technology in the sector, and standardizing of telecom monitoring methods. Industry chief executive officers have acknowledged the untapped opportunities in the South Asian market and the need to leverage each other's abilities. A SAARC industry forum has been launched for the telecom sector to focus on network expansion and mobile security. The discussions have highlighted the need for the cross-border availability of services and for cooperation among operators for both voice and data services. Possibilities for regional operators, such as India's BSNL, to service the regional market, and the need for discussions among the major operators in the region to finalize roaming agreements, have been highlighted. Industry participants have also pointed to the need for standardization of products and services to facilitate outsourcing and sharing of opportunities linked to India's IT sector. There is growing interest on the part of companies in the region, especially in some of the big telecom operators in India (Airtel, BSNL, and Reliance Infocomm), to establish facilities and services regionally. In 2010, India's Bharti Airtel took management control of a leading telecom company in Bangladesh and rebranded its services under the Airtel name. This was the company's second foray in the regional market, coming after its entry to Sri Lanka in 2009.

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<sup>15</sup> See Asia Pacific Telecommunity (2004).

### Challenges

Cooperation and market access in telecom services have been affected by regulatory, institutional, and political factors. Security considerations have posed a challenge to cross-border investments, associated movement of people, and sharing of telecom infrastructure. In the case of Telenor Pakistan, which was interested in entering India, the Indian authorities granted permission only on the condition that no employees from Telenor's Pakistan subsidiary work for the Indian company, keeping human resources of the Indian and Pakistani wings of the company separate. Regional investment in telecom remains constrained by the fact that some segments still remain closed to private participation. However, the main challenge to regional cooperation in telecom services stems from anticompetitive "behind-the-border" regulatory practices<sup>16</sup> rather than market access per se. Companies interested in entering other markets in the region have been impeded by unfair competition from incumbent mobile telecom operators. For example, Bharti Airtel was not provided adequate points of interconnection upon its entry into Sri Lanka, and thus experienced call congestion. The continued presence of restrictive and monopolistic practices has, in turn, affected the creation of a regional network and resulted in very high intraregional tariffs among SAARC members (the cheapest intra-SAARC price from Pakistan is four times that of its cheapest extra-SAARC price).

The results of telecom regulatory surveys conducted in 2008 clearly indicated that while South Asian countries have done quite well in expanding market access, they have not done well with regard to institutional and regulatory practices. Their telecom sectors are subject to a litany of problems including lack of institutional transparency; anticompetitive practices; a tendency to favor incumbents; lack of independence of telecom regulatory authorities; political interference and lobbying by incumbents; regulatory uncertainties; policy gaps arising from differences between policies on paper and policies in practice; continued monopoly in certain segments; problems of infrastructure, particularly in spectrum allocation; and high surcharges and levies on telecom operators as a source of government revenues. Such behind-the-border measures undermine regional cooperation in the sector.

### Possible Steps Forward

In view of the regulatory, infrastructure, investment climate, and security-related challenges of the telecom sector, initiatives are required at the regional and national levels. The following three main issues need to be addressed.

First, the pace of discussions on regulatory cooperation must be accelerated, leading to concrete results, such as harmonization of numbers for identified services. This would lend credibility to the various sector discussion forums that have been held in the region in the 1990s and 2000s. Second, the countries need to focus on lowering intraregional call rates, which would benefit many sectors, including tourism, business travel, investment, and potential outsourcing and ICT services in the region. This would require a more pro-competitive stance, lowering termination charges for calls originating in other SAARC countries and passing on these benefits to consumers in these countries. The third issue

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<sup>16</sup> The term "behind-the-border" refers to policies and measures which affect the operating terms and conditions for service suppliers once they have entered the overseas market. These measures could distort the playing field between domestic and foreign suppliers of services.

pertains to improving the investment climate more generally and institutional streamlining of investment approvals and clearances in SAARC countries. Several intraregional investment projects, including in the telecom sector, have experienced delays in approval, resulting in uncertainties for investors and changes in investment plans. An improved investment climate is essential for intraregional collaboration for the full development of telecom opportunities in the region.

### **Cooperation in Tourism Services**

The strong commonality of interest and affinity among SAARC members, in terms of language, culture, history, religion, and geography provide an excellent basis for regional cooperation in the tourism sector. There are several segments, such as sports and recreational tourism, adventure and ecotourism, religious and cultural tourism, and medical tourism, where the potential is well recognized. The spin-off benefits of regional cooperation in promoting tourism would be substantial, including in infrastructure development and employment creation. Tourism has been identified as a priority sector under SAARC.

Several intergovernmental initiatives have been undertaken in tourism services: the Scheme for Promotion of Organized Tourism in 1986 (to collectively promote tourism and introduce an intra-SAARC travel voucher system), the setting up of the SAARC Technical Committee on Tourism in 1991, and the formation of the SAARC Working Group on Tourism in 2004. There are some bilateral agreements among SAARC governments to promote hospitality and tourism, such as India and the Maldives joint development of hospitality projects, increased flight frequency, and cross-border cooperation between travel agents. Well-known private sector companies, including the Taj Hotels and Resorts Group, the Leela Group, and the Oberoi Group, are present in the hotels segment of other SAARC countries through equity ownership, management contracts, and joint ventures. Companies from some of the smaller SAARC countries have shown interest in investing in tourism-related services in the larger countries.

For India–Pakistan tourism cooperation, there is scope to expand tourism by building on the two countries' cultural, historical, religious, and linguistic ties. Religious and cultural tourism is increasingly popular, especially among Hindu, Muslim, and Sikh pilgrims who visit noted religious sites in the two countries. Sikh pilgrimage tourism is seen as an important potential source of foreign exchange earnings for Pakistan. The Pakistan Tourism Development Corporation has identified 32 temples, gurdwaras, and Sufi shrines of interest to pilgrim groups from India. The development corporation has renovated historic Sikh shrines and is improving accommodation at these places. It has built a 200-room complex to provide accommodation to Hindu and Sikh pilgrims at Gurdwara Punja Sahib in Hasanabdal, at an estimated cost of \$236,000 (Jamal 2011). In Lahore, large-capacity guest houses are being built at the Gurdwara Janamsthan Nanakana Sahib and Gurdwara Dera Sahib. The government has also renovated the Hindu shrine of Katasraj. Pakistan's Tourism and Resorts Development Department plans to build affordable hotel facilities in Punjab to accommodate the growing number of religious pilgrims visiting gurdwaras, Hindu temples, and Sufi shrines. There is also potential to expand historical and cultural tourism in other areas of Pakistan, such as in Sindh and Balochistan provinces, where there are a large

number of Buddhist stupas and monasteries of interest to Indian tourists. Thus, despite the difficult bilateral relationship between the two countries, there are promising opportunities for promoting trade in tourism services.

### *Challenges*

Intraregional travel (for tourism and other purposes) among SAARC members remains low, accounting for about 20% of all international arrivals in these countries during 2001–2008. However, there is considerable variation across countries, from 50% for Bangladesh to less than 5% for the Maldives. There are three sets of challenges to expanding intraregional trade in tourism services: connectivity and infrastructure constraints, visa and security concerns, and the regulatory and business environment.

**Connectivity and infrastructure constraints.** The failure to increase intraregional travel and promote cooperation in tourism services can be attributed to the lack of integrated transport infrastructure in South Asia. Many experts and agencies have pointed out that integration of South Asia's transport network is critical to reducing costs and facilitating travel and trade in the region. The transport networks and infrastructure badly need upgrading in many parts of South Asia. For example, the northeastern region of India is connected to the rest of the country by a narrow, congested land corridor between Bangladesh and Nepal, restricting the transport of goods and the movement of people. The absence of extensive cross-border road and rail links is a major constraint to subregional tourism. Some capital cities in the region are not directly connected, and connections with other major cities are often poor. Weekly flight frequencies between capital and major cities in the region range from 2 to 6 for some countries. India is the best connected SAARC member, accounting for about half of all weekly flights operating in the region. All SAARC member countries, except Pakistan, have a sizeable number of direct flights with India's capital and other major cities. For India–Pakistan tourism, the absence of good road links, and visa and security difficulties are major challenges.

**Visa and security concerns.** The relaxation of visa regulations is an important requirement for greater connectivity and tourism. Although visa on arrival and gratis visas with minimal conditions are available for tourists in some SAARC countries, visa requirements for business travel, employment, and other purposes, such as medical and educational services, are cumbersome. Multiple-entry visas are normally not provided, and the duration of single-entry visas is typically only 15–30 days. The documentation requirements between India and Pakistan are particularly onerous. There are reporting requirements at the local police station or registration authorities for Indians and Pakistanis traveling to each other's countries and when moving within the countries, reflecting internal security concerns. Added to this, visa fees are quite high in many SAARC countries; there are no separate counters for SAARC travelers to facilitate intraregional travel, either for business purposes or tourism; and some countries lack provisions for transit visas, undermining connectivity. In contrast, ASEAN countries provide facilitation counters for ASEAN travelers; gratis visas are issued on arrival for partner countries; and there is provision for an ASEAN Air Pass, where travel to one ASEAN country qualifies a traveler to visit other countries at a concessional airfare.

Visa and security-related restrictions have been the main constraint to expanding bilateral tourist flows between India and Pakistan. After the terror attacks in Mumbai, these restrictions have become more stringent.<sup>17</sup> Another constraint to India–Pakistan cooperation in tourism services is the lack of consular facilities and the need to travel long distances to apply for visas. To illustrate the problem, the Amritsar–Nankana Sahib bus service was launched in 2006 but failed within a year, in part because the travel time to get a visa was longer than some other alternatives. In addition, there were security clearances hassles and other disruptions; travel services have frequently failed due to excessive security checks.

#### *Possible Steps Forward*

Tourism services are an area where successful and mutually beneficial outcomes are possible, and would contribute to building confidence in the overall regional integration process in South Asia. Both sector-specific and cross-cutting issues would need to be addressed. These include lowering travel costs among the countries in the region; improving surface and air transport connectivity; streamlining visa procedures along with providing longer-duration and more flexible visa arrangements for cross-border travel; streamlining the tax structure in the tourism industry; jointly marketing and developing tourism projects around selected themes such as religion, heritage, nature, and geography; and sharing best practices within the region. Joint marketing is another consideration. SAARC members could build on existing intergovernmental initiatives in the region (such as the SAARC Working Group on Tourism) and frame bilateral agreements in this sector (such as that between India and the Maldives) to promote joint development of hospitality projects, increase flight frequency, and enable cross-border cooperation between travel agents. The intangible benefits in terms of goodwill and confidence building could be substantial and would encourage further liberalization of trade, investment, and mobility of people in the region.

The overall investment climate is an important area of concern. A transparent, well-defined investment approval process is needed for hospitality projects, accompanied by clear environmental and other standards. Institutional capacity building and training of personnel for the tourism sector is also important. Overall, regional cooperation efforts must be supported by national efforts. Regional cooperation cannot succeed without the development of tourism and related transport infrastructure and a supportive business environment for tourism services at the national level.

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<sup>17</sup> At the end of 2012, however, steps have been taken to ease visa restrictions for selected categories of travelers between the two countries. Under the new visa policy, there will be a single-entry visitor visa for up to 6 months, for no more than 3 months at a time, and for five places for visiting relatives, and friends, for business, or other legitimate purposes. The visa can be issued for up to a year if needed, depending on the nature of work or business. In addition, a visitor visa for a maximum of five specified places may be issued for up to 2 years, with multiple entries in the case of senior citizens (65+), a spouse of a national of one country married to a national of the other country, and children below 12 years with accompanying parents. The time taken to issue transit visas will be reduced to within 36 hours from 72 hours. Another important development is the separation of the business visa from the visitor visa. There are ongoing discussions to allow people to cross the line of control for pilgrimage and cultural reasons. But the fragility of these measures was underlined by the suspension of all cross-border trade and travel services between the two countries following border clashes in early 2013.

## Cooperation in Health Services

Health care is another sector where the potential for regional cooperation and integration has been well recognized. Regional initiatives and recent developments, particularly in the private sector, highlight some of the regional opportunities in the health sector.

### *Opportunity Segments*

One area of opportunity is regional investment in hospitals. Several leading Indian hospitals have entered other markets in the region through joint ventures with a local partner, wholly owned subsidiaries, and management contracts. For example, India's Apollo Hospitals made its first overseas investment in Colombo, where it set up a 350-bed super-specialty hospital. Apollo has also taken on an operations management contract for a 330-bed tertiary care hospital in Dhaka, and has entered into a joint venture with its Bangladeshi partner, STS Holdings, Dhaka. These projects aim mainly to cater to the large number of patients from these countries that require specialty treatment and would otherwise have to travel to India or other markets (e.g., Thailand) for treatment. News reports suggest that Indian hospitals are increasingly looking at entering Bangladesh through joint ventures and as stand-alone entities.<sup>18</sup> Kolkata's BM Birla Heart Research Centre is setting up a hospital in Dhaka and managing a hospital in Chittagong. AMRI Hospitals, Kolkata is similarly considering setting up a branch in Bangladesh. Cultural and linguistic similarities and geographic proximity make Bangladesh an attractive market for Indian hospitals in the eastern part of the country. The BM Birla Group is considering setting up a hospital in Bhutan, given the need for state-of-the-art health-care facilities in that country.

Other ventures by leading Indian hospitals illustrate the regional opportunities and interest of the private sector in cross-border investment. Manipal Hospitals in India has a 700-bed hospital in Pokhara, Nepal. It also runs a hospital attached to a Kathmandu university as part of a joint educational program under which Nepali medical students can go to India to complete part of their qualifications. The Government of Bhutan has expressed interest in attracting private sector investment by Indian hospitals. The Hinduja Group in India also considered setting up a hospital in Sri Lanka in response to a request by the Government of Sri Lanka (Hindu Business Line 2005).

Another promising commercial opportunity for the private sector is medical tourism. Medical tourism from Bangladesh, the Maldives, Nepal, and Pakistan has been identified as of strategic value for Indian hospitals, given the underdeveloped facilities and lack of availability of specialized treatment in these markets.<sup>19</sup> Patients from these countries find medical care in India attractive in terms of cost, quality, cultural, and geographic proximity considerations. The Manipal Hospital in Bangalore receives patients from over 30 countries, including Sri Lanka, Bangladesh, Nepal, and Pakistan. Apollo Gleneagles Hospital in Kolkata receives patients from Bangladesh and Nepal, and Apollo Hospital in Chennai receives patients from Sri Lanka. The Government of Bhutan sends patients to Delhi and Kolkata and pays for their treatment. In view of the promising prospects for medical tourism in South Asia, Bangalore-based Narayana Hrudayalaya Hospital has established referral

<sup>18</sup> See, Oberholzer-Gee, Khanna, and Knoop (2007), p.6.

<sup>19</sup> The other three segments are the Indian diaspora who would come to their home country for medical treatment, countries with large public health care systems such as Canada and the United Kingdom where waiting periods can be long, and the uninsured in markets such as the United States who might prefer low-cost, quality treatment in India. See Oberholzer-Gee, Khanna, and Knoop (2007).

arrangements with hospitals and agents. Further, it has coordinated with travel operators in some South Asian countries to provide an integrated set of services to medical tourists in the region. There are also reports of patients in the less-developed parts of Assam and Bihar states in India seeking health care across the border in Nepal (Hindustan Times 2012).

There has been a lot of media attention on the prospects for medical tourism between India and Pakistan, as Pakistan is seen as a potential source market for patients seeking high-end treatments at a reasonable cost. Indian hospital chains, such as Apollo, Max, Medanta, and Ganga Ram, attract Pakistani patients, mostly for liver and kidney transplants, oncology-related treatments, and cardiac and orthopedic surgeries.<sup>20</sup> Overall, patients from Pakistan account for 15%–20% of the total international patient inflow to India.

Telemedicine is another area with promising prospects for trade and collaboration within the region, as it circumvents the challenges arising from mobility restrictions and safety concerns. There is some evidence of telemedicine links between major hospitals in India and establishments in other South Asian countries, mainly for teleconsultation and tediagnostic services. Some identified potential opportunities are in remote monitoring of patients and telepsychiatry. Companies that make telemedicine equipment in the region, such as GE, could provide telehealth services for SAARC member countries. For instance, GE's subsidiary in Delhi provides telemedicine services to hospitals in Nepal. Wipro, an Indian IT company, is considering setting up a telemedicine center in Colombo. Apollo exports telemedicine throughout the SAARC region and its telemedicine arm, Apollo Telemedicine Networking Foundation (ATNF), has set up more than 120 telemedicine centers, 7 of which are outside India, including in the Maldives, Nepal, Oman, Pakistan, and Sri Lanka (SACEPS 2011). In October 2004, the Apollo Group set up a telemedicine link between its Indraprastha Apollo Hospital in Delhi and the Apollo Information Centre in Lahore. Through this link, Lahore doctors can access video conferencing-based medical programs offered by Apollo specialists to help them upgrade their skills. Telemedicine holds great promise because it is least affected by political instability and does not require people to travel.

### Challenges

There are numerous public and private sector challenges to regional cooperation in health services. Medical tourism within the region is hampered by difficulties in obtaining visas, including expedited medical visas, poor airline connectivity, inadequate local support infrastructure in the receiving country for patients and their families, difficulties with pre- and post-treatment consultations, and poor political relations among some member countries. Bangladeshi patients traveling to India for treatment often go on a tourist visa to avoid the onerous documentation requirements of obtaining a medical visa Rahman (2000). Medical tourism from Pakistan to India is hampered by poor transport connectivity, especially by air. Although many Pakistani patients go to India as a cheaper option than

<sup>20</sup> Apollo receives 50–60 patients each month from Pakistan, accounting for approximately 3% of its total revenues from international patients (which constitute around 20%–25% of its total revenues). The hospital performed 130 liver transplants for Pakistani patients in 2012. Ganga Ram Hospital receives 30–40 Pakistani patients per month, while Medanta receives 8–10 Pakistani patients per month (Dey 2013a and Rediff 2013); See Obberholze-Gee, Khanna, and Knoop (2007).

the United States, disruption in transport services (such as the closure of the bus service) requires them to travel via other routes, such as the Middle East.

Adverse political relations between SAARC members are also an impediment to expanding medical tourism. Border tensions between India and Pakistan and resulting visa delays periodically disrupt the flow of patients from Pakistan to India. Leading Indian hospitals cited a fall in the number of patient arrivals from Pakistan soon after the border conflict in 2013 (Hindustan Times 2009). Even factors such as the inability of Pakistani nationals to register for an Indian subscriber identity module (SIM) and the requirement to register with the Foreign Regional Registration Offices are impediments to medical tourists from Pakistan to India.

Regional investment projects in health care also face challenges. These relate to managing partnerships with local stakeholders, restrictions to mobility of health care professionals, and difficult business environments. Investments in Nepal, for example, have been affected by political instability, uncertainties over profit repatriation, and problems of worker discipline and unionization. In 2009, an indefinite closure of the Manipal Teaching Hospital in Pokhara, Nepal was called by a trade union. As a result, the All Nepal Health Workers' Association and Manipal Non-teaching Staff Union closed all departments except emergency services at the hospital (Hindustan Times 2009). In the India–Pakistan context, investment relations in hospital and telemedicine services encounter restrictions imposed by India. Experts believe that foreign direct investment (FDI) in health care will remain limited because of political instability and security concerns.<sup>21</sup>

Telemedicine services face various infrastructure, regulatory, and capacity-related challenges. Practitioners observe that expanding regional telemedicine services has been hampered by poor infrastructure (the high cost of bandwidth, poor quality of image delivery, and lack of home devices) and problems of data security and patient confidentiality.<sup>22</sup> Shortages of trained specialists to serve local markets in countries such as India have made it difficult for telemedicine providers to focus on the regional market.

Finally, the cross-border mobility of health professionals will remain limited until strict visa policies are relaxed. Restrictions on the regional mobility of professionals have affected staffing of investment ventures in the region and have made it difficult to organize regional seminars and conferences. While mobility for employment purposes is unlikely, mobility should be eased for those attending seminars and conferences, and especially for health professionals engaged in managing medical establishments and providing specialized skills and expertise. Another limitation is the lack of a formal mechanism for recognizing medical professionals' qualifications among SAARC members.<sup>23</sup>

<sup>21</sup> Apollo's investment in Sri Lanka also encountered problems because of differences with its local partner and because of concerns about the quality of hospital staff. This led Apollo to exit via an initial public offering. The hospital was taken over by one of the largest insurance companies in Sri Lanka, subsequently, there were issues about its privatization and eventually the government took over. Today, it is the Lanka Hospital where 25% of the shares is held by the public and majority ownership is held by the government. See Economic Times 2006a and 2006b).

<sup>22</sup> It is still not practical to perform surgeries remotely. Although data privacy is not yet a major issue in the region, awareness of it is growing, raising issues of liability and jurisdiction.

<sup>23</sup> The Indian Medical Council Act notifies medical degrees from Bangladesh, Nepal, Pakistan, and Sri Lanka under a reciprocal arrangement provision, which also means that these countries recognize medical qualifications from notified Indian colleges and universities. However, recognition among SAARC members of qualifications in dentistry and nursing is not clear.

Overall, while health services present promising opportunities for regional cooperation and integration, a variety of infrastructure, human resource, regulatory, professional, and inherent barriers limit the realization of these opportunities. Nonetheless, there is considerable scope for strategically building relations in this sector and creating goodwill.

#### *Possible Steps Forward*

Given the many challenges and complex nature of the health sector, where there is a mix of social and commercial objectives, a gradualist approach would be a prudent regional strategy. This would include pilot-based initiatives and cooperation in selected segments. There are three segments that need to be targeted regionally: commercial opportunities in cross-border investment, medical tourism, and capacity building and regulatory cooperation. Regional investment discussions would need to focus on (i) facilitating cross-border investments, particularly in hospitals and potentially in telemedicine centers; (ii) facilitating the regional mobility of patients; (iii) instituting mechanisms to make the region more attractive as a destination for medical tourists from within and outside the region; and (iv) initiating joint efforts in research, training, and capacity building.

To further facilitate medical tourism, better arrangements need to be made for insurance and cross-border payment. A regional insurance product could be developed to include provision for treatment in other countries. International insurance premiums are high, so there is a need for an insurance policy initiated within the region. This would help promote medical tourism among SAARC members. A leading Indian health practitioner suggests that a regional Medicare system could be introduced with fixed payments for different procedures and treatments according to those prevailing in each country. Medical tourism would also be facilitated if regional insurance brokers were to recognize payments in each other's markets, backed by bank-to-bank guarantees in the region. As a first step, Indian insurers could lead this initiative and treatment could be limited to the Indian market, with a different fee structure for regional medical tourists.<sup>24</sup> Pilot schemes could be introduced for specialized elective treatments and procedures that may not be available in the patient's home country. Potential medical segments for inclusion in the scheme include transplant surgery, infertility medicine, joint replacements, and treatments for cardiac, eye, dental, urological, and gastrointestinal problems. Governments, insurance companies, and hospitals in the region should explore the possibility of cross-border insurance arrangements with agreed rates for treatment within the region. The experience of other regional blocs, such as in Mercosur, which have entered into regional payment arrangements to promote medical tourism, could be instructive in this regard.

The issuance of visas for medical tourism must be streamlined, including the documentation requirements and processing time. In addition, related support services for medical tourism, such as accommodation, must be improved. While a multiplicity of taxes and high tax rates are common in the region, governments could consider reducing the burden of such levies in the case of health care tourism. An integrated approach to medical tourism is required, including instituting follow-up facilities in the home country of the patient for pre- and post-treatment consultations and telemedicine consultations.

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<sup>24</sup> There would, however, be some inherent limitations in the regional medical tourism market as there would be less scope for the insurance companies to increase prices, and their insurance model would need to be more service delivery based rather than revenue-led given the lower paying capacity in this region compared with other regions.

Similar to cultural and leisure tourism, health care tourism could benefit from a coordinated marketing and promotion campaign by SAARC members, such as marketing specific health tourism products, wellness tourism, and alternative treatments.

Most of these efforts to promote medical tourism would need to be initiated by private enterprises, with support from SAARC member governments on issues such as visas and registration requirements. Governments and private sector representatives would need to take a regional perspective on medical tourism, to enable the movement of patients to identified centers of excellence and better utilization of super specialists and high-end equipment available in the region.

Another area requiring attention is the facilitation of cross-border investment in hospitals and telemedicine establishments. Investment regulations for setting up hospitals in the region need to be streamlined, the approval process speedier, and investment conditions transparent and predictable. Restrictions need to be relaxed concerning the movement of doctors from the source country of investment, the special registration and approval requirements for foreign doctors, and the restrictions on their practice. Not relaxing such restrictions would compromise the ability of the investing hospital to staff or manage their facility. A more favorable business environment provides scope for regional establishments in the health sector.<sup>25</sup> There could also be government-sponsored investments, where member governments invite investment by leading hospitals in the region and work out arrangements with the source countries for staffing the facilities.<sup>26</sup>

In short, the range of measures required for promoting regional trade and cooperation in health services is wide-ranging, including measures pertaining to investments in physical infrastructure, human resource development, harmonization of standards, streamlining of regulatory frameworks, and engaging with professional bodies and industry associations. But the potential synergies across the different opportunity segments are extensive, with investment driving medical tourism and vice versa, leading to management links and joint ventures, telemedicine possibilities, and the cross-border movement of professionals. There are also health sector synergies with trade and investment, such as in medical equipment, pharmaceuticals, and manufacturing. Many areas of health care offer regional scope for economies of scale and resource pooling.

### Cross-Cutting Challenges

The preceding discussion has highlighted several cross-cutting issues that constrain regional integration in the service sector. Visa restrictions and constraints to intraregional mobility of service providers and consumers cut across many sectors. Supply-side constraints in the form of poor transport connectivity impede intraregional flows of goods, services, investments, and people. Constraints related to the national investment and business environment affect the prospects for intraregional investment. These issues largely pertain to the institutional and regulatory environment and capacity of SAARC

<sup>25</sup> According to industry sources in India, there are some 10 organizations like Apollo with the potential to expand into the regional market.

<sup>26</sup> The Government of Bhutan, for example, is interested in getting specialists from India to work in facilities in Bhutan.

members.<sup>27</sup> Regional liberalization of the service sector can only take place in a meaningful way if supported by reforms in member countries. Market access offered or received under the regional integration process must be backed at the national level by adequate regulatory, institutional, infrastructure, and human resource capacity; a conducive business environment; and a favorable policy orientation and mindset. Only when such conditions are in place can SAARC members be expected to be prepared and willing to undertake legally binding commitments on market access in accordance with a regional agreement.

As shown in Table 6.9, there are many behind-the-border barriers that undermine liberalization at the borders of SAARC members. These countries almost uniformly rank very low across a wide range of business environment indicators. The generally poor business environment and institutional quality in the region discourages foreign as well as regional investors.

**Table 6.9: Doing Business Indicator Rankings for South Asian Countries, 2011**

Economy	Ease of Doing Business	Starting a Business	Dealing with Construction Permits	Getting Electricity	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Resolving Insolvency
Maldives	79	59	20	132	152	166	79	1	137	92	41
Sri Lanka	89	38	111	95	161	78	46	173	53	136	42
Pakistan	105	90	104	166	125	67	29	158	75	154	112
Bangladesh	122	86	82	182	173	78	24	100	115	180	107
India	132	166	181	98	97	40	46	147	109	182	128
Bhutan	142	83	135	145	83	126	147	67	169	35	183
Afghanistan	160	30	162	104	172	150	183	63	179	161	105

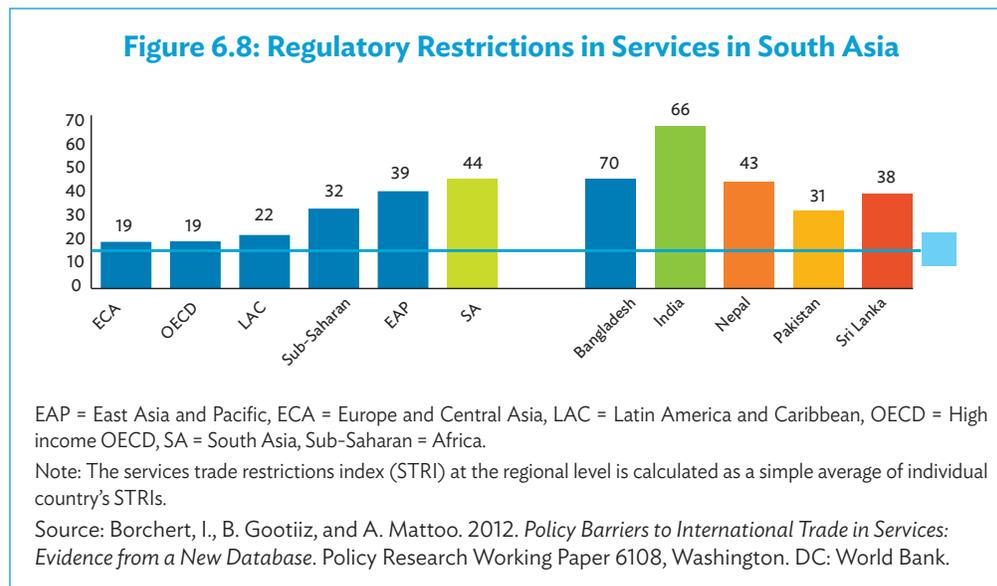
Source: World Bank. Doing Business Indicators. <http://data.worldbank.org/data-catalog/doing-business-database> (accessed 27 June 2012)

A similar picture emerges for the service sector. South Asia as a region and several SAARC members exhibit high degrees of restrictiveness in services compared with other regions, reflecting the presence of many behind-the-border domestic regulations in the form of carve-outs, anticompetitive practices, and monopoly provisions, impeding trade and investment in services (World Bank 2014a). Monopolistic market structures and state-owned enterprises dominate some services (such as electricity and ports) and continue to undermine market access that has been granted at the border. For example, although foreign investor participation is permitted in many services in Bangladesh, investors may not be able to repatriate service sector profits even though this is permitted for the manufacturing

<sup>27</sup> It is well established that institutions and the regulatory environment play a critical role in economic development. In the context of services liberalization, institutions may play a more significant role because of (i) the intangible nature of services, which increases the possibilities for market failure due to asymmetric information; (ii) the need for specialized distribution networks to provide many services (energy telecommunications, transport) and the prevalence of natural monopolies and oligopolies in such sectors, thus requiring independent regulation; and (iii) the significance of consumer-supplier-specific relations in many services, which makes contract enforceability, quality assurance, and consumer protection very important aspects of services trade.

sector. Some strategic sectors, such as ports, airports, and electricity transmission and distribution, are dominated by public sector enterprises, which operate under monopolistic market structures, hampering the entry of foreign investors. Some segments of India's transport sector, such as freight transport, are not only dominated by public monopolies but are also closed to foreign equity participation. In several key services, including insurance and publishing, foreign ownership is highly restricted and only minority participation is permitted. In Pakistan, while the manufacturing and primary industries are fully open to foreign equity ownership, restrictions include residency and nationality requirements, government approval, caps on FDI, and minimum investment requirements. Similar restrictions on foreign investment apply in Sri Lanka. Clearly, there is a need for unilateral liberalization as a condition for regional liberalization.

Figure 6.8 highlights the frequency of regulatory barriers in services (as measured by the overall services trade restrictiveness index) in South Asia compared with other developing regions. India has the highest overall level of regulatory barriers in services, mainly stemming from its more restrictive FDI regulations across many services.<sup>28</sup> This is troubling, as India, being the largest economy in South Asia, would need to provide much of the momentum for services integration.



The restrictive environment characterizing many services in South Asia affects the overall prospects for regional integration. Restrictions in financial services include (i) exchange controls, (ii) limits on listing foreign companies in SAARC member countries except through locally incorporated subsidiaries, (iii) limits on foreign companies concerning raising capital in local capital markets, (iv) restrictions on the establishment of banks and other financial institutions in each other's markets, and (v) restrictions on the repatriation of foreign currency earnings and outward remittance flows. Compounding such regulatory

<sup>28</sup> Restrictions on foreign equity ownership in India, as measured by the World Bank's investing across sectors indicator, are greater than the average level of FDI restrictions for South Asia as a whole.

impediments are factors such as the lack of harmonization of standards and regulations in financial services.<sup>29</sup>

The regional, country level, sector-specific, and cross-sectoral evidence reviewed indicates that South Asia's regulatory and business environment compares poorly with East Asia. There are many behind-the-border barriers and additional requirements and conditions, undermining border level liberalization across a range of services. South Asian countries perform poorly on most of the World Bank's Doing Business indicators, affecting their willingness and ability to commit to integrating the service sector more deeply under SATIS. Given that the regional negotiating process is in large part a function of preparedness at the national level, the lack of progress under SATIS may reflect the lack of preparedness and defensive mindset of SAARC members.

## A Road Map for Services Integration in South Asia

Slow progress toward regional integration in South Asia is frequently attributed to the difficult political economy in the region. However, it is largely due to the approach taken. There has been a tendency to declare ambitious projects and targets without addressing fundamental problems critical to integration. Action plans, documents, and summit declarations have been made without attention to core issues, such as investment regulations, institutional and regulatory capacity, and mobility of people, without which action plans cannot be translated into outcomes. Thus, a clear road map is needed for services integration under SATIS.

### Possible Steps and Approaches under SATIS

Several steps should be taken to promote services integration under SATIS. First and foremost, it will be important to address the fundamental constraints to services integration in the region. Integration of factor and consumer markets is needed, and regional discussions will have to address cross-cutting issues that affect factor and consumer mobility in the region. These include streamlining investment regulations, improving the business environment, enhancing institutional and regulatory capacity, ensuring regulatory cooperation, and enhancing the mobility of people. Initiatives will need to be undertaken at the regional level on each of these issues, complemented by country-level reforms and policy initiatives.

#### *Investment Facilitation*

Regional discussions on investment should focus on (i) speedier clearances and approval procedures in general, (ii) fast-track procedures for regional investors with prior collaboration or expertise in the country or sector, (iii) fast-track clearances in services that are largely commercial in nature and where there are fewer sensitivities, and (iv) provision of regularly updated information through government websites and reports on the regulatory framework for investment as well as on the bidding processes and award of contracts.

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<sup>29</sup> See Chapter 15 of this volume for further discussion on financial integration in the SAARC region.

A regional investment treaty and double taxation treaties should be considered to help reduce barriers to investment in the region. A regional investment framework would need to address issues of investment facilitation, investor protection, dispute settlement, and contract enforcement to ensure greater ease, transparency, and security for regional investments. A common investment framework would help in coordinating investment policies, harmonizing regulations and procedures, and mutually recognizing standards and technical service specifications. The bilateral investment treaty under discussion between India and Pakistan should also be finalized. Investment facilitation and related regulatory cooperation would need to be supported by harmonization of financial services regulations and by facilitating remittance and investment flows through formal banking and capital market channels.

There have been some regional and local initiatives to increase cooperation between finance sector regulators in the SAARC region under the SAARCFINANCE Network. The Government of India has explicitly recognized the need to enhance links among the financial institutions of SAARC countries, including cross-border banking arrangements. However, to date, progress has been limited to discussions on monetary policy and global developments. Concrete steps for the removal of exchange restrictions, harmonization of regulations, adoption of common standards, and capacity building in the region's financial sector have yet to be addressed in a results-based manner.

The negotiating architecture of SATIS needs to provide a legal framework for addressing investment issues more effectively. Except for SATIS commitments made under mode 3,<sup>30</sup> there is no legal framework for addressing investment-related concerns. Inclusion of an investment chapter with provisions on investor protection and dispute settlement and clear definitions of investment is needed. Further, given the asymmetries in country size and competitiveness in the region, special and differential treatment provisions under SATIS need to be incorporated into a legal framework for investment.

#### *Facilitating Intra-regional Mobility*

Facilitating the regional mobility of people for service delivery and services consumption requires streamlining of visa procedures and requirements for selected categories of people. Attention should be focused on simplifying and expediting visa procedures for business visitors, intracorporate transferees, professionals and academics, institutional links, and exchange arrangements. Likewise, streamlined processes and approval of visas should be introduced for special categories of services consumers, such as medical tourists, students, leisure travelers, and transit travelers. Security concerns about relaxing visa regulations should, nonetheless, allow increased mobility for specified sets of people. Similarly, mobility restrictions could be streamlined and eased for services identified as high priority or fast-track sectors. The Government of India's doubling of business visa exemption stickers for the Fifth SAARC Business Leaders Conclave, held in New Delhi in January 2014, was a welcome step. However, there are no concrete proposals to move this issue forward and the matter remains aspirational rather than a deliverable.

<sup>30</sup> Mode 3 refers to a form of trade in services through the overseas establishment of commercial presence by a service supplier. This presence could be in the form of a subsidiary, branch, affiliate, joint venture, liaison office, etc.

### *Improving Connectivity*

The related issue of transport connectivity will need to be addressed, including selected bilateral and subregional projects to develop road, rail, and air transport links. Subregional projects for transport logistics and trade facilitation have endeavored to provide transit facilities for landlocked Afghanistan, Bhutan, and Nepal; create land corridors through member countries or link remote parts of the region; and address related procedural issues.<sup>31</sup>

### *Regulatory Cooperation and Harmonization*

Institutional and regulatory cooperation in specific services is urgently required, notably concerning standards. Governments, regulatory bodies, professional and industry associations, research institutions, and civil society representatives need to share information, exchange best practices, collect data, conduct joint feasibility and impact analysis studies, identify priority areas for a services agreement, develop soft skills, and create regional templates for investment initiatives. SATIS should establish a set of regulatory principles for the service sector. In line with the recommendations of the Pacific Economic Cooperation Council Task Force on Services, these principles would ensure that SATIS member countries retain their regulatory autonomy in the service sector, while also ensuring that national regulations do not constitute unnecessary barriers to trade, as per Article VI.4 of the General Agreement on Trade in Services (GATS). This balance between regulatory harmonization and regulatory autonomy will have to be formulated carefully under SATIS.

### *Fast-Tracking and Prioritization*

A similar incremental approach is required for sector coverage. It would be useful to first liberalize the least-contentious services, such as tourism or IT, where there are fewer regulatory complexities and success is more likely. Pilot projects could be launched in these services on a subregional basis. There are, for example, initiatives that have already been agreed upon in the tourism sector, such as the Buddhist tourism circuit under the South Asia Subregional Economic Cooperation (SASEC) Program. A pilot-based approach in selected services could provide the much-needed confidence and practical experience to engage in larger and more complex regional projects, such as in the energy or telecom sectors.

### *Subregional Platforms*

An incremental approach could also be taken with regard to country participation. It may be useful to proceed on issues and sectors or subsectors where there is a minimum core group of three or more interested member countries, rather than waiting for buy-in from all SAARC members. The group could be expanded over time as outcomes are realized. Bilateral and plurilateral agreements in the region, such as the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), could be the basis for

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<sup>31</sup> Examples of such cooperation include (i) the approval of a SAARC Regional Multimodal Transport Study, (ii) the construction of a key transport corridor between Agartala and Akhaura via a rail link, (iii) an agreement for truck movement between Bangladesh and India to improve cross-border operations at Petrapole and Benapole, (iv) the initiation of feasibility studies for road and rail links in the subregion (involving Bangladesh, Bhutan, India, and Nepal), and (v) reviews of various transit agreements and development of operational frameworks for bilateral or trilateral agreements in the region (Asian Development Bank 2007).

negotiations under the South Asian Framework Agreement on Services, providing an open approach to services integration as adopted in ASEAN.

At present, SATIS is based on an “all member” and “all services” negotiating approach. It does not provide for an incremental strategy that would allow subregional groupings to pursue negotiations on specific issues and sectors. Currently, the only flexibility is in the discretion countries can exercise in the scheduling process. The negotiating process should be made more flexible, allowing subgroups of member countries to pursue discussions in selected services of mutual interest, such as tourism and IT. These smaller groups would be akin to the subgroups that have been created under the GATS on specific issues and services (such as the Friends of Mode 4 group). As part of this incremental approach, consideration should be given to a request-and-offer approach for liberalizing temporary movement of natural persons for select categories of service providers or persons in select disciplines.

#### *Specificity in Deliverables and Timelines*

While the approach to services integration needs to be realistic and phased, there must also be a degree of specificity on timelines and deliverables. The timelines should vary depending on the sectors and issues under consideration. Those with fewer sensitivities or complex regulatory issues should be fast-tracked.

#### *Linking SAARC Agreements and Synergizing the Discussions*

SATIS and trade facilitation discussions should be linked, given the synergies between the two. At present, the discussions are held as independent tracks. Progress in regional liberalization of transport, energy, and other infrastructure services requires progress in trade facilitation and vice versa.

### **Learning from ASEAN and the ASEAN Economic Community Blueprint**

The experience of ASEAN and other regional blocs can be instructive for SAARC in promoting regional integration of the service sector. An examination of the ASEAN Economic Community (AEC) Blueprint and progress to date under the ASEAN Framework Agreement on Services (AFAS) points to three important elements that could be explicitly addressed or adopted under SATIS: (i) prioritizing sectors for expedited liberalization and focused initiatives, (ii) prioritizing certain cross-cutting issues for expedited action and establishment of institutional mechanisms at the regional level for cooperation and liberalization in these areas, and (iii) flexible and phased negotiating arrangements within the region to maintain the negotiating momentum.<sup>32</sup>

#### *Prioritization of Sectors for Action*

The AEC Blueprint identifies 12 priority sectors, including four in the service sector: air transport, health care, logistics, and tourism. It also identifies infrastructure development, taxation, and e-commerce as key elements for the creation of a competitive economic

<sup>32</sup> Although AFAS and the AEC Blueprint are referred in this section as a benchmark that SATIS could follow, there have been difficulties in implementing the provisions and commitments. A midterm review found that commitments are less than actual practice in some services, and the services trade restrictiveness indexes for ASEAN countries remain high. The agreement also lacks enforcement mechanisms, and failure to implement commitments does not incur penalties. Notwithstanding such issues with AFAS implementation, this agreement is used to highlight important elements that must be prioritized under SATIS.

region. This prioritization has enabled the members to conclude agreements on issues of common interest, such as multimodal transport, a competitive air services policy, and a protocol for moving toward an open skies agreement. Similar identification of priority areas under SATIS would enable concrete steps to be taken in transport and logistics, ICT and telecom connectivity, and energy, where cooperation could yield substantial benefits to SAARC members.

#### *Prioritizing Cross-Cutting Issues for Action*

The AEC Blueprint also prioritizes cross-cutting issues, such as the free flow of services, investment, capital, and skilled labor, as core elements for creating a single market and production base. Investment liberalization, promotion, and protection are emphasized, together with a list of priority sectors, including services such as education, health care, telecommunication, tourism, banking, finance, insurance, trading, e-commerce, distribution and logistics, transport and warehousing, and professional services (accounting, engineering, and advertising). An ASEAN Comprehensive Investment Agreement is in place, which provides a framework for negotiating investment liberalization commitments in the region. The AEC Blueprint also addresses related financial services integration, providing a framework for liberalizing the transfer and repatriation of capital, profits, and dividends. A similar negotiating framework for investment and related issues such as taxation, dispute settlement, and financial integration should be included under SATIS as part of the move toward eventual economic union. At present, SATIS has no explicit provisions for investment liberalization and the promotion of intraregional investment flows.

AFAS explicitly recognizes the importance of the free flow of skilled labor for regional integration. The AEC Blueprint outlines measures for enhancing intraregional mobility, including the facilitation of visas and employment passes, conclusion of mutual recognition agreements (MRAs) for selected professional services, and harmonization of service skills and qualifications. Formal reference to these objectives under the AFAS negotiating framework has made progress possible. Enhanced cooperation for the movement of natural persons was agreed upon in late 2012. MRA frameworks for professional qualifications have been completed in ASEAN for architecture, accountancy, surveying, engineering, medical and dental practitioners, and nursing. MRAs for other professional services are expected to be completed by 2015.

The importance of MRAs and visa facilitation is not evident under SATIS. Reference to this issue is aspirational rather than binding for SAARC members. Further, except for periodic statements about visa facilitation for business visitors, medical tourists, and other selected categories, there has been no progress on labor mobility.

It is important to note that, although AFAS provides a role model for SATIS on issues to be considered and approaches to be taken, implementation under AFAS has been partial. For example, conditions are attached to the ASEAN MRAs; foreign engineers and architects cannot practice independently; and there are conditions for recognition and required undertakings for nursing, medical, and dental services. Hence, in addition to explicitly including MRAs and professional mobility objectives, as has been done under AFAS, SATIS should include penalties for failing to meet deadlines or implement commitments.

### *Negotiating Approaches: Flexibility with Accountability*

The ASEAN integration program is instructive for SATIS as it allows for flexibility in negotiations combined with timelines and deliverables. For instance, the AEC Blueprint provides timelines for specific measures, including in services, investment, and finance. In parallel, the AFAS framework provides some flexibility. It allows two or more ASEAN members to initiate and participate in intra-ASEAN economic arrangements, allowing other members to join at a later stage when ready to do so. In contrast, SATIS is quite loose about timelines and deliverables and also does not allow for subregional negotiations, which could in part explain the slow progress in services negotiations under SAARC.

## Conclusions

A regional services agreement must be broad-based and flexible. It must ensure commitments to a selected set of services but must also provide scope for expanding these commitments to a larger number of services. It must also address key cross-cutting issues through ongoing cooperation efforts and discussions in various forums. Successful implementation of SATIS is essential toward realization of a South Asian economic union.

Implementation of SATIS involves four critical steps. First, the information on services must be improved, not only in relation to individual member countries but also on bilateral trade and investment flows among SAARC members. A proper understanding of the significance and nature of services in bilateral relations and of the associated trade barriers is a fundamental requirement for meaningful negotiations. Second, more focused regional discussions must be held on regulatory and institutional issues. Discussions on regulatory frameworks and standards can help the countries reach an understanding on issues such as visas, taxes, and standards, which would form the basis for greater labor and capital mobility in the region. National efforts to improve competitiveness and functioning of the regulatory system are also needed. Third, regional transport infrastructure and trade facilitation need to be developed for the service sector. Improved air and land connectivity within the region and transit agreements among groups of countries in the region would greatly advance regional integration of the service sector. Fourth, the frameworks and institutions for cooperation in the service sector need to be strengthened in the region. This could include research and development activities; joint projects in selected services such as health care, environment, education, renewable energy, and tourism; regional training and development of human resources; and sharing of best practices.

Only an incremental and progressive approach to services liberalization is feasible under SATIS. Working groups could be set up on issues and services of common interest and the ambit of liberalization expanded gradually to cover more services. Pilot projects could be launched selectively, while cross-cutting issues of investment, regulatory harmonization, labor mobility, and connectivity are addressed in parallel. Industry in the region will need to play a greater role, highlighting the benefits of cooperation and the costs of noncooperation. The region's leaders must show commitment and political will. These negotiating frameworks and initiatives can only succeed if they are backed by a business-friendly environment and a favorable policy orientation and mindset at the country level.



## CHAPTER VII

# Labor Mobility and Remittances in South Asia

*Arpita Mukherjee*

This chapter examines recent trends and developments in labor mobility and remittances in South Asia and provides a comparative analysis with other regions. Drawing on this analysis, policy measures are recommended for greater regional cooperation in labor mobility and remittances consistent with the goal of the South Asian Economic Union (SAEU). Although labor mobility issues in South Asia mainly involve the low-skilled category, this chapter focuses on facilitating the movement of professionals and skilled workers, because it is easier to remove barriers to such movement under trade agreements.

## Defining Labor Mobility and Remittances in South Asia

Labor mobility broadly refers to the movement of people within a country (for example, movement of agriculture workers from the state of Bihar in India to the state of Punjab), or from one country to another country (for example, movement of workers from Nepal to India). Such movement can be temporary or permanent. Different international organizations define labor mobility in different ways. In the General Agreement on Trade in Services (GATS) of the World Trade Organization (WTO), labor mobility is conceptualized as the “temporary movement of natural persons,” or “mode 4.” Article 28 of the GATS defines mode 4 as “the supply of a service (including the production, distribution, marketing, sale and delivery of a service) by a service supplier of one Member, through the presence of natural persons of a Member in the territory of other Member.”<sup>1</sup> This definition extends to independent service providers, self-employed, and foreign individuals employed by foreign companies established in the territory of a WTO member. Accordingly, WTO members have classified four categories of movement based on the purpose of the visit:

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<sup>1</sup> For details, see WTO. GATS Article 1 and Annex on Movement of Natural Persons Supplying Services under the Agreement. <http://www.wto.org/> (accessed 2 January 2014).

business visitors,<sup>2</sup> intracorporate transferees,<sup>3</sup> independent professionals,<sup>4</sup> and contractual services suppliers.<sup>5</sup>

The GATS agreement does not apply to measures affecting natural persons seeking access to the employment market or to measures regarding citizenship, residence, or employment on a permanent basis. Thus, mode 4 under GATS only covers the temporary movement of natural persons. Countries have the right to regulate the entry and stay of temporary service providers, but such measures should be applied in a manner that they do not nullify the benefits accruing to any WTO member under the terms of specific commitments. Because the GATS has been able to isolate contiguous issues related to permanent migration from labor mobility, this definition is often used as a basis for negotiating trade agreements. Negotiations on labor mobility among members of the South Asian Association for Regional Cooperation (SAARC) follow this definition.

Temporary movement of people can be further categorized, depending on their skill levels and purpose of visit. While the GATS negotiations have largely focused on easier access for professionals or highly skilled workers, several bilateral and regional agreements have facilitated easier movement of specialized skills (such as nurses under the Japan–Philippines Economic Partnership Agreement and Thai chefs and spa workers under the Thailand–Australia Free Trade Agreement), or even movement of semiskilled and unskilled workers (as allowed between European Union [EU] member states). Comprehensive free trade agreements and regional trade agreements address labor mobility in a wide variety of ways. Some agreements, such as the EU, focus on complete labor mobility. EU citizens are entitled to look for a job in another EU country, work there without a work permit, reside there for the purpose of work, stay there after the completion of the employment, and enjoy equal treatment with nationals in access to employment, working conditions, and all other social and tax advantages. Other trade agreements also allow free mobility of labor, including entry to the local labor market, but these are subject to certain conditions. The Agreement on the European Economic Area (EEA)<sup>6</sup> allows EEA nationals to enter EU member states as workers or self-employed service providers or service recipients, provided they have sufficient funds to support themselves.

Some trade agreements facilitate movement for certain kinds of skills related to trade or investment. The North American Free Trade Agreement (NAFTA) signed by Canada, Mexico, and the United States provides easier access to four highly skilled categories: business visitors, traders and investors, intracompany transferees, and specified professionals. It also has provision for a new kind of professional visa known as the Trade NAFTA visa. The Asia-Pacific Economic Cooperation (APEC) member states have an APEC Business Travel Card, which allows the holder visa-free entry for commercial purposes to any participating member country listed on the back of the card. The members

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<sup>2</sup> Business visitors refer to persons who visit another country for a short duration, specifically for business negotiations and/or for preparatory work for establishing a business presence. Their main purpose is to facilitate future transactions rather than to actually carry out transactions.

<sup>3</sup> Intracorporate transferees refer to employees of a company who are transferred from the originating country's office to its office in another country.

<sup>4</sup> Independent professionals refer to self-employed persons who are supplying a service to a company or an individual in a host country.

<sup>5</sup> Contractual services suppliers refer to employees of a foreign services company who entered another country temporarily to perform or provide a service under contract.

<sup>6</sup> The EEA is an agreement between 27 EU member countries and Iceland, Liechtenstein, and Norway.

of the Association of Southeast Asian Nations (ASEAN) signed the ASEAN Agreement on the Movement of Natural Persons in November 2012. This agreement covers temporary movement of skilled workers, professionals, and executives, and is limited to business, intracorporate transferees, and contractual service suppliers.

Many trade agreements in South and Southeast Asia follow the GATS framework, and are limited to the temporary movement of professionals. Some agreements have a chapter to facilitate the movement of certain types of skills (with a focus on professionals), but these agreements do not go beyond the work permit and visa regimes of the signing countries. An example of this is the India–Singapore Comprehensive Economic Cooperation Agreement (CECA), which lists 127 categories of professionals (including information technology (IT), professionals, engineers, nurses, and university lecturers) eligible for easier market access, but there are no provisions for special visas or easier procedures.

The differing approaches of free trade agreements and regional trade agreements to labor mobility reflect a range of factors, including the degree of geographical proximity of the parties and the extent of similarities in their levels of development, the nature and degree of specialization of the domestic workforce, and their cultural and historical ties (OECD 2002). While in general agreements among countries enjoying geographical proximity and similar levels of development have a more liberal approach to labor mobility (e.g., the EU), this is not always the case, and agreements such as SAARC and MERCOSUR<sup>7</sup> have so far achieved only limited labor mobility.

The connection between labor mobility and remittances is well-documented (Khadria 2005, SACEPS. 2010, Ozaki 2012, and Hugo 2005). Cross-country labor mobility not only enables workers to increase their income and upgrade their skills, but also provides financial benefits to their families back home and to the home country in general through the multiplier effect (Wickramasekera 2002, Martin 2008, and Hear et al. 2012). Labor mobility can bring both costs and benefits to the home and host countries. Benefits include the opportunity for the home country to build up its human capital and social assets (Wickramasekera 2002, and Abella 2012), and to experience technology and know-how transfers (Wickramasekera 2002, and AHN 2005). Costs may include a brain drain and loss of human resources for labor-scarce countries, or where skilled and semiskilled workers are in short supply. South Asian countries are labor abundant and are ranked among the highest source countries for migrant workers. They are also some of the largest recipients of remittances and are recognized as “remittance economies” (Ozaki 2012 and Wickramasekera 2011). However, intra-SAARC mobility of labor is still heavily restricted and largely limited to the low-skilled workforce. A substantial part of the labor movement is not recorded, and a large percentage of remittances are sent home through informal channels.

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<sup>7</sup> MERCOSUR is a customs union among five countries: Argentina, Brazil, Paraguay, Uruguay, and Venezuela.

## Patterns and Trends of Labor Mobility and Remittances in South Asia

Data limitations hamper analysis of the patterns and trends in labor mobility and remittances in South Asia (SACEPS. 2010, Ozaki 2012, and Wickramasekara 2011). Data sources tend to report on migration flows but fail to record temporary movements. Even countries such as India, which collect data by purpose of visit (through disembarkation cards), do not publish the data and hence labor mobility by skill level is largely undocumented. Where a visa is not required for working in a host country, as is the case for Nepalis working in India, labor mobility in the region is unrecorded. Also, there is a sizeable degree of illegal migration or informal labor mobility even when a visa is required, as has been the case of labor mobility from Bangladesh to India (see Khadria 2005). Most South Asian countries record foreign employment, but the published data do not show employment in SAARC member countries. Some countries record disaggregated data for foreign employment by skill level, such as for Sri Lankans working in SAARC countries. Often, business visitors categorize themselves as tourists, as they require the same type of visas. Thus, migration statistics, foreign employment statistics, tourism statistics, and remittances are often used as proxies to understand labor mobility in South Asia.

Similar to labor mobility, there are several issues in measuring remittances. A substantial percentage of remittances to and within the region is through informal channels and, therefore, goes unrecorded.

### Labor Mobility

Several factors influence labor mobility, including geographical proximity, skill endowments, economic and demographic imbalances, globalization, barriers to the movement of people, cultural and historical ties, and natural disasters (Battistella and Khadria 2011). Studies show that South Asian countries are endowed with a young population and similar skill levels (Wickramasekara 2011, Premaratne and De-Mel 2009, Srivastava and Khare 2012). Countries in the region are labor abundant and have contributed significantly to international labor mobility. However, they have not been able to benefit from the demographic dividend, and low-skilled labor accounts for most mobility from and within the region (Wickramasekara 2011, Premaratne and De-Mel 2009, and Battistella and Khadria 2011). One of the reasons for low-skilled labor mobility is that South Asian countries have not been as successful as East Asia or ASEAN countries in developing organized manufacturing and services sectors; a large part of the workforce in South Asia is employed in the unorganized or informal sector, and market integration is weak (Ghani and Ahmed 2009). India is an exception, and a large number of professionals take up employment and other opportunities overseas, especially in developed countries in sectors such as IT and IT-enabled services.

While a large number of studies focus on labor mobility from South Asia (SACEPS. 2010, Ozaki 2012, Wickramasekara 2011, Chanda 2004), there are relatively few studies on labor mobility within South Asia. Various factors have contributed to labor mobility in the region. Geographical proximity and sociocultural linkages, along with expectation of higher income and better living conditions, have encouraged labor mobility within South Asia (Abrar 2005, Ozaki 2012, Wickramasekara 2011). Visa regimes have also been progressively

liberalized among South Asian countries, facilitating labor mobility. Table 7.1 shows the visa regimes of South Asian countries in terms of ease of entry as of May 2014. Some countries in the region have allowed people from selected South Asian countries to enter without a visa or have allowed visa-on-arrival, which has facilitated labor mobility. As noted earlier, India allows nationals from Nepal and Bhutan visa-free entry. Table 7.1 also shows that while some SAARC countries have liberal visa regimes for nationals or citizens of non-SAARC countries, they may nonetheless discriminate against citizens or nationals of other SAARC countries for security reasons, lack of reciprocity, or other issues. For example, in February 2014, India announced that it will permit visa-on-arrival for 180 countries. However, this facility will not be extended to three South Asian countries—Afghanistan, Pakistan, and Sri Lanka (Indian Express 2014).

**Table 7.1: Visa Regime for Short-Term Entry in SAARC Countries, as of May 2014**

Country	Visa-Free Entry	Visa-on-Arrival	Details
Afghanistan	All nationalities need a visa which have to be obtained in advance. There is no visa-on-arrival or visa-free entry.		
Bangladesh	Bhutan and the Maldives (90 days)		Bangladesh issues “No Visa Required for Travel to Bangladesh” stamp to Bangladesh-origin citizens of Australia, Canada, New Zealand, the United States, and European countries in their foreign passports, as well as to non-Bangladeshis who are descendants or relations of Bangladeshis. Bangladeshi citizens of SAARC member countries cannot avail of this facility.
Bhutan	Bangladesh, India, and the Maldives		
India	Bhutan, the Maldives, and Nepal (90 days for the Maldives)	Official passport holders of Bangladesh	The visa application for nationals of Afghanistan and Pakistan is more rigid.
Maldives		A 30-day free visa, subject to certain conditions, for all nationalities	
Nepal	India	Bangladesh, Bhutan, the Maldives, Pakistan, Sri Lanka (30 days)	Nationals of Afghanistan do not get the visa-on-arrival facility.
Pakistan	Maldives (3 months), Nepal (1 month), Sri Lankan diplomatic and official passport holders (30 days)	Businessmen of 66 countries on Business Visa List (30 days) No SAARC country.	The visa application for nationals of India is more rigid.  Police registration is required for nationals of Bangladesh and India.  There is a special category of visa for nationals of Afghanistan.
Sri Lanka			As of January 2012, the Government of Sri Lanka has introduced an electronic travel authorization for travel to Sri Lanka for a stay of up to 30 days applicable to SAARC countries.

Source: Compiled from the websites of government ministries and departments.

Male workers account for most labor mobility in the region (Ozaki 2012). Studies indicate that labor mobility from Bangladesh and Nepal to India is mainly composed of semiskilled and unskilled workers (SACEPS. 2010, Khadria 2005, Khadria 2009), and that a substantial part of the movement is unrecorded. It is estimated that about 1.5 million Nepali nationals work in India (Ozaki 2012), mostly as unskilled permanent or seasonal laborers. They are largely employed in informal sectors, such as agriculture, factory, trade, restaurants, and security services. Bangladeshis in India include domestic workers, construction laborers, petty traders, and rickshaw pullers (Naujoks 2009). A survey-based study by Samuel et al. (2011) showed that the main pull factor for labor mobility from Bangladesh and Nepal to India is better economic opportunities, while the push factors are debt concerns and the lack of employment and business opportunities at home. Overall, the pattern of labor mobility in South Asia shows that poor and unskilled workers account for most of the labor movement among geographically proximate and culturally similar countries. The cost of such labor mobility is low, as much of the movement is through borders that are either open or difficult for governments to monitor. The higher earnings of the migrants lead to positive outcomes for their families and host countries, thereby helping to reduce poverty.

#### *Migration Statistics*

Migration statistics are often used to measure labor mobility in South Asia. Historically, war, political unrest, racial discrimination, and economic backwardness have been some of the main reasons for labor migration in the region. The partition of India and Pakistan in 1947 compelled nearly 20 million people to move across the borders. Bangladeshi refugees entered India after the war in 1971. Sri Lankan Tamils migrated to India and elsewhere to escape civil war. Millions of Afghans migrated to Pakistan as refugees, and some 3 million are still resident there (Wickramasekara 2011). The 1950 India–Nepal Treaty of Peace and Friendship facilitates the free movement of persons and labor between the two countries. Nationals of both countries can travel and work freely across the border, and are regarded as native citizens.

South Asian countries are ranked among the largest host and source countries for labor migration in the world. Intra-regional migration, however, is relatively limited. Data published by the United Nations Department of Economic and Social Affairs indicate that intra-regional migration in 2013 accounted for only 4.5% of total migration for South Asian countries (compared to 2.8% for ASEAN countries).<sup>8</sup>

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<sup>8</sup> Calculated from the United Nations. Social Affairs database on International Migration. <http://www.un.org/en/development/desa/population/migration/data/estimates2/estimatesorigin.shtml> (accessed 15 September 2013).

In 2013, India and Pakistan were ranked among the top 15 host countries for international migrants. During 2013, about 12.4 million international migrants resided in South Asian countries (5.3% of the world's total international migrants); by comparison, 9.5 million (4.1%) resided in ASEAN countries. Data for 2013 also indicate that India was the largest source country for labor migration in the world, and that Afghanistan, Bangladesh, and Pakistan were among the top 15 source countries. As of 2013, India had some 14.2 million of its people living outside the country, compared to 7.7 million for Bangladesh, 5.6 million for Pakistan, and 5.1 million for Afghanistan. South Asian countries accounted for about 15% of the global migrant stock, compared to 8% for ASEAN countries. India and Pakistan are countries of origin and destination in the South Asia region, while other SAARC members are primarily countries of origin for international migrants (Wickramasekara 2011).

Intraregional labor migration in South Asia is shown in Table 7.2. Relative to the size of their populations, countries such as Afghanistan, Bhutan, and Nepal appear to have higher levels of migration within the region compared to India, the Maldives, and Sri Lanka.

**Table 7.2: Intra-South Asia Labor Migration Stock, September 2013**

Destination	Country of Origin							
	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Afghanistan	...	...	...	...	...	...	49,319	...
Bangladesh	1,396	...	...	33,795	...	38,337	5,063	7,804
Bhutan	...	56	...	48,076	...	769	24	37
India	8,237	3,230,025	6,770	...	203	553,050	1,126,796	158,083
Maldives	...	47,951	...	19,801	...	...	149	8,451
Nepal	...	772	79,823	810,172	...	...	13,882	618
Pakistan	232,6275	186,114	...	1,395,854	...	...	...	...
Sri Lanka	...	...	...	309,489	...	...	278	...

... = no data.

Source: United Nations. Social Affairs database on International Migration. <http://www.un.org/en/development/desa/population/migration/data/estimates2/estimatesorigin.shtml> (accessed 15 September 2013).

### Employment Statistics

Employment statistics for the region are incomplete, as some countries do not record their nationals working in other SAARC countries or do not do so on a regular basis. Moreover, there are inconsistencies among the recording agencies (Table 7.3). Within South Asia, India has been a favored work destination for people from neighboring countries, notably Nepal and Bangladesh.

**Table 7.3: Type and Coverage of Statistics on Overseas Employment for South Asian Countries**

Country	Agency Collecting the Information	Ministry in Charge	Type of Data in Public Domain	SAARC Countries Covered	Publication	Frequency
Afghanistan	Not known	Ministry of Foreign Affairs	...	–	–	–
Bangladesh	Bureau of Manpower, Employment and Training	Ministry of Expatriates' Welfare and Overseas Employment	Overseas Employment by country	No SAARC country	Overseas Employment and Remittances	Yearly
Bhutan	Department of Employment	Ministry of Labor and Human Resources	Foreign workers employed by nationality	Bangladesh, India, Nepal, Pakistan, Sri Lanka	Labor Market Information Bulletin	Yearly
India	India Centre for Migration	Ministry of Overseas Indian Affairs	...	–	–	–
Maldives	Not known	Ministry of Foreign Affairs	...	–	–	–
Nepal	Department of Foreign Employment	Ministry of Labor and Employment	...	–	–	–
Pakistan	Bureau of Emigration and Overseas Employment	Ministry of Overseas Pakistanis and Human Resource Development	Pakistani workers registered for overseas employment by country	No SAARC country	Migration Statistics of Pakistan	Yearly
Sri Lanka	Bureau of Foreign Employment	Ministry of Foreign Employment Promotion and Welfare	By country, skills, and gender	Afghanistan, Bangladesh, India, the Maldives, Pakistan	Annual Statistical Report of Foreign Employment	Yearly

SAARC = South Asian Association for Regional Cooperation.

Source: Websites of government agencies and ministries.

Data provided by Sri Lanka's Bureau of Foreign Employment, shows that the bulk of the Sri Lankan overseas employment during 2007-2011 was in the Maldives followed by Afghanistan (Table 7.4). However, despite the geographical proximity, Sri Lankans migrating to South Asia for employment has a small share in the global migration. Skilled and unskilled labor accounted for significant proportion of the foreign employment. Data published by Bhutan's Department of Employment, under the Ministry of Labour and Human Resources shows that out of total foreign employment of 53,052 people in Bhutan, around 52,306 were from India, 80 from Nepal, 63 from Bangladesh, 6 from Sri Lanka, and 2 from Pakistan in 2012.<sup>9</sup>

<sup>9</sup> Government of Bhutan. 2012. *Labour Market Information Bulletin 2012*. [http://www.molhr.gov.bt/molhrs/site/wp-content/uploads/2013/06/LMI\\_Bulletin\\_2012.pdf](http://www.molhr.gov.bt/molhrs/site/wp-content/uploads/2013/06/LMI_Bulletin_2012.pdf)

**Table 7.4: Employment of Sri Lankans in Other South Asian Countries by Skills, 2012 (in number)**

Country	Professional	Middle Level	Clerical and Related	Skilled	Semiskilled	Unskilled	Housemaid	Total
Maldives	337	240	297	1,548	38	1,428	151	4,039
Afghanistan	3	24	34	260	45	111	0	477
Bangladesh	49	26	1	32	1	9	0	118
India	24	12	21	26	1	13	0	97
Pakistan	6	3	0	5	0	0	21	35
Total of South Asia	419	305	353	1871	85	1561	172	4766
Global Total	4,445	9,278	16,166	6,7078	3,465	62,847	119,052	282,331
Share of South Asia (%)	9.43	3.29	2.18	2.79	2.45	2.48	0.14	1.69

Source: Extracted from Table 10, p. 19, Sri Lanka Bureau of Foreign Employment. <http://www.slbfe.lk/file.php?FID=56> (accessed 10 February 2015).

#### Other Labor Mobility Statistics

Some South Asian countries provide tourism data according to the purpose of visit.

Data from India's Ministry of Tourism show that about 12% of visitors from other SAARC member countries in 2012 reported that their purpose was for business and professional activities (Table 7.5).

**Table 7.5: Number of Foreign Visitors by Purpose of Visit in India, 2012**

Country	Business and Professional	Leisure, Holiday, and Recreation	Visiting Friends and Relatives	Medical Treatment	Others	Total
Afghanistan	19,332 (20.3)	10,666 (11.2)	12,380 (13.0)	15,713 (16.5)	37,140 (39.0)	<b>95,231</b>
Maldives	908 (1.8)	4,085 (8.1)	1,916 (3.8)	29,904 (59.3)	13,616 (27.0)	<b>50,429</b>
Nepal	11,033 (8.8)	14,418 (11.5)	18,806 (15.0)	1,128 (0.9)	79,990 (63.8)	<b>125,375</b>
Pakistan	12,927 (21.6)	11,012 (18.4)	26,811 (44.8)	1,317 (2.2)	7,780 (13.0)	<b>59,847</b>
Bangladesh	30,706 (6.3)	187,160 (38.4)	134,522 (27.6)	37,530 (7.7)	97,479 (20.0)	<b>487,397</b>
Sri Lanka	58,506 (19.7)	102,756 (34.6)	45,141 (15.2)	4,752 (1.6)	85,828 (28.9)	<b>296,983</b>
Bhutan	1,893 (12.4)	2,091 (13.7)	336 (2.2)	748 (4.9)	10,198 (66.8)	<b>15,266</b>
Total	135,305 (12.0)	332,188 (29.4)	239,912 (21.2)	91,092 (8.1)	332,031 (29.4)	<b>1,130,528</b>

Notes: Percent share is given in parentheses. Percentage may not total 100% because of rounding.

Source: Ministry of Tourism. 2012. *Tourism Statistics 2012*. New Delhi: Government of India.

### Remittances Sustainability and Effect on the Current Account Balance

Remittances have become a major source of external financial support for South Asian countries. Studies indicate that remittances are more stable and reliable than private debt and portfolio equity flows. Remittances are also more stable than foreign direct investment (FDI) (Ratha 2005, Mohapatra et al. 2010). The steady flow of remittances has helped countries in the region ease their foreign exchange constraints, improve their balance of payments, and strengthen their national savings. Remittances also contribute to the countries' development budget and the economic well-being of migrant family members.

Given the importance of remittances, South Asian countries have taken policy measures to maximize the benefits, including various measures to increase the inflow of remittances through formal channels. These include exchange rate liberalization, establishment of special remittance units at central banks, formalizing money transfer agencies, and banking partnerships in countries with high concentrations of migrant workers. SAARC member governments have become increasingly proactive in supporting migrant workers and their families in investing in small businesses and income-generating activities. These efforts have had some success. Still, the steady increase in remittances is more a reflection of the growing network of banks and money transfer agencies in recent years, together with better reporting on remittances (Battistella and Khadria 2011).

South Asia was the second largest recipient of remittances in the world in 2012, after East Asia (World Bank 2013c). Data published by the World Bank show that India was the largest recipient of remittances, receiving \$67.3 billion in 2012 (Table 7.6). Bangladesh and Pakistan are also among the largest recipients of remittances. Bangladesh's world ranking improved from ninth to eighth and Pakistan's rose from 11th to ninth in 2012.<sup>10</sup>

As expected, India accounts for the bulk of remittances (more than 60% in 2012) to South Asia. Somewhat surprisingly, remittance inflows and outflows for most South Asian countries were not adversely impacted during the global financial crisis. Remittances as a share of gross domestic product (GDP) are very significant for Bangladesh, Nepal, and Sri Lanka. Remittances have helped offset trade deficits in India and other South Asian countries.

Remittances are the most important external funding source for most South Asian countries. In 2011, remittances for South Asia as a whole, were more than double FDI inflows and six times larger than official development assistance (Table 7.7).

Middle East countries are the main host countries for South Asian migrant workers. Remittances from Qatar, Saudi Arabia, and the United Arab Emirates account for about 60% of total remittance flows to South Asia (Ozaki 2012).

<sup>10</sup> World Bank. Annual Remittances Data - Inflows and Outflows. <http://econ.worldbank.org> (accessed 20 October 2013).

**Table 7.6: Remittances Inflows and Outflows of South Asian Countries**

Country	Remittances Inflows (Current \$ million)						Remittances Outflows (Current \$ million)						Remittances as a Share of GDP (%)
	2000	2008	2009	2010	2011	2012	2000	2008	2009	2010	2011	2012	
Afghanistan	...	104	228	460	460	460	...	189	332	355	...	...	...
Bangladesh	1,968	8,941	10,521	10,850	12,071	14,085	4	14	8	9	12	12	12.2
Bhutan	...	4	5	8	10	10	...	61	54	63	98	...	0.6
India	12,883	49,977	49,204	53,480	63,011	67,258	486	3,812	2,890	3,853	4,097	...	3.7
Maldives	2	6	5	3	3	3	46	219	190	189	217	254	0.1
Nepal	111	2,727	2,985	3,469	4,217	4,793	17	5	12	32	39	50	24.7
Pakistan	1,075	7,039	8,717	9,690	12,263	14,007	2	...	8	9	28	30	6.1
Sri Lanka	1,166	2,925	3,337	4,123	5,153	6,001	20	373	420	526	581	...	10.1

... = no data, GDP = gross domestic product.

Source: Extracted from World Bank. Annual Remittances Data - Inflows and Outflows. <http://econ.worldbank.org> (accessed 20 October 2013).

**Table 7.7: Remittances Received Compared to Foreign Direct Investment Inflows and Net Official Development Assistance, 2011**

Country	Remittances Received (Current \$ million) <sup>a</sup>	Foreign Direct Investment Net Inflows (Current \$ million) <sup>b</sup>	Net Official Development Assistance Received (Current \$ million) <sup>b</sup>
Afghanistan	460	91	6,711
Bangladesh	12,071	1,138	1,498
Bhutan	10	26	144
India	63,011	36,499	3,221
Maldives	3	256	46
Nepal	4,217	94	892
Pakistan	12,263	1,308	3,509
Sri Lanka	5,153	956	611

Source: <sup>a</sup> Extracted from World Bank. Annual Remittances Data - Inflows and Outflows. <http://econ.worldbank.org> (accessed 20 October 2013).

<sup>b</sup> Compiled from World Bank. World Development Indicators. <http://data.worldbank.org/data-catalog/world-development-indicators> (accessed 20 April 2014).

Data from the World Bank's bilateral remittance matrix 2012 show that bilateral remittances within the region are relatively low, amounting to about \$20 billion (Table 7.8). Again, reflecting the size of its population and economy, India plays a prominent role in remittance flows in the region. However, total remittances from India to other South Asian countries are higher than the amounts received from them.

**Table 7.8: Bilateral Remittances between South Asian Countries, 2012 (\$ million)**

Remittance Sender	Remittance Receiver								Total Remittances Sent
	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	
Afghanistan		0	0	0	0	0	0	0	0
Bangladesh	0		0	4,082	0	0	40	0	4,122
Bhutan	0	0		160	0	2	0	0	162
India	1	6,620	1		0	1,634	2,189	400	10,845
Maldives	0	0	0	0		0	0	0	0
Nepal	0	1	7	3,224	1		39	2	3,274
Pakistan	0	0	0	0	0	0		0	0
Sri Lanka	0	0	0	1,410	0	0	0		1,410
Total Remittances Received	1	6,621	8	8,876	1	1,636	2,268	402	19,813

Source: Compiled from World Bank. Bilateral Remittances Matrix 2012. <http://econ.worldbank.org> (accessed 26 November 2013).

Remittances support economic development, encouraged by appropriate fiscal and financial policies. Remittance securitization and diaspora bonds,<sup>11</sup> for example, attract remittances directed to investments in the region (Ratha 2005). Among South Asian countries, Bangladesh, India, and Nepal have used such bonds effectively to raise resources (Ketkar and Ratha 2007, Ozaki 2012).<sup>12</sup> Foreign currency accounts and preferential interest rates for saving and credit in countries such as Bangladesh, India, Nepal, Pakistan, and Sri Lanka have also attracted remittances through formal channels. However, although there has been a shift from informal to formal channels, various barriers remain.

## Barriers to Labor Mobility and Remittances Flows

The previous section noted that labor mobility in South Asia is largely concentrated in the low-skilled category, and limited by concerns about informal and illegal migration, human trafficking, and terrorism. It also highlighted that remittance flows within the region are low and most are through informal channels. This section focuses on the barriers to labor mobility and remittance flows. Before these barriers are detailed, it should be noted that, in general, SAARC member countries have been slow to introduce domestic reforms, impeding market integration and labor mobility in the region. Labor market regulations are mostly outdated. Delays in enactment of key regulations have prevented countries such as India from fulfilling market access commitments in trade agreements.

<sup>11</sup> Diaspora bond is a bond issued by a country to its own diaspora to tap into their assets in the destination country.

<sup>12</sup> India has issued India Development Bonds, Resurgent India Bonds, and India Millennium Deposits; Bangladesh has issued US Dollar Premium Bonds and Wage Earners Development Bonds; and Nepal has issued Foreign Employment Bonds.

## Barriers to Labor Mobility

### *Similar Skill Endowments and Limited Mobility of Skilled Labor*

One of the barriers to labor mobility in South Asia is the similar skill endowments of the labor force. Much of the population is dependent on agriculture, and the quality of higher education, if accessible, is poor. SAARC member countries rank low in the human development index. Further, they lack infrastructure, limiting high-value manufacturing. Informal manufacturing and service sectors and low labor productivity therefore characterize the region (Ghani 2011). These factors have combined to limit the cross-border movement of professionals.

### *Lack of Synergies in Government Policy and Regulations*

In South Asian countries, several ministries and departments decide on policies related to labor mobility, with insufficient coordination in dealing with labor, foreign affairs, immigration, and other relevant policy areas. In Bhutan, for example, labor issues are under the purview of the Ministry of Labour and Human Resources, whereas immigration issues are handled by the Ministry of Foreign Affairs. Moreover, the institutional and policy frameworks vary greatly among the countries. In Sri Lanka, residence visas are issued by the Department of Immigration and Emigration, upon prior approval from the concerned agency (such as the Board of Investment). For further information, see website of the Department of Immigration and Emigration of the Government of Sri Lanka Institute of Architects.

In Pakistan, while visas are issued by the Directorate General of Immigration and Passports, under the Ministry of Interior, work permits are issued by the Board of Investment (in coordination with various security agencies) (ITC 2012). SAARC member countries also differ with respect to their overseas employment policies. Bangladesh has a comprehensive overseas employment policy, adopted in 2006 (Ozaki 2012 and Kulkarni 2013). The presence of multiple ministries and authorities within each country responsible for labor policies and remittances makes coordination difficult among SAARC member countries.

### *Barriers Related to Visa and Work Permit*

Many South Asian countries have bilaterally liberalized their visa regimes (Table 7.1). Nevertheless, there are significant restrictions on the movement of people across countries, which often differentiate between short-term labor mobility within SAARC and migrant labor from other regions or countries. People travelling between India and Pakistan must specify in their visa application the cities that they intend to visit. Pakistani nationals are required to register at the check post of entry into India. Further, except those who are granted “Exempted from Police Reporting” (EPR) visa, Pakistani nationals entering India on a police reporting Visa (PRV) must also report their arrival and intended departure at each place of stay as permitted in the visa within 24 hours to the concerned Foreigner Regional Registration Office (FRRO) or Foreigner Registration Office (FRO) authorities or the nearest police station. For Pakistani nationals visiting India, there are specific entry and exit points based on modes of travel. For example, air travelers must enter India through Chennai, Delhi, or Mumbai;<sup>13</sup> if travelling by bus, they can enter through Attari. Similarly, for Indian nationals traveling to Pakistan, the point of entry and exit should be same. Travelers entering by air can exit from a different airport, but they need prior permission. Indian

<sup>13</sup> Due to the lack of direct flights, visitors are advised not to enter through Chennai.

short-term visitors have to report for police registration within 24 hours of entry in Pakistan at each subsequent place of visit in Pakistan.

Restrictions are largely country-specific. For example, in India, Afghan citizens must register with the nearest FRRO within 14 days of arrival. They have to submit the full address of the hotel or residence they are staying, together with proof of this. Even the “No Visa Required for Travel to Bangladesh” (Table 1) is subject to conditions for Bangladeshis living in other SAARC countries. Although such measures are implemented for security reasons, they are very restrictive, especially when they are imposed on short-term business travel. Restrictions not only cause delays but also lead to rejection of visa clearance in many cases.

The duration of visas and work permits, visa fees, time for processing, and types of skills eligible for work permits vary among South Asian countries. For example, India provides conditional employment visas for 1 year to a foreign worker who is a highly skilled professional and/or a qualified professional engaged with a company, organization, industry, or undertaking in India on contract at a senior level (e.g., technical expert, senior executive, or manager). Proof of employment in the form of an employment contract must be provided. For further information, see website of the Ministry of External Affairs, Government of India.<sup>14</sup>

In Sri Lanka, residence (or employment) visas are provided to categories such as professional personnel whose services are required for projects approved by the state; personnel employed by banks and their dependents; personnel employed in a private company and their dependents; personnel employed in a project, institution, or organization under diplomatic missions in Sri Lanka; and personnel attached to nongovernment organizations (NGOs). The duration of residence (or employment) visas is 2 years for directors of a company and personnel employed in a project, institution, or organization under diplomatic missions in Sri Lanka, and 1 year for all other categories.<sup>15</sup> In the Maldives, employment approval is necessary for a foreigner applying for a residence visa. Although residence visas for foreign workers are open-ended, they are valid only as long as the employment approval is valid.<sup>16</sup>

Work permits are often issued for only a limited period, and they are sometimes difficult to renew. Further, checks required for employment eligibility include a drug test, policy and security clearances, reference checks, and medical checks. Sometimes multiple checks are conducted and at different places. For example, a foreign professional must undergo two medical examinations in the Maldives—first before leaving the home country and secondly on arrival in the Maldives.

Some countries have minimum salary requirements for employment, which restrict labor mobility. For example, an employment visa issued to a foreign national applying to work in India must be able to draw a salary in excess of \$25,000 per annum (except for certain categories such as ethnic cooks). This is a major barrier to migrant workers from other countries in the region.

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<sup>14</sup> Government of India. Visa Services. <http://www.passportindia.gov.in/AppOnlineProject/online/visaServices>

<sup>15</sup> Department of Immigration and Emigration Sri Lanka. Residence Visa. [http://www.immigration.gov.lk/web/index.php?option=com\\_content&view=article&id=153&Itemid=198&](http://www.immigration.gov.lk/web/index.php?option=com_content&view=article&id=153&Itemid=198&)

<sup>16</sup> Department of Immigration and Emigration Maldives. Tourist Visa. [http://www.immigration.gov.mv/index.php?option=com\\_content&view=article&id=112&Itemid=96](http://www.immigration.gov.mv/index.php?option=com_content&view=article&id=112&Itemid=96)

### *Nationality, Citizenship, and Residency Requirements*

Regulated professions include accounting, auditing, medicine, engineering, and law.

To practice these professions in most SAARC countries, the individual must meet citizenship and residency requirements. For example, membership in the Bar Council of India is mandatory to practice law in India. However, membership is limited to Indian citizens; foreign law firms are not allowed to open offices in India (USTR 2013).

### *Local Partnership Requirements*

In Pakistan, a foreign engineer or consultant is required to enter into a joint venture with a Pakistani partner (ITC 2012). In Sri Lanka, foreign architects can only work in collaboration with a local registered architectural firm.

### *Registration Requirements and Other Restrictions Imposed by Professional Bodies*

Migrant workers in professional categories must be registered with professional bodies in the host country. This can be cumbersome and time-consuming. In Pakistan, to provide accountancy services, foreign professionals must register with the Institute of Chartered Accountants of Pakistan and the Institute of Cost and Management Accountants of Pakistan. Applicants must (i) complete 3 years of training in a chartered accountant firm; (ii) clear a prescribed examination conducted by these professional bodies; and (iii) have experience of at least 1 year in the field of accounting, finance, auditing, and corporate affairs (ITC 2012). In Sri Lanka, architects are required to meet three requirements for registration: education, experience, and examination. Education can be from either of the two available institutions: University of Moratuwa or City School of Architecture (owned by the Sri Lanka Institute of Architects). Alternatively, the applicant's education requirement can be fulfilled through any foreign university recognized by the Sri Lanka Institute of Architects (SLIA 2013).

In India, foreign architects are required to register with the Council of Architecture, which has been campaigning against allowing their registration. Similarly, the Bar Council of India is against liberalization of legal services, either through the World Trade Organization (WTO) or through bilateral and regional trade agreements.

### *Lack of Recognition of Professional Qualifications*

Lack of recognition of professional qualifications adversely affects the ability of professionals to supply services in other South Asian countries. In Pakistan, foreign doctors are required to take an exam conducted by the Pakistan Medical and Dental Council; specialists also have to accredit their degrees with the council.

### *Nontransparent Immigration Policies*

Migration policies and frameworks vary widely among South Asian countries, and most lack comprehensive policies or institutional mechanisms to manage labor mobility. They also lack clearly defined and coherent policies on immigration and employment of foreign laborers. Some immigration laws are seriously outdated (SACEPS 2010, Wickramasekara 2011, and Kulkarni 2013).

### *Biases and Discretion in Admission of Foreign Workers*

Migration policies are generally biased toward higher-skilled categories of workers. Work permit applications and visas for higher skill levels, such as intracorporate transferees, are easier to obtain than permits for personnel such as systems analysts (Chanda 2004, Wickramasekara 2011). In particular, migration policies are relatively liberal with respect to labor mobility associated with the establishment of commercial businesses. However, middle- and low-level service professionals on contract or in an independent capacity face stringent admission requirements with respect to wage conditions and prior employment. Entry may be especially difficult for artisans and trades people, who may be technically competent in their trade and qualified on the basis of work experience but are not highly educated or qualified professionally.

### *Terrorism and Other Issues*

Terrorism and illegal migration are a major barrier to liberalization of labor mobility and financial flows in the region. The open borders between India and Nepal have been used by terrorists as an escape route or as a transit route for illegal migrants from countries such as Bangladesh to enter Nepal through India. SAARC member countries also face issues such as smuggling (of arms, drugs, etc.) and human trafficking. Large numbers of young women are trafficked from Nepal to India, which acts as a transit to the Gulf countries and Europe (Samuel et al. 2011, Wickramasekara 2011). These issues have prompted governments to restrict labor mobility and financial transactions. However, labor mobility continues because the borders are porous.

### *Inadequate Data and Information Sharing*

There is a lack of adequate mechanisms for recording and monitoring labor mobility among South Asian countries. Although some countries, such as Bhutan and Sri Lanka, record intraregional labor movements, there are discrepancies, and the data of a host country often does not match that of the home country (Wickramasekara 2011).

## **Barriers to Remittance Flows**

Substantial remittance flows are through informal channels<sup>17</sup> (Wickramasekara 2011, Ozaki 2012, World Bank 2013c). This is because of the various barriers to sending remittances through formal channels, some of which are discussed below.

### *Limited Formal Channels for Remittance Transfer*

Most South Asian countries initiated finance sector reforms in the 1990s, but the reform process is ongoing and their banking sectors lag those in mature markets (Goyal 2012). Many senders and recipients of remittances in South Asia, especially in the rural areas, do not have access to banks. According to India's Population Census 2011, among rural households, little more than half have access to bank savings accounts and almost three-quarters lack access to formal credit facilities. In Nepal, only 30% of households have accounts with banks and other financial institutions (Ozaki 2012). Lack of access to banks is a major deterrent to the flow of remittances through formal channels. Moreover, there are restrictions on the establishment of intraregional banking services. The use of technology (such as cell phones) for money transfers has been a recent phenomenon in the region, but

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<sup>17</sup> These include *hawala* (an informal money transfer system) brokers, traders, friends, or relatives that do not have legal status or licenses for foreign exchange transactions.

growth in their use has been slow, reflecting failure to open up the telecommunication and financial services sectors in SAARC member countries.

Post offices have a fairly strong network in the region and can be a medium for remittances. Bangladesh has about 1,600 post office branches throughout the country, and India Post has about 15,000 branches. India Post has entered into agreements with money transfer operators, such as Western Union, to disburse remittances through its post offices. Despite their extensive networks, the contribution of the postal system to facilitating remittance transfers in the two countries is limited because of inefficiencies, security concerns, low technology, and slow services. Further, the post offices charge high fees for money transfers (Ozaki 2012).

Exchange rate controls and restrictions on the repatriation of foreign currency discourage remittance transfers through formal channels. For example, the Indo–Nepal Remittance Facility Scheme, introduced in 2008, encourages bilateral remittances through formal channels but it has certain conditions. Remittances can be disbursed only through branches of the State Bank of India and agents of Prabhu Money Transfer in Nepal, and there is a maximum remittance ceiling of \$810 (Rs50,000)<sup>18</sup> (Ozaki 2012, RBI 2011).

#### *Regulatory Issues*

Regulations relating to money laundering and countering the financing of terrorism vary across the region, and in general are weak and cumbersome. This not only makes it difficult to use formal channels but also increases the cost of remittance transfers. Financial service regulations are not harmonized across SAARC member states, hampering the development of formal remittance channels.

#### *Low Level of Financial Literacy*

Labor mobility in the region is skewed toward low-skilled workers, who generally have limited financial literacy and awareness of formal channels for money transfers. Often they face difficulties in opening a bank account because of their lack of knowledge.

#### *Lack of Investment in Technology*

Banking sectors in South Asia lack the latest technology for tracing money laundering and irregular transactions. There is a need for significant investment in technology to trace and stop such transactions.

## Labor Mobility and Services Liberalization: Trade Agreements of South Asian Countries

Labor mobility can be facilitated through bilateral, regional, and multilateral trade agreements. This section reviews the extent of liberalization undertaken by SAARC members through the WTO under General Agreement on Trade in Services (GATS) negotiations, and bilateral and regional agreements covering services.

<sup>18</sup> The exchange rate of Re1.00 = \$0.0162 is used, which was the rate on 19 February 2014.

### World Trade Organization General Agreement on Trade in Services Negotiations

GATS negotiations include liberalization of the temporary movement of labor under mode 4, which is one of the key modes of trade in services. The GATS negotiations largely focus on removal of barriers to market access and discriminatory barriers to the movement of professionals. GATS has provisions for regulatory cooperation (such as among professional bodies for mutual recognition of qualifications) and the development of domestic regulations. However, there has been little progress in these areas. The Uruguay Round of WTO negotiations made limited progress toward the liberalization of mode 4, and most countries made commitments only to market access for business visitors and highly skilled workers or professionals. In all other areas, most countries referred to their existing visa regimes with no commitment for further liberalization. Moreover, there are differences in definition, coverage, and duration of stay across countries, which limit the gains from the commitments (Dawson 2013 and Self and Zutshi 2002).

Among SAARC members, Bangladesh, India, the Maldives, Pakistan, and Sri Lanka are founding members of WTO; Nepal became a WTO member in 2004. Afghanistan and Bhutan have observer status at the WTO. The second round of WTO negotiations, the Doha Round, is ongoing. For the Doha Round, India submitted its revised offer (2005) to the WTO, while Pakistan and Sri Lanka only submitted initial offers (also in 2005).<sup>19</sup> Nepal submitted accession commitments in 2003. Bangladesh and the Maldives made commitments in the Uruguay Round, but they have not made any offers for the Doha Round. The offers and commitments of India, Nepal, and Pakistan are in Table 7.9.<sup>20</sup>

As already noted, the offers of India and Pakistan and accession commitments of Nepal differ in definition, coverage of the professionals, and duration of stay. For instance, for business visitors, Pakistan includes those who supply after-sales or after-lease services and service sales persons (e.g., installers, repairers, and maintenance personnel). These categories of service suppliers are not included in India's revised offer. Under the intracorporate transferee category, Nepal and Pakistan define specialists as persons with "proprietary knowledge." This definition is not used by India because it is difficult to define proprietary knowledge in terms of the required skill qualifications. While India allows market access to all four categories of service suppliers—business visitors, intracorporate transferees, contractual services suppliers, and independent professionals—Nepal allows market access only for business visitors and intracorporate transferees. Pakistan allows market access for business visitors, independent professionals, and intracorporate transferees. Pakistan also allows entry for foreign service providers under two categories: professionals and other skills (Table 7.9). In terms of coverage of natural persons, Pakistan has the widest coverage. In terms of duration of stay, India allows for a longer stay than Pakistan does, but Nepal permits even longer stays.

<sup>19</sup> In 2003, the WTO member states tabled their initial offers based on the negotiating proposals. In 2005, a second round of negotiation offers was initiated within the framework of the Doha Round. This resulted in submitting to the WTO partners. WTO member states the so-called revised offers which several of the WTO member states either revised or newly created.

<sup>20</sup> Bangladesh, the Maldives, and Sri Lanka did not make any horizontal or sector-specific commitments regarding mode 4 in the Uruguay Round or any offers in the Doha Round.

India's revised offer does not cover professional services, such as legal services, in its sector-specific commitments. Pakistan's initial offer does not cover urban planning and landscape architectural services. Nepal excludes medical and dental services and services provided by midwives, nurses, physiotherapists, and paramedical personnel. Table 7.9 shows that India, Nepal, and Pakistan have shown willingness to multilaterally liberalize several professional services. However, they have not made sector-specific commitments under mode 4 and have only referred to their horizontal commitments.

**Table 7.9: Comparison of Horizontal Offers and Commitments of South Asian Countries under Mode 4**

Category or Parameter	India Revised Offer (August 2005)	Pakistan Initial Offer (May 2005)	Nepal Accession Commitment (August 2003)
Covered professional services (as per W/120 classification) in sector-specific commitments	Accounting and bookkeeping services, architectural services, engineering services, integrated engineering services, urban planning and landscape architectural services, medical and dental services, veterinary services and services provided by midwives, nurses, physiotherapists, and paramedical personnel	Legal Services, accounting and bookkeeping services, architectural services, engineering services, integrated engineering services, medical and dental services, veterinary services and services provided by midwives, nurses, physiotherapists, and paramedical personnel	Legal Services, accounting and bookkeeping services, architectural services, engineering services, integrated engineering services, urban planning and landscape architectural services, veterinary services
Horizontal commitments: Types of service suppliers	BV, CSS, ICT, IP	BV, ICT, IP, Professionals and Other skills <sup>a</sup>	BV, ICT
Time frame for entry of BVs	180 days	30 days to 180 days for business persons; and 30 days to 1 year for service sales persons	1 year for person responsible for setting up a commercial presence and 90 days for service sales person, which can be renewed
Time frame for ICT	Maximum period of 5 years	30 days to 3 years	3 years initially which may be extended to 7 years for a total period not exceeding 10 years

BV = business visitor, CCS = contractual services supplier, ICT = intracorporate transferee, IP = independent professional.

<sup>a</sup> Pakistan defines professionals as natural persons who seek to engage, as a part of a services contract granted by a juridical entity engaged in substantive business in Pakistan, in an activity at a professional level included in the specific commitments of Pakistan. Other skills are defined as natural persons having skills inter alia in information technology, construction engineering, tourism, educational services, health related services, selected sporting services; or who enter for temporary stay to impart training.

Source: Compiled from WTO. India Revised Offer. [http://commerce.nic.in/trade/revised\\_offer1.pdf](http://commerce.nic.in/trade/revised_offer1.pdf) (accessed 10 February 2015); WTO. Nepal Accession Offer. <http://docsonline.wto.org/Dol2FE/Pages/FormerScriptedSearch/directdoc.aspx?DDFDdocuments/t/WT/ACC/NPL16A2.doc> (accessed 10 February 2015); and WTO. Pakistan Conditional Offer on Services. [http://wtopunjab.gov.pk/initial\\_offer.html](http://wtopunjab.gov.pk/initial_offer.html) (accessed 10 February 2015).

India has been a proponent of mode 4 liberalization in the WTO and has tabled a proposal on liberalization in the Doha Round. This proposal focused on improved market access commitments for professionals, a uniform definition and broader coverage of service providers, expansion of the scope of “other persons and specialists categories” to include middle- and lower-level professionals, improvement in administrative procedures related to work permits and visas, removal of economic needs tests,<sup>21</sup> introduction of norms to address social security issues, and strengthening of GATS norms on recognition of education and qualifications of professionals. Some of the administrative and procedural suggestions proposed by India have formed the basis of not only multilateral liberalization but also of bilateral and regional trade agreements. For instance, India has proposed that temporary service providers should be separated from permanent migration and a “GATS visa” for special categories of service providers should be developed for easier temporary entry. This proposal is similar to the APEC Business Trade Card, which allows the holder visa-free entry and stay in the participating member countries for short-term commercial purposes.

During the Doha Round, India was the coordinator of the plurilateral<sup>22</sup> negotiations on mode 4 for removal of barriers to the movement of professionals. Pakistan was a part of the group supporting India. The plurilateral mode 4 negotiations sought new and improved commitments for contractual services suppliers and independent professionals delinked from commercial presence. They also clarified definitions and categories of contractual services supplier and independent professional for which commitments have been requested. The target group of developed countries has been asked to remove or substantially reduce economic needs tests. Wage parity should not be a precondition for entry, and the duration of stay should be 1 year or the duration of the contract (if longer), with a provision for renewal. India pushed for agreements on discipline on domestic regulations in order to facilitate labor mobility

The slow progress of the WTO negotiations has led to a proliferation of bilateral and regional trade agreements. SAARC member countries are actively engaged in such agreements, some of which are discussed in the following section.

### Labor Mobility in Bilateral Free Trade Agreements and Regional Trade Agreements

Among SAARC members, only India and Pakistan have comprehensive bilateral trade agreements with ASEAN members and East Asian countries. To date, India has signed four comprehensive agreements: the India–Singapore Comprehensive Economic Cooperation Agreement (CECA), in June 2005; the India–Korea Comprehensive Economic Partnership Agreement (CEPA), in August 2009; the India–Japan CEPA, in February 2011; and the India–Malaysia CECA, in February 2011. Pakistan has a comprehensive agreement with Malaysia—the Malaysia–Pakistan Closer Economic Partnership Agreement, 2007, referred to as the Malaysia–Pakistan Agreement. Other SAARC members have bilateral free trade

<sup>21</sup> An economic needs test is a market access test on fulfilment of certain economic criteria. Under this provision, a Member grants full market access in a sector when it does not adopt or maintain any of the six types of measures listed in subparagraphs (a) to (f) of Article XVI:2. For further information, see WTO’s GATS website.

<sup>22</sup> Under plurilateral negotiations, a group of members with a common interest make a joint request to individual members to improve specific commitments in a particular sector or mode of supply. Subsequently, they meet collectively with the countries that have received this request. It is up to each member to respond individually to the collective request.

agreements but these do not cover services. In April 2010, SAARC members signed the SAARC Agreement on Trade in Services (SATIS), which came into force in November 2012. Negotiations on the schedule of specific commitments of individual SAARC member countries are ongoing and each country is in the process of making offers to its trading partners.<sup>23</sup>

A review of India's four bilateral agreements and the Malaysia–Pakistan agreement (Table 10) indicates that both countries have followed the GATS definition of services and modes of service delivery including the definition of mode 4. Unlike the trade agreements of the United States, which follow a negative-list approach, India and Pakistan follow the GATS-style hybrid approach for scheduling commitments, which involves a positive list of sectors with applicable restrictions for each sector noted in the schedule.

India and Pakistan have different definitions for certain categories service suppliers, as shown in their respective WTO revised offer and initial offer. However, Pakistan has provided greater clarity under its horizontal commitments for natural persons in the Malaysia–Pakistan agreement. Here, Pakistan defines intracorporate transferees as those who are in the employment of a juridical entity of another member country of the WTO for a period of at least 1 year. Pakistan also allowed market access to all four categories of service suppliers and to natural persons who enter to provide training in IT, construction, or engineering. India, in its four comprehensive agreements, has a separate chapter on movement of natural persons in which it discusses the coverage and definition of different service suppliers.

The bilateral trade agreements of India and Pakistan provide for mutual recognition agreements (MRAs).<sup>24</sup> Pakistan has formulated a framework for MRAs highlighting the scope, definition, and administration of MRAs. For several years, India has been negotiating with countries such as Singapore on MRAs for selected professional categories, including dentistry, nursing, architecture, accountancy, and company secretaries. However, so far there has been limited progress by India on MRAs.

Although India's trade agreements with Singapore and the Republic of Korea identify several professional categories for which India seeks easier market access, the categories do not match the International Labor Organization definitions. Further, within each professional category, such as software professionals or architects, the definition does not cover the entire value chain. Furthermore, the two trade agreements have no provision for specialized visa arrangements.

<sup>23</sup> For details, see SAARC. Agreement in Trade in Services. [http://saarc-sec.org/areaofcooperation/detail.php?activity\\_id=46](http://saarc-sec.org/areaofcooperation/detail.php?activity_id=46).

<sup>24</sup> MRAs enable professional service suppliers that are certified or registered by the relevant authorities in their home country to be mutually recognized by other signatory countries.

**Table 7.10: Comparison of Mode 4 Provisions and Commitments of India and Pakistan in Their Bilateral Trade Agreements**

Parameters	India–Singapore CECA	India–Korea CEPA	India–Malaysia CECA	India–Japan CEPA	Malaysia–Pakistan Agreement
Professional services covered	Different from WTO Revised Offer— includes advisory taxation services but excludes landscape architectural service	Same as the WTO Revised Offer	Same as the WTO Revised Offer	Same as the WTO Revised Offer	Same as the WTO Initial Offer
Types of service suppliers covered	BV, CSS, ICT, IP	BV, CSS, ICT, IP	BV, CSS, ICT, IP and other category (installer and servicer)	BV, CSS, ICT, IP, and other category (instructors)	BV, ICT, IP, CSS, and other skills <sup>a</sup>
Duration of stay for business visitors	60 days and multiple entry visa for up to 5 years	180 days up to 5 years	180 days and multiple entry visa for up to 2 years	180 days and can be extended subject to Indian law	6 months - business persons; 1 year - service sales persons
Duration of stay for intracorporate transferees	2 years extendable to 8 years	1 year extendable to 5 years	1 year extendable to 5 years	1 year extendable to 5 years	3 years on extendable basis
Duration for stay for contractual service suppliers	90 days and can be extended for another 90 days	1 year	1 year	1 year	1 year
Duration of stay for independent professionals	1 year	1 year	1 year	1 year	1 year
Separate annex on professionals	Yes	Yes	No	No	No
Number of professional categories covered	127	163	-		
Provision on MRAs	Yes	Yes	Yes	Yes	Yes

BV = business visitor, CCS = contractual services supplier, CECA = comprehensive economic cooperation agreement, CEPA = comprehensive economic partnership agreement, ICT = intracorporate transferee, IP = independent professional, MRA = mutual recognition agreement, WTO = World Trade Organization.

<sup>a</sup> Other skills include the same categories in Pakistan's initial offer to the WTO (May 2005).

Sources: Information compiled from the trade agreements of India and Pakistan.

India's Trade Agreements are available at the Ministry of Commerce and Industry. India's Trade Agreements. [http://commerce.nic.in/trade/international\\_ta\\_current\\_details.asp](http://commerce.nic.in/trade/international_ta_current_details.asp)

Government of India. India-Singapore Agreement. [http://commerce.nic.in/MOC/international\\_trade\\_agreements\\_CECA.asp](http://commerce.nic.in/MOC/international_trade_agreements_CECA.asp)

India-Korea Agreement <http://commerce.nic.in/trade/INDIA%20KOREA%20CEPA%202009.pdf>

India-Malaysia Agreement <http://commerce.nic.in/trade/IMCECA/title.pdf>

India-Japan Agreement [http://commerce.nic.in/trade/IJCEPA\\_Basic\\_Agreement.pdf](http://commerce.nic.in/trade/IJCEPA_Basic_Agreement.pdf)

Government of the Islamic Republic of Pakistan. Pakistan-Malaysia Agreement. [http://www.commerce.gov.pk/PMFTA/PAK-Malaysia-FTA\(TXT\).pdf](http://www.commerce.gov.pk/PMFTA/PAK-Malaysia-FTA(TXT).pdf)

### Labor Mobility in SAARC: Progress so Far and Comparison with Other Agreements

In 1992, SAARC launched the SAARC Visa Exemption Scheme, designed to enhance people-to-people contact by eliminating visas for certain categories of movement. The list includes 24 categories of persons (including dignitaries, judges of higher courts, parliamentarians, senior officials, journalists, and those involved in sport and business). Under the scheme, visa stickers are issued by member states to the entitled categories of the particular country. The validity of the visa sticker is generally for 1 year. Periodically, SAARC members discuss simplification of visa procedures and requirements to assist business-related travel and to accelerate the promotion of trade and tourism within the region. However, there has been limited progress in labor mobility under SAARC, although bilateral agreements and consultations between members have facilitated some labor mobility.

The previous sections have reviewed the many barriers to labor mobility among SAARC countries. Some of the barriers are discriminatory against selected members and have been imposed for security and other reasons. There are differences among SAARC members in terms of the definition of service providers, classifications of workers (highly skilled, skilled, etc.), and duration of stay. The review also noted that labor mobility among SAARC countries has largely been by unskilled workers, while liberalization under trade agreements has focused on highly skilled workers. Different policy actions and strategies are needed for highly skilled workers versus low-skilled workers. SAARC members can learn from the experience of ASEAN countries, such as the Philippines, in monitoring labor mobility and remittances. Measures such as the ASEAN Declaration on the Protection and Promotion of the Rights of Migrant Workers are also instructive.

SATIS, which entered into force in November 2012, has been a major milestone in facilitating labor mobility in South Asia. This agreement broadly follows the GATS framework of positive listing of sectors for liberalization, and is based on a “request-and-offer approach.”<sup>25</sup> The coverage of mode 4 under SATIS has not yet been decided, but it is likely to include professionals and some skilled workers. Article 11 of SATIS on domestic regulations states that measures relating to qualification requirements, technical standards, and licensing requirements should not constitute unnecessary barriers to trade in services. Article 12 focuses on recognition of education and experience. It states that professional bodies should negotiate and conclude MRAs within a reasonable time frame. While the agreement focuses on the movement of professionals, some SAARC members (e.g., Bangladesh) would like the scope of the agreement to be extended to include skilled workers (such as textile workers). SAARC members are in the process of making their offers under SATIS.

There is a strong interrelationship between labor mobility and liberalization of trade in goods, services, and investment. Liberalization of trade in goods often precedes

<sup>25</sup> In the Doha Round, negotiations on individual services commitments have been conducted on a request-offer basis, whereby a WTO member has requested better access to a particular services sector in another WTO member's economy. This has been followed by an offer to grant all, some, or none of the additional access requested. The process upheld the voluntary nature of GATS commitments, whereby each member is entitled to decide its own levels and sectors of liberalization. An important element of the process is that any offer made is nonbinding, and could be amended or withdrawn at any time during the negotiations.

liberalization of trade in services, as has been the case of regional blocs such as the European Union (EU) and ASEAN. Under the ASEAN Free Trade Area (AFTA), ASEAN members have achieved significant progress in the removal of tariffs and nontariff barriers to trade in goods. In contrast, tariffs are still relatively high among SAARC members, and they have large negative lists for trade in goods. In the services sector, the ASEAN members have identified priority sectors, such as logistics, air transport, and tourism, for liberalization and market integration by 2015. They have also taken various measures to facilitate labor mobility, especially the mobility of skilled workers and professionals as shown in the box. Some of these measures can be replicated by SAARC as it moves toward a South Asian Economic Union (SAEU). This is discussed in the next section.

### Labor Mobility and the ASEAN Economic Community

After signing the Association of Southeast Asian Nations (ASEAN) Free Trade Agreement in goods in 1993, the member countries began to formalize an agreement in services. In 1995, the ASEAN Framework Agreement on Services (AFAS) was signed, mandating negotiations on the liberalization of trade in services. AFAS followed the broad structure and approach of the General Agreement on Trade in Services (GATS), i.e., a positive-list approach. The objective is to enhance cooperation, eliminate restrictions, and liberalize trade in services beyond GATS. The AFAS introduced the 'ASEAN Minus X' formula; under this formula, countries that are ready to liberalize a selected service sector may proceed to do so without having to extend the concessions to nonparticipating countries.

In 2007, ASEAN adopted the ASEAN Economic Community (AEC) Blueprint for 2015 to strengthen the institutional framework through a unified rules-based system. For trade in services, the blueprint includes subsectors to be scheduled in each round of negotiations, thresholds for modes 1 and 2, foreign equity participation under mode 3, overall flexibility, mutual recognition agreements (MRAs), parameters for liberalizing national treatment limitations under mode 4, and limitations on horizontal commitments. The ASEAN Agreement on the Movement of Natural Persons, signed in November 2012, covers temporary movement of skilled workers, professionals, and executives, and is limited to business visitors, intracorporate transferees, and contractual services suppliers. The AEC Blueprint acknowledges that the entry of natural persons engaged in trade in goods, services, and investments is in accordance with the prevailing regulations of the receiving country. It aims to

- (i) facilitate the issuance of visas and employment passes for ASEAN professionals and skilled labor engaged in cross-border trade and investment-related activities;
- (ii) work toward harmonization and standardization, with a view to facilitate their movement within the region;
- (iii) enhance cooperation among ASEAN University Network members to increase mobility for both students and staff within the region;
- (iv) develop core competencies and qualifications for job and/or occupational and trainers skills required in the priority services sectors and in other services sectors (from 2010 to 2015); and
- (v) strengthen the research capabilities of ASEAN member countries in terms of promoting skills, job placements, and developing labor market information networks in the region.

MRAs are an important initiative for facilitating the movement of highly skilled professionals. In addition to facilitating the movement of persons within ASEAN, the MRAs are designed to facilitate the exchange of information and enhance cooperation among professional bodies, promote the adoption of best practices on standards and qualifications, and provide opportunities for capacity building and training. MRAs have been signed by ASEAN member states for engineering services, nursing services, architectural services, accountancy services, medical practitioners, dental practitioners, and surveyors. These MRAs are in various stages of implementation.

Sources: Websites for AEC Blueprint and ASEAN Integration in Services.

## Enhancing Labor Mobility and Remittance Flows: A Road Map for South Asian Economic Union

This section outlines policy measures for enhancing labor mobility and remittance flows with the objective of moving toward an SAEU. In this context, South Asian countries can draw from the experience of ASEAN countries and their AEC Blueprint for facilitating labor mobility and financial markets integration.

### Enhancing Intra-SAARC Labor Mobility

As illustrated by the AEC Blueprint and WTO GATS, trade agreements generally focus on facilitating the mobility of skilled or highly skilled professionals. While SAARC members are proponents of liberalizing the movement of professionals under the WTO framework, the intra-SAARC movement of professionals is limited by the countries' similar skill endowments and barriers to labor mobility. As between the WTO and SATIS, the negotiating positions of SAARC members differ widely. Under the WTO negotiations, India wants greater access and removal of discriminatory treatment for its professionals in markets of export interest (which are largely the developed countries); however, it has adopted a defensive position concerning opening up its own market to professionals from other SAARC members. South Asia is troubled by concerns such as terrorism and human trafficking, which prompts countries in the region to retain restrictive labor mobility policies. Nonetheless, some countries, such as Bangladesh, would like to have wider market access for skilled and unskilled workers and not only for professionals. This can be a sensitive issue in trade negotiations.

It is important for SAARC members to realize that the free flow of skilled labor is vital for enhancing trade in goods, services, and investment and for moving toward an SAEU. As a step in this direction, SAARC members should work together to take short- and long-term measures to facilitate the mobility of skilled and highly skilled labor in the region. Such movements benefit businesses and investment, and are less sensitive than opening up the labor market to low-skilled workers. Greater mobility can be facilitated through streamlining the issuance of visas and employment passes for selected categories of SAARC professionals, skilled labor, and/or labors in certain specialized categories (such as textile workers) engaged in cross-border trade and investment-related activities. As evidenced by WTO commitments and bilateral trade agreements, there is widely shared support for easier market access for certain professional and skilled services—engineers, IT professionals, architects, doctors, nurses, and teachers and trainers. Mobility for professionals could be addressed under an SAARC business travel card, similar to the APEC card. This would enable them to have visa-free entry and stay for short periods for business purposes. The business visa should have provision for multiple entries.

Many SAARC members have relaxed their short-term visa entry procedures for selected member states, either unilaterally or bilaterally (Table 1). However, as described earlier, there are country-specific barriers to short-term labor mobility. SAARC members should strive to establish a common format for easier market access for business travel. The SAEU should include provisions for implementing an SAARC business travel card, preferably

within a 2-year time frame. The SAEU road map should also include provisions for review of the categories and for a more inclusive step-by-step approach. The process could begin by formalizing the existing SAARC Visa Exemption Scheme to include more categories of professionals and skilled workers. To begin the process, each SAARC member country could be designated the right to choose a set of five or more skill categories, ensuring that a broad range of labor mobility interests is taken into account.

To further facilitate labor mobility, SAARC should have common definitions for different categories of service providers, such as business visitors, intracorporate transferees, and contractual services suppliers, possibly modeled after the ASEAN Agreement on the Movement of Natural Persons. This would help remove ambiguity in defining the eligible categories and facilitate labor mobility. SAARC members should also have common provisions regarding the duration of stay. While the SATIS negotiations will take time, agreement on temporary movement would ease the entry barriers for professionals and certain specialized skills. Allowing for the movement of independent professionals is a sensitive issue.

While mode 4 liberalization can be achieved under SATIS, progress under the agreement has been slow and firm timelines are needed for completing the request-and-offer process and scheduling of commitments. Restrictions on the mobility of professionals imposed by SAARC members include local partnership requirements and minimum wage conditions. These and other restrictions should be removed under the SATIS mode 4 negotiations by the end of 2015.

The AEC Blueprint has laid down an action plan toward harmonization and standardization of professional qualifications (Box). Specifically, it focuses on enhancing cooperation between the ASEAN University Network, developing core competencies and qualifications for priority service sectors, and strengthening research capabilities. For the SAEU, it is important to enhance cooperation among universities in the region, including through student and staff exchange programs. Joint research programs will strengthen research capabilities in the region and help develop mutual trust. Skill levels in the region are low, and the quality of professionals varies widely. SAARC members need to promote access to quality higher education, workplace training, and skill development programs. Regional initiatives in this regard include (i) designing common curricula frameworks at all educational levels; (ii) undertaking a study on a common language for the SAARC region; (iii) furthering collaboration among higher education institutions, research institutions, and skill development institutions; and (iv) establishing student exchange programs.

A number of barriers have been imposed by professional bodies in the region. SAARC members have not been very successful in concluding MRAs. To help spur progress in negotiating MRAs among SAARC countries, there should be exchanges of information between professional bodies in the region on best practices and standards, collaboration between educational institutions providing professional degrees, and collaboration in capacity building and training. This will generate a better understanding of each other's degrees and qualifications. Further, adoption of best practices will enable countries to enhance their skill levels. Often, professional bodies acknowledge each other's degrees on a reciprocal basis, facilitating the movement of professionals.

SAARC members should identify shortages and surpluses of skilled labor and professionals in their domestic markets. Data on the availability and mobility of skilled personnel in the SAARC region are poor. Members should adopt a common framework for recording and monitoring the availability of professionals and skilled personnel in the region, and publish it on a yearly basis. This would help optimize the use of skilled workers in the region.

Security issues pose a serious barrier to labor mobility. Appropriate technology can be used (such as iris and finger print scans) to identify and record people moving across borders. For this, SAARC member countries need the appropriate technology and facilities for sharing information. A short-term SAARC business travel card could be implemented within 2 years if appropriate technology is available and information is shared among member countries to prevent misuse. Also, visa counters for intra-SAARC labor mobility should be established in points of entry (such as airports and land borders), equipped with the means to identify and record migrant workers. Fast-track measures of this sort would be effective in facilitating labor mobility, as demonstrated by ASEAN and other regions. A joint working group of SAARC member countries should be established for this purpose.

Some countries, notably India, have expressed concerns that greater labor mobility within the region will create serious imbalances between host and source countries. More specifically, India is concerned that the number of professionals moving to it from other SAARC countries will be far greater than the number of Indian professionals wanting to work elsewhere in the region. Given that India has a surplus of skilled workers, it may be difficult for it to allow easier market access for foreign professionals. On the other hand, other SAARC countries fear that Indian professionals could dominate opportunities in their labor markets. One way to address such concerns would be to implement special quotas for the easier movement of certain skills, with reviews at regular intervals. Quotas of this sort are included in bilateral trade agreements, such as the United States–Singapore Free Trade Agreement and the proposed India–EU Broad-Based Trade and Investment Agreement. There are arguments for and against quotas, and they are viewed as a second-best option for facilitating labor mobility. Still, quotas may offer a phased approach to overcome the lack of willingness to liberalize labor mobility.

There is a considerable degree of informal and illegal labor mobility among SAARC member countries, and measures must be taken to reduce the problem. However, measures taken at the country level have not been very successful. For example, India introduced *aadhaar* (individual identification numbers) for residents, to provide a national database for social benefits and to improve national security. This system has been compromised as an unknown number of illegal immigrants from Bangladesh and elsewhere in the region now have *aadhaar* cards. Greater regional cooperation is needed to reduce illegal labor mobility. It is also important to protect the rights of migrant workers through collaboration between the sending and receiving countries. In this regard, the ASEAN Declaration on the Protection and Promotion of the Rights of Migrant Workers is a possible model. The declaration highlights the contributions of migrant workers to both the origin and destination countries, and the obligation to protect their rights.

Several government departments typically have responsibilities for labor mobility and foreign migrant workers. A focal agency in each country should be designated to work with counterparts in other SAARC countries to facilitate labor mobility.

Outdated regulations in SAARC member countries should be revised or replaced by new regulations. There is also an urgent need for reforms to improve the quality of higher education and the qualifications of professionals. SAARC member countries should focus on reforms (including labor market reforms) that would enable them to develop formal sectors and to move up the scale to higher value-added manufacturing and services. SAARC members must improve labor productivity in agriculture, manufacturing, and services, which in turn will facilitate development of a skilled workforce and greater mobility of highly skilled professionals. In this context, they can learn from each other's successful experience, such as India's success as an exporter of IT and IT-enabled services.

### **Enhancing Remittance Flows**

SAARC members have been cooperating in the finance sector, and there are regular meetings of finance ministers and relevant government officials. SAARCFINANCE was established in 1998 as a regional network of the SAARC central bank governors and finance secretaries. Its objectives include the exchange of information among central banks and finance ministries, harmonization of banking legislation and practices, and a more efficient payments system in the region. Progress, however, has been mixed, as is evident from the wide variations in the state of the banking sector (e.g., outdated technology) in SAARC member countries and the lack of access to financial services by much of the population. Further, there are regulatory barriers and other restrictions on sending remittances through formal channels, and the cost is high. Given security and other concerns in the region, banks tend to be over-cautious and implement restrictive procedures as a substitute for appropriate regulations and technology for tracing unusual money transactions. Moreover, SAARC cooperation is still largely at the government level; private sector involvement in regional cooperation in the finance sector is limited. The combination of these factors has resulted in low remittance flows through formal channels.

Financial sector reforms should include enhanced competition, allowing more banks to be involved in money transfers rather than restricting such transfers to designated banks. Further, there should be incentives to improve money transfer technologies, such as through the use of mobile phones, online payments, and swipe cards. Improvements in the payment systems would increase the speed of transactions, reduce the costs, and improve efficiency in remittance flows. There is an urgent need to harmonize the payments infrastructure among banks in SAARC countries, leading to a common platform within a specified timeline. In the SAEU road map, a joint working group on developing the payment system should be established, involving government agencies (central banks and finance ministries) and public and private sector financial representatives. Some member countries may need financial support in developing the payment infrastructure.

Extensive private sector involvement should be encouraged, balanced by the need for proper regulation and monitoring of financial services—including of nonbank financial institutions. The cost of money transfers could be reduced through competition among money-transfer providers. Nonbank financial institutions, such as microfinance institutions and cooperatives, should have a more active role in facilitating remittances and helping to

reach low-income households in the region. Experience with microfinance institutions and other forms on nonbank financial institutions should be shared among SAARC members.

Remittances significantly contribute to development, improve the standard of living of migrant households, and help reduce poverty. SAARC members should initiate measures to reduce the cost of sending remittances, especially the remittance fees. In 2009, the G8 Heads of State made a commitment to reduce the global average remittance costs by 5 percentage points in 5 years—the so-called “5 x 5 objective”—at the L’Aquila Summit. In 2011, the G20 decided to join the effort to achieve the 5 x 5 objective. This should also be a part of the SAEU agenda.

Financial literacy needs to be promoted to enhance access to formal channels for money transfers. The use of informal channels for remittances reflects language barriers, lack of financial literacy, and the inability to use relevant technology. SAARC member governments should share their experience in curbing informal remittance flows, such as India’s Foreign Exchange Management Act (2000), which explicitly prohibits *hawala*-type transactions. Greater regulatory cooperation among SAARC members is also needed to counter money laundering and the financing of terrorism, drugs, and other illegal activities.

Liberalization of financial services is closely linked to labor mobility and remittance flows. SAARC members should provide market access and nondiscriminatory treatment to each other’s banking and other financial institutions. Greater cross-border banking access could be advanced on a reciprocal basis, as provided for in the India–Singapore Comprehensive Economic Cooperation Agreement (CECA).

## The Way Forward

Facilitating increased mobility of skilled professionals and cross-border flows of financial resources (including remittances) is important for the SAEU. While SAARC members have so far made only limited progress in these areas, a series of short- and long-term measures would be transformational. SAARC members should (i) design and sign a framework agreement facilitating the short-term movement of business visitors, intracorporate transferees, and contractual services suppliers; (ii) designate a specialized visa category for business travel, prioritizing the categories of professionals and skilled labor eligible for easier entry processes, and broadening the list in a phased manner; (iii) advance SATIS negotiations for the removal of barriers to mode 4 trade, with a clearly defined timeline for conclusion of these negotiations; (iv) promote more collaboration among universities, professional bodies, and research institutes in the region, leading to greater mutual trust and knowledge about each other’s standards and qualifications; (v) establish timelines for entering into MRAs for designated categories of professions; and (vi) coordinate to ensure that the technology and infrastructure (such as SAARC visa counters) is in place to facilitate labor mobility.

Liberalization of labor mobility is a sensitive issue and generally evolves in a phased manner. In the short run, SAARC members should focus on noncontroversial targets that can be easily achieved—such as facilitating the short-term movement of professionals and specialized skills. Overall, specific targets and clearly defined timelines are needed to achieve greater labor mobility, while maintaining flexibility for member countries to adopt phased reforms.

Enhancing use of formal channels for remittances also requires commitment, cooperation, and collaboration among SAARC members. While commitments under SATIS will contribute to some degree of harmonization and liberalization of the finance sector, the road map to SAEU should stress more proactive progress within a specified time frame. Further, remittance fees should be reduced by 5 percentage points in 5 years, as has been adopted by G8 and G20 countries.

SAARC members must undertake sweeping domestic reforms to enhance their competitiveness, labor productivity, and efficiency in the finance sector. Unless reforms are initiated, member countries will tend to take defensive positions during trade negotiations. Political and security concerns in the region are influential in determining labor mobility and finance sector liberalization. Strong political commitment will be needed to make an SAEU a reality. SAARC members need to understand how market integration has benefited other regions, and how the low level of SAARC integration has adversely impacted its members' ability to integrate into global production and trade networks. Unless SAARC countries work together to create a skilled workforce and facilitate its movement within the region, movement up the value chain in manufacturing and services will be hampered.

## CHAPTER VIII

# Regional Investment Cooperation for a South Asian Economic Union

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Regional investment cooperation and integration in South Asia has received relatively little attention. Unlike bilateral, subregional, and regional trade agreements for goods and services, only limited progress has been made toward regional investment agreements. While members of the South Asian Association for Regional Cooperation (SAARC) have followed relatively liberal foreign direct investment (FDI) regimes since the 1980s, reflecting their need for foreign investment, most restrict FDI outflows. Member countries have been cautious about investment liberalization, in part because of concerns about weak balance of payments situations and cross-border flows undermining domestic business enterprises.

Despite limited intraregional investment, South Asian economies are increasingly integrated with other economies through trade and investment cooperation. Investment is a major component of the India–Sri Lanka Comprehensive Economic Partnership Agreement. It is also a major component of the ongoing negotiations for a bilateral trade and investment agreement between India and the European Union (EU). Further, trade and investment are the priority sectors under the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) and the proposed Bangladesh–People’s Republic of China (PRC)–India–Myanmar Economic Corridor Initiative.

During the 14th SAARC Summit, held in New Delhi in 2007, member countries agreed to promote and facilitate intraregional capital flows and long-term investment. Accordingly, the SAARC Agreement on Trade in Services (SATIS), signed in 2010, includes provision for investment in services in member countries through the establishment of a commercial presence. However, a long-standing comprehensive draft agreement on the promotion and protection of regional investment has yet to be approved. With the commitment to a South Asian Economic Union (SAEU), the issue of investment cooperation has become increasingly important.

This chapter reviews the bottlenecks to investment cooperation among SAARC members under the broad framework of an SAEU, and recommends measures to move the agenda forward. The chapter addresses three broad areas: an FDI regime for the region designed to facilitate intraregional investment flows, a comparative review of South Asia and Southeast Asia with regard to inward and outward flows of FDI, and recommendations for achieving greater investment cooperation and integration in South Asia.

## Foreign Direct Investment-Related Policies of South Asian Countries

### Major Features of Foreign Direct Investment Policies of South Asian Countries

SAARC members have followed relatively liberal FDI policies since the 1980s and continued to liberalize these policies to promote foreign investment (Sahoo 2006). However, they have different requirements for FDI. Table 1 lists their FDI-related policies. Major provisions regarding the pre-establishment level include sector prohibitions, investment caps, screening requirements, minimum capital requirements, and locational issues. In general, SAARC members prohibit foreign investment in defense industries, and printing and production of currencies. They also restrict investment in certain sectors to safeguard local investment, culture, and values. The restricted sectors include gambling, real estate, tobacco, and atomic energy in India; alcohol and tobacco in Nepal; alcohol in Pakistan; mining, timber, fishing, mass education, and freight forwarding in Sri Lanka; and media, wholesale and retail businesses, and hotels in Bhutan. Prohibited sectors should not create stumbling blocks for eventual vertical and horizontal FDI if intraregional trade integration broadens and deepens over time. FDI in the service sector has opened up to some degree in most South Asian countries, following the World Trade Organization (WTO) agreement. The scope for investment in services will open up further with the implementation of SATIS. Regional investment has been blocked in several cases by special country-specific provisions. For example, investment sourced from Bangladesh and Pakistan was barred in India until 2012; similarly, Indian investment in Pakistan is still not officially open.

Foreign ownership provisions vary among SAARC members, depending on their perceptions of the need to safeguard domestic investment. For example, Bangladesh, the Maldives, and Sri Lanka allow 100% foreign ownership in all sectors; in contrast, Bhutan, India, and Pakistan allow 100% investment in a limited number of sectors only. India has capped foreign ownership in different sectors to protect domestic investment in information and communication technology, print media, air transport, telecom services, banking and insurance, and power exchanges. Some countries maintain minimum investment requirements and closely screen foreign skilled workers. Harmonization of these provisions is needed, particularly for promoting intraregional investment.

Provisions of post-entry treatment are relatively less diversified. Most SAARC members provide fiscal incentives for foreign investment in the form of income tax holidays and exemption from import duties for raw materials, intermediate products, and capital machinery. Repatriation of invested capital is subject to conditions in some cases; Bangladesh allows 100% repatriation of capital and dividends, but India allows repatriation of profits only under specified conditions. In general, post-establishment treatment is less varied than pre-establishment treatment.

FDI regimes in members of the Association of Southeast Asian Nations (ASEAN) are more homogenous, both in the pre- and post-establishment phases. This reflects an effective integration mechanism for trade and investment issues, which reduces country-specific differences. Most countries in the region allow 100% foreign ownership. Incentives, however, vary considerably. Investors are provided with duty-free and preferential export

access in Cambodia and Viet Nam. In Indonesia, investors in high-priority areas are eligible for a 30% reduction in income taxes; further, the withholding tax on dividends is reduced. Thailand provides land ownership and easier work permits to foreign investors. Singapore promotes FDI by not taxing capital gains. South Asia could draw lessons from ASEAN, particularly with respect to reducing the difference in pre- and post-entry treatment of investment sourced in the region.

### Bilateral Investment Treaties Signed by South Asian Countries

With a view to promoting and protecting FDI, South Asian countries have signed bilateral investment treaties (BITs) both within and outside the region (Table 8.1). By 2012, South Asian countries had signed BITs with 105 countries. India signed the largest number of BITs (33), followed by Sri Lanka and Pakistan (23 each). However, only a few of these BITs are intraregional, as the restrictions on outward flows of capital discourage most investors.

As part of the promotion and protection of FDI, BITs generally provide similar treatment to local investment, particularly at the post-entry level. Table 8.2 outlines BIT provisions included in agreements signed by South Asian countries. Major provisions include compensation in case of expropriation of investment and repatriation of investment earnings. The provisions generally exclude their automatic extension in the case of formation of a free trade area or other forms of international agreement. BITs signed between South Asian and Southeast Asian countries have some detailed investment provisions, such as installment payments for compensation and for the transfer of assets (Table 8.3).

Most SAARC members have BITs with developed and advanced developing countries (e.g., the PRC). India has a wide-ranging set of BITs. Despite the numerous BITs, they have had limited impact only on enhancing inward FDI. Nonetheless, BITs have helped to create the impression of improving business environments in SAARC countries.

**Table 8.1: Bilateral Investment Treaties Signed by South Asian Countries**

Country	As of 1980	As of 1985	As of 1990	As of 1995	As of 2000	As of 2011
Bangladesh	1	1	8	8	12	19 (0, 3)
India	0	0	0	1	13	33 (1, 4)
Nepal	0	1	2	3	3	4 (0, 3)
Pakistan	2	4	7	10	15	23 (1, 4)
Sri Lanka	4	13	16	17	20	23 (2, 4)
Afghanistan						3
<b>Total</b>	<b>7</b>	<b>19</b>	<b>33</b>	<b>39</b>	<b>63</b>	<b>105</b>

Notes:

1. Figures in the parentheses indicate the number of bilateral-investment treaties and double-taxation treaties signed in South Asia.

Sources:

Banga, R. 2003. Impact of Government Policies and Investment Agreements on FDI Inflows to Developing Countries: An Empirical Evidence. Working Paper [italics]. No. 116. New Delhi: Global Development Network. <http://www.eldis.org/go/home&id=19501&type=Document#.VQIHgY6UeAV>

Moazzem, K. G. 2013. *Regional Investment Cooperation in South Asia: Policy Issues*. Dhaka: Centre for Policy Dialogue.

**Table 8.2: Intraregional and Interregional Investment Agreements of South Asian Countries**

Major Issues Addressed	Detailed Provisions	Countries under Agreements
Promotion and protection of investment	Each contracting party shall encourage and create favorable conditions for investment in the territory.  Treatment of investment and returns to the contracting parties.	Bangladesh–India, India–Nepal, Pakistan–Sri Lanka, India–People’s Republic of China (PRC), India–Myanmar, India–Indonesia, Indonesia–Pakistan, India–Thailand
National treatment and most favored nation treatment	Equal treatment as per own investors.	Bangladesh–India, India–Nepal, Pakistan–Sri Lanka, India–PRC, India–Myanmar, India–Indonesia, Indonesia–Pakistan, India–Thailand
Exclusion of principles in case of future integration	Provisions of equal treatment are not applicable in case of any future integration (free trade area, customs union, or international agreement).	Bangladesh–India, India–Nepal, Pakistan–Sri Lanka, India–PRC, India–Myanmar, India–Indonesia, Pakistan–Indonesia, India–Thailand
Expropriation of investment	Investment of either contracting party is not to be expropriated except for public purpose according to the law, in which case compensation will be made equal to the market value of investment.  In case of an expropriation of investment of any company of a contracting party, the said can approach for a review by the judicial or administrative authority.	Bangladesh–India, India–Nepal, Pakistan–Sri Lanka, India–PRC, India–Myanmar, India–Indonesia, Indonesia–Pakistan, India–Thailand
Compensation for losses	Losses experienced by an investor in a contracting party in the territory of the other contracting party due to war or armed conflict will be subject to compensation.	Bangladesh–India, India–Nepal, Pakistan–Sri Lanka, India–PRC, India–Myanmar, India–Indonesia, Indonesia–Pakistan, India–Thailand
Repatriation of investment and return	Complete repatriation.  Currency transfer is permitted in the currency of original investment or any other convertible currency at the prevailing market rates of exchange.	Bangladesh–India, India–Nepal, Pakistan–Sri Lanka, India–PRC, India–Myanmar, India–Indonesia, Indonesia–Pakistan, India–Thailand
Applicable law	All investment shall be subject to the law in the territory of the contracting party where the investment has taken place.  The provision precludes the host contracting party from taking action for the protection of its own security and in the case of extreme emergency situations.	India–Nepal, Pakistan–Sri Lanka, India–PRC, India–Myanmar, India–Indonesia, Indonesia–Pakistan, India–Thailand
Application of other rules	If the provisions of laws and regulations of either contracting party, or obligations under international law, contain more favorable provisions for the investor than is provided for by the present agreement, then these rules shall prevail.	Bangladesh–India, India–Nepal, Pakistan–Sri Lanka, India–PRC, India–Myanmar, India–Indonesia, Indonesia–Pakistan, India–Thailand
Dispute settlement between investor and a contracting party	Settlement is on the basis of negotiation between the contracting parties.  In case the dispute is not settled within 6 months, it will be submitted to either (i) judicial, arbitration, or administrative body of the contracting party which has permitted the investment; or (ii) international conciliation under the United Nations Commission on International Trade.	Bangladesh–India, India–Nepal, Pakistan–Sri Lanka, India–PRC, India–Myanmar, India–Indonesia, Indonesia–Pakistan, India–Thailand

*continued on next page*

Table 8.2 continued

Major Issues Addressed	Detailed Provisions	Countries under Agreements
	Arbitration is through the International Centre for Settlement of Investment Disputes, or in accordance with Arbitration Rules of the United Nations Commission on International Trade Law, 1976.	
Dispute settlement between contracting parties	<p>Dispute is to be settled through negotiation.</p> <p>If not settled within 6 months, on the request of either of the contracting parties, the dispute shall be submitted to an arbitration tribunal.</p> <p>Members of the contracting parties and a chair for the tribunal from a third state must be appointed.</p> <p>In case of failure of the above appointment process, the President of the International Court of Justice will make the appointments.</p> <p>The decision of the arbitral tribunal shall be binding on the contracting parties.</p>	Bangladesh–India, India–Nepal, Pakistan–Sri Lanka, India–PRC, India–Myanmar, India–Indonesia, Indonesia–Pakistan, India–Thailand
Subrogation	If either of the contracting parties makes any payment under an indemnity in respect of an investment in the territory of the other party, then the latter party shall recognize the assignment and the former party is entitled by virtue of the subrogation to exercise the rights and enforce the claims of such a party.	Bangladesh–India, India–Nepal, Pakistan–Sri Lanka, India–PRC, India–Myanmar, India–Indonesia, Indonesia–Pakistan, India–Thailand
Entry of personnel	Personnel employed by the companies of the contracting parties shall be permitted to enter and remain in the territory where the investment is made, for the purpose of engaging in activities connected with the investment.	Bangladesh–India, India–Nepal, Pakistan–Sri Lanka, India–PRC, India–Myanmar, India–Indonesia, Indonesia–Pakistan, India–Thailand
Denial of benefits	<p>A contracting party may deny benefits under the agreement to an investor of the other contracting party if the investor is owned by a nonparty and the contracting party does not maintain diplomatic relations with the nonparty.</p> <p>A contracting party may deny the benefits of an agreement to an investor of the other contracting party if the enterprise has no substantial business activities in the country.</p>	Bangladesh–India, India–Nepal, Pakistan–Sri Lanka, India–PRC, India–Myanmar, India–Indonesia, Indonesia–Pakistan, India–Thailand

Note: The agreements are Bangladesh–India (2008), India–Nepal (2011), Pakistan–Sri Lanka (1997), India–PRC (2006), India–Myanmar (2008), India–Indonesia (1999), Indonesia–Pakistan (1996), and India–Thailand (2000).

Source: Authors' compilation based on the Bilaterals.org. Bilateral Agreements. <http://www.bilaterals.org/>

The BITs signed among South Asian countries since the 1990s provide policy support for regional investment. However, restrictions by most countries on the outward flow of capital have meant that the policy supports have not been effective in prompting intraregional investment. In contrast, BITs signed with ASEAN countries have more fully incorporated the interests of the private sector (provisions for consultation, compensation, and transfer of funds), and have been more effective in promoting interregional foreign investment (Table 8.3).

**Table 8.3: Provisions Incorporated in Agreements between South Asia and ASEAN Countries**

Issues	Detail on Provisions under the Issues	Countries under Agreements
Consultation	The representatives of the contracting parties shall hold meetings from time to time to review implementation of the agreement, exchange legal information, resolve disputes, etc.	Bangladesh–Philippines (1997), India–Indonesia, (1999), Indonesia–Pakistan (1996)
Payment of compensation in installments	In the case of a large amount of compensation, payment may be made in installments.	Bangladesh–Thailand (1988)
Modification of agreement	The agreement may be amended by mutual consent of both contracting parties at any time.	India and 16 other countries (1995) (Australia, Austria, Belgium, Bulgaria, Egypt, France, Kyrgyz Republic, Malaysia, Morocco, Oman, Philippines, Qatar, Romania, Switzerland, Uzbekistan, Viet Nam)
Transfers	Funds necessary for the (i) acquisition of raw and auxiliary materials, and semi-fabricated or finished products; (ii) replacement of capital assets; and (iii) development of capital.	Indonesia–Pakistan (1996)

Source: Authors' compilation based on the Bilaterals.org. Bilateral Agreements. <http://www.bilaterals.org/>

Most South Asian countries have double taxation treaties included in or alongside their BITs. Various other agreements have been signed to facilitate foreign investment, including those with the Multilateral Investment Guarantee Agency, the International Centre for Settlement of Investment Disputes, the World Intellectual Property Organization, and the Overseas Private Investment Corporation (Table 8.4). India has notified its concurrence with the SAARC Limited Multilateral Agreement on Avoidance of Double Taxation and Mutual Administrative Assistance in Tax Matters. The agreement is applicable to Bangladesh, Bhutan, the Maldives, Nepal, Pakistan, and Sri Lanka. Once adopted, the SAARC Investment Promotion and Protection Agreement will be an additional measure for regional cooperation in economic and financial matters. However, South Asian countries should draw lessons from the ASEAN Comprehensive Investment Agreement (ACIA) regarding provisions for promoting and facilitating investment.

**Table 8.4: Various Multilateral Investment-Related Treaties Signed by South Asian Countries**

Name of the Investment Treaties	Member Countries
Multilateral Investment Guarantee Agency	Afghanistan, Bangladesh, India, the Maldives, Nepal, Pakistan, Sri Lanka
International Centre for Settlement of Investment Disputes	Afghanistan, Bangladesh, Pakistan, Sri Lanka
World Intellectual Property Organization	Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, Sri Lanka
Overseas Private Investment Corporation	Afghanistan, Bangladesh, India, the Maldives, Nepal, Pakistan, Sri Lanka

Source: Compiled by the authors based on web documents.

The ACIA emphasizes investment promotion and facilitation to enhance and deepen regional integration. Harmonization of investment policies has been advanced through capacity building, and the dispute settlement procedure is well defined. Compared with the South Asian Free Trade Area (SAFTA) agreement, the provisional articles of the ACIA with regard to conciliation, arbitration, and consultation are detailed and transparent.

In light of the ACIA, SAARC members should strengthen the human and other resource capacity factors necessary for the promotion and facilitation of investment.

## Investment Cooperation in South Asia under the SAARC Agreement on Trade in Services

Service sector investment through commercial presence is a major component of cross-border investment. Increased FDI in the service sector has been experienced in the South Asian countries following increasing liberalization of the sector (Raihan 2008). The telecommunication and finance sectors are now open to foreign investment in India, Pakistan, and Sri Lanka. FDI is allowed in hotel management services in Bangladesh, and in insurance, telecommunication, and hotel services in Nepal. FDI is concentrated in the business services, retail, health, banking, consulting, and telecommunication sectors in Sri Lanka.

Commitments of South Asian countries under the WTO negotiations process vary considerably. A total of 10 service sectors are to be opened: accounting and auditing, maritime transport, management consultancy, financing, computer and software, education, audio–video, construction consultancy, data or technical testing, and courier services.<sup>1</sup> Nepal has committed to liberalize 11 service sectors, while Sri Lanka has only committed to opening two sectors—tourism and travel services. Pakistan has extensively liberalized market in the services sector, in combination with strong domestic regulatory frameworks (Paracha 2008). Recognizing the significance of liberalizing trade and investment in the service sector, negotiations by SAARC members have addressed issues such as market access, progressive liberalization, domestic regulations, recognition, dispute settlement, safeguard measures, and monopoly practices (Table 8.5).

In contrast to SAARC members, ASEAN members have long recognized the significance of intraregional economic cooperation for enhancing trade and investment in the service sector. The ASEAN Framework Agreement on Services (AFAS) was signed in 1995, based on the provisions of the General Agreement on Trade in Services (GATS).<sup>2</sup> Following liberalization of the service sector in the region, FDI in the sector increased sharply. The establishment of the Coordinating Committee on Services and the Coordinating Committee on Investment facilitates negotiations among ASEAN Economic Ministers on issues related to further liberalization of the service sector.<sup>3</sup> A total of 11 sectors

<sup>1</sup> India has been receiving offers from many developed countries in telecommunication, finance, education, and environmental services (under mode 3).

<sup>2</sup> For an assessment of the AFAS, see Thanh, V. T, and Bartlett, P. 2006. *Ten Years of ASEAN Framework Agreement on Services (AFAS): An Assessment*. Jakarta: Association of Southeast Asian Nations.

<sup>3</sup> The liberalization process is subject to the provisions of the ASEAN Investment Area.

**Table 8.5: Major Provisions of the SAARC Agreement on Trade in Services**

Issues	Details
Market access	In sectors where market access commitment has been made, the measures, which a contracting state shall not adopt, are the following: (i) limitation on the number of service suppliers, (ii) limitation on the total number of service operations, (iii) limitation on the total number of natural persons that may be employed in a particular service sector, and (iv) measures that restrict access.
Progressive liberalization	The schedules under the Agreement shall be reviewed after every 3 years, or earlier if mandated by the SAFTA Ministerial Council.
Domestic regulations	Ensuring that domestic regulations and measures relating to qualification requirements and procedures, technical standards, and licensing requirements do not create unnecessary barriers to trade in services. Hence, the contracting states shall jointly review the results of the negotiations on disciplines on these measures, pursuant to Article VI.4 of the WTO GATS.
Recognition	A contracting state shall recognize the education or experience obtained, requirements met, or licenses or certifications granted in the other contracting state.
Settlement of dispute	For the purposes of this Agreement, the mechanisms available as per Articles 19 (consultations) and 20 (dispute settlement mechanism) of the Agreement on SAFTA would be applicable and enforced through Article 27 (institutional mechanism) of this agreement.
Existing monopolies or exclusive service suppliers	Each contracting state shall ensure that monopolies in its territory do not act inconsistently with the schedule of specific commitments of the other contracting state. If any inconsistency is observed, then the contracting state may request the other contracting state to authorize its monopoly supplier to provide specific information on the inconsistent activity.
Business practices	The contracting states recognize that certain business practices of service suppliers, other than those falling under Article 13 of the Agreement, may restrain competition and thereby restrict trade in services.
Safeguard measures	The contracting states note the multilateral negotiations pursuant to Article X of the GATS on the question of emergency safeguard measures based on the principle of nondiscrimination.
Subsidies	The agreement shall not apply to subsidies or grants provided by a contracting state. If such subsidies or grants significantly affect trade in services committed under this Agreement, any contracting state may request for consultations. Contracting states shall, when requested, provide information on subsidies related to trade in services.
Balance of payments	In case of any serious balance of payments and external financial difficulties, a contracting state may adopt or maintain restrictions on trade in services with respect to the provisions of National Treatment principle (Article 5) and Market Access principles (Article 6) under the Agreement, subject to conditions.
Transparency	Contracting states need to publish all relevant measures affecting trade in service.
Required cooperation	<ul style="list-style-type: none"> <li>• Cooperation from the following are required:</li> <li>• (i) regulatory bodies,</li> <li>• (ii) relevant national authorities and stakeholders,</li> <li>• (ii) statistics departments, and</li> <li>• (iv) WTO GATS negotiations.</li> </ul>
Exceptions	A contracting state may adopt measures to (i) protect public morals and human, animal, or plant life; (ii) prevent deceptive and fraudulent practices; and (iii) protect the privacy of individuals and confidentiality of individual accounts.

GATS = General Agreement on Trade in Services, SAFTA = South Asian Free Trade Area, WTO = World Trade Organization.

Source: SAARC. Agreement on Trade in Services (SATIS). [http://saarc-sec.org/uploads/document/SAARC%20Agreement%20on%20Trade%20in%20Services%20%28signed%29\\_20121011091030.pdf](http://saarc-sec.org/uploads/document/SAARC%20Agreement%20on%20Trade%20in%20Services%20%28signed%29_20121011091030.pdf)

are targeted: air transport, business services, construction, distribution, education, environment, financial services, health care, telecommunications, transport, and tourism. Further, mutual recognition agreements for licensing, authorization, and certification of professional service providers facilitate trade in services in the ASEAN region.

Under Article 1a, AFAS provides for investment cooperation in services within the region, particularly with regard to production capacity and the supply and distribution of service suppliers within and outside the region. The areas identified for further strengthening among member countries include infrastructure facilities, marketing and purchasing arrangements, research and development (R&D), and exchange of information.

Similarly, SATIS has incorporated some well-defined measures, including development of regulatory authority and cooperation in the collection and exchange of statistical information. AFAS provides for a specific dispute-settlement mechanism, which should be incorporated in SATIS.

The gradual removal of restrictions on trade in services is a distinct feature of the ASEAN Economic Community Blueprint. Another feature is the sector-specific liberalization process. Liberalization in the trade of professional services is another feature of the blueprint, notably for architectural services, accountancy services, and medical and dental practitioners. Provision for mutual recognition agreements for these services has been incorporated in the blueprint.<sup>4</sup> In contrast, liberalization provisions under SATIS are largely based on a positive-list approach.

## Initiatives for Investment Cooperation under the Framework of SAARC

During the 1980s and early 1990s, SAARC initiatives for the promotion of FDI were limited due to the relatively low levels of global FDI at that time. Also, during that period, most SAARC members had not opened their economies, and outward transfers of capital were not allowed. However, with the rise in global FDI in the late 1990s, SAARC members, as indicated in the SAARC Summit Declaration in 1997, began urging developed countries to invest in South Asia (see Annex 1 for SAARC Declarations).

SAARC initiatives for the promotion of trade-led intraregional FDI include the SAARC Preferential Trading Arrangement (SAPTA) in 1995 and SAFTA in 2006. There was no broad discussion at the time on the promotion of investment. Discussion of regional investment cooperation focused on preparation of an agreement for the promotion and protection of intraregional investment.

The major objective of the agreement is to ensure equal treatment of investors in SAARC member countries, without restriction, quotas, and marketing limitations. To promote cross-border trade and investment, the products of such investments will not be included in the sensitive lists. However, the draft agreement has been pending approval since 2007.

<sup>4</sup> Unlike SATIS, the BITs among the South Asian countries have not been able to address issues related to service sector cooperation and the gradual liberalization process.

During the 17th SAARC Summit, held in the Maldives in 2011, fast-tracking of the regional investment agreement was called for, along with the creation of regional production chains to deepen intraregional links.

SAARC initiatives for the promotion of intraregional investment need to take into account some features of the region. First, FDI in South Asia is mainly targeted toward local markets, particularly domestic market-oriented manufacturing and services-related industries. Thus, intraregional trade has relatively limited implications for the promotion of intraregional FDI. Second, South Asia is part of global production networks linked with countries outside the region. Thus, promotion of an extensive regional production network is attractive to foreign investors, including those in the region. Third, foreign investors from outside the region dominate FDI in most SAARC countries; promotion of interregional investment should be considered equally, or at least should not be adversely affected by regional measures. Fourth, with the rise of global FDI, South Asian countries need to further relax their capital accounts, including interregional capital flows. During the 2011 SAARC Summit, the regional flow of financial capital was stressed, along with the promotion and protection of investment. Thus, there is scope for taking initiatives in South Asia beyond the traditional framework of regional investment cooperation. The institutional framework for investment should cater to the multidimensional aspects of investment cooperation, both within and outside South Asia.

There is a SAARC Subgroup on Investment and Arbitration which has held eight meetings to consider Draft Investment Agreement. The Eighth Meeting of the Subgroup was held at the SAARC Secretariat, Kathmandu on 7-8 August 2014.

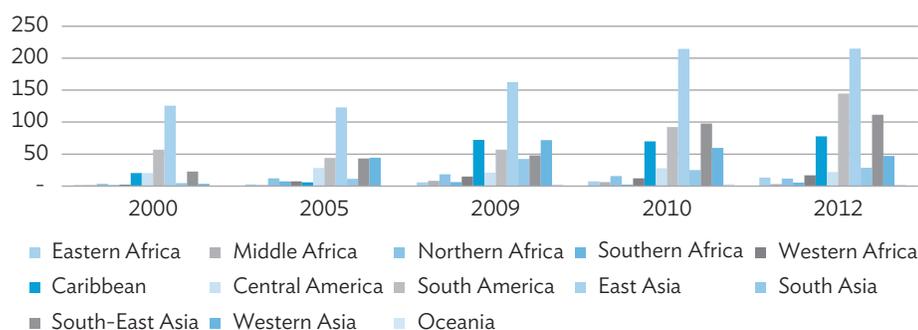
## Trends and Pattern of Foreign Direct Investment in South Asia

### Flow and Stock of Foreign Direct Investment in South Asia

Despite South Asia's liberalized FDI regime, the inward flow of FDI in South Asia remains one of the lowest among developing regions (Figure 8.1). In terms of attracting FDI, South Asia ranked sixth of the 13 developing regions for attracting FDI, whereas East Asia is in the top position followed by South America and South East Asia. In 2012, FDI inflow to South Asia amounted to \$28.6 billion, representing just over 2% of global FDI inflows. By comparison, FDI inflows to Southeast Asia amounted to \$111.3 billion in the same year, or more than 8% of global FDI.

Still, South Asia's FDI position has improved since 2000, when it accounted for less than 1% of global FDI. The liberalized investment policies and opening up of the economies have made South Asia a more attractive host for investors. South Asia's total FDI stock was \$269.3 billion in 2012, or 1.2% of the global total.

**Figure 8.1: Foreign Direct Investment Inflows to Developing Economies, 2000–2012 (\$ billion)**



Source: UNCTAD. Online statistics database. <http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx> (accessed 19 December 2013)

### Destination of Foreign Direct Investment in the Region

FDI to South Asia is largely destined for India, and increasingly so since 2000 (Table 8.7). Of the \$28.6 billion of FDI to South Asia in 2012, about \$25.5 billion, or 89%, was to India. The second highest recipient of FDI was Bangladesh, which received \$990 million, or 3.5% of the total to South Asia (compared with 12.4% in 2000). Pakistan, which was once a major FDI recipient but now experiencing political unrest and serious infrastructure deficiencies, received only \$847 million FDI in 2012 (compared with \$2.2 billion in 2005). Most South Asian countries continue to be relatively unattractive locations for FDI. Investment cooperation under SAARC auspices will need to take this imbalance into account.

FDI to South Asia dropped 28.53% in 2012 (Table 8.6) as a result of sharp declines in both cross-border merger & acquisition (M&A) and greenfield investment (UN 2013). Major South Asian economies participated in this sharp decline: Pakistan 36%, India 29%, Sri

**Table 8.6: Foreign Direct Investment Inflows to South Asia**

Country	FDI Inflow (\$ million)					Share of FDI (%)				
	2000	2005	2010	2011	2012	2000	2005	2010	2011	2012
Afghanistan	0	271	211	83	94	0.0	2.4	0.8	0.2	0.3
Bangladesh	579	845	913	1,136	990	12.4	7.5	3.6	2.8	3.5
Bhutan	...	6	26	10	16	...	0.1	0.0	0.1	0.1
India	3,588	7,622	21,125	36,190	25,543	76.8	67.5	84.2	90.3	89.2
Maldives	22	73	216	256	284	0.5	0.6	0.9	0.6	1.0
Nepal	0	2	87	95	92	0.0	0.0	0.3	0.2	0.3
Pakistan	309	2,201	2,022	1,327	847	6.6	19.5	8.1	3.3	3.0
Sri Lanka	173	272	478	981	776	3.7	2.4	1.9	2.4	2.7
Total	4,671	11,292	25,078	40,078	28,642	100.0	100.0	100.0	100.0	100.0

... = no data, FDI = foreign direct investment.

Source: UNCTAD. Online statistics database. <http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx> (accessed 19 December 2013).

**Table 8.7: Foreign Direct Investment Stock in South Asia, 2000–2012,**  
(\$ million)

Countries	Foreign Direct Investment Stock				
	2000	2005	2010	2011	2012
Afghanistan	17	584	1,392	1,475	1,569
Bangladesh	2,162	3,537	6,343	6,166	7,156
Bhutan	4	22	23	7	23
India	16,339	43,202	205,580	206,435	226,345
Maldives	128	331	1,114	1,371	1,655
Nepal	72	127	253	348	440
Pakistan	6,919	10,209	19,828	20,916	25,395
Sri Lanka	1,596	2,447	5,008	5,990	6,765
Total (South Asia)	27,237	60,458	239,540	242,706	269,347
World	7,511,311	11,673,845	20,380,267	20,873,498	22,812,680
Share of world (%)	0.36	0.52	1.18	1.16	1.18

Source: UNCTAD. Online statistics database. <http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx> (accessed 19 December 2013).

Lanka 21%, and Bangladesh 13%. Indian's economy experienced a high inflation rate and its slowest growth in a decade, resulting in reduced investor confidence (UN 2013).

Most SAARC members have not yet developed a sizable stock of FDI (Table 8.7). Bhutan's FDI stock at the end of 2012 was only \$23 million, Nepal's was \$440 million, Afghanistan's was \$1.6 billion, and the Maldives' was \$1.7 billion. In part, these low figures simply reflect the small size of the economies. The Maldives, as the smallest country in the region, ranks highest in terms of FDI as percentage of gross domestic product (GDP), followed by Afghanistan, Pakistan, and India. The FDI–GDP ratios of Bangladesh, Bhutan, and Sri Lanka are below the 2000–2012 average for the region. Nepal had the lowest FDI–GDP ratio, with an average of 0.15 during the same period (UN 2013). The poor domestic business environment and limited scope for investment and regional integration resulted in low levels of FDI in some destinations. In addition, obstacles at the borders and behind-the-border also impede investment flow in these countries (Kumar and Singh 2009).

### Sources of Foreign Direct Investment in South Asia

Most FDI in South Asia originates from outside the region, especially for Bangladesh, India, Pakistan, and Sri Lanka (Table 8.8). Intraregional sources, on the other hand, are important for Afghanistan, Bhutan, and Nepal. Although most FDI is from developed countries, the volume and share of FDI from developing countries has been increasing since 2005; some 45 developing countries were FDI sources for South Asia during this period (World Bank 2013). For India, most FDI is from the European Union (EU), Japan, the Republic of Korea, and the United States (US). For Bangladesh, the main sources are the People's Republic of China (PRC), the EU, India, and the US, in that order. FDI to Pakistan is dominated by the Middle East countries. The Maldives has a diverse range of sources, including the PRC, the EU, India, Thailand, and the US. The PRC has invested extensively in mining in Afghanistan, renewable energy in Nepal, and transport in Sri Lanka (UNCTAD 2013). SAARC-based

**Table 8.8: Sources of Foreign Direct Investment Stock: Within and Outside the Region, 2012**

Source of FDI	Bangladesh	Bhutan	India	Nepal	Pakistan
Volume (\$ million)					
From World	8,063	132	218,134	506	17,726
From South Asia	571	44	33	171	2
Outside South Asia	7,492	88	218,101	336	17,724
Share (%)					
From South Asia	7.08	33.33	0.02	33.79	0.01
Outside South Asia	92.92	66.67	99.98	66.40	99.99

FDI = foreign direct investment.

Source: UNCTAD. Online statistics database. <http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx> (accessed 19 December 2013)

investment cooperation will need to take account of both intraregional and extraregional FDI sources.

### Intraregional Foreign Direct Investment Flows and Stock

Intraregional FDI accounts for only a small share of total FDI to South Asia (less than 5%). Following the liberalization reforms, share of FDI has been increasing. India was the dominant investor within the region during 2006–2010 (Table 8.9). During 2010, some 44% of FDI to Nepal was from India, and most of it was in the service sector. As shown in the table, Bangladesh and Sri Lanka have experienced sharp increases in the share of FDI originating from within South Asia, especially from India. In the case of India, however, less than 1% of its total FDI originates from other SAARC member countries. In turn, India's growing outward investment is mainly targeted to developed countries to enable its

**Table 8.9: Intraregional Inward Foreign Direct Investment to SAARC Countries**  
(% of total inward foreign direct investment)

Investment from:	India		Bangladesh		Nepal		Sri Lanka	
	2007–2008	2009–2010	2006	2010	2008–2009	2009–2010	2009	2010
India	..	..	0.50	15.00	43.70	43.90	19.30	28.70
Sri Lanka	0.50	0.30	0.00	0.40	0.00	0.00	..	..
Nepal	0.00	0.10	0.00	0.00	..	..	0.00	0.03
Maldives	0.02	0.10	0.00	0.00	0.00	0.00	0.07	0.37
Bangladesh	0.00	0.00	0.00	0.00	0.50	1.10	0.00	0.00
Pakistan	0.00	0.00	0.20	0.00	0.04	0.00	0.00	0.00
Bhutan	0.60	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Share of South Asia	1.10	0.50	0.70	15.40	44.30	45.00	19.40	29.13

.. = no data available, SAARC = South Asian Association for Regional Cooperation.

Source: Kanungo, A. K. 2012. *FDI Inflows into South Asia: A Case Study of India's Investments in Bangladesh*. <http://ssrn.com/abstract=2140737> or <http://dx.doi.org/10.2139/ssrn.2140737>

Kumar, R, and M. Singh. 2009. *India's Role in South Asia Trade*. ADB Working Paper Series No 32, Manila: Asian Development Bank.

multinational corporations to build on global value chains (Kanungo 2012). Only a small share of India's outward FDI is targeted to the region because of the limited investment opportunities.

India is by far the largest regional investor in Bangladesh, followed by Pakistan and Sri Lanka. India's major investments in Bangladesh include chemical manufacturing, building and construction materials, industrial machinery, and consumer products. Indian banks and health care providers have been established in Bangladesh (World Bank 2013c). Recently, a Bangladeshi group made an investment in food processing in India. This is the first of its kind since India withdrew its restrictions on Bangladeshi investment.

India is one of the largest investors in Sri Lanka, especially in energy business. The increased flow of investment from India to Sri Lanka followed the increased investor confidence as a result of the India–Sri Lanka Free Trade Agreement (FTA) (Kelegama 2014). Also, the liberal yet strong regulatory regime of Sri Lanka became a pull factor for Indian investors (Kanungo 2012). In turn, Sri Lankan apparel producers have set up apparel manufacturing parks in India.

India has made large investments in the energy sectors of Bhutan and Nepal. The Government of India has agreed to develop 10,000 megawatts of hydropower in Bhutan, with the surplus power to be exported to India by 2020. India is Nepal's main trading partner and the source of most of Nepal's foreign capital (World Bank 2013c). Pakistan's energy sector has attracted investors from the PRC, the EU, and the US.

A major feature of intraregional investment is that it is led by Indian investment. Taking advantage of an open capital account, Indian investors are increasingly investing abroad including South Asia. This trend is not common for most of the South Asian countries. An important reason for the low level of intraregional investment is the restrictions on bilateral investment between India and Pakistan. The positive impact of the decision on investment and trade between the two countries is subject to easing of the visa process, sustaining mutual trust, and improving border trade facilities.

The insignificant degree of cross-border investment within South Asia is attributable to the overall regulatory restrictions on FDI, specific restrictions on doing business with other countries in the region, and weak institutions for protecting foreign investors. Safeguard measures taken by some countries to protect domestic industries indicate limited interest in welcoming regional investment (Alam and Aowrangazab 2005). Tariff and nontariff trade barriers, such as standardization and certification processes, subsidies on agricultural products, and different customs rules and regulations, also discourage intraregional investment in South Asia. One of the preconditions for attracting FDI is adequate infrastructure, which—except for India—SAARC members have not been able to provide. Corruption, bureaucratic delays, and property disputes create a sense of uncertainty for investors. Lack of cross-border facilities, such as transport and communications infrastructure, and the absence of effective banking networks, further discourage investment within the region.

### Sector Composition of Foreign Direct Investment

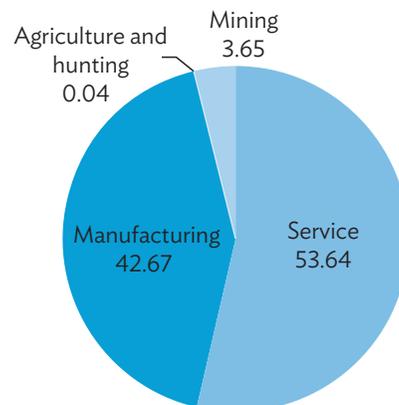
FDI in South Asia is predominantly market-seeking. Manufacturing investment in India and Pakistan is mainly in domestic market-seeking industries. In contrast, Sri Lankan investment is concentrated on the export-oriented textile and clothing sector. Service sectors, such as telecommunications, energy, and finance, received considerable shares of FDI in recent years (Raihan 2013). In 2011, FDI in the service sector accounted for 53.64% of total FDI in the region, whereas manufacturing accounted for 42.67%, mining 3.65%, and agriculture 0.04% (Figure 8.2). This underscores the importance of the service sector in the region and of accelerating trade and investment in services within and outside the region.

Afghanistan attracts FDI in its mineral extraction and transport and logistics industries. Bhutan and Nepal offer investment opportunities in hydropower.

India dominates FDI, with much of the inflow to the service sector, including banking and insurance, R&D, and outsourcing. In 2011, the service sector (business, finance, miscellaneous services, and R&D) accounted for 18.8% of total FDI to India, followed by drugs and pharmaceuticals (11.4%), telecommunications (8.2%), construction (6.7%), and automobiles (3.1%). The telecommunication sector, particularly telephone services, is a rapidly growing FDI destination for India. Computer software and hardware businesses are also attracting many foreign investors.

Like India, FDI to Bangladesh is concentrated in the service sector, followed by the textile and petroleum sectors. During 2005–2010, the telecommunication sector attracted the largest amount of FDI but this dropped sharply in 2011. FDI in the textile sector has increased gradually since 2004, because of Bangladesh's comparative advantage in low labor costs; in 2011, investment in the sector accounted for 30% of total FDI. The power sector has also been of growing interest for foreign investors, reflecting favorable government policies and facilities, and incentives such as tax exemptions and easier access to finance. In Pakistan, oil and gas exploration is now the main focus for FDI.

**Figure 8.2: Sector Distribution of South Asia Foreign Direct Investment, 2011 (%)**



Source: IMF. Coordinated Direct Investment Survey (CDIS). <http://www.imf.org/external/np/sta/cdis/> (accessed 1 March 2014).

FDI to Sri Lanka is increasingly directed to the service sector. Post-conflict foreign investment has been directed to business services, retail, the health sector, banking, and consulting. The telecommunication and power sectors were leading FDI destinations in 2009. Since then there has been a shift to manufacturing and services. The hotel and restaurant sector accounted for 20% of total FDI to the country in 2011.<sup>5</sup> FDI to Sri Lanka was a record high in 2011, indicating growing investor confidence in the country. The Maldives has experienced rapid growth of FDI in the hotel and real estate sector, mainly associated with international hotel and resort chains.<sup>6</sup>

As noted earlier, most FDI in South Asia from outside the region is not vertical in nature. South Asian countries have yet to attract FDI directed to the development of regional value chains. Bangladesh, India, Pakistan, and Sri Lanka are important participants in the global apparel sector, and investment in this sector could be expanded. Joint-venture initiatives among these countries would add value, enhance productivity, and reduce the cost of production.

A major constraint to intraregional investment among SAARC members is the limited knowledge about investment opportunities in the sectors of interest. Intraregional investment requires country-specific knowledge about sectors, markets, and financial conditions (Moazzem 2005, Aggarwal 2008). Moreover, regulatory regimes in the member countries impose sector-specific conditions on investment. Potential investors need to gather knowledge on regulatory aspects applicable to sectors of interest in each country. Table 8.10 identifies some priority industries for investment in South Asian countries.

**Table 8.10: Priority Sectors for Investment in South Asian Countries**

Countries	Potential Sectors for Investment
Bangladesh	Textiles, electronics, IT, natural gas-based industries, frozen foods, leather, ceramics, light engineering, and agro-based production
Bhutan	Hydropower, agro-processing, tourism, and medicinal plants
India	Power, renewable energy, infrastructure, aerospace and defense, automotive, banking, biotechnology, IT, insurance, real estate, retail, telecommunications, textile and apparel, and health care
Maldives	Marine-based industries, tourism, infrastructure, and air and sea transport
Nepal	Medicinal and aromatic plants, agriculture-based (mushroom, spices, vegetables, fruits), dairy, tea, sericulture, hydropower, leather, poultry, and textiles
Pakistan	Value-added export industries: garments, bed linens, surgical instruments, sporting goods, and high-technology and IT industries—chip manufacturing, software development, and precision equipment manufacturing Others: tourism, housing, engineering, chemicals, and construction
Sri Lanka	Electronics, light engineering, textiles, rubber, mineral and processing, tourism, IT, gems and jewelry, health care and pharmaceuticals, ceramics, and services

Note: The sectors identified as investment potentials in Bangladesh, Bhutan, the Maldives, Nepal, Pakistan, and Sri Lanka have been compiled from FDI promotion agencies of each country.

Source: Aggarwal, A. 2008. Regional Economic Integration and FDI in South Asia: Prospects and Problems [italics]. Working Paper. No. 128. New Delhi: Indian Council for Research on International Economic Relations. [http://www.eaber.org/sites/default/files/documents/ICRIER\\_Aggarwal\\_2008.pdf](http://www.eaber.org/sites/default/files/documents/ICRIER_Aggarwal_2008.pdf)

<sup>5</sup> Key FDI projects in this sector are the investments of the Shangri-La hotel chain and the Sheraton Group.

<sup>6</sup> Examples include the Four Seasons (US) and Centara (Thailand).

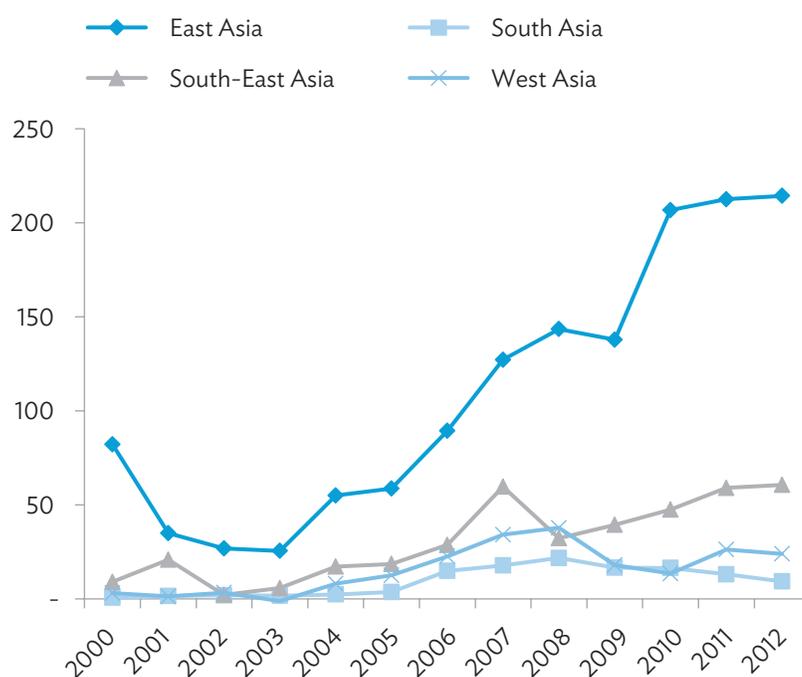
## Outward Foreign Direct Investment from South Asia: Trends and Patterns

Outward FDI from South Asian countries is still very limited, mainly because of restrictions on investment and the movement of capital. Nonetheless, it amounted to \$8.8 billion in 2012, compared with only \$529 million in 2000. Despite this increase, South Asia's share of outward FDI in 2012 was less than 1% of the world total (Figure 8.3); East Asia (the PRC, Japan, and the Republic of Korea) are the largest source of outward FDI in Asia.

As noted earlier, India has been a major overseas investor. In 2012, its outward investment totaled \$8.6 billion, which was about 98% of the total outflow of FDI from the region. The FDI outflow from other SAARC members was insignificant: \$53 million from Bangladesh, \$73 million from Pakistan, and \$80 million from Sri Lanka. Afghanistan, Bhutan, the Maldives, and Nepal recorded almost no FDI outflow.

India's emergence as a global investor has resulted from the easing of foreign exchange restrictions on overseas capital transfers and the liberalization of outward FDI. India has become one of the top five sources of FDI in Asia (Banga 2003, Kanungo 2012). Overseas investment liberalization by India has included the following steps: allowing entities to invest abroad up to 200% of their net worth, enabling mutual funds to invest overseas, and

**Figure 8.3: Trends of Foreign Direct Investment Outflows, 2000–2012**  
(\$ billion)



Source: UNCTAD. Online statistics database. <http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx> (accessed 19 December 2013).

facilitating exporters to invest globally (Kanungo 2012). Indian investment experience in South Asia has been mostly horizontal, but investors have been looking for vertical export-oriented investment opportunities in South Asia, especially in Bangladesh and Sri Lanka (Kanungo 2012).

India's multinational corporations are competing successfully in developed markets. India's outward FDI has been motivated by market size considerations and the need for multinational corporations to have access to strategic technologies critical to improving their global competitiveness (ADB 2009). Due to the rising demand for oil, gas, and minerals to support industrialization and urbanization, India's outward FDI has included overseas extractive industries.

## Domestic Regulatory Aspects: Barriers and Suggested Measures

### Issues Related to Foreign Direct Investment in Trade and Industrial Policy

FDI regimes in most South Asian countries are related to trade policies and industry considerations, including for small and medium-sized enterprises (SMEs), providing strategic direction in production, exports, imports, and investment. Nepal, under the Industrial Policy, 2009, gives priority to carpets and woolen goods, pashmina and silk products, handicraft goods, tea, wooden craft products, processed leather, coffee, vegetables, and spices. Nepal provides these industries with fiscal, monetary, and other forms of support. India's Foreign Trade Policy, 2009–2014 provides specialized support for agriculture and village industry, handlooms, handicrafts, gems and jewelry, leather and footwear, marine services, electronics and information technology (IT), sports goods, and toy manufacturing. Investment in these industries has been promoted by duty-free import provisions, special development funds, and other fiscal incentives. Bangladesh's Export Policy, 2012–2015 promotes 12 “booster sectors,” which include fruits and vegetables, SMEs, ready-made garments (RMG), frozen fish, handicrafts, tea, jute, and leather. Similarly, Bangladesh's Industrial Policy, 2010 identified 32 “thrust sectors” designed to advance industrialization.<sup>7</sup> Priority sectors for Sri Lanka include fabrics, pharmaceuticals, milk powder, cement, agriculture, manufacturing, and SMEs, all of which are eligible for various kinds of fiscal support (especially tax exemptions). Pakistan's Strategic Trade Policy Framework, 2009–2012 identifies SMEs, textiles and clothing, leather, pharmaceuticals, agro-processing, dairy, and light engineering and machinery as priority sectors, providing various forms of fiscal (tax reduction), monetary (financing), nonfiscal (warehouse facilities), and other (training) support measures. The preferential sectors of South Asian countries are in many respects similar, and this should be taken into account when negotiating regional investment cooperation.

<sup>7</sup> These industries include agro-based and agro-processing; human resource export; ship building; renewable energy (solar and wind); tourism; basic chemicals/dye; information and communication technology (ICT) and ICT-based services; readymade garments; active pharmaceuticals ingredients and radio pharmaceuticals; herbal medicinal plant; radio-active (diffusion) application (e.g., developing quality of decaying polymer, preservation of food, disinfecting medicinal equipment); development of polymers; jute and jute products; leather and leather products; hospital and clinics; light engineering; plastics; furniture; handicrafts; energy-efficient appliances; manufacturing of electronic goods; development of electronic materials; frozen fish; tea; home textiles; ceramics; tissue grafting and biotechnology; jewelry; toys; container service; warehouse; innovative and import substitute; cosmetics and toiletries; and light engineering.

### Regional Value Chains and Investment Promotion

There is scope for vertical integration among complementary sectors. Least-developed countries (LDCs) of different regions have long been left out of global value chains, due to the low-technology and labor-intensive nature of their industries. South Asian countries have not been able to establish strong regional value chains, even though they could be an important foundation for entering global value chains. Based on their comparative advantages (e.g., low factor prices), multinational corporations could invest in complementary products in low-cost locations in the region.

South Asian countries generally have lagged ASEAN countries, particularly Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam, in integrating with global and regional value chains. This is reflected in the low foreign value added in the gross exports of South Asian countries (Banga 2014).<sup>8</sup> The difficulty of measuring value added by a trading country from entering regional or global value chains has led to insufficient attention to this type of integration. However, measuring such gains would help reshape the industrial and FDI policies of SAARC members. SAARC investment agreements should include provisions to attract interregional FDI, thereby accelerating links with global value chains.

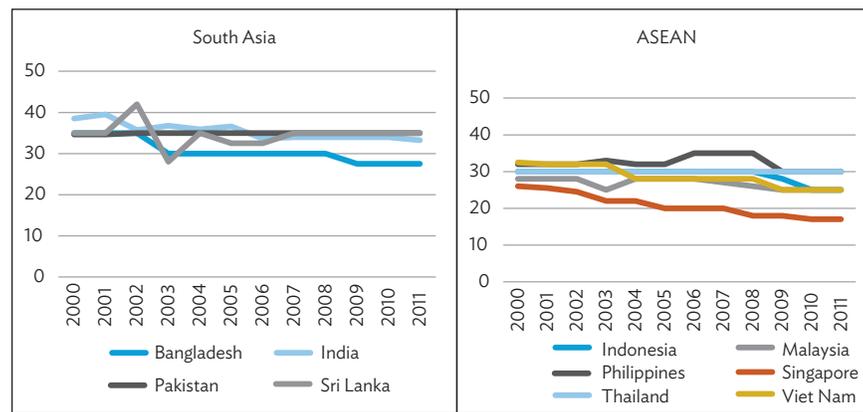
Integration with global value chains could be led by brand-name companies, with their well-known trademarks drawing participation by independent suppliers in other SAARC member countries. Value-added activities under a regional or global value chain often are founded on upstream activities, such as R&D (WIPO 2013). These activities are performed comparatively better by some member countries; hence the upstream and downstream activities within a production process should be distributed within the region according to competitive or comparative strengths. The branded companies could be expected to take the lead in marketing and other activities critical to integrating with global networks. Such networks have recently developed in South Asia. Among these are big manufacturing companies such as the Tata Group and Arvind Mills in India, and Brandix, a Sri Lankan apparel company.

### Tariff and Nontariff Measures

Regional trade takes place under tariff structures set out in bilateral and regional trade agreements. The South Asian Free Trade Area (SAFTA) is the main regional trade agreement, providing preferential tariffs for products originating in the region, except for products on the members' sensitive lists. Despite repeated reductions in the sensitive lists, the number of products included is still large. Unless there is significant pruning of the lists, it will be difficult to develop regional value chains across different sectors (Moazzem, Kishore and Sehrin 2013.). However, LDCs, including Afghanistan, Bangladesh, Bhutan, Maldives, and Nepal, enjoy duty-free market access to India for most of their products. Preferential tariffs under the India–Sri Lanka FTA have strongly stimulated trade between the two countries. As part of establishing an economic union, harmonization of the tariff structure will be required, together with significant reduction in the sensitive lists.

<sup>8</sup> Foreign value added refers to the total value added created in other countries used in production and exported by the reporting country (Banga 2013). It is measured by subtracting the value of output from the value of input. India's share was 24% in 2008 compared with 42% in the Philippines, 40% in Viet Nam, and 38% both in Malaysia and Thailand (Banga 2013).

**Figure 8.4: Corporate Tax Rates in South Asian and ASEAN Countries, 2000–2011 (%)**



ASEAN = Association of Southeast Asian Nations.

Source: KPMG. Corporate and Indirect Tax Survey 2011. <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/corporate-and-indirect-tax-rate-survey-2011.pdf>

Rules of origin (RoO) under the trade agreements among South Asian countries are an important factor restricting the development of regional value chains. The RoO in SAFTA, the India–Sri Lanka FTA, and the ASEAN–India FTA need to be examined closely and eventually harmonized to provide for effective regional cumulation.

### Corporate Tax Rates and Investment Promotion

Corporate tax rates in South Asian countries are high compared with those in ASEAN countries (Figure 8.4). Except in the case of Bangladesh, corporate tax rates in South Asian countries have remained almost constant during 2007–2011. In contrast, corporate tax rates in ASEAN countries were significantly reduced over the same period.

### Capital Account Convertibility and Financial Integration

As part of regional financial integration, capital account convertibility needs to be greatly improved.<sup>9</sup> However, the experience of Latin American and some Asian countries has raised concerns about the risks involved in full capital account convertibility. Because the balance of payments situation of South Asian countries generally is not strong, particularly in an unforeseen shock, such as a natural calamity, most are cautious about liberalizing their capital accounts (Islam et al. 2014).

<sup>9</sup> Capital account convertibility refers to the free movement of the components of debt, equity, and direct and real investment in the balance of payments of a country. On the other hand, current account convertibility means free inflows and outflows of investments and loans for all purposes other than for capital purposes. Trade-related payments for export and import of goods and services, remittances, studies abroad, medical treatment, and gifts are considered under the current account. Currency convertibility is the ability to exchange one currency for another, which is required for international transaction.

India has gradually liberalized portfolio equity flows, but liberalization of external borrowing was restricted, as was capital outflows. Market-based regulations were introduced gradually after 2000 through phased foreign exchange and money market reforms. Institutional development was also emphasized.

The Bangladeshi taka was declared convertible on current account transactions in 1993. Repatriation of profits and portfolio investment inflows are now permitted freely. However, repatriation of direct investment in industry must be approved by Bangladesh Bank. The Bangladesh has recently allowed outward investment on a case-by-case basis, in part to reduce Bangladesh's foreign exchange reserves, which amounted to \$19 billion in February 2014.

Pakistan has taken aggressive measures to improve capital account convertibility. Full convertibility was granted in 1994. During the process of liberalizing its current and capital account, foreign banks were allowed to take out their capital, profits, dividends, and fees without prior approval. Moreover, the corporate sector has been permitted to acquire equity abroad, and foreign investors are allowed to acquire up to 100% equity of industrial companies, with the facility of full repatriation (Goyal 2012).

Intraregional investment is strongly dependent on openness in capital accounts. However, as indicated earlier, the finance sectors of most SAARC member countries are still weak and vulnerable to possible capital flight. Despite current restrictions on the outward movement of capital, considerable capital flight from South Asian countries allegedly continues in different forms. South Asian countries experienced average yearly outflows of \$4.7 billion during 2000–2011, indicating in part the failure to control capital flight (Kar and LeBlanc 2013). This illustrates the risk of large outflows of capital in the name of outward FDI if countries open their capital accounts without putting in place effective monitoring and control mechanisms. In the early 1990s, South Asian countries have adopted various measures related to financial market liberalization and banking and capital market reforms. Nonetheless, loopholes in the regulatory framework for commercial transactions persist (ADB 2009), hampering regional integration. Best international practices need to be followed, drawing on the experience of ASEAN and other regions.

### **Sector Approach in Foreign Direct Investment Regulations**

India has adopted a multidimensional approach to promoting FDI in its various sectors, with emphasis on technology upgrading among many dimensions. In the agriculture sector, safety requirements in accordance with laws enacted under the Environment (Protection) Act have been emphasized. With large reserves of minerals, India has permitted FDI in mining of certain minerals linked to technology transfer conditions. The FDI mining provisions of 2013 are intended to ensure that raw materials are used efficiently in a manner that facilitates downstream industries and the upgrading of local technology. Full foreign equity ownership is permitted in both agriculture and mining. In the manufacturing sector, FDI regulation has focused on microenterprises and SMEs.

In Bhutan, sector provisions apply to agriculture, forestry, energy, and water-based projects. In agriculture and forest-based production, the maximum foreign equity share is 74%. Sri Lanka's FDI focus has been on nontraditional export manufacturers and export-oriented services. In Bangladesh, the FDI emphasis has been on export-oriented industries, industries in the export processing zones, and high-technology products. However, unlike in Bhutan, India, and Sri Lanka, there are no sector provisions in Bangladesh stipulating foreign equity limits or specific conditions for FDI. Bangladesh also assists small and medium-scale investors when allotting spaces in industrial enclaves and economic zones. There is scope for further alignment of FDI priorities with those of the trade and investment policies of SAARC members.

A sector approach has been adopted in ASEAN's investment framework. A limited number of sectors have been prioritized to act as catalysts for ASEAN economic integration. A road map for each priority sector has been developed, with specific and broad-based initiatives, including trade facilitation measures. ASEAN identifies potential sectors through regular consultations and monitoring. The ASEAN region has also emphasized harmonization of standards and procedures in agricultural production; the promotion of environment-friendly technologies in mining; regional cooperation in energy trade; logistics and human resources development for infrastructure investment; and SME development through information, technology, and finance.

South Asian countries follow similar FDI-related provisions for some sectors which include agriculture, mining, energy, infrastructure, and SMEs. Although the sectoral focus of ASEAN countries is the same, their FDI-related provisions are more detailed. Table 8.11 provides a brief review of the sector provisions of South Asia and ASEAN.

### **Regulatory Issues of the Service Sector**

The service sector is subject to various regulatory measures by SAARC members, including caps on foreign equity ownership and minimum investment size. However, there are significant differences in these measures among member countries.

India's conditions on FDI in the service sector apply to wholesale trading, multibrand retail trading, financial services, and private banking. Conditions on wholesale trading include undertaking of normal business practices, such as extending credit facilities and not allowing opening of retail shops to sell directly to consumers. Multibrand retailing conditions are specific to the products for sale, and limit the location of outlets.

Sri Lanka's investment policies apply to IT services and training, export trading houses, and R&D. Bhutan's service sector-related investment policies apply to the education, health, hotel, construction, and consultancy and financial services sectors.

Investment restrictions need to be addressed at the policy level. A collaborative approach must be adopted by SAARC members, leading to their substantial reduction. Professional services should be engaged to explore the possibilities for easing restrictions at the country level. The signing of the SAARC Agreement on Trade in Services (SATIS) indicates that SAARC members are positively disposed to opening up the service sector to trade and investment.

**Table 8.11: Sector Provisions in South Asia and ASEAN**

Sectors	Sector Provisions in South Asian Policies	Sector Provisions in the ASEAN Economic Community Blueprint
Agriculture	Safety requirements, import of raw materials under the national policy perspectives	<ul style="list-style-type: none"> <li>• Establish good practices in the case of hygiene and manufacturing practices.</li> <li>• Harmonize quarantine and inspection procedure, use of chemicals and maximum use of pesticides, and application of sanitary and phytosanitary measures .</li> <li>• Harmonize regulatory framework for agricultural products from modern biotechnology.</li> </ul>
Mining	Transfer of technology, efficient utilization of resources for facilitating downstream industries	<ul style="list-style-type: none"> <li>• Facilitate and increase investment in minerals.</li> <li>• Promote environmentally and socially sound and sustainable production in the sector.</li> <li>• Build institutional capacity and develop human resources for the development of mineral sector.</li> </ul>
Energy	Emphasis on national policies for the sector approach	<ul style="list-style-type: none"> <li>• Enhance regional collaboration on energy trade.</li> <li>• Promote private sector involvement in energy projects.</li> <li>• Ensure implementation of projects.</li> </ul>
Infrastructure development	Provisions for foreign equity participation and adopting public–private partnership models for the development of the sector	<ul style="list-style-type: none"> <li>• Emphasize logistics services, multimodal transport infrastructure development, tourism integration, and liberalization of air and maritime transport.</li> <li>• Develop information infrastructure and facilitate high-speed connection of national information infrastructure.</li> <li>• Encourage participation of all stakeholders in the development of ICT.</li> <li>• Implement capacity building and training program for human resources development.</li> <li>• Deepen regional policies and regulatory framework for dealing with the challenges of new generation information systems.</li> </ul>
SME development	Foreign investment in the sector subject to specific conditions	<ul style="list-style-type: none"> <li>• Optimize diversification of SMEs.</li> <li>• Ensure access of SMEs to information, finance, and updated technology.</li> <li>• Develop human resources.</li> </ul>

ASEAN = Association of Southeast Asian Countries, ICT = information and communication technology, SMEs = small and medium-sized enterprises.

Source: Authors' compilation from South Asian policies and ASEAN. 2008. *ASEAN Economic Community Blueprint*. Jakarta: Association of Southeast Asian Nations.

## SAARC Development Fund: An Overview

The South Asian Development Fund (SADF), introduced in 1996, was formed by amalgamating the SAARC Fund for Regional Projects and the SAARC Regional Fund. The SADF addressed facilitation of industrial development, poverty alleviation, environmental protection, institutional development, and promotion of social and infrastructure development in the region. The 13th SAARC Summit, held in Dhaka in 2005, reconstituted the SADF into the SAARC Development Fund (SDF). The SDF is considered the umbrella financial mechanism for all SAARC projects and programs. It has three windows: social, economic, and infrastructure.

Two of the six SDF projects aim to improve the investment environment of the region, while the other four projects relate to social development (Tables 8.12 and 8.13). Currently, the social window of the SDF is operating, but the economic and infrastructure windows appear to pose challenges for SAARC members. As shown in the tables, disbursements in most cases have been much less than budgeted.

The overall objective of the SDF is to improve quality of life, reduce poverty, and accelerate economic growth in the SAARC region through cross-country initiatives. The SDF is mandated to promote social and economic projects but not in competition with commercially viable investment projects. Hence, although the SDF could facilitate cross-border flows of capital resources, it can do little to enhance large-scale intraregional FDI.

In contrast, the EU has several regional funding facilities, such as the European Social Fund and the European Regional Development Fund (ERDF). The ERDF mainly facilitates regional development, economic change, enhanced competitiveness, and territorial cooperation across the EU. Its investment focus has evolved into “thematic concentrations”—innovation and research, the digital agenda, support for SMEs, and a low-carbon economy. This focus enables the ERDF to operate successfully.

**Table 8.12: Ongoing and Pipeline Social Projects under the SAARC Development Fund**

Project Title	Start Date	End Date	Project Budget (\$)	Total Disbursement (\$)	Participating Countries
Strengthening the Livelihood Initiative for Home-Based Workers in SAARC Region (Phase I and II)	1 Aug 2008	31 Dec 2014	15,952,291	11,206,376	Afghanistan, Bangladesh, Bhutan, Maldives, Nepal, Pakistan, Sri Lanka
Strengthening Maternal and Child Health Including Immunization	19 Jun 2009	31 Dec 2013	15,039,229	3,918,723	Afghanistan, Bangladesh, Bhutan, Maldives, Nepal, Pakistan, Sri Lanka
Empowering Rural Communities “Reaching the Unreached”	1 Apr 2011	31 Mar 2014	7,938,335	2,867,570	Bangladesh, Bhutan, Maldives, Nepal
South Asia Initiative to End Violence Against Children (SAIEVAC)	1 Jan 2012	31 Dec 2014	2,600,000	507,862	Afghanistan, Bangladesh, Bhutan, Maldives, Nepal, Pakistan, Sri Lanka
SAARC Regional Inter-professional Master’s Program in Rehabilitation Science	1 Jun 2013	31 May 2018	2,025,600		Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka
Toll-Free Helplines for Women and Children in SAARC Member States	3 Years		4,000,000		Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka
Strengthening of Water, Sanitation and Hygiene (WASH) Services in selected areas of SAARC Countries	3 Years		6,299,437		Afghanistan, Bhutan, India, Nepal, Pakistan, Sri Lanka
<b>Pipeline Project</b>					
Implementation of Climate and Energy Use Component of HCFC Phase-Out Management Plan (HPMP) in Afghanistan, Bangladesh, Bhutan, Nepal and Sri Lanka	2013	2017	9,479,360		Afghanistan, Bangladesh, Bhutan, Nepal, Sri Lanka

SAARC = SAARC Development Fund. <http://www.sdfsec.org/?q=projects-listing>

Source: SAARC Development Fund. Available at: <http://www.sdfsec.org/?q=projects-listing>

**Table 8.13: Ongoing Investment-Related Projects under the SAARC Development Fund**

Project Title	Start Date	End Date	Project Budget (\$)	Total Disbursement (\$)	Participating Countries
Scaling up of Zero Energy Cold Storage (ZECS) technology for horticultural commodities in the high hills of SAARC countries	1 Dec 2010	31 May 2014	3,380,931	2,065,819	Afghanistan, Bhutan, India, Nepal
Post-Harvest Management and Value Addition of Fruits in Production Catchments in SAARC Countries	1 Jan 2013	31 Dec 2015	4,979,075	193,270	Afghanistan, Bangladesh, Bhutan, Nepal, Pakistan, Sri Lanka
<b>Pipeline Projects</b>					
Promoting Integrated Bamboo -Based Enterprise Development among SAARC Countries	3 Years		2,988,925		

SAARC = South Asian Association for Regional Cooperation.

Source: SAARC. Development Fund. <http://www.sdfsec.org/?q=projects-listing>

## Regional Investment Cooperation: Establishing Linkage Towards Regional Regulatory Investment Regime

Most South Asian countries are still at an early stage of development, and are looking for FDI to promote industrialization of their economies. Thus, they have followed liberal FDI regimes for attracting inward FDI and imposed various restrictions to discourage outward FDI. However, such restrictions constrain regional investment by most SAARC members. Only India allows outward flows of FDI. Given the generally weak balance and payments situation in most SAARC countries, as well as the risk of capital flight, they are not in a position to fully open up their capital accounts. However, the promotion of regional investment requires allowing outward FDI, at least on a limited scale, particularly for regional projects.

As discussed earlier, investment in South Asia is highly imbalanced and concentrated in a few locations, particularly in India. This has occurred because of India's overwhelming competitive advantage in market size, resources, skills, and institutions. Unless other countries are able to develop competitive strength, it would not be easy to attract more investment to these locations by simply allowing outward investment from South Asian countries. The proposed South Asian Economic Union (SAEU) would help to improve the competitiveness of member countries by creating a common market, building value chains, harmonizing exchange rates, and reducing the policy gaps between countries. In effect, these are preconditions for enhancing intraregional investment in South Asia. The challenge of promoting intraregional investment is considerable, given the limited degree of trade integration, the extent of nontariff barriers, poor physical connectivity, differences in sanitary and phytosanitary standards, technical barriers, differences in the RoO, exchange rate uncertainties, and other problems.

Regional investment cooperation would be facilitated by maintaining a better intraregional political environment. The restrictions on bilateral investment between India and Pakistan until 2012 obstructed development of regional value chains; similarly, India's restriction on investment in Bangladesh obstructed the development of value chains between the two countries. However, India has recently lifted these restrictions which should contribute to strengthening regional investment cooperation. Further, investment cooperation under SATIS could be accelerated by completing negotiations on the offer and request lists for opening the service sector to regional investment.

South Asian countries are overwhelmingly dependent on external FDI; hence regional sources are relatively less important for the development of value chains among SAARC members. Integration initiatives in South Asia should put more emphasis on joint efforts to create a positive environment for attracting external FDI, which in turn would help to promote intraregional investment flows. Open regionalism is important for South Asian countries, while maintaining national treatment both for intraregional and interregional investors.

Regional investment needs to be promoted, particularly for the LDCs. Regional investors should be encouraged by pre- and post-establishment measures. South Asian countries need to improve pre-establishment assessment of the markets (size, growth, potential, profitability, and market risks), information on market players, and possible joint venture opportunities. During the pre-establishment, home country measures could be as important as host country measures. Fiscal and monetary supports could be provided by the home country for investment within the region. Regional investment could also be facilitated by ensuring the availability of low-cost financing. Establishment of a regional investment fund, separate from the SDF and supported by SAARC members and multilateral financial agencies, could be instrumental in helping promote intraregional investment.

South Asian countries have similar policies for the promotion of FDI, including in their bilateral investment treaties, double taxation treaties, and industrial and trade policies, and as reflected in their memberships in international organizations (e.g., the Multilateral Investment Guarantee Agency). The proposed SAEU would advance harmonization of these policies and provisions, and thereby assist regional investors. In working toward a common regulatory framework for investment, SAARC members should (i) agree on an overarching development objective, (ii) achieve a better balance among SAARC members in their rights and obligations, (iii) strengthen investment promotion provisions, and (iv) develop regional mechanisms for managing investment.

Country-specific sector priorities concerning production, trade, and investment should be taken into account in promoting investment, especially with respect to bolstering investment in export-oriented industries. In view of the complementarity of investment opportunities among member countries, regional investors could advance vertical integration in key sectors. However, a trade-led investment approach would require improvement in intraregional connectivity and infrastructure.

Most member countries receive small-scale FDI in various sectors, requiring well-established intraregional supply chains. A major challenge is to ensure that supply chains

**Table 8.14: Issues Regarding Development of a Regional Regulatory Framework for Investment**

Issue	Domestic Investment Policy	Regional Investment Agreements	Investment-Related Issues in other Agreements
Guiding principles	Benefit investors	Maintain preferential treatment for member states	Establish a liberal and competitive investment regime
Treatment of foreign investors	Treat investors from member states fairly and equitably	Grant special facilities and maintain flexibility for investors from member countries	Treat investors from other member states and local investors equally
Sector aspects	Identify sectors requiring protection  Monitor protected and opened sectors regularly	Revise sensitive list  Lower restrictions for investment in selected sectors	Reinforce dialogue and strengthen working groups to identify trade and investment links within sectors  Encourage regional discussion on various sectors  Jointly identify priority sectors with potential for strong cooperation and explore ways to collaborate in the identified sectors
Capital flows	Identify best practices and apply gradual liberalization of current and capital accounts	Limited level of flow of capital among member states	Cooperate in promoting intraregional capital flows
Technology transfers	Encourage investment in industries of member states with updated technology not available locally	Assess and implement performance requirements among member states jointly	Exchange information on desired technology transfers in support of specific sector investments
Employment generation	Include employment-related aspects of the policies  Emphasize small-scale sectors	Recognize skills and training in the other contracting state  Set limitations on employment requirement	Conduct training exchanges for skill development
Protection of migrants workers' rights	Promote decent and productive environment for migrant workers	Facilitate data sharing on issues related to migrant workers, including available opportunities and facilitating measures  Adopt specific measures to prevent smuggling and trafficking	Undertake joint programs on human resources development
Intellectual property rights (IPR)	Develop and strengthen institutional framework for enforcement of IPR-related domestic regulations	Explore initiatives for developing a technological base for conducting research and experiment on a harmonized legal system for IPR in line with Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement	Develop specialized court system for dealing with IPR issues in the regional member countries  Develop regional institute for research and experiments in dealing with technological aspects of IPR as per TRIPs agreement
Link with production chain	Incorporate provisions for outward investment in sectors of mutual interest	Reserve options for local sourcing requirements and for liberalizing restrictions on establishment	Regularly exchange information on areas of mutual interest and competition policy  Establish strong network among the enterprises within the region for improving the investment environment

Source: The authors.

meet international standard in key industrial sectors. In this respect, harmonization of customs, domestic rules and regulations, and excise duties, among other factors, is vital to creating efficient supply chains within the region. A fast-track approach to harmonization is needed.

As concluded in Finger and Wilson (2006), agreements alone are insufficient. Key requirements for attracting and facilitating investment are good institutions and infrastructure (transport and energy), efficient financial services, and skilled human resources (UNCTAD 2014b). These requirements need to be addressed by a combination of policies and cross-border arrangements. Regulatory regimes, in the form of bilateral and regional trade agreements, and domestic provisions for investment promotion should be complementary. A number of investment cooperation issues are reviewed in Table 8.14.

## Concluding Remarks: Investment Cooperation under the Proposed Road Map of South Asian Economic Union

The road map for strengthening investment cooperation under the proposed SAEU should be designed consistent with the following objectives:

- (i) SAARC members will cooperate under the framework of open regionalism, emphasizing both intraregional and extraregional investment.
- (ii) Promotion of intraregional investment should be facilitated with appropriate home and host country measures; member countries should endeavor to ensure that political barriers do not create bottlenecks in promoting long-term investment relations within the region.
- (iii) Regional investment cooperation—in parallel with trade integration—should focus on the development of a common market, reduction of nontariff barriers, regional connectivity, and development of physical infrastructure and regional value chains.
- (iv) Strong domestic regulatory frameworks need to be harmonized under the regional investment framework.
- (v) Country-specific sector priorities should be taken into account in building regional supply chains, and necessary support measures should be provided.

Based on these objectives, the following provisions need to be considered for ensuring investment cooperation within the proposed SAEU.

### Benchmarking Intraregional Investment and Strengthening Extraregional Investment

South Asian countries should reduce their restrictions on outward investment. In this regard, a greater degree of capital account convertibility is needed, consistent with the national agenda of each country.

Each country should simplify its procedures regarding outward investment, particularly for intraregional investment.

Regional investment cooperation should not be subject to political problems among member countries. In view of recent developments, bilateral investment cooperation between India and Pakistan should be promoted. This cooperation should lead to the development of long-term investment relations, in turn facilitating the development of region-wide vertical FDI links.

SAARC members should continue to emphasize FDI from outside the region. The facilities under different agreements and arrangements should continue.

### **Institutional Mechanism for Regional Investment Cooperation**

South Asia should draw lessons from the ASEAN on investment promotion. Although there are major differences between the two regions in terms of the level of economic development and integration, the experience of the ASEAN provides a model for the SAARC region.

South Asia should work to adopt an institutional framework for investment cooperation similar to that of ASEAN, following the principle of open regionalism. SAARC members should establish a South Asian Investment Area to (i) implement investment cooperation programs and investment awareness activities, (ii) ensure national treatment, (iii) facilitate the active involvement of the private sector, (iv) provide a more streamlined investment process, (v) eliminate investment barriers, and (vi) liberalize investment rules and policies. However, effective functioning of such an institution requires a proactive role of both government and private sector of member countries. For example, government-supported private sector initiatives should include the formation of a South Asia industrial joint venture, brand-to-brand complementation schemes, and a South Asia industrial cooperation scheme.

At the government level, an industrial cooperation scheme could promote joint venture initiatives in South Asia's manufacturing sectors. Government support would facilitate the physical movement of products between participating companies, as well as resource sharing or pooling and/or industrial complementarities. Joint ventures would enable participation among companies operating at different stages of production value chains. Products of the participating companies should benefit from assured intraregional market access.

### **Country-Level Operational Issues for Investment Cooperation**

South Asian countries should reduce, and where possible, eliminate restrictions on regional and foreign investors seeking entry in national priority sectors.

National and MFN treatment provisions, especially fiscal incentives, should be extended to investors from member countries.

SAARC members should ensure protection of intraregional investment in the same manner as protection is given under bilateral investment treaties. Protection should address issues concerning repatriation of investment assets and earnings from investment, expropriation compensation, equity limits, minimum foreign capital requirements, and screening of investment.

Domestic regulations should be consistent with current regional agreements on investment and the rights and obligations of the member countries. This provision should also apply to investors from outside the region.

SAARC members should establish a more effective dispute settlement mechanism. The settlement procedure should include reference to the judicial, arbitration, and administrative body of the state where the investment has taken place. Settlement issues should be guided by the United Nations Commission on International Trade Law.

Each country should ensure transparency and consistency of investment-related regulations with other member countries.

In advancing their individual investment positions during multilateral negotiations, SAARC members should nonetheless endeavor to adhere to a regional framework.

### Facilitation of Investment Procedures

Investment procedures need to be simplified, including by (i) streamlining the application and approval process; (ii) simplifying cross-border customs regulations; (iii) disseminating information on investment-related rules and regulations among the member countries; (iv) developing a manual for harmonizing the guidelines for investment in specific sectors within the region; (v) strengthening the institutional regulatory frameworks; (vi) establishing an effective regional financial and banking network for facilitating transactions; and (vii) resolving trade-related barriers including nontariff barriers such as sanitary and phytosanitary (SPS) standards, sensitive lists, connectivity problems, and conflicting RoO.

South Asian countries should facilitate sector investment by introducing measures for promoting investment in national priority sectors, specifying foreign equity caps and conditions, and giving priority to SAARC-based investors by maintaining flexibility with respect to investment regulations and conditions.

### Sector-Specific Provisions for Promoting Regional Investment

**Agriculture.** Common products across the region should be subject to harmonized measures with respect to the regulatory framework for production chains, hygiene practices, and the use of chemicals and pesticides.

**Mining and mineral resources.** SAARC members should work together to identify potential mineral resources in the region, facilitate investment in the identified mineral resources, and disseminate information on the region's mineral sector.

**Energy.** SAARC members should work together to identify potential energy resources in the region, promote private sector involvement, ensure efficient implementation of projects under bilateral agreements, and facilitate investment in the energy sector of the region.

**Infrastructure.** Measures necessary for the development of the region's infrastructure include (i) identifying transport and other infrastructure priorities for better connecting and integrating the region, (ii) undertaking communications and other measures critical to linking the region, (iii) developing a cross-border highway network, (iv) facilitating private sector involvement in infrastructure projects, and (v) ensuring efficient implementation and monitoring of key regional infrastructure projects.

**Apparel.** To develop regional value chains and promote vertical FDI, it will be necessary to identify complementarities in the sector among SAARC member countries and initiate intraregional joint ventures for facilitating production value chains.

**Small and medium-sized enterprises.** SAARC initiatives to support SMEs should include identifying potential SME products, developing the skills of SME workers, and disseminating information on production networks within and outside the region.

**Services.** Under SATIS, SAARC members should complete discussion and negotiation of their request and offer lists as quickly as possible. Operationalization of SATIS needs to focus on mode 3 (commercial presence), as early completion of its negotiation would accelerate investment in related services. South Asian countries should harmonize service-related regulatory policies to support cross-country investment in the sector.

### Promotion of Intraregional Investment

**Pre-establishment measures.** Measures for promoting intraregional investment during the pre-establishment include (i) establishing an investment-friendly environment for the promotion of all forms of intraregional investment, (ii) promoting production networks among member countries and extending them to multinational corporations, (iii) recognizing skills and training provided in other member countries, (iv) sharing technology among investors in the region, (v) exchanging information on existing and required technology for sector investment, and (vi) developing networks among potential investors in selected sectors.

**Financial measures.** Fiscal and monetary measures to promote intraregional investment include establishing a commercially based regional investment fund that is separate from but complements the SAARC Development Fund (SDF).

To further facilitate intraregional investment, double taxation treaties must apply to regional investors.

SAARC members should coordinate their corporate and income tax rates and reduce them as much as possible for investment in high-priority sectors.

### Promotion of Extraregional Investment

SAARC members should gradually liberalize their capital accounts, consistent with their financial stability requirements and national agendas.

FDI designed to advance efficiency should be promoted in support of regional value chains and their extension to global value chains.

SAARC members should adopt home country measures to encourage investment in the less developed regions of South Asia.

## Annex 8.1

### Major Provisions of Foreign Direct Investment Policies of South Asian Countries

Issues	Bangladesh	India	Nepal	Pakistan	Sri Lanka	Bhutan	Maldives	
<b>Pre-Entry Treatment</b>								
Prohibited sectors for FDI	Private ownership restricted in four sectors: arms and ammunition, security printing, commercial, and forestry	<ol style="list-style-type: none"> <li>Lottery business including government and private lottery, online lotteries, etc.</li> <li>Gambling and betting, including casinos, etc.</li> <li>Trading in transferable development rights</li> <li>Real estate business or construction of farm houses</li> <li>Manufacturing of cigars, cheroots, cigarillos, and cigarettes, and of tobacco or tobacco substitutes</li> <li>Activities or sectors not open to private sector investment e.g., atomic energy and railway transport (other than mass rapid transport systems)</li> <li>Foreign technology collaboration in any form, including licensing for franchise, trademark, brand name;</li> <li>Management contract is also prohibited for lottery business and gambling and betting activities.</li> </ol>	<ol style="list-style-type: none"> <li>Defense-related industries (manufacture of arms and ammunition)</li> <li>Cigarettes and bidi (hand-rolled cigarettes)</li> <li>Alcohol (excluding 100% export-oriented)</li> </ol>	<ol style="list-style-type: none"> <li>Arms and ammunition</li> <li>High explosives, radioactive substances</li> <li>Securities, currency</li> <li>Consumable alcohol</li> </ol>	<ol style="list-style-type: none"> <li>Limited investment in the sectors below; up to 40% with approval from the Board of Investment of Sri Lanka</li> <li>Production of goods in which Sri Lanka's export products are subject to quota restrictions</li> <li>Growing and primary processing of tea, rubber, coconut, cocoa, rice, sugar, and spices</li> <li>Mining and primary processing of nonrenewable national resources</li> <li>Timber-based industries using local timber</li> <li>Fishing (deep-sea)</li> <li>Mass communications</li> <li>Education</li> <li>Freight forwarding</li> <li>Travel agencies</li> <li>Shipping agencies</li> </ol>	<ol style="list-style-type: none"> <li>Media and broadcasting</li> <li>Distribution services including wholesale, retail, and micro trade</li> <li>Mining for sale of minerals in primary or raw form</li> <li>Hotels 3 star and below</li> <li>General health services</li> <li>Industries that do not meet the certificate of origin requirements</li> </ol>		

Issues	Bangladesh	India	Nepal	Pakistan	Sri Lanka	Bhutan	Maldives
Caps on foreign ownership	100% in all sectors	Agriculture and animal husbandry (100%); tea plantation (100%); mining (100%); petroleum and natural gas (100%); defense (26%); broadcasting and information services (74%); print media (26%); airport projects (100%); air transport services (49%–100%); construction development—townships, housing, built-up infrastructure (100%); industrial parks—new and existing (100%); telecom services (49%); trading (100%); banking—private sector (74%) including investment by FII; banking—public sector (20%); infrastructure company in the securities market (49% [FDI and FII] [FDI limit of 26% and FII limit of 23% of the paid-up capital]; insurance (26%); nonbanking finance companies (100%); pharmaceuticals (100%); power exchanges (49%, FDI and FII).	Maximum foreign equity participation limited to 85%.	No upper limit on the share of foreign equity except in specific sectors (e.g., airline, banking, agriculture, and media)  Relaxed equity caps for setting up of banks, life and nonlife insurance business	100% in all sectors	70% in all sectors	100% in all sectors
Screening	No screening except in telecom, power, and mineral sectors	Screening of specific sectors, e.g., broadcasting	Detailed screening done by the Ministry of Finance	No prescreening provided that conditions of corporate registration under the Companies Ordinance, 1984 are met	No screening except for five manufacturing sectors	Strict screening by Board of Investment	Mandatory screening if foreign equity is greater than 51%; conditional screening if it is below 51%

Issues	Bangladesh	India	Nepal	Pakistan	Sri Lanka	Bhutan	Maldives
Minimum capital requirement	None	Minimum capital requirements vary by sector (\$10 million for wholly owned subsidiaries and \$5 million for joint ventures, differential rates for nonbank financial companies, etc.)	None	Agriculture and infrastructure: \$0.3 million	\$500,000	Manufacturing: \$1 million Services: \$0.5 million	None
Location	None	Applied in certain cases, such as for telecom service providers and setting up of retail sales outlets.		None	None	None	None
<b>Post-Entry Treatment</b>							
Repatriation of capital	100% repatriation of capital and dividends is allowed	Repatriation basis is subject to certain conditions. Nonresident Indian or a person of Indian origin may seek prior permission of the Reserve Bank for investment in sole proprietorship concerns and/or partnership firms with repatriation option.	Foreign investors allowed to repatriate the received amount through the sale of the share of foreign investment as a whole or part, the received profit from FDI, the received amount from payment of the principal and interest on any foreign loan, the amount received under an agreement for the transfer of technology	Repatriation of profits, dividends, or any other funds allowed in the currency of the country from which the investment originated (as per Foreign Private Investment Act and the Foreign Exchange Manual		Foreign investors given the right to repatriate their invested capital and any capital gains secured, in the currency of investment.	
Technology	None		Subject to approval	Industrial units with technology not available in Pakistan will be declared as pioneer industry and provided incentives as per special economic zones.			

Issues	Bangladesh	India	Nepal	Pakistan	Sri Lanka	Bhutan	Maldives
Fiscal Incentives	(i) Tax holiday for 7 years, (ii) tax exemption on royalties, interest on foreign loans and capital gains from the transfers of shares, (iii) 5% import duty on capital equipment and spare parts for initial installation	(i) Income tax holiday of 10 years for export processing zone firms and 5 years for other investors, (ii) access to finance for export-oriented industries at concessional interest rates, (iii) tax relief under double taxation agreements, (iv) 10-year income tax holiday for firms located in export processing zones	(i) Corporate tax rate for export-oriented industries is 8% of profit or 0.5% of export earnings, (ii) corporate tax rate for import competing industries is 20%, (iii) 2.5% duties on imports of M/E and spare parts, (iv) 5%–10% duties on most industrial intermediate inputs refunded to export-oriented industries under the duty drawback scheme	(i) No custom duty on imports of plant, machinery, and equipment for export-oriented and hi-tech industries, (ii) zero import tariff on plant and machinery (not available locally) used for agriculture	(i) Exempted from income tax on capital gains arising from share transfers, (ii) income tax reduction, (iii) duty drawback for export-oriented industries	Selective tax exemption	(i) No income tax, corporate tax, or property tax in the Maldives; (ii) right to 100% foreign ownership; (iii) legally backed investment guarantee; (iv) provision for overseas arbitration of disputes; (v) long-term contractual agreements and long-term lease of land; (vi) freedom of choosing foreign managerial, technical, and unskilled workers; (vii) no restrictions on foreign exchange; (viii) no restrictions on repatriation of earnings or profits
<b>Prerequisite for Outward Investment</b>							
Outward Investment	Prior approval required	Limit of \$100 million in one financial year which is subject to approval. Investment by Indian nationals in Pakistan not permitted under the approval route	Permission not given for foreign investment for Nepalese citizens without government notice	Prior approval required	Prior approval required  Promotion of domestic exports to be prioritized	All foreign investments strictly controlled	All foreign investments strictly controlled

FDI = foreign direct investment, FII = foreign institutional investor, M/E = \_\_\_\_\_.

Source: Prepared by the authors based on various documents available in the websites.

## Annex 8.2

### SAARC Declarations on Promotion of Regional Investment

Summit	Venue and Year	Status of Mention	Major Highlights
First	Dhaka, 1985	No mention	
Second	Bangalore, 1986	No mention	
Third	Kathmandu, 1987	No mention	
Fourth	Islamabad, 1988	No mention	
Fifth	Malé, 1990	No mention	
Sixth	Colombo, 1991	No mention	
Seventh	Dhaka, 1993	<ul style="list-style-type: none"> <li>Importance of adequate investment in health and education for the success of their population programs was mentioned.</li> <li>The economies of developing countries continued to suffer as a result of limited market access for their exports, dwindling resource flows, absence of adequate foreign investment, mounting external indebtedness, inadequate transfer of technology, and inequities in the global monetary, financial, and trading systems.</li> <li>Referring to the competing demands for capital investment resources, the heads of state or government underscored the need to ensure the adequate flow of investment resources to the developing countries through increasing global savings and a more equitable utilization of the peace dividends.</li> </ul>	Extraregional FDI was stressed.
Eighth	New Delhi, 1995	No mention	
Ninth	Malé, 1997	<ul style="list-style-type: none"> <li>The heads of state or government agreed that efforts to enhance trade and economic cooperation in the region would be further strengthened by initiating specific steps to promote and protect investment, increase complementarities in economic activities of member states, and other measures supportive of the promotion of joint ventures of SAARC.</li> <li>The offer of India to host a meeting on the promotion and protection of investment was welcomed, as was the offer of Pakistan to host a meeting on dealing with double taxation problems.</li> </ul>	<p>Promotion and protection of intraregional investment were stressed.</p> <p>Domestic measures of developed countries to enhance investment in developing countries were pursued.</p>

Summit	Venue and Year	Status of Mention	Major Highlights
		<ul style="list-style-type: none"> <li>Measures of cooperation in the areas of customs standardization, arbitration, and enhancing industrial economy and management were welcomed.</li> <li>The heads of state or government reaffirmed their determination to encourage the private sector in the region to contribute increasingly to the strengthening of intra-SAARC links in key areas of trade, investment, and finance.</li> <li>The decision by the SAARC Chamber of Commerce and Industry to convene annually an economic cooperation conference in conjunction with the annual meeting of SAARC commerce ministers and SAARC trade fairs was welcomed.</li> <li>The heads of state or government called on developed countries to assist in creating a favorable global economic environment, and to strengthen investment flows to developing countries.</li> </ul>	
10th	Colombo, 1998	<ul style="list-style-type: none"> <li>Increased opportunities in trade and investment have bypassed many developing countries. The least-developed countries have in particular been marginalized through a series of developments, including shrinking of official development assistance, and concessional and other financial flows to these countries.</li> <li>The heads of state or government cautioned that efforts to formulate a new multilateral investment agreement should allow for developing countries to formulate specific investment policies appropriate to their stage of development.</li> <li>The need to strengthen SAARC's policy analysis was acknowledged, with a specific emphasis on international financial, monetary, trade, and investment issues.</li> <li>The heads of state or government agreed that the benefits of economic liberalization would be more extensive and better balanced through the promotion of trade-creating joint ventures, investment, and trade in services such as tourism</li> </ul>	Multilateral investment agreement should provide scope for least-developed countries and developing countries to formulate specific investment policies. Stressed the need for building analytical capacity at regional level .
11th	Kathmandu, 2002	<ul style="list-style-type: none"> <li>The heads of state or government agreed to accelerate cooperation in the core areas of trade, finance, and investment to realize the goal of an integrated South Asian economy in a step-by-step manner</li> <li>The heads of state or government instructed the Secretary General to facilitate the early finalization of a regionally agreed investment framework.</li> <li>The heads of state or government acknowledged that investment in poverty alleviation programs contributes to social stability, economic progress, and overall prosperity</li> </ul>	Finalization of regional investment framework was stressed.
12th	Islamabad, 2004	<ul style="list-style-type: none"> <li>Investment in human resources was cited as critical for development of South Asia, leading to the resolution for establishing a network of centers of higher learning, and training and skill development institutes across South Asia.</li> </ul>	Investment in human resources was stressed.

Summit	Venue and Year	Status of Mention	Major Highlights
13th	Dhaka, 2005	<ul style="list-style-type: none"> <li>The heads of state or government recognized the need to take the process of regional economic integration further by expanding the scope of SAFTA to include trade in services, enhanced investment, and harmonized standards.</li> </ul>	Acceleration of trade in services and investment under SAFTA framework was stressed.
14th	New Delhi, 2007	<ul style="list-style-type: none"> <li>The heads of state or government stressed that to realize its full potential, SAFTA should integrate trade in services. They called for finalization of an agreement in the services sector as early as possible. They also directed that the Agreement on Investment Promotion and Protection should be finalized.</li> </ul>	Finalization of Agreement on Investment Promotion and Protection was stressed.
15th	Colombo, 2008	<ul style="list-style-type: none"> <li>Toward achieving further economic integration, the heads of state or government directed that the Draft Agreement on Investment Promotion and Protection should be finalized early, and that the SAARC Arbitration Council should be operationalized.</li> </ul>	Finalization of Agreement on Investment Promotion and Protection was reiterated. Operationalization of SAARC Arbitration Council was stressed.
16th	Thimphu, 2010	<ul style="list-style-type: none"> <li>The leaders emphasized the need to strengthen the role of the private sector in regional initiatives through appropriate mechanisms, including through public-private partnerships, as well as the need for greater intra-SAARC investment promotion efforts.</li> <li>The leaders underlined the important role of SDF for financing regional and subregional programs and projects. They welcomed ratification of the SDF Charter. The leaders also welcomed the inauguration and operationalization of the Permanent Secretariat of the SDF, including the appointment of its first chief executive officer. The leaders stressed that projects funded through the SDF should be demand-driven, time-bound, and aligned with the developmental priorities of the region. The leaders also emphasized the need for the member states to take full advantage of the mechanism of the SDF through expeditious clearance and implementation of projects and programs to promote the welfare of the people of the SAARC region, to improve their quality of life, and to accelerate economic growth, social progress, and poverty alleviation in the region.</li> </ul>	Stressed the need to strengthen the role of private sector through greater intraregional investment promotion efforts. SAARC Development Fund for financing regional and subregional programs and projects was ratified.
17th	Addu City, 2011	<ul style="list-style-type: none"> <li>The leaders directed SAARC finance ministers to chart a proposal allowing for the greater flow of financial capital and intraregional long-term investment.</li> <li>The leaders directed SAARC member countries to make available an appropriate percentage of national income for renewable energy investments.</li> </ul>	Called for proposal for greater flow of financial capital and interregional long-term investment. Investment in renewable energy was stressed.

Source: Prepared by the authors based on the SAARC declarations.

# Developing Economic Corridors in South Asia: Priorities and Tasks Ahead

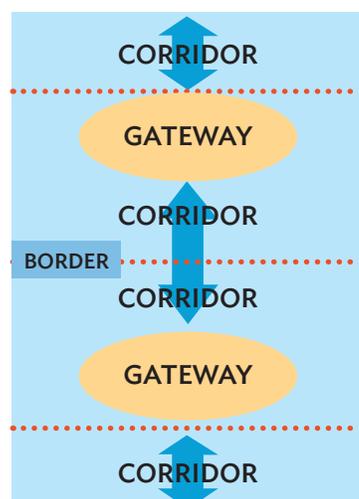
*Prabir De*

An efficient, secure, and integrated transport network is essential to support South Asian Economic Union (SAEU).<sup>1</sup> Connectivity is central to regional economic integration. Gateways and multimodal corridors are the building blocks for creating an integrated spatial economic region (Rimmer and Howard 2012). The term “economic corridor” refers to a gateway, multimodal corridor, and logistics corridor integrated by long-term investment measures that seek to generate economic development across a geographic space. Initially, corridors (i.e., the linear orientation of goods, people, and information) were the focus of attention. However, this approach is considered too narrow and one-dimensional, and there is an explicit need to include gateways. Once a systems approach, consisting of gateways and corridors, is adopted, policies can be considered for rebalancing development patterns to meet politically informed priorities. This entire system is then elevated to an economic corridor (Figure 9.1).

Economic corridors connect gateways and economic nodes or hubs (Figure 9.1). The economic corridor approach emphasizes integration of infrastructure improvement (hard and soft) with economic opportunities, such as trade and investment, and it includes efforts to address the social and other outcomes of increased connectivity (De, P, and K. Iyengar. eds. 2014).

Telecommunication transcends economic space and brings business cores in South and East Asia into instant contact. The spatial outcome of this connectivity is that city cores

**Figure 9.1: Corridor–Gateway Links**

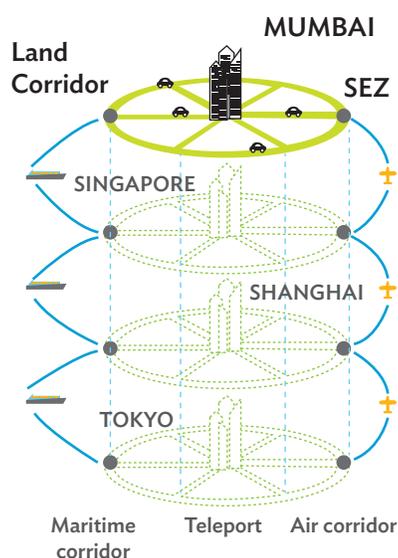


Source: Adapted from Rimmer, P. 2010. *Pan-Asian Corridors and Gateways*. The International Conference on “India - East Asia Economic Integration: Role of Economic Corridors and the Emerging Architecture,” New Delhi. 10 September.

<sup>1</sup> This chapter draws from De, P. and K. Iyengar.eds.2014. *Developing economic corridors in South Asia*. New Delhi: Asian Development Bank

are stacked like pancakes on top of one another (Figure 9.2). The city cores of Mumbai, Singapore, Shanghai, and Tokyo are more adjacent than their physical hinterlands. Economic space involving physical movements of goods and people is more continuous, but time differences in transport modes (air, sea, and land) have become increasingly critical. Economic corridors are successful when they connect corridors and gateways (e.g., cities) coupled with supporting institutions (e.g., logistics), leading to greater competitiveness of a geographic space (e.g., country).

**Figure 9.2: Economic Space and Corridor**



Source: Rimmer, P. 2010. *Pan-Asian Corridors and Gateways*. The International Conference on “India - East Asia Economic Integration: Role of Economic Corridors and the Emerging Architecture,” New Delhi. September. 10.

The economic corridor approach has gained momentum in Asia, with the support of the Asian Development Bank (ADB) under the Greater Mekong Subregion (GMS) Program and later the Central Asia Regional Economic Cooperation (CAREC) Program. A major achievement of the GMS Program is improved transport connectivity in the subregion, particularly in the less developed areas, as exemplified by the main GMS economic corridors—the East–West, the North–South, and the Southern corridors.

An economic corridor typically (i) covers a relatively small geographical space, straddling a transport artery such as a road, rail, or canal, which connects gateways; (ii) emphasizes bilateral rather than multilateral initiatives, focusing on strategic nodes at border crossings between two countries; and (iii) highlights physical planning so that infrastructure development achieves positive benefits.

The economic corridors concept is now increasingly included in national development programs. However, in South Asia, the idea is relatively new and has yet to be applied. Various studies, including the ADB-supported SAARC (South Asian Association for

Regional Cooperaton) Regional Multimodal Transport Study and the BIMSTEC (Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation) Transport Infrastructure and Logistics Study, have identified the important transport or industrial corridors in the region. The development of multimodal economic corridors would lead to significant opportunities for trade, investment, and economic growth in South Asia. However, the challenges are considerable, including the acquisition of land and rising taxes for the development of infrastructure, townships, and industrial or economic zones.

Regional trade liberalization , such as the South Asian Free Trade Area (SAFTA), has not been sufficient to achieve increased intraregional trade. Equally essential is infrastructure development, capacity building, removal of nontariff barriers, and the presence of supportive policies and institutions that promote economic activities along identified transport corridors. In this manner, increased regional trade will follow and cross-border corridors can be converted into genuine economic corridors (Brunner 2013, De, P, and K. Iyengar. eds. 2014). As a regional public good, regional economic corridors generate “non-rival” and “nonexcludable” benefits (benefits that are endless and everyone gets access to) that, if properly designed and implemented, exceed the costs.

This chapter discusses the emerging architecture and key priorities for development of economic corridors in South Asia. It also reviews the rationale for developing economic corridors in the region.

## Economic Corridor: Concept and Stages of Development

Banomyong (2007) identifies four types of corridors: transport, multimodal (combinations of two or more modes), logistics (institutional framework), and economic (investment). In general, an economic corridor consists of infrastructure that facilitates economic activities. Figure 9.3 shows the stages in the development of an economic corridor. Economic corridors can be interpreted as public capital comprising transport networks, human resources, communication facilities, energy grids, and institutional infrastructure (De 2011a, 2014). A corridor can be national (e.g., the Leipzig–Frankfurt or Tokyo–Osaka corridors), regional (e.g., the GMS or CAREC corridors), or international (e.g., submarine telecommunication cables or energy pipelines). Trade facilitation and logistics services are the main catalysts in the development of economic corridors, strengthening the agglomeration of industries and services through the establishment of industrial zones or special economic zones (SEZs) and cluster-type development of enterprises.

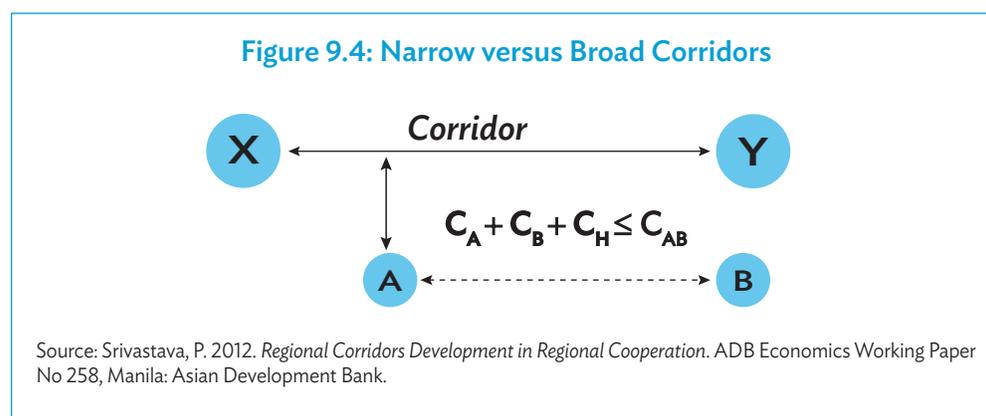
**Catalysts: Trade facilitation, logistics services, among others.**

**Figure 9.3: Stages of Development of Economic Corridors**



Source: Authors.

Srivastava (2012) notes that a corridor begins with physical connectivity in the form of a road or highway connecting two or more nodes. It is natural to view the corridor as a means of transport, and this view is useful and practical. However, a corridor comprises not only a highway but also the surrounding areas that use it. The relationship between the development of connectivity and the areas or zones around the connecting infrastructure is not always direct. The demand for connectivity may arise from existing developed areas or plans for new or further development. The concepts of narrow and broad corridors are depicted in Figure 9.4, where Y and X denote two nodes connected by a highway.



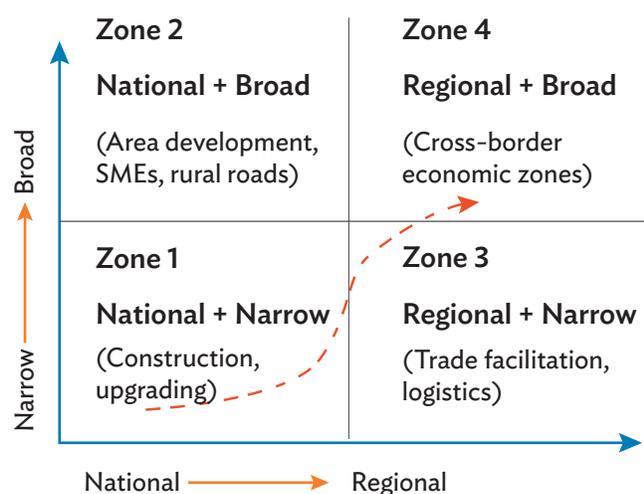
A narrowly defined corridor is the dumbbell comprising X and Y, and the arrow representing the highway or corridor simply connects X and Y. But consider the points A and B off the highway. Let  $C_A$  represent the cost of moving goods from A to the highway and  $C_B$  represent the same for B. These transport costs ( $C_A$  and  $C_B$ ) depend on the distance of A and B from the highway, the road conditions that determine fuel costs and the cost of wear and tear, the speed or time of travel, the availability of vehicles appropriate to the road, and other factors such as local taxes and surcharges.

Those traveling from A to B can either go directly via a relatively poor local road or go to the highway from A, travel along the highway, and get off to reach B. If the cost of directly going from A to B is  $C_{AB}$ , and the cost of travelling on the highway is  $C_H$ , it is better to go from A to B via the highway if  $C_A + C_B + C_H \leq C_{AB}$ . All points off the highway like A and B that satisfy this relationship can be deemed to be part of the corridor, which would then constitute a broader view of the corridor than the dumbbell connection between X and Y.

In most developing economies, the lack of physical infrastructure is a major constraint on growth. Inadequate infrastructure causes congestion, resulting in diminishing returns to capital in industry. The low rate of return acts as a disincentive to investment. This implies a low rate of labor absorption, which perpetuates a vicious cycle of poverty. An economic corridor is a bulky commodity, such as a highway, and it involves a large investment of capital and long planning and implementation stages. Further, the trade and service flows generated by economic corridors often assume public good features, although their extent could vary across services.

Srivastava (2012) envisages five stages in the transformation of a transport corridor to an economic corridor: (i) transport corridor, (ii) transport and trade facilitation corridor, (iii) logistics corridor, (iv) urban development corridor, and (v) economic corridor. The framework for development of a regional corridor is based on the regional extent of the corridor and its area of influence or width. On this basis, four zones are demarcated with the following sequence: (i) narrow national corridor; (ii) broad national corridor, including area development and railroads; (iii) narrow regional corridor, including trade facilitation and logistics; and (iv) broad regional corridor, including cross-border economic zones (Figure 9.5). The development of a national corridor to a regional one (i.e., the transformation from zone 2 to zone 3) may involve the linking of national corridors. It includes reducing border barriers to enable the movement of people and goods at least cost. The growth of logistics companies needs to be supported while procedures are standardized. The private sector has a critical role in zone 3 of corridor development. The seamless integration implied in the move from zone 3 to Zone 4 requires regional plans and the coordination of national plans. Investment and institutions are keys to success of economic corridors (ADB 2014b).

**Figure 9.5: Four Zones of Regional Corridor Development**



SME = small and medium-sized enterprises.

Source: Srivastava, P. 2012. *Regional Corridors Development in Regional Cooperation*. ADB Economics Working Paper No 258, Manila: Asian Development Bank.

The GMS program is an advanced regional cooperation initiative, encompassing zone-3 activities and steps for progressing to zone 4. It is supported by ADB and the Economic Corridors Forum (ECF).<sup>2</sup> Subregions such as the GMS, the Indonesia–Malaysia–Thailand Growth Triangle (IMT-GT), and the Brunei Darussalam–Indonesia–Malaysia–Philippines

<sup>2</sup> The corridor approach in the GMS was adopted in 1998 and a ministerial-level Economic Corridor Forum (ECF) was set up at Kunming, People's Republic of China, in 2008 to coordinate regional initiatives. See, for example, Srivastava and Kumar (2012), Ishida (2012), among others.

East ASEAN (Association of Southeast Asian Nations) Growth Area (BIMP–EAGA) include multiple industrial corridors connecting countries and regions at different development stages. Each country in the region has national plans and priorities for corridor development, which include developing rural roads and growth centers. But transforming these into zone 3 corridors requires the linking of national plans and corridors—a process that may not have high priority in national plans. Developing the regional road corridors identified by the SAARC Regional Multimodal Transport Study (SRMTS), could be a first step toward creating economic corridors in the region.

## Economic Corridors: Economic Links and Role in Production Networks

Economic corridors play a key role in regional economic integration. Despite some negative environmental effects (e.g., increasing air pollution, hastening deforestation), well-functioning and efficient economic corridors are essential for the development of a region. Reducing the costs of transport, both within and across the region, improves international market access, increases trade flows, increases employment and incomes, and reduces poverty. The positive effects of improved cross-border transport infrastructure in the GMS have been well documented, including poverty reduction.<sup>3</sup> Economic corridors are meant to fill regional infrastructure gaps and promote pro-poor socioeconomic development. The box presents some of the benefits of an economic corridor.

The welfare impact of a regional economic corridor is both direct (through changes in distribution of resources) and indirect (through wider growth effects and stimulation of economic activity). Economic corridors have been viewed as major determinants of economic integration (Vickerman 2002). They not only increase intraregional trade and investment, but also play a pivotal role in integrating economies across a region. It is well documented in the literature that regional integration is hampered if countries are not interlinked through modern transport and communication networks (Venables 2007). Economic corridors facilitate global value chains as an important dimension of regional economic integration, and have become building blocks in an era of globalization (Kuroda et al. 2007).

The literature indicates three specific advantages of economic corridors. First, sustained economic growth increases the demand for infrastructure services—software or hardware. Improved economic corridors help provide the required infrastructure services. Second, economic corridors facilitate trade and investment and serve as a vital component of regional integration. Third, better infrastructure (supply links) facilitates specialization of production and enhances regional and global trade, expediting regional integration.

Corridors have gained importance, particularly since the 1990s, reflecting the increasing role of the People's Republic of China (PRC) in vertically integrated supply chains and its growing share of international trade in intermediate goods and openness to foreign direct

<sup>3</sup> The remarkable progress in the GMS is reflected in the increase in average per capita income from about \$630 in 1992 to about \$1,100 in 2006 (World Bank 2007). Edmonds and Fujimura (2008) found a positive effect of cross-border infrastructure on trade in major goods in the GMS.

### Benefits of Economic Corridors

Economic corridors are meant to serve as a blueprint for enhanced connectivity, increased competitiveness, and a greater sense of community in a region. In particular, they have the following benefits:

- improving national and regional connectivity by making it faster, cheaper, and easier for people and goods to move within a country and across borders;
- reducing the cost of trade, thus enhancing the competitiveness of national and regional production networks, and promoting greater investment;
- promoting greater regional and global integration, and thus faster economic growth;
- helping reduce poverty by improving poor people's access to economic opportunities, lowering the cost of goods and services they consume, and providing better access to essential infrastructure services such as electricity;
- helping narrow development gaps among regional economies by providing small, poor, landlocked, and remote countries and areas with better access to regional markets and production networks, thereby stimulating investment, trade, and economic growth in those areas; and
- promoting greener technologies and a more efficient use of regional resources, such as gas reserves and rivers with hydroelectric potential, by developing cross-border projects that permit regional energy trade.

Source: De, P, and K. Iyengar. eds. 2014. *Developing Economic Corridor in South Asia*. New Delhi: Asian Development Bank.

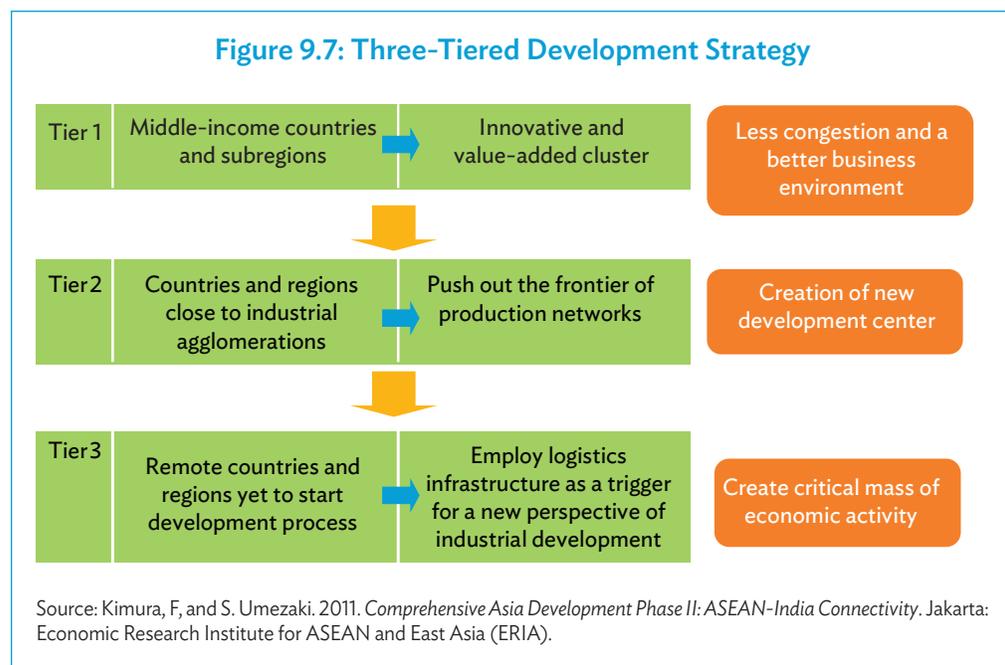
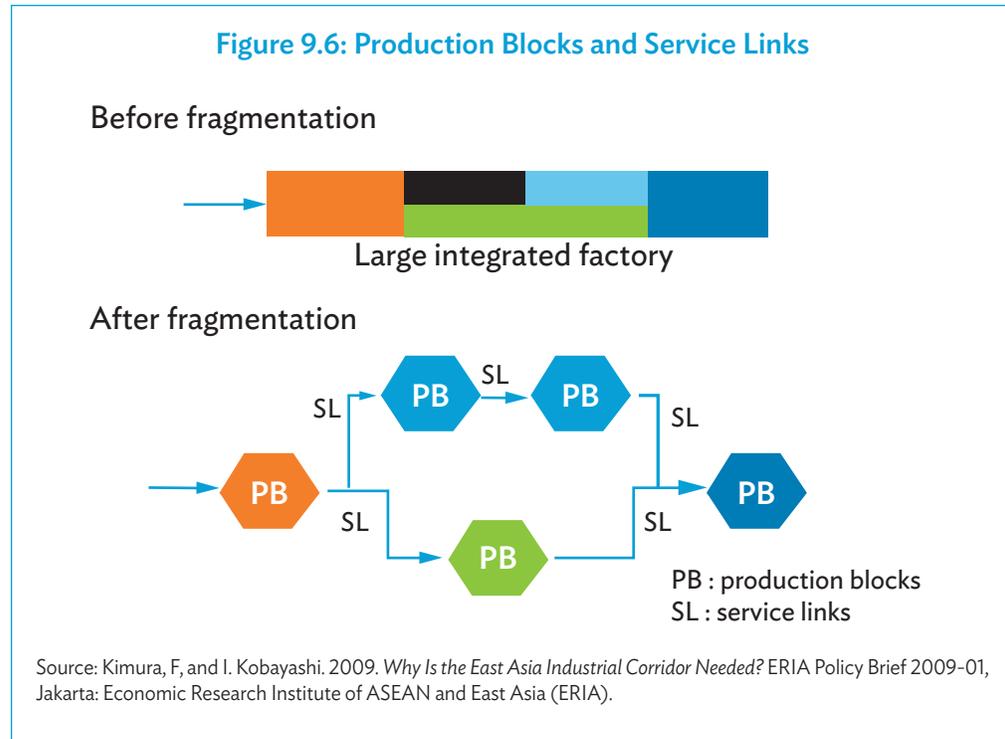
investment. If India aims to become a manufacturing powerhouse, it will need to invest in transport and communication infrastructure for just-in-time delivery and opportunities for vertically integrated supply chains.

Furthermore, an economic corridor can help countries reduce their export dependence and vulnerability to external shocks by increasing their reliance on regional markets (e.g., for fruits and vegetables, textile and clothing, and automobile parts). Building regional economic corridors will strengthen regional trade, especially if accompanied by reductions in tariff and nontariff barriers (Raihan 2014).

Economic corridors also facilitate vertical intra-industry trade. By driving down trade transaction costs and reducing trade and transport logistics barriers, countries can realize the potential of production-sharing arrangements. The drivers of such trade go beyond relative factor endowments to factors such as the complementary use of information and communications technology (ICT), and natural geographies (clustering, agglomeration, and scale effects). Kimura and Kobayashi (2009) indicate that the keys to attracting specialized production blocks include (i) improving the locational advantages for investment by establishing SEZs and other forms of support, and (ii) reducing the cost of service links connecting remote production blocs through improved trade and transport facilities. Figure 9.6 shows the links between production blocks, illustrating why improved economic corridors between countries are important for strengthening production networks. Improved service links (represented by SL in Figure 9.6) and better connectivity help

expand production networks across a region, and are critical to successfully enabling the disaggregation of production and the growth of global value chains.

As illustrated in Figure 9.7, economic corridors help strengthen industrial or services agglomeration over time through the establishment of industrial zones (or SEZs). They also help in dispersing development from congested zones to less congested or periphery areas.



Neogi (2014) concluded that the agglomeration of industries in India, as in other countries, depends on availability of new economic geography variables, such as infrastructure facilities in the region and human capital.

Various methodologies have been used to monitor the performance of corridors. ADB regularly conducts corridor performance measurement and monitoring for corridors under the CAREC Program. The United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) uses a time–cost–distance method at border points to measure performance, while the World Customs Organization (WCO) depends on time release surveys (TRS). The time taken to implement each stage affects the quality and development of an economic corridor.

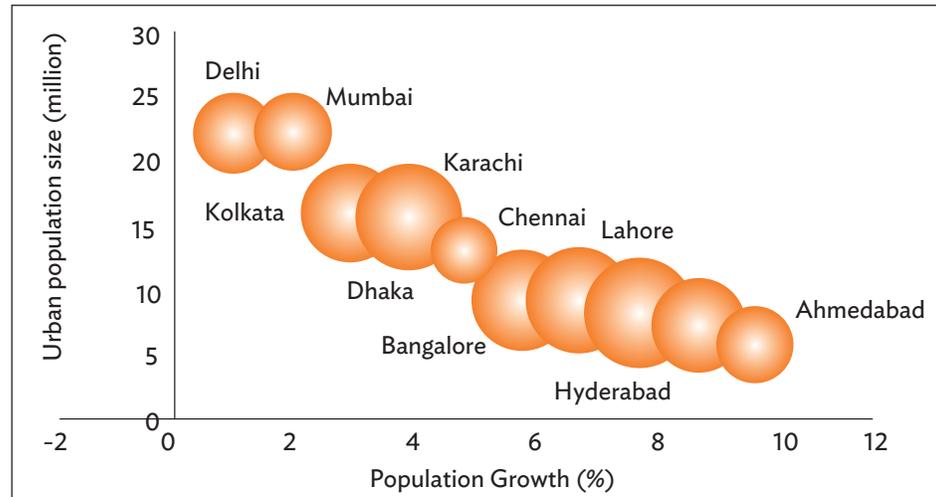
## Developing Economic Corridors in South Asia: Policy Framework

India's free trade agreement with ASEAN in 2010 and the SAFTA agreement in 2006 herald new momentum for economic integration between South and Southeast Asia. This will encourage more specialization of production and services between the two regions if adequately supported by cross-border infrastructure facilities (both hardware and software). South Asia's merchandise trade is expected to increase substantially in coming years, particularly if the region's competitiveness is advanced through regional value chains. Infrastructure services will need to be improved considerably, for both production and consumption and international trade. Corridors for exchanging production inputs and outputs among intermediaries and end users will reduce trade costs and transport times, strengthening competitiveness along the value chain. Failure to adequately invest in corridors will hamper trade and slow South Asia's growth. South Asia's infrastructure challenges require better understanding and support. The region needs a comprehensive policy with the following objectives:

- (i) exploit synergies in the transport system and narrow the divide between urban and rural areas;
- (ii) move toward an open and free market and integrated borders for transport services;
- (iii) improve economic efficiency through reduced transport costs and time;
- (iv) complete the South Asian transport network and improve links with other regions and subregions (Southeast and Southwest Asia); and
- (v) encourage the use of different modes of transport.

Cities in South Asia flourish as major gateways, connected by corridors within the country and in many cases intraregionally (Figure 9.8). Industrial (and knowledge) clusters in and around the gateways have been evolving, such as the Dhaka–Chittagong, Mumbai–Pune, Kolkata–Haldia, and Chennai–Bangalore corridors. Congestion will eventually push out the frontier of production networks to remote, border, or inland areas, and economic corridors will trigger a new phase of industrial development. Economic corridors will link new industrial zones and towns within SAARC member countries and across borders.

Figure 9.8: Major Gateways in South Asia



Note: Urban population refers to 2011, while growth rates are averages from 2001 to 2011.

Source: Author's illustration based on Census of India.

South Asia has identified 10 regional road corridors, 5 regional rail corridors, 2 regional inland waterways corridors, 10 maritime gateways, and 16 aviation gateways for implementation in phase 1 of the SRMTS.<sup>4</sup> The proposed regional road corridors, which are designed to facilitate national, regional, and international transport, and promote industrialization in the hinterland. Examples are the Delhi–Mumbai Industrial Corridor, the Mekong–Ganga Economic Corridor, and the India–Myanmar–Thailand Trilateral Highway. The Mekong–Ganga and India–Myanmar–Thailand corridors both link South and Southeast Asia.<sup>5</sup>

In moving to the economic corridor stage, South Asia's transport corridors may have to first become trade corridors, as has been the case with CAREC in Central Asia (ADB 2012c). The transformation of South Asian transport corridors into economic corridors will depend on the volume, type, and pattern of trade and how this encourages development in the surrounding areas. Figure 9.9 illustrates the transformation of corridors in a geographic space. Spatial planning beyond national policies is needed to support the development of corridors in South Asia. The development of one section of a corridor depends on trading conditions along the entire corridor, including intraregionally. Building corridor nodes and linking them with gateways along the corridor would help the region move toward developing an economic corridor.

Table 9.1 shows the stages in transforming transport corridors to economic corridors and the requisite policies for South Asia.

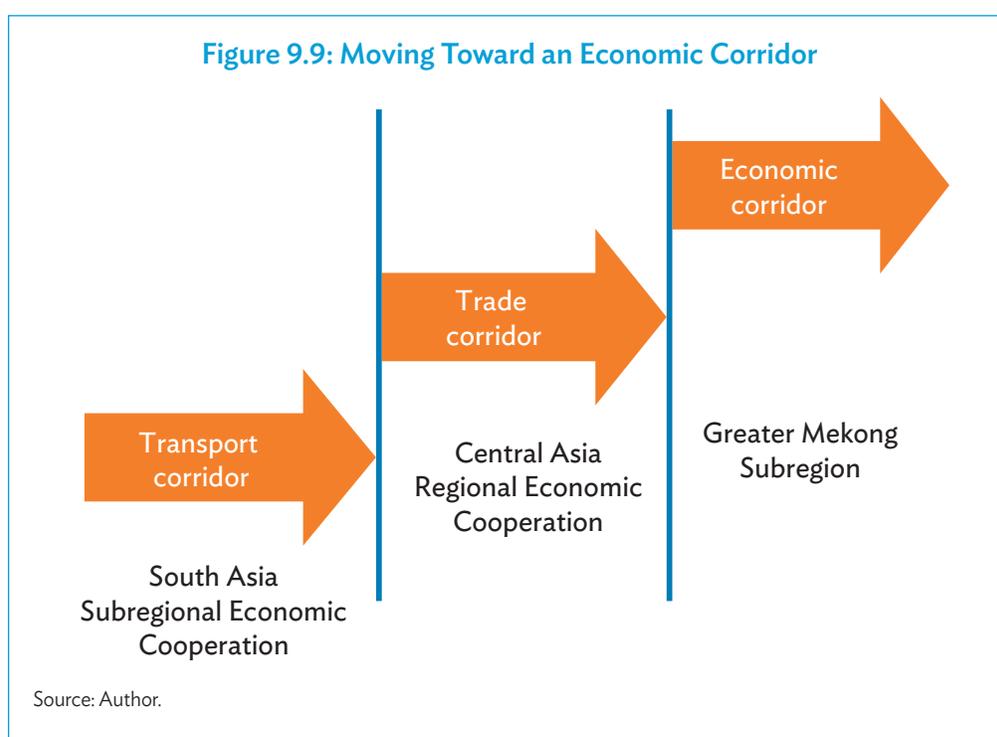
<sup>4</sup> SAARC. 2006. *SAARC Regional Multimodal Transport Study (SRMTS)*. Kathmandu: South Asian Association for Regional Cooperation.

<sup>5</sup> Refer to RIS (2012) and Kimura, F, and S. Umezaki. 2011. *Comprehensive Asia Development Phase II: ASEAN-India Connectivity*. Jakarta: Economic Research Institute for ASEAN and East Asia (ERIA).

**Table 9.1: Corridor Development Policy**

Stage	Corridor	Policy	Measure	Role
1	Transport corridor	Trade facilitation	Integrated trade facilitation Customs cooperation	Government Private sector
2	Trade corridor	Trade liberalization	Border policies Behind-the-border policies	Government
3	Economic corridor	Economic development	Corridor value chains Corridor township development Cross-border investments	Government Private sector

Source: Adapted from ADB, 2012c. CAREC 2020: A Strategic Framework for the Central Asia Regional Economic Cooperation Program 2011-2020. Manila: Asian Development Bank.



The tasks are threefold: developing transport corridors, building corridor nodes, and linking corridor nodes and gateways.

### Developing Transport Corridors

Soft and hard infrastructure measures along selected SAARC transport corridors aim to support area-wide development. For example, South Asian countries have adopted trade facilitation programs in line with their regional and global commitments. South Asian countries are also signatories of the World Trade Organization (WTO) Trade Facilitation Agreement, adopted in December 2013 in Bali, Indonesia. Bilateral and regional customs cooperation is progressing among South Asian countries, particularly between those that share land borders. Most South Asian countries now have national trade facilitation committees. Nevertheless, regional trade facilitation is lagging in South Asia. On customs cooperation, several important issues have been discussed for implementation:

(i) harmonization of customs clearing procedures and documentation, (ii) interoperability of customs systems, (iii) preparation of a simplified form for customs declaration for trade in goods in the SAARC region, (iv) harmonization of 8-digit tariff lines among SAARC countries, and (v) capacity building. The Ninth Meeting of the SAARC Sub-Group on Customs Cooperation, held in Colombo in June 2013, included discussion on the possibility of (i) accepting electronic copies of SAFTA certificates of origin received from importers for clearance of consignments, (ii) having a 7-day work week in case of congestion of consignments at customs border points, and (iii) having a single joint customs point for speedy movement of consignments across SAARC countries.

However, these steps would need to be complemented by (i) improvement of customs operations, including a regional single-window system; (ii) planning and implementation of a coordinated border management strategy; (iii) joint customs control, or at least the selection of one post; (iv) infrastructure improvements such as approach upgrades and scanners; and (v) capacity building for customs and border officers. To operationalize regional transport corridors in South Asia, governments and private sector have shared responsibilities. While governments need to promote an integrated trade facilitation and customs program, private sector cooperation is needed in support of such measures.

### **Building Corridor Nodes**

The next level of corridor development involves improvements in spatial interaction among nodes located along the corridor. Nodes can be classified into (i) commercial nodes, where major business activities are conducted; (ii) border nodes, where cross-border movements of goods and services occur; (iii) gateway nodes, where a corridor ends, and the entry and exit points to the corridor are located; and (iv) interchange nodes, where two or more corridors intersect (ADB 2014b).

Primary commercial gateway nodes (such as Colombo, Delhi, Dhaka, Islamabad, Kabul, Karachi, Kolkata, Lahore, Male, and Mumbai) have already been developed in South Asia. SEZs at border crossings may emerge as new nodes. In parallel, gateways and nodes must become more efficient. Special attention must be given to streamlining border and/or behind-the-border policies. Finally, the focus of economic corridor development in South Asia should be on strengthening and redeveloping the gateways, border nodes, and corridor towns. Examples of production and export-quality infrastructure include certification of products and management systems, competence and accreditation of laboratories, proficiency testing, and metrology and inspection systems.

### **Linking Corridor Nodes and Gateways**

Interaction between nodes along the corridors creates new economic opportunities. Linking corridor nodes would lead to enlargement of markets and creation of industrial complexes or SEZs along the corridor. For the private sector, these activities would facilitate regional value chains. Governments, industry associations, and multilateral organizations would need to ensure that proper infrastructure is in place, and that products originating from different areas along the corridor meet the standards required by domestic or foreign markets.

Trade facilitation and the mobility of professionals along the corridors are key factors for promoting cross-border investment in value chain opportunities. Support in the form of skills development, trade finance, business support services, e-commerce, and public-private-sector networking is also required. In parallel, the involvement of small and medium-sized enterprises (SMEs) is an important part of converting transport corridors into economic corridors. One proven mechanism is through the integration of SMEs into value chain activities; another is the promotion of subregional business development services along the corridors, supported by a cost-sharing facility and a credit guarantee facility (ADB 2012c). Establishment of a project development facility to promote bankable projects for SMEs would contribute to making economic corridor development more inclusive.

By linking cities, towns, and villages, the development of South Asian economic corridors will contribute to modernizing the rural economy, leading to the application of new technologies in agriculture and higher outputs. This will be followed by agro-industry for the processing of local products. Microfinance facilities and training centers will also be needed. The economic corridor framework will serve as a good guide for South Asian countries to promote cooperation and economic integration between and among them.

## Developing Economic Corridors: Key Policies and the Enabling Environment

South Asian Economic Union (SAEU) will result in expanded trade and improved industrial competitiveness. To advance this goal, development of economic corridors in the region should be a priority. They will greatly help to diversify the region's industries and make them globally competitive through improvements in technology, logistics, and other business support services. An economic corridor network is essential for South Asian countries to move their goods to markets more efficiently, quickly, and cheaply. However, economic corridors alone cannot be successful until and unless other operational priorities, such as trade policy, trade facilitation and transit, institutions, energy corridors, and effective telecommunication services, are in place. Regional cooperation and integration and development of economic corridors must progress in tandem, supported in each case by strategic partnerships for policy development.

One of the challenges of economic corridors is that their success closely depends on policy reform, capacity development, and institutional strengthening, underscoring the importance of regional cooperation.<sup>6</sup> For instance, greater regional cooperation would end the relative isolation of landlocked Afghanistan, Bhutan, and Nepal by better linking them to the South Asian region. The challenges are broadly twofold. First are the hardware aspects, such as transport facilities (physical infrastructure, logistics networks, and maintenance) that are important to ensure the flow of goods and services within South Asia and beyond. Second are the software aspects, such as trade facilities (customs, time and cost expended at borders, institutions and governance, dispute settlement, and

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<sup>6</sup> These lessons draw on the experience of the GMS economic corridors.

safeguards), that are critical to efficient use of the hardware. Both require comprehensive interventions by governments and policy makers. The task will be to overcome institutional constraints and bottlenecks that undermine regional competitiveness.

### Accession to International Conventions

As more goods move along regional and international transport corridors, the need for harmonization of laws and processes among countries becomes increasingly important. International conventions related to transport facilitate the movement of goods, especially at border crossings, by reducing the procedures and formalities, and thereby saving time and money. South Asian transport networks require appropriate legal frameworks to define the rights of passage for goods, people, and vehicles and to harmonize permits, licenses, and other measures, as well as mechanisms for consultation and dispute settlement. Recognizing that efficient transport facilities are a prerequisite for enhancing intraregional and international trade, South Asian countries must accede to international conventions on land transport networks (road and rail). All SAARC members should accede to seven international transport conventions, originally developed under the auspices of the Economic Commission for Europe:<sup>7</sup>

- (i) Customs Convention on the Temporary Importation of Commercial Road Vehicles, 1956;
- (ii) Convention on the Contract for the International Carriage of Goods by Road, 1956;
- (iii) Convention on Road Traffic, 1968;
- (iv) Convention on Road Signs and Signals, 1968;
- (v) Customs Convention on Containers, 1972;
- (vi) Customs Convention on the International Transport of Goods under Cover of Transit International Routier (TIR) Carnets (TIR Convention), 1975; and
- (vii) International Convention on the Harmonization of Frontier Controls of Goods, 1982.<sup>8</sup>

The revised Kyoto Convention is the main trade facilitation customs convention relevant to the development of economic corridors.<sup>9</sup> While some South Asian countries (Afghanistan, India, and Pakistan) have signed a few of the conventions listed, progress in acceding to the international standards has been generally slow and uneven. Further, countries have sometimes acceded to different versions of the conventions, adding complexity and weakening the efficiency of the transport networks.

### Multimodal Transport, Transit, and Logistics

Transit and trade facilitation are pivotal to well-functioning economic corridors. In South Asia, the lack of transit rights is a major reason for the low level of economic exchanges. SAARC members need to establish region-wide multimodal transport and transit facilities to reduce transport costs. South Asia should have a regional transit agreement,

<sup>7</sup> As of 2015, there are 56 transport-related international legal instruments initiated by the Economic Commission for Europe aimed at facilitating the movement of goods, people, and vehicles across international borders.

<sup>8</sup> For details of selected international conventions on transport facilitation, see UNESCAP (2007).

<sup>9</sup> The revised International Convention on the Simplification and Harmonization of Customs procedures (Kyoto Convention) promotes trade facilitation and effective controls through its legal provisions that detail the application of simple yet efficient procedures. The revised convention also contains new and obligatory rules for its application, which all contracting parties must accept without reservation.

commencing possibly with the corridors in eastern South Asia that are covered by the South Asia Subregional Economic Cooperation (SASEC) program. Door-to-door logistics should be developed with equal treatment for both transnational and domestic connections. Key players must acknowledge that not all players will benefit equally from cooperation to overcome externalities and bottlenecks in the region (e.g., India bears the cost of the Bangladesh and Nepal road connections). The Cross-Border Transport Agreement, initiated by the members of the GMS and CAREC, is an important step toward harmonizing the software related to cross-border transport and transit. SAARC members should follow suit.

### **Strengthening and Harmonizing Rules, Regulations, and Standards**

For South Asia's transport network to function effectively, rules, regulations, standards, and other soft infrastructure must be in place. The infrastructure must meet established regional benchmarks, and should preferably meet international benchmarks. These measures should be paralleled by trade facilitation initiatives, including reducing tariff and nontariff barriers and differences in trade-related national laws, standards, and conformity assessment procedures. SAARC members should harmonize their national standards with international ones and develop mutual recognition arrangements to recognize each other's standards. High-level coordination is needed among the stakeholders and agencies, such as transport, customs, immigration, and quarantine authorities. The capacity of national institutions must be enhanced for the effective implementation of these agreements. There is also need for a uniform or compatible standard for developing cross-border transport networks. Establishment of an efficient management system for harmonizing standards would contribute greatly to the development of regional economic corridors. It would also support the establishment of single-stop and single-window customs offices along South Asian economic corridors.

### **Border Policies**

Integration of national infrastructure through regional connectivity projects is essential to reap the full benefits from strengthening economic links in South Asia. SAARC members should view borders as connectors and not as walls of separation, enabling peace dividends to accrue (Raihan 2014). In South Asia, there has been an important perceptual change in dealing with border barriers. There is general realization that safe and secure borders are essential to facilitate cross-border trade. Adequate border infrastructure also makes investment easier. India, which shares the longest borders with South Asian countries, has set up in 2013 a Border Connectivity Division in the Ministry of External Affairs to strengthen connectivity across borders. In addition, India is investing in border infrastructure through integrated check post projects. Other SAARC members have taken steps to strengthen their infrastructure at border crossings. Complementary border and corridor management is another important factor for converting transport corridors into economic corridors.

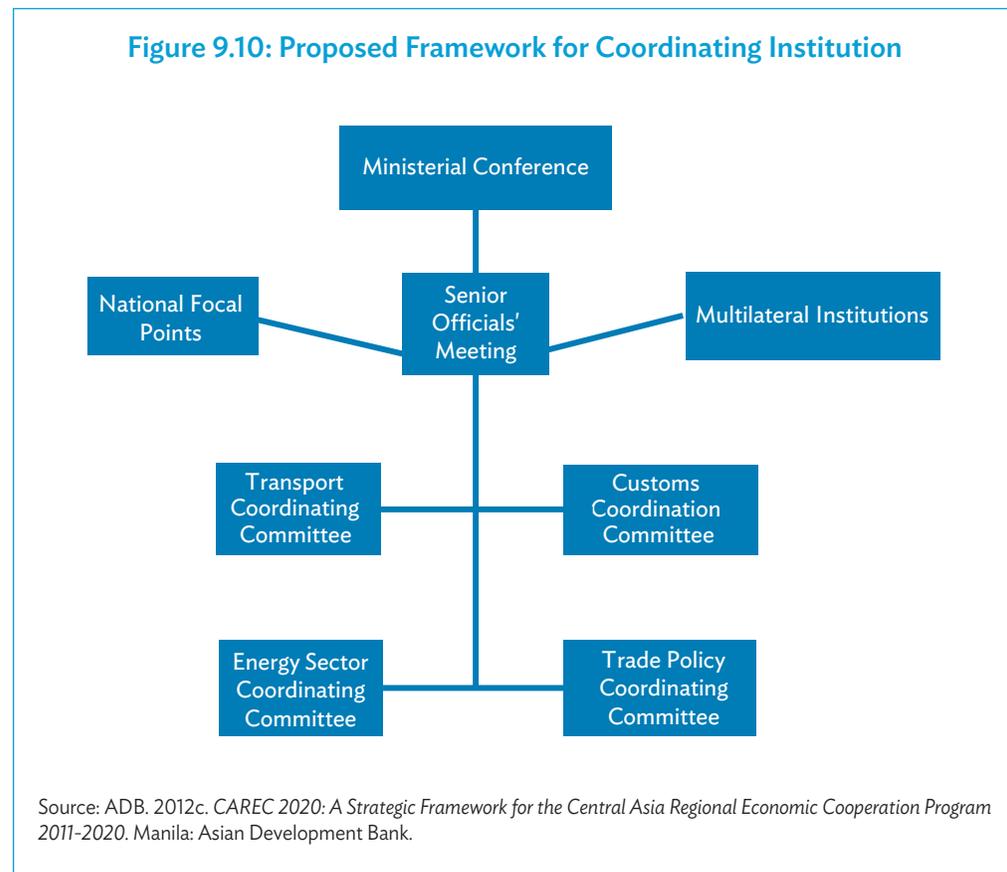
### **Financing Cross-Border Corridors**

Connecting South Asia requires substantial investments, and the financing will be difficult to mobilize. This calls for an appropriate financing mechanism to muster South Asia's huge savings for infrastructure development. Such a financing scheme should aim to raise resources from the public and private sectors, and multilateral development banks, such as ADB, using public-private partnerships. The region's larger economies, such as the People's

Republic of China, India, Japan, and the Republic of Korea, could take leading roles in filling financing gaps. They could unilaterally help to solve problems in developing SAARC corridors, particularly by financing and managing missing links, bridges, industrial zones, townships, and rural roads.

**Building Institutions and Stronger Coordination**

Weak intraregional coordination among planning, implementing, and financing agencies leads to inefficiency in infrastructure development and hinders trade. Similarly, weak coordination among a country’s agencies or institutions leads to inefficiencies, undermines growth, and hinders trade. In the absence of effective coordination among all stakeholders, cross-border infrastructure is likely to be less effective and efficient than it should be. An effective coordinating institution is therefore necessary to generate willingness among key stakeholders to participate in cross-border projects. The coordinating institution could also assist in resolving conflicting interests. Figure 9.10 illustrates a possible institutional framework, featuring an annual ministerial conference followed by a meeting of senior officials responsible for setting the strategy and guiding economic corridor projects. The SAARC Secretariat should serve as overarching coordinator of the projects. A master plan for economic corridors in South Asia is needed, together with an action plan for implementation.



### Closer Cooperation on Security

Secure trade is as important as free trade. Security concerns must be addressed properly before countries will agree to regional transport and transit arrangements. Governments in South Asia can address security concerns using modern technology. If they fail to do this, a reluctance to open borders could drive up trade costs and, in the worst-case scenario, result in closed borders. Focused attention is needed on measures to promote transport security and improve customs regimes, port facilities, and logistics management. South Asian countries need to commit to increasing security in all transport modes and to promoting policy coherence and coordination.

Programs to combat terrorism involving investment in new technology and infrastructure could raise the costs of trade in the short to medium term. However, reducing future threats through the use of technology-intensive security and customs inspections should be viewed as an investment in greater efficiency. Automated technology, such as bar codes, wireless communication, radio frequency identity tags, Radio Frequency Identification (RFID)- or General Packet Radio Service (GPRS)-enabled cargo movement, and tamper-proof seals, help to greatly improve security and accelerate trade.<sup>10</sup> Sharing information among security agencies, port and airport authorities, shippers, and customs officials will also help to expedite the movement of freight through terminals.

### Strengthening Regional Cooperation

Regional cooperation programs in South Asia must be more proactive in addressing regional infrastructure needs and in enabling institutions (e.g., the SAARC Secretariat) and policies to be effective. Through sponsoring intraregional dialogue on experience and lessons learned, regional cooperation will be a catalyst in prompting the planning and implementation steps for creating economic corridors and the trade they foster.

## Conclusions

This chapter has reviewed the role that economic corridors play in increasing trade and industrial competitiveness. Institutions, coordination, and governance are fundamental to the development of economic corridors. Efforts to promote economic corridors need to address key policy reforms in a number of areas. The reforms will require strong institutional input backed by extensive investment in infrastructure development. Economic corridors will generate substantial benefits in South Asia at a time when the region is promoting much greater investment in industry and trying to deepen regional trade through regional and global value chains. In the absence of economic corridors, the regional integration process will continue to lag, and links with ASEAN and other regions will be much weaker than hoped. Making South Asia seamless requires complementary policy initiatives by SAARC members, regional organizations, and multilateral development institutions. Regional corridors are the essential next phase of SAARC's transport corridors.

<sup>10</sup> Such measures were introduced by the Thanaleng border post in the Lao People's Democratic Republic and the Nong Khai border post in Thailand (author's visit on 10 September 2013).



## CHAPTER X

# Trade Facilitation Measures for South Asian Economic Union

*Prabir De*

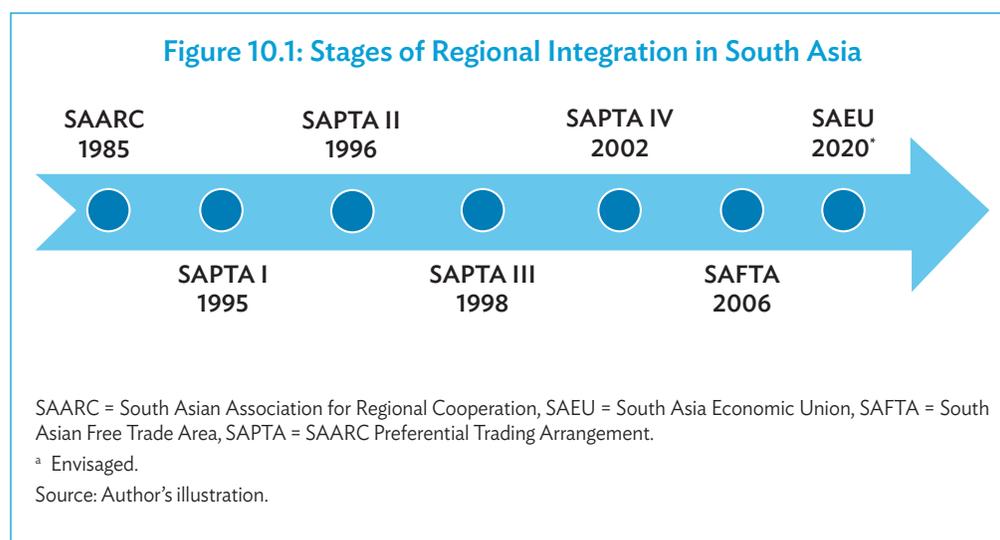
Although they recognize the importance of trade as a driver of economic growth, South Asian countries in general have been slow to reduce the barriers to trade. Further, they have not moved quickly to proactively facilitate trade so as to participate more effectively in regional and international export opportunities.

Trade realities in South Asia include high transaction costs and long delays in the export and import of goods and services. Country-specific constraints have added to the impediments to intraregional trade. As a result, goods often lose much of their competitiveness before they are exported overseas. One of the key challenges for South Asian countries is to strengthen their trade competitiveness in global and regional markets.

South Asia has made some progress in regional integration. As illustrated in Figure 10.1, members of the South Asian Association for Regional Cooperation (SAARC) have endorsed five major trade liberalization initiatives since SAARC's formation in 1985. These steps partially explain the doubling in intraregional trade from \$10 billion in 2006 to \$20 billion in 2012, following the signing of the South Asian Free Trade Area (SAFTA) agreement; this represents a compound annual growth rate of about 13%. Since the 1980s, tariff barriers to trade have gradually been reduced, but nontariff measures continue to seriously impede intraregional trade. New trade theory holds that there is little scope for fostering intraregional trade unless nontariff measures are greatly reduced or eliminated. Table 10.1 lists the main factors limiting South Asian integration and intraregional trade. They include the high transport costs, poor institutions, inadequate cross-border infrastructure, and an absence of regional transit arrangements.<sup>1</sup> While business processing improved during 2006–2012 for certain products, the average time and cost of cross-border trade in South Asia are still high relative to transaction costs in other developing regions (ADB 2015).

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<sup>1</sup> See Asian Development Bank (ADB) (2012d, 2013e), De (2009a, 2011b); and UNESCAP (2012a, 2013b).



**Table 10.1: Elements Holding Back South Asia's Integration**

Macro Elements	Micro Elements
<ul style="list-style-type: none"> <li>• Inadequate national and regional infrastructure (poor stock and lack of infrastructure links)</li> <li>• Absence of regional transit trade (no regional transit)</li> <li>• High nontariff measures, which are complicated and nontransparent</li> <li>• Lack of harmonization of axle loads for vehicles</li> <li>• Poor institutions and governance (no regional mechanism)</li> <li>• Lack of coordination of border authorities</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of simplification and harmonization of trade procedures, particularly at border crossings</li> <li>• Absence of modern corridor management techniques</li> <li>• No fast-track lane and priority of goods in transit</li> <li>• Lack of standard operating procedures at selected border</li> <li>• Variation in or absence of testing facilities, banks, scanners</li> <li>• Nonacceptance of customs transit document at some border posts</li> </ul>

Source: Author.

Although collective trade facilitation among South Asia countries has made little progress to date, South Asian countries have implemented trade facilitation measures individually.

The next stage for deepening SAARC integration would be to form a common market with a common external trade policy. Economic union could follow as a natural progression. The benefits from implementing trade facilitation measures leading to a common market would be significant. Undoubtedly, trade facilitation will play a key role in forming a common market and economic union in South Asia.

This chapter discusses the trade facilitation challenges and reforms SAARC member countries must address.

## Changing Definition of Trade Facilitation

Defined broadly, trade facilitation is any policy action (other than cutting tariffs) that reduces international trade costs. Trade facilitation includes modern and effective customs administrations, streamlined and transparent trade processes and procedures, and improved services and information for private sector traders and investors. It often refers to measures for reducing or removing nontariff institutional, administrative, and technical barriers to trade. In some studies, trade facilitation is described as including measures to deal with geography, social and cultural costs (language), and logistics. “Narrow” trade facilitation refers to customs and border procedures. Differences between countries in product standards (sanitary and phytosanitary restrictions and technical barriers to trade) and regulations are also trade facilitation issues. Grainger (2011) identifies four sets of factors involved in trade facilitation: (i) simplification and harmonization of applicable rules and procedures, (ii) modernization of trade compliance systems, (iii) administration and standards, and (iv) institutional mechanisms and tools (Box).

### Four Interdependent Topics that Define Trade Facilitation

#### 1. Simplification and harmonization of applicable rules and procedures

- **Harmonize procedures.** For example, adopt international conventions and instruments, and harmonize controls applied by various government agencies.
- **Avoid duplication.** For example, adopt regional or bilateral agreements to recognize export controls in lieu of import controls; share inspection facilities, such as customs officers, veterinarians, plant health inspectors, and health inspectors; and formally recognize private sector controls (e.g., in the area of security or quality) in lieu of official checks.
- **Accommodate business practices.** For example, accept commercial documents (such as invoices) in lieu of official documents, and allow goods to be cleared inland, away from the bottlenecks at ports and border posts.

#### 2. Modernization of trade compliance systems

- **Solutions.** For example, use electric information systems, the single-window concept, electronic customs systems, port community systems, websites, and information portals.
- **Standardization.** For example, electronic standards for the exchange of information between computers, paper document standards, barcode standards, document referencing conventions, and standards for the description of locations.
- **Sharing of experiences.** For example, training and awareness building, development of toolkits and implementation guides, collaborative and open-source systems developments.

#### 3. Administration and standards

- **Service standards.** For example, public service-level commitments, publish and make available applicable rules and procedures, produce plain language guides, develop online websites, keep the customs tariff up-to-date, provide for efficient appeal mechanisms.
- **Management principles.** For example, enforce controls in proportion to the risk against which they seek to protect, introduce selective (risk-based) controls that reward compliant behavior (e.g., preferential treatment at the border).

#### 4. Institutional mechanisms and tools

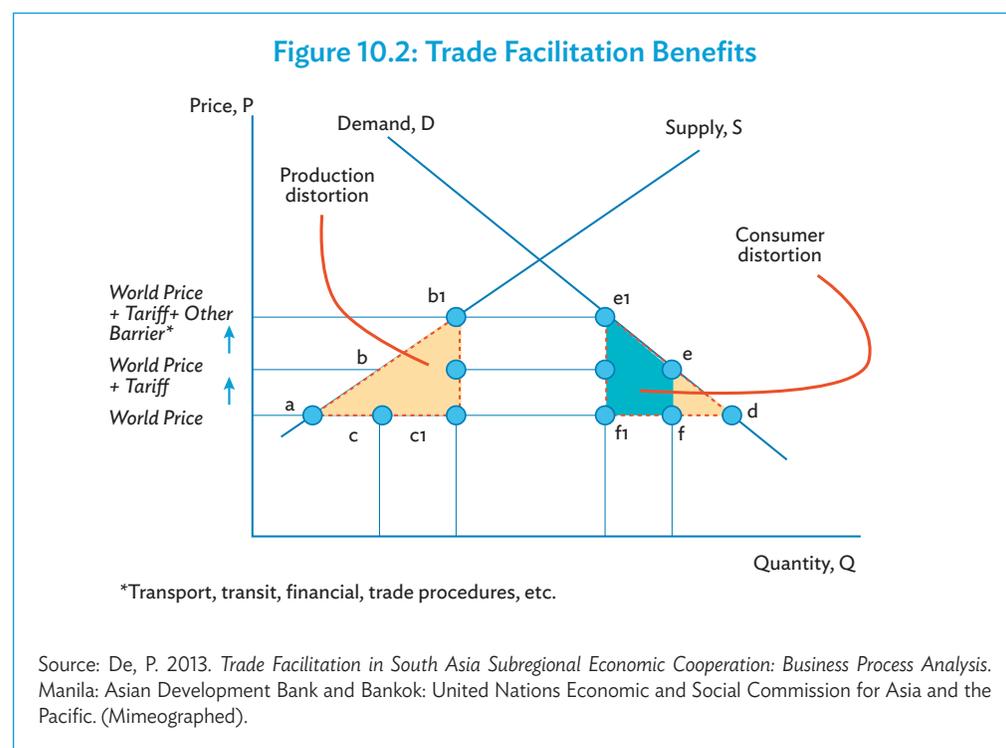
- For example, establish a national trade facilitation body, produce and publish white papers setting out reform ambitions and inviting stakeholder comments.

Source: Grainger, A, and G. Mclinden. 2013. “Trade Facilitation and Development.” In *Handbook of Trade Policy for Development*, Edited by Lukauskas, A., R. M. Stern, and G. Zanini. New Delhi: Oxford University Press.

Several international organizations are actively engaged in trade facilitation projects, notably the Asian Development Bank (ADB), the United Nations (UN) Centre for Trade Facilitation and Electronic Business, the UN Conference on Trade and Development, the UN Economic and Social Commission for Asia and the Pacific (UNESCAP), the World Bank, the World Customs Organization (WCO), and, most importantly, the World Trade Organization (WTO). Trade facilitation under the WTO refers to Articles V, VIII, and X of the General Agreement on Tariffs and Trade, which relate to the freedom of transit, fees and formalities, and publication and administration of trade regulations. The WTO's Trade Facilitation Agreement, signed at the WTO's Ninth Ministerial Meeting in December 2013, has added a new institutional dimension to trade facilitation, which is seen as increasingly vital to trade promotion and development.<sup>2</sup>

Theoretically, improvements in trade facilitation reduce production and consumer losses and result in net economic welfare benefits. Barriers to trade above the tariff level (Figure 10.2) cause substantial economic welfare losses: the production loss goes up from  $abc$  to  $ab_1c_1$ , and the consumer loss goes up from  $def$  to  $de_1f_1$ . A free trade agreement eliminates the tariff barrier but not necessarily other trade barriers. Trade facilitation coupled with better connectivity helps raise trade volumes and economic welfare.

Trade facilitation research priorities are changing rapidly, particularly following the WTO Trade Facilitation Agreement. The following five areas of policy research and knowledge products have been gaining interest: (i) trade processes and procedure analysis by product and corridor (to support paperless trade), (ii) trade sophistication



<sup>2</sup> At the Ninth Ministerial Conference, held in Bali, Indonesia, from 3 to 7 December 2013, WTO members adopted the "Bali Package," a series of decisions aimed at streamlining trade, allowing developing countries more options for providing food security, boosting least developed countries' trade, and helping development more generally.

and diversification analysis (to help build value chains), (iii) corridor and trade facilitation analysis (to strengthen value chains), (iv) border management coordination and cooperation (to build border crossing as a single unit for trade purposes), and (v) removal of nontariff measures. However, questions have been raised as to whether the gains from trade facilitation exceed the costs. In particular, there are concerns about the distributional consequences of trade reforms.

## Key Facts about Trade Facilitation

### Trade Facilitation Eases Burden of Policy-Related Nontariff Trade Costs

The UNESCAP–World Bank trade database suggests that the costs of interregional trade are lower than those of intraregional trade (Table 10.2). In other words, the costs of trade within South Asia are higher than the costs of trade with external partners. Bilateral trade costs within South Asia in 2011 are estimated to have been 244% in 2011 (ad valorem equivalent for manufactured goods), compared with 121% for trade with East Asia and the Pacific region, indicating that trade impediments are more serious within the South Asia region.

**Table 10.2: Bilateral Trade Costs, 2011**  
(% ad valorem equivalent, manufactured goods)

Region	East Asia and Pacific	Europe and Central Asia	Latin America and Caribbean	Middle East and North Africa	South Asia	Sub-Saharan Africa
East Asia and Pacific	80.0					
Europe and Central Asia	218.0	142.9				
Latin America and Caribbean	218.2	286.0	170.4			
Middle East and North Africa	213.2	179.3	281.7	119.8		
South Asia	121.4	216.3	234.6	143.6	243.5	
Sub-Saharan Africa	238.3	319.8	316.4	232.9	188.3	181.5

Source: Arvis, J. F., Y. Duval, B. Shepherd, and C. Utoktham. 2012. *Trade costs in the developing world: 1995–2010*. ARTNeT Working Paper No 121, Bangkok: United Nations Economic and Social Commission for Asia and the Pacific.

The same observation holds at the country level. In South Asia, landlocked and island countries experience higher trade costs. For example, the ad valorem equivalent nontariff trade cost for India–Pakistan trade in manufactured goods was 124.1% in 2011 (Table 10.3). This indicates that trade in manufactured goods between India and Pakistan involves, on average, additional costs amounting to approximately 124% of the value of the goods in domestic markets.<sup>3</sup> In contrast, the ad valorem equivalent nontariff trade cost of India–United States trade in manufactured goods was 89% in 2011. A similar result was observed in the case of Pakistan’s nontariff trade cost with India compared with that of the People’s Republic of China (PRC) or the United States (US). At the same time, the nontariff trade cost of India’s exports to Afghanistan or Sri Lanka, and Pakistan’s exports to Nepal, appear to be very high. Figures 10.3 and 10.4 substantiate this. Clearly, policy-related nontariff trade costs are relatively more important for South Asian countries.

<sup>3</sup> The UNESCAP trade cost measure (Novy 2012) is a comprehensive all-inclusive measure based on micro-theory and calculated using macroeconomic data, providing an alternative measure of trade facilitation performance (Arvis et al. 2012).

Trade facilitation measures need to combine both origin and destination countries. For example, a high-end cargo handling system at a seaport in a developed country might clear a container destined for a developing country within few hours, but an inefficient port in the destination country could negate the benefit. Variations in rankings in the logistics performance index (LPI) capture this concern (Table 10.3). Developing countries need to pay special attention to trade facilitation because they suffer from supply-side constraints. Improvements in trade facilitation could generate \$250 billion in additional trade for Asia and the Pacific (ADB 2013e).

**Table 10.3: Trade Costs in South Asian Developing Countries, 2011**

Country	Partner	Exports (\$ million) <sup>a</sup>	NTC (%)
India (47)	Afghanistan (143)	458.4	226.8
	Bhutan (128)	202.7	55.5
	PRC <sup>b</sup> (27)	17,168.8	79.6
	Maldives (125)	114.0	220.7
	Nepal (147)	2,549.3	48.9
	Pakistan (110)	1,891.5	124.1
	Sri Lanka (137)	4,103.0	87.7
	US <sup>b</sup> (15)	31,055.3	88.8
Pakistan (110)	Afghanistan (143)	1,889.4	72.8
	PRC <sup>b</sup> (27)	2,119.4	96.0
	India (47)	384.5	124.1
	Nepal (147)	1.0	229.2
	Sri Lanka (137)	286.9	136.4
	US <sup>b</sup> (15)	3,509.8	103.8
Sri Lanka (137)	PRC <sup>b</sup> (27)	94.0	126.8
	India (47)	526.8	87.7
	Maldives (125)	50.3	80.4
	Nepal (147)	0.6	303.5
	Pakistan (110)	72.3	136.4
	US <sup>b</sup> (15)	1,972.3	125.7

NTC = nontariff trade cost, ad valorem equivalent; PRC = People's Republic of China; US = United States.

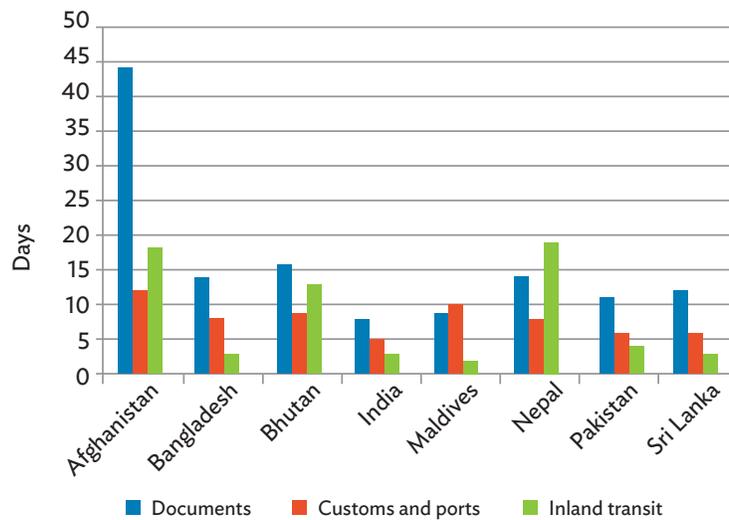
Note: Numbers in parentheses are global ranks of countries in the World Bank's 2012 Logistics Performance Index.

<sup>a</sup> Simple average for 2010, 2011, and 2012.

<sup>b</sup> NTC relates to 2010.

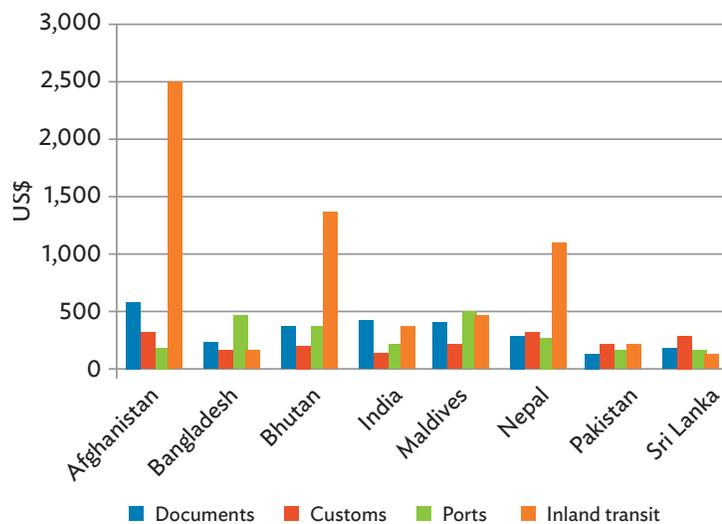
Sources: Based on the IMF. International Monetary Fund Direction of Trade Statistics on exports. <http://elibrary-data.imf.org/FindDataReports.aspx?d=33061&e=170921> (accessed 1 March 2014); World Bank. United Nations Economic and Social Commission for Asia and the Pacific trade costs. <http://databank.worldbank.org/data/views/variableselection/selectvariables.aspx?source=ESCAP-World-Bank-International-Trade-Costs> (accessed 1 March 2014), and the World Bank. Logistics Performance Index. <http://lpi.worldbank.org/> (accessed 27 June 2012).

Figure 10.3: Export Time, 2013



Source: World Bank. Doing Business Indicators. <http://data.worldbank.org/data-catalog/doing-business-database> (accessed 27 June 2012).

Figure 10.4: Export Cost, 2013



Source: Calculated based on the World Bank Doing Business. <http://www.doingbusiness.org/>

In many cases, border costs exceed behind-the-border costs. High trade transaction costs obviously hamper regional integration. Given South Asia's growing volume of trade with the PRC and the US, it would be appropriate to adopt multidimensional trade facilitation strategies, tailored to the needs of trade with different regions. The marginal return from improved trade facilitation rises as trade volumes increase, but a single trade facilitation measure may not fit all trade destinations and origins.

### Regional Trade Facilitation Yields Benefits

Pakistan's extension of most favored nation (MFN) status to India, combined with enhanced trade facilitation in South Asia, will lead to significant welfare gains, in particular for India and Pakistan but also for other SAARC or SAFTA members (De, Raihan, and Ghani 2013). Estimates in Table 10.4 suggest that SAFTA together with MFN status would lead to higher welfare gains for India and Pakistan than a scenario of SAFTA without MFN status. However, when a South Asian trade facilitation scenario is added, the gains become much larger. The SAFTA scenario (with or without MFN) could, however, lead to some welfare loss for Bangladesh because the trade diversion effect is larger than trade creation effect (Raihan 2012). Under the SAFTA agreement combined with MFN status for India and trade facilitation, Pakistan's exports are expected to increase significantly. These results point to the importance of improved connectivity and trade facilitation between the two countries to reap the benefits of economic cooperation. The greater the degree of connectivity, the larger the benefit; trade facilitation and connectivity are mutually reinforcing.

**Table 10.4: India–Pakistan Alternative Welfare Results of SAFTA**  
(\$ million in 2007 prices)

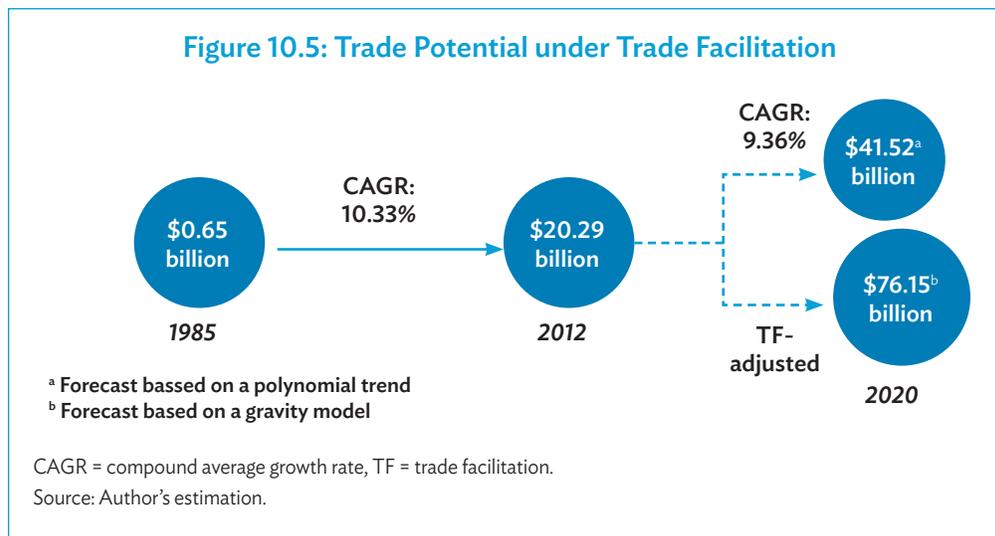
Country or Region	SAFTA without MFN	SAFTA with MFN	SAFTA + MFN + STF
Bangladesh	(132.8)	(111.8)	1,479.6
India	1,650.0	1,810.7	5,452.0
Nepal	467.0	485.0	1,654.2
Pakistan	1,022.5	1,121.7	2,618.4
Sri Lanka	37.0	71.9	2,173.1
Rest of South Asia	282.5	298.2	1,265.0
PRC	(205.7)	(216.2)	(760.1)
US	(252.1)	(270.5)	(985.5)
EU25	(318.8)	(348.3)	(1,394.9)
Rest of the World	(615.0)	(681.7)	(3,020.8)

( ) = negative, EU = European Union, MFN = most favored nation, PRC = People's Republic of China, SAFTA = South Asian Free Trade Area, STF = trade facilitation among SAFTA members, US = United States.

Source: De, P., S. Raihan, and G. Ghani. 2013. *What does MFN trade mean for India and Pakistan?—Can MFN be a Panacea?* World Bank Policy Research Working Paper 6483, Washington, DC: World Bank.

### Trade Facilitation Unlocks Huge Trade Potential

The volume of regional trade has grown from less than \$1 billion in 1985, when SAARC was established, to about \$20 billion in 2012; this represents a compound annual growth rate of 10.3%. As illustrated in Figure 10.5, trade facilitation measures would generate \$76.1 billion in additional regional trade in South Asia by 2020, whereas a business-as-usual scenario without trade facilitation would generate only \$41.5 in regional trade in the same year.



### Trade Facilitation Promotes Production Networks

Trade facilitation helps promote cross-border production networks. With production processes and tasks increasingly deconcentrated or fragmented across national borders, time-sensitive logistics services along with information and communication technology (ICT) are vital to creating and participating in cross-border production networks (Kimura and Kobayashi 2009). Strengthening South Asian corridors through investment in cross-border infrastructure and trade facilitation measures would help the region improve the efficiency of corridor and supply chain connectivity. Intuitively, a stronger network of supply chains is essential for strengthening regional value chains.

### Border Connectivity Is Essential for Trade Facilitation and Multimodal Transport

Aggregate growth matters but so do changes in the trade composition, as they change the kinds of infrastructure needed. For example, air transport is the best choice for trade in light goods; it is also the preferred mode of transport when certainty of delivery and timeliness are essential. Multimodal transport has been promoted for the bulk transport of goods within and between regions. Technological progress in transport coupled with global operators and trade facilitation measures have enabled multimodal transport in the region. However, the full potential of multimodal transport networks and logistics hubs will only be realized if the region is able to establish faster and low-cost border-crossing points that facilitate the movement of people, goods, and vehicles more efficiently around the region. Improved border connectivity is an essential component of trade facilitation.

### Connectivity Reduces Poverty

Although substantial economic progress has helped South Asian countries to ease the burden of poverty, about one-quarter of the overall population continues to live in poverty.<sup>4</sup> The high incidence of poverty acts as a persistent drag on growth. South Asia also faces

<sup>4</sup> The poverty incidence ranges from 36% in Afghanistan to 9% in Sri Lanka. Source: World Bank. World Development Indicators. <http://data.worldbank.org/data-catalog/world-development-indicators> (accessed 13 February 2014).

tremendous population pressure, particularly in urban areas. Productive employment opportunities are far too few to absorb the huge and growing labor force. It can be argued, though, that market size and scale economies will eventually lead to sustained rapid growth and quality jobs in the region. Connectivity improvements will reduce trade costs and thereby lead to increased trade flows. Better connectivity attracts investment, creates employment, and reduces poverty. One of the best solutions to the challenges facing South Asia, therefore, is to strengthen regional integration through improved trade facilitation measures and stronger connectivity.<sup>5</sup>

Cross-border investment in connectivity-related infrastructure has been limited, and despite the need for regional cooperation for this purpose, there has been little to date. Trade facilitation measures vary among transport modes, procedures, products, and country groups. Removing obstacles to trade, by improving transport and logistics connectivity and lowering tariffs and other trade barriers, is a high priority for South Asia. This is especially so for the poorest landlocked countries.

### **Trade Facilitation Reforms Are Key to Trade Competitiveness**

Trade facilitation includes better logistics, which are increasingly critical to competitiveness and investment given the growing importance of global and regional value chains. Streamlined customs and border management and improvement in transit provisions contribute to more efficient logistics (World Bank 2014b). Additional cost-cutting measures through trade facilitation have helped countries develop new export markets and strengthen their overall trade performance. Behind-the-border measures were used comprehensively during the 2008–2010 global economic crisis. These have continued to be important trade policy tools in the post-crisis economic recovery phase.<sup>6</sup> For example, a government task force report in India recommended reducing trade-related transaction costs by cutting the red tape at border points and providing easier access to trade-related information.<sup>7</sup> Simplification of trade processes and procedures along with harmonization of trade transaction data and documents are viewed by most South Asian countries as important factors in improving export competitiveness.

### **Trade Facilitation Helps Streamline Nontariff Measures**

Nontariff measures are all trade-restricting measures other than tariffs. They include trade-related procedures, regulations, standards, licensing systems, and even trade defense measures such as antidumping duties, which have the effect of restricting trade between countries. Some of these measures can be justified according to provisions or exceptions provided under the multilateral agreements governing international trade. Nontariff measures that cannot be justified under any of these legal provisions are normally termed nontariff barriers. Much larger welfare gains can be achieved by reducing transaction costs in bilateral trade than can be achieved by simply cutting tariffs. Trade facilitation measures are important for reducing nontariff measures, which, particularly in South Asia,

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<sup>5</sup> There is a causal link between improvement in connectivity and regional integration and cooperation. See, for example, Brooks (2010).

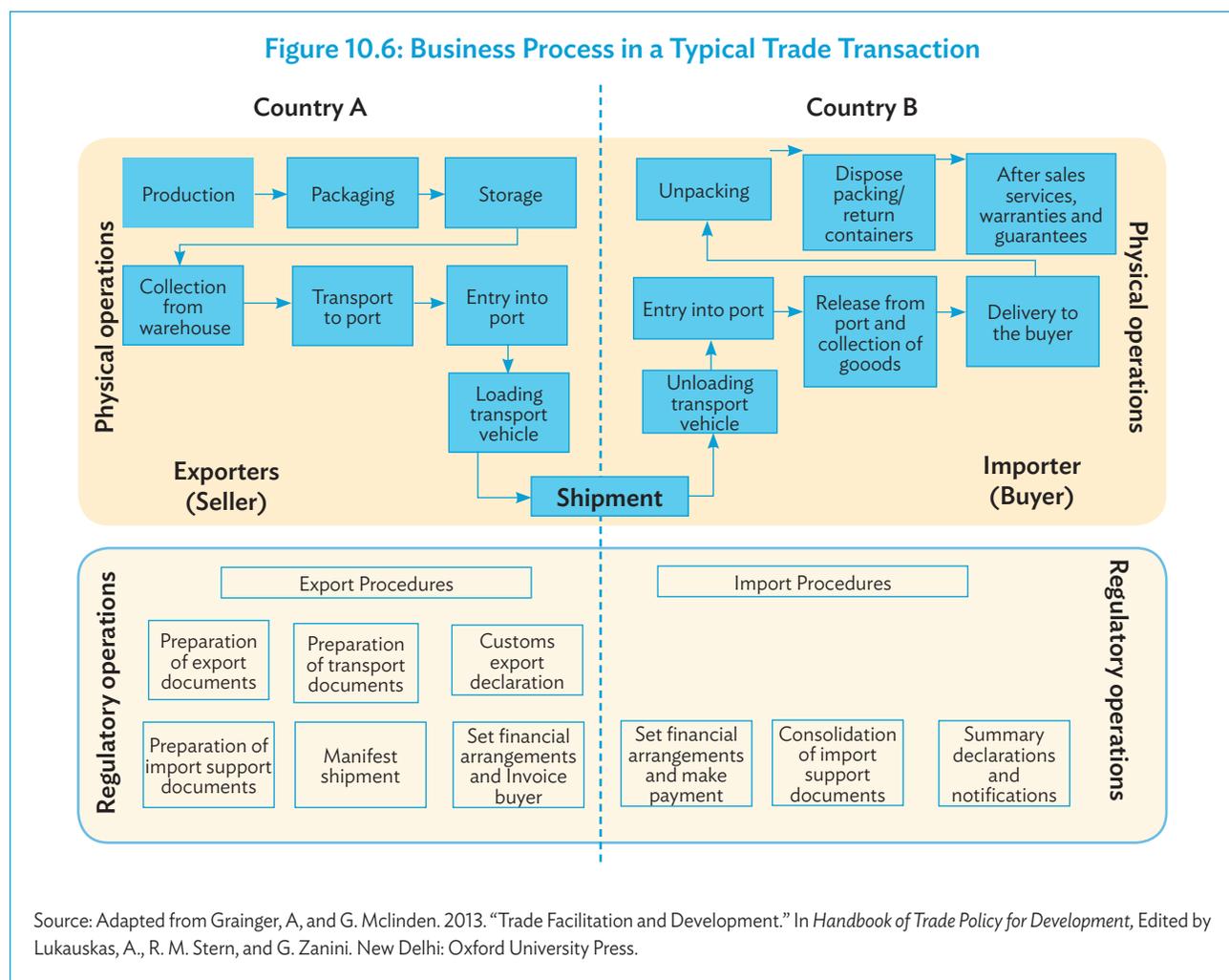
<sup>6</sup> Refer, for example, to UNESCAP (2011a).

<sup>7</sup> The report of the task force to reduce transaction costs in exports, released in February 2011 by the Government of India, has recommended certain measures that are expected to save Rs210 billion (about \$450 million) for exporters every year. This amount represents about 0.02% of India's exports, where exporters suffer transaction costs equivalent to 7%–10% of exports. The task force report identified 44 issues. Closure has been achieved on 23 of them. Refer to Government of India (2011) for further details.

are numerous and complex. Raihan et al (2014) commented: “There is no denying that nontariff measures and nontariff barriers are responsible for the high degree of transaction costs in bilateral trade among the South Asian countries. Therefore, the reduction in such transaction costs through streamlining nontariff measures or the elimination of nontariff barriers would generate large welfare gains for all South Asian countries.”

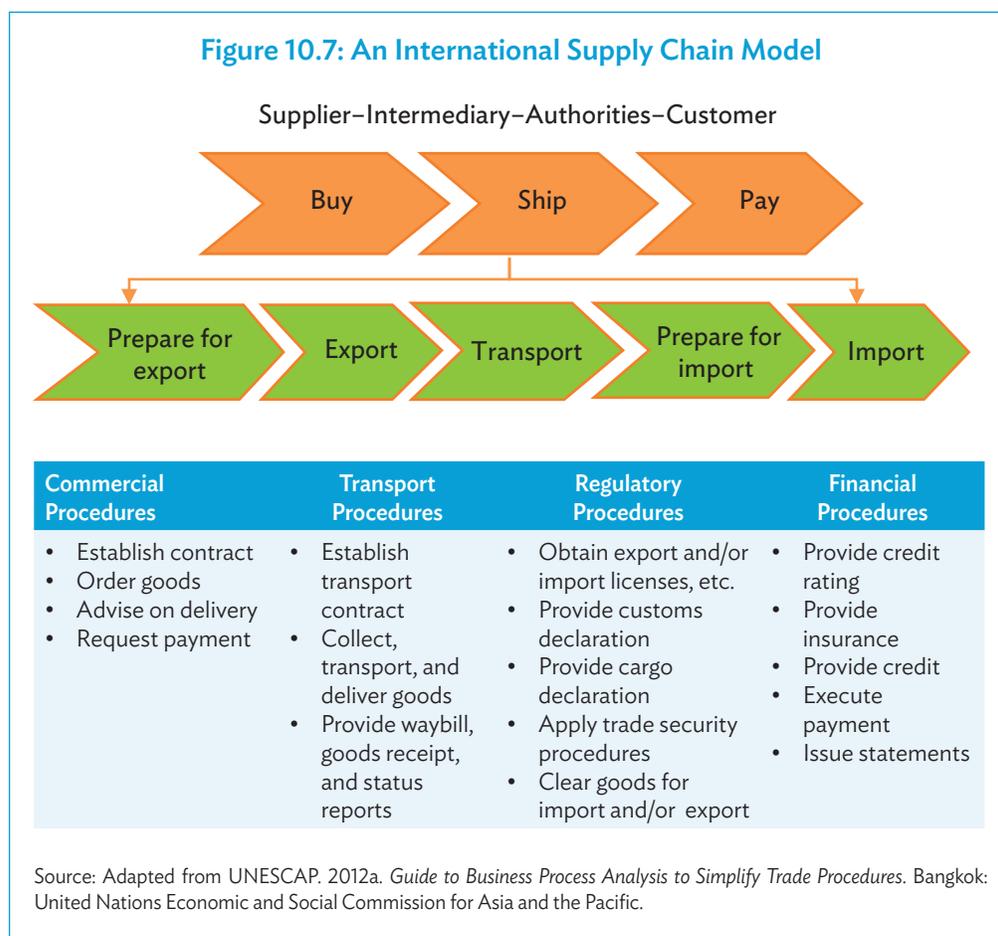
## Identifying the Cross-Border Trade Environment

One of the challenges for trade facilitation reform is the complexity of cross-border trade practices. Trade processes and procedures are not only complex but also diversified across products. Figure 10.6 illustrates the business process for a typical trade transaction and identifies some of the physical and regulatory operations necessary for moving goods between contracting parties in the region. Identifying and mapping trade procedures is an essential prerequisite for reforms. Procedures in a particular trade transaction can be



identified and mapped using the methodology outlined in the *UNNExT Business Process Analysis Guide to Simplify Trade Procedures*. Trade processes and procedures need to be simplified not only to reduce red tape, corruption, and bribery, but also to improve the efficiency of trade transactions. An efficient trade transaction process helps to make trade competitive.

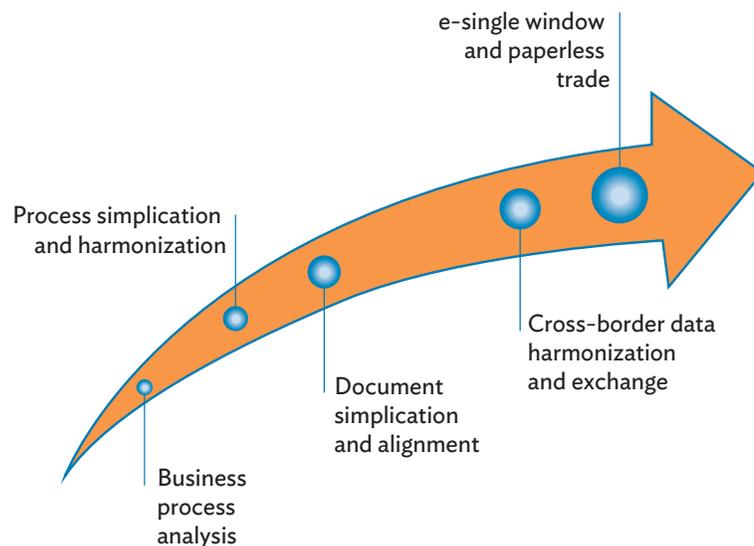
Recommendation No. 18 of the UN Centre for Trade Facilitation and Electronic Business illustrates a simplified view of the international supply chain in the buy–ship–pay model (Figure 10.7). The model not only suggests a series of fragmented activities that are carried out during the international trade transaction, but also defines different actors associated with them. Key actors in the international supply chain are authorities, intermediaries, suppliers, and customers. The UNESCAP (2009) suggests that an international trade transaction encompasses all activities related to the establishment of commercial contracts (commercial procedures), the arrangement of inland and cross-border transport of goods (transport procedures), the export and import formalities to meet regulatory requirements (regulatory procedures), and the payment for purchased goods (financial procedures). As illustrated in Figure 10.6, the steps require cooperation among many individuals, including traders, government agencies, and service providers from different countries. Business process analysis of international trade transactions is recommended as the first step to understand the changes that will need to be made as part of the simplification, harmonization, and automation of trade procedures and documents.



The scope of the trade process includes all procedures involving the exporter (seller) or its representatives, from signature of the contract between the buyer and seller to loading of the goods onto a sea vessel (or, if by land, to the border checkpoint of the importing country), and to receiving payment. The scope of the import process analyzed generally includes all procedures involving the importer (buyer), i.e., procedures related to the signature of the contract between the buyer and seller, all procedures from arrival of goods at the border (or seaport of the importing country) to delivery at the warehouse in the importing country. Tracking the procedures in this manner will help determine the extent and nature of trade transaction reforms to be undertaken. Process reengineering, along with document simplification and alignment, helps countries to move toward data harmonization and exchanges across borders. These measures lead to an electronic single window and paperless trade environment (Figure 10.8).

In recent years, South Asian countries have conducted business process analysis for selected products as well as process simplification and harmonization. National customs in most South Asian countries have undertaken reforms and initiatives for electronic submission of documents through online procedures. While there has been some progress at the country level in simplifying processes and harmonizing documentation, there has been limited cross-border data harmonization and exchange at the regional level.<sup>8</sup> These improvements require a regional single window.

**Figure 10.8: Approach to Developing an Electronic Single Window and Paperless Trade Environment**



Source: Adapted from UNESCAP. 2012a. *Guide to Business Process Analysis to Simplify Trade Procedures*. Bangkok: United Nations Economic and Social Commission for Asia and the Pacific.

<sup>8</sup> Refer to SASEC. 2013. *Business Process Analysis Report 2013*. Mandaluyong City: South Asia Subregional Economic Cooperation. (Unpublished).

## Performance of South Asian Countries in Trade Facilitation

Trade facilitation performance is assessed using three data sources: (i) the World Bank's Doing Business database for the cost and time to export and import goods, (ii) the logistics performance index (LPI) database for aggregate and sector performance indicators, and (iii) the database compiled by Raihan et al. (2014) for nontariff measures. The following paragraphs contain observations derived from an analysis of these sources.

In South Asia, it still takes about 33 days to move goods from factory to deck of ship at the nearest seaport (2014), which is even longer than the average for sub-Saharan Africa (31 days). For imports, in South Asia it takes less time (34 days) to move goods compared with sub-Saharan Africa (38 days). However, performance varies among South Asian countries. The more developed countries have performed better than the least developed countries (LDCs) in time and cost to export and import goods (Table 10.5). From a comparative global perspective, the performance of South Asia in trade facilitation has been mixed.

**Table 10.5: Time to Export and Import Goods, 2006 and 2014 (days)**

Country	Export Time		Import Time	
	2006	2014	2006	2014
Afghanistan	66	81	80	85
Bangladesh	35	25	60	35
Bhutan	38	38	38	38
India	27	16	41	20
Maldives	21	21	20	22
Nepal	43	42	35	39
Pakistan	31	21	39	18
Sri Lanka	25	20	26	17
South Asia	36	33	42	34
Coefficient of variation	0.40	0.65	0.45	0.66

Source: World Bank. Doing Business Indicators. <http://data.worldbank.org/data-catalog/doing-business-database> (accessed 27 June 2012).

During 2006–2014, Sri Lanka appears to have had the best time performance among South Asian countries for imports; India had the best time performance for exports (Table 10.5). As shown in Table 10.6, Pakistan and Sri Lanka were the only countries in South Asia in which export costs per container decreased, while only India experienced decrease in import costs.

While South Asian countries have succeeded in reducing the number and complexity of documents required to export and import, considerable time is still required to complete the process, particularly for landlocked countries such as Afghanistan. Landlocked South

**Table 10.6: Cost to Export and Import Goods**  
(\$ per container)

Country	Export Cost		Import Cost	
	2006	2014	2006	2014
Afghanistan	2,500	4,645	2,100	5,180
Bangladesh	902	1,075	1,287	1,470
Bhutan	1,150	2,230	1,780	2,330
India	864	1,170	1,324	1,250
Maldives	1,200	1,625	1,200	1,610
Nepal	1,600	2,295	1,725	2,400
Pakistan	996	660	317	725
Sri Lanka	647	595	639	775
South Asia	1,232	1,787	1,297	1,968
Coefficient of variation	0.47	0.74	0.46	0.73

Source: World Bank. Doing Business Indicators. <http://data.worldbank.org/data-catalog/doing-business-database> (accessed 27 June 2012).

Asian countries take longer to export than neighboring countries with sea ports. They also face rising costs for export. In addition, transport times required for exports and imports vary widely among South Asian countries (Table 10.5). In general, imports take more time than exports.

Landlocked LDCs face innumerable trade barriers, both physical and nonphysical, resulting in high costs and lengthy periods of time to trade. For example, in 2014, it took about 81 days to export goods from Afghanistan and 85 days to import goods. In 2006, however, it took only 66 days for exports and 80 days for imports (Table 10.5). One of the critical factors for the increase in the cost and time needed to export and import goods for Afghanistan, Bhutan, and Nepal could be inefficient logistics.

As shown in Tables 10.5 and 10.6, the increase in the coefficients of variation from 2006 to 2014 indicates increasing divergence among South Asian countries in the time and cost of exporting and importing goods. Some countries did relatively well in reducing the time and cost of exporting and importing, while other countries—the landlocked LDCs—were unsuccessful in improving their trade facilitation performance. Much more needs to be done to close the performance gap.

Logistics performance data also indicate a widening performance gap between the more developed and LDCs in South Asia (Table 10.7). The coefficients of variation further indicate the increasing divergence in logistics performance.<sup>9</sup> The more developed countries

<sup>9</sup> The overall score in the World Bank's logistics performance index reflects perceptions of a country's logistics based on efficiency of customs clearance process, quality of trade- and transport-related infrastructure, ease of arranging competitively priced shipments, quality of logistics services, ability to track and trace consignments, and frequency with which shipments reach the consignee within the scheduled time.

in South Asia have been able to be more efficient in moving goods and connecting manufacturers and consumers in regional and international markets than the LDCs. The gap in logistics performance between the best-performing countries included in Table 10.7—the People’s Republic of China (PRC), India, and the Republic of Korea—is small. However, South Asian LDCs lag far behind India, indicating little convergence between 2007 and 2014. Four SAARC members (Nepal, the Maldives, Pakistan, and Sri Lanka) improved their global LPI ranking between 2010 and 2014, while four (Afghanistan, Bangladesh, Bhutan, and India) slipped in ranking (Table 10.8).

**Table 10.7: Logistics Performance Index, 2014**

Country	Overall LPI Score	Overall LPI Rank		% of Highest Performer	
		2014	2007	2007	2014
Republic of Korea	3.67	100.0	100.0	100.0	100.0
PRC	3.53	92.1	95.4	95.4	92.1
India	3.08	82.2	78.0	78.0	82.2
Pakistan	2.83	64.2	68.5	68.5	64.2
Maldives	2.75	...	65.5	65.5	...
Sri Lanka	2.70	55.5	63.6	63.6	55.5
Nepal	2.59	45.1	59.6	59.6	45.1
Bangladesh	2.56	58.4	58.6	58.6	58.4
Bhutan	2.29	45.9	48.4	48.4	45.9
Myanmar	2.25	34.2	46.9	46.9	34.2
Afghanistan	2.07	8.4	40.1	40.1	8.4

... = data not available, LPI = logistics performance index, PRC = People’s Republic of China.

Source: World Bank. Logistics Performance Index. <http://lpi.worldbank.org/> (accessed 27 June 2012).

**Table 10.8: Variations in Logistics Performance Index**

Country	Overall LPI Score		Overall LPI Rank	
	2010	2014	2010	2014
Republic of Korea	3.64	3.67	23	21
People’s Republic of China	3.49	3.53	27	28
India	3.12	3.08	47	54
Pakistan	2.53	2.83	110	72
Maldives	2.40	2.75	125	82
Sri Lanka	2.29	2.70	137	89
Nepal	2.20	2.59	147	105
Bangladesh	2.74	2.56	79	108
Bhutan	2.38	2.29	128	143
Myanmar	2.33	2.25	133	145
Afghanistan	2.24	2.07	143	158

LPI = logistics performance index, PRC = People’s Republic of China.

Source: World Bank. Logistics Performance Index. <http://lpi.worldbank.org/> (accessed 27 June 2012).

The LPI global ranking of most South Asian countries worsened during 2010–2014 (Table 10.9).<sup>10</sup> Further, the dispersion in each dimension of LPI increased during this period, with variations within indicators and across countries. For example, India improved its global rank for international shipments and timeliness, whereas its ranking in other categories fell. The Maldives, Pakistan, and Sri Lanka improved their global rankings for border and customs clearance processes, and Sri Lanka raised its performance substantially in timeliness of shipments in reaching destination within the scheduled delivery time.

Nontariff measures impede the growth of regional trade and limit the benefits from trade liberalization. Nontariff measures have been used as entry barriers against imports and, in some cases, to restrict low-value-added exports. Nontariff measures are numerous and widespread in South Asia, and many are not WTO-consistent. Table 10.10 lists the most frequently cited nontariff measures in South Asian countries. Port restrictions, sanitary and phytosanitary restrictions and technical barriers to trade, licensing requirements, standards, and para-tariffs are common in most South Asian countries. Streamlining and reducing nontariff measures should be another important objective of trade facilitation.

**Table 10.9: Sectoral Logistics Performance Index Rank**

Country	Customs		Infrastructure		International Shipments		Logistics Quality and Competence		Tracking and Tracing		Timeliness	
	2010	2014	2010	2014	2010	2014	2010	2014	2010	2014	2010	2014
Republic of Korea	26	24	23	18	15	28	23	21	23	21	28	28
PRC	32	38	27	23	27	22	29	35	30	29	36	36
India	52	65	47	58	46	44	40	52	52	57	56	51
Pakistan	134	58	120	69	66	56	120	75	93	86	110	123
Maldives	98	49	111	82	125	72	117	74	121	92	133	148
Sri Lanka	143	84	138	126	117	115	142	66	142	85	125	85
Nepal	131	123	143	122	143	104	143	107	140	87	139	92
Bangladesh	90	138	72	138	61	80	96	93	92	122	70	75
Bhutan	118	140	141	132	120	131	127	111	105	140	122	158
Myanmar	146	150	134	137	131	151	148	156	129	130	82	117
Afghanistan	104	137	139	158	141	156	141	152	128	159	146	149
CV <sup>a</sup>	0.27	0.39	0.30	0.31	0.35	0.40	0.29	0.37	0.26	0.31	0.30	0.34

CV = coefficient of variation, PRC = People's Republic of China.

<sup>a</sup> CV is calculated for South Asia only.

Source: World Bank. Logistics Performance Index. <http://lpi.worldbank.org/> (accessed 27 June 2012).

<sup>10</sup> World Bank's LPI is the weighted average of the country scores on six key dimensions: (i) efficiency of the clearance process (i.e., speed, simplicity, and predictability of formalities) by border control agencies, including customs; (ii) quality of trade- and transport-related infrastructure (e.g., ports, railroads, roads, information technology); (iii) ease of arranging competitively priced shipments; (iv) competence and quality of logistics services (e.g., transport operators, customs brokers); (v) ability to track and trace consignments; and (vi) timeliness of shipments in reaching destination within the scheduled or expected delivery time.

Table 10.10: Most Frequently Cited Nontariff Measures in South Asia

Country	Nontariff Measures	Country	Nontariff Measures
Afghanistan	Port access limitations Licensing and registration requirements SPS restrictions TBT restrictions Para-tariffs Miscellaneous payment requirement	Bangladesh	Para-tariffs Port restrictions Pre-shipment inspection requirements SPS restrictions TBT restrictions Fluctuating standards and procedural steps
Bhutan	Port restrictions Quantitative restrictions License requirements Certification requirements Temporary ban on imports Para-tariffs	India	Port restrictions SPS restrictions TBT restrictions Fluctuating standards and procedural steps
Maldives	Quantity restrictions License and registration requirements Certification requirements Quality standards	Nepal	License requirements Quantitative restrictions Para-tariffs Export restrictions Special export permission
Pakistan	Port restrictions SPS restrictions TBT restrictions Political restrictions Fluctuating standards and procedural steps	Sri Lanka	License requirements Para-tariffs SPS restrictions TBT restrictions Quality standards Quantitative export restrictions

SPS = sanitary and phytosanitary, TBT = technical barrier to trade.

Note: The table lists the nontariff measures that were cited most frequently in trade transaction during 2011–2012. Some measures are WTO-consistent. The list follows the United Nations Conference on Trade and Development classifications of nontariff measures.

Source: Adapted from Raihan, S., M. A. Khan, and S. Quoreshi. 2014. NTMs in South Asia: Assessment and Analysis. Kathmandu: SAARC- Trade Promotion Network.

Finally, landlocked LDCs, such as Afghanistan, Bhutan, and Nepal, are beset with structural (geography-related) and supply-side (connectivity-related) constraints that limit their participation in regional and global production and trading opportunities. The forgoing discussion indicates that the trade facilitation gap in South Asia has widened rather than narrowed. Gaps in trade infrastructure development among South Asian countries need to be addressed explicitly as a part of SAARC's program for promoting balanced regional development. South Asia's trade potential will be realized only if the trade facilitation gap can be narrowed, not only among the South Asian countries but also relative to global best practices. Efficient customs and other border management agencies are critical for improving trade facilitation. The WTO Agreement on Trade Facilitation, signed in 2013, underscored the importance of the facilitation agenda for expanding world trade. The agreement aims to achieve paperless trade by reforming trade processes and procedures worldwide.

## Trade Processes and Procedures: Current Structure and Scope of Reforms

The information provided in this section is based on the study on four countries and three corridors conducted under the South Asia Subregion Economic Cooperation (SASEC) Program (ADB-UNESCAP 2014).<sup>11</sup> Given that the four countries included in the study (Bangladesh, Bhutan, India, and Nepal) have very different geographic and development characteristics, the findings have potential implications for the entire South Asia region.

### Procedures and Parties Involved in Exporting and Importing

Tables 10.11 and 10.12 present the business procedures, parties involved, and time and costs in exporting and importing using three SASEC corridors. The data suggest that in all three corridors, importing involves fewer procedures and parties than exporting. Specifically, exports of oranges from Bhutan to Bangladesh along corridor 2 involve the largest number of procedures and the second greatest number of parties, whereas exports of lentils from Nepal to Bangladesh along corridor 1 involve the second largest number of procedures and the greatest number of parties. Among the three countries in Table 10.11 (Bangladesh, Bhutan, and Nepal), Bangladesh appears to be more trade-friendly in both exporting and importing. Based on the number of procedures and parties involved, exports of lentils and carpets from Nepal to Bangladesh and a third country, and exports of oranges from Bhutan to Bangladesh, involve the most complex processes identified in the study. Trade in Bhutan and Nepal involves a relatively large number of procedures and parties along corridors 1 and 2.

**Table 10.11: Business Processes, Time, and Cost**

Corridor	Exporter	Importer	Products	Procedures (No.)			Time (Days)	Cost (\$/TEU)
				Exporter	Importer	Total		
Corridor 1: Kakarvitta–Panitanki–Phulbari–Banglabandha	Nepal	Bangladesh	Lentils	18	13	31	23.40	791.80
	Bangladesh	Nepal	Lead acid accumulator	12	16	28	29.26	1,402.05
Corridor 2: Phuentsholing–Jaigaon–Hasimara–Changrabandha–Burimari	Bhutan	Bangladesh	Oranges	18	14	32	18.60	569.84
	Bangladesh	Bhutan	Fruit juice	9	16	25	20.13	527.61
Corridor 3: Kathmandu–Birgunj–Raxaul–Kolkata	Nepal	Third country <sup>a</sup>	Carpets	23		23	26.00	2,260.60
	Third country <sup>b</sup>	Nepal	Crude soya bean oil		21	21	18.00	689.74

TEU = twenty-foot equivalent unit.

<sup>a</sup> Excluding export processes.

<sup>b</sup> Excluding import processes.

Source: Author.

<sup>11</sup> The study was conducted based on UNNEXt's business process analysis guide to simplify trade procedures.

Table 10.12: Parties Engaged in Export and Import Processes

Corridor	Exporter	Importer	Products	Number of Parties						
				Exporter			Importer			
				Public	Private	Total	Public	Private	Total	Total
Corridor 1: Kakarvitta– Panitanki– Phulbari– Banglabandha	Nepal	Bangladesh	Lentils	7	7	14	4	5	9	23
	Bangladesh	Nepal	Lead acid accumulator	3	4	7	7	5	12	19
Corridor 2: Phuentsholing– Jaigaon– Hasimara– Changrabandha– Burimari	Bhutan	Bangladesh	Oranges	10	4	14	3	4	7	21
	Bangladesh	Bhutan	Fruit juice	3	4	7	11	2	13	20
Corridor 3: Kathmandu– Birgunj–Raxaul– Kolkata	Nepal	Third country <sup>a</sup>	Carpets	8	7	15				15
	Third country <sup>b</sup>	Nepal	Crude soya bean oil				7	6	13	13

<sup>a</sup> Excluding export processes.

<sup>b</sup> Excluding import processes.

Source: Author.

The involvement of parties and procedures increases sharply in Nepal when exports and imports are via corridor 3, making it the most expensive corridor, both in terms of cost and time. A container-load of carpets exported from Kathmandu to a third country costs about \$2,261 per twenty-foot equivalent unit and takes about 24 days to reach the port of Kolkata. Nevertheless, the business process steps and corresponding parties are relatively less dispersed for exports than they are for imports. The completion of trade procedures in Bangladesh takes more time than in Bhutan or Nepal. For example, the procedure to export fruit juice along corridor 3 from Bangladesh to Bhutan takes 2.8 days to complete and costs \$59 per container. In contrast, completing the procedure for imports of crude soya bean oil by Nepal takes less than 1 day, thus making it the fastest route among the three corridors. Of the three corridors, corridor 1 appears to be the most costly and corridor 2 the least costly.

Import and export process analysis shows that, while many steps involve both public and private parties across the three corridors, a significant number of the procedures involve private parties only. The private sector is more involved in both exporting and importing in Bangladesh than in Bhutan and Nepal. As illustrated in Table 10.13, most of the business procedures involved in exporting lead acid accumulator from Bangladesh to Nepal involve private sector entities. This, in turn, suggests that the efficiency of the international trade process depends to a great extent on the capacity of the private sector to exchange information and to provide effective transport, logistics, payment, and other services.

**Table 10.13: Parties Involved in the Export of Lead Acid Accumulator from Bangladesh to Nepal**

No.	Procedures	Procedure
1	Contacting importers	Private
2	Fixing terms of trade with importer via local office	Private
3	Sending draft contract and pro forma invoice	Private
4	Receiving acceptance letter and acknowledging letter of credit copy	Private
5	Obtaining cargo insurance	Private
6	Preparing documents for export	Private
7	Loading in truck and delivering to land port	Private
8	Depositing challan fee, VAT, and customs declaration	Public and Private
9	Customs inspection and clearance by clearing and forwarding agent	Public
10	Handing over out pass by clearing and forwarding agent to importer's representative and unloading of the commodity to importer's carrier	Private
11	Receiving payment	Private

VAT = value-added tax.

Source: ADB-UNESCAP. 2014. *SASEC Trade Facilitation Report: Business Process Analysis*. Manila: Asian Development Bank. (Mimeographed)

### Documents and Copies Needed for Exporting and Importing

In general, the number of documents needed for importing exceeds the number needed for exporting (Table 10.14). Importers in Nepal must submit 22 documents and 49 copies to import crude soya bean oil from a third country. Exports of lentils from Nepal to

**Table 10.14: Documents and Copies Required**

Corridor	Exporter	Importer	Products	Number of Documents and Copies		
				Exporter	Importer	Total
Corridor 1: Kakarvitta–Panitanki–Phulbari–Banglabandha	Nepal	Bangladesh	Lentils	18 (44)	18 (71)	36 (115)
	Bangladesh	Nepal	Lead acid accumulator	15 (50)	15 (33)	30 (83)
Corridor 2: Phuentsholing–Jaigaon–Hasimara–Changrabandha–Birimari	Bhutan	Bangladesh	Oranges	14 (26)	18 (69)	32 (95)
	Bangladesh	Bhutan	Fruit juice	9 (30)	16 (44)	25 (74)
Corridor 3: Kathmandu–Birgunj–Raxaul–Kolkata	Nepal	Third country <sup>a</sup>	Carpets	19 (44)		19 (44)
	Third country <sup>b</sup>	Nepal	Crude soya bean oil		22 (49)	22 (49)

Note: The number of copies needed for export and import are in parentheses.

<sup>a</sup> Excluding export processes.

<sup>b</sup> Excluding import processes.

Source: Author.

Bangladesh along corridor 1 involves the submission of 36 documents and 115 copies—18 documents and 44 copies by the Nepal exporter and 18 documents and 71 copies by the Bangladesh importer. The documentation requirements for exporting oranges from Bhutan to Bangladesh are also very high, involving 32 documents and 95 copies. These excessive documentation requirements underscore the scope for simplification of trade processes.

In addition, the import process is highly dispersed, and most of the export and import documents have to be submitted manually. Of the 36 documents needed for the export of lentils using corridor 1, 31 must be submitted manually. Electronic submission of documents would greatly simplify the process.

The application of modern information and communications technology (ICT) to trade processes is an important component of national and regional trade facilitation (UNESCAP 2011c, ADB 2012d). As shown in Table 10.15, many of the export and import documents along SASEC corridors are still not being submitted and/or processed electronically. On average, more than 80% of trade documents are handled manually. Exporters and importers (or their customs house agent) can submit customs declarations online, although a hard copy often needs to be submitted at some point during the process. This was the case in Bangladesh, Bhutan, and Nepal at the time the survey for this study was conducted. Automation of trade documentation is a relatively new process for SASEC members, except for India, which has introduced an electronic data interchange system called ICEGATE. The system facilitates the submission of trade documents electronically and handles all e-filing, e-payments, drawback disbursal, and message exchange. Almost 98% of India's international trade is handled in this manner. During 2011–2012, the total number of documents filed exceeded 13 million (Directorate General of Systems and Data Management, Central Board of Excise and Customs, Government of India). ICEGATE's web portal provides comprehensive real-time tracking and information services, and all services are free.

**Table 10.15: Submission of Documents**

Corridor	Exporter	Importer	Product	Exporter			Importer			Total
				Manual	Electronic	Mixed	Manual	Electronic	Mixed	
Corridor 1: Kakarvitta–Panitanki–Phulbari–Banglabandha	Nepal	Bangladesh	Lentils	17		1	14	4		36
	Bangladesh	Nepal	Lead acid accumulator	10	5		11	1	3	30
Corridor 2: Phuentsholing–Jaigaon–Hasimara–Changrabandha–Burimari	Bhutan	Bangladesh	Oranges	11		4	14	4		33
	Bangladesh	Bhutan	Fruit juice	5	4		11	1	1	22
Corridor 3: Kathmandu–Birgunj–Kolkata	Nepal	Third country <sup>a</sup>	Carpets	17	1	1				19
	Third country <sup>b</sup>	Nepal	Crude soya bean oil				19	1	2	22

<sup>a</sup> Excluding export processes.

<sup>b</sup> Excluding import processes.

Source: Author.

Some trade procedures are handled electronically in Bangladesh.<sup>12</sup> There is considerable scope for the application of ICT in trade process management in SASEC countries, particularly in Bangladesh, Bhutan, and Nepal. Application of ICT for managing trade processes in India has gained popularity as exporters and importers have found it to be increasingly beneficial. Today, most of the export processes are dealt with electronically (Table 10.16).

**Table 10.16: Managing Export Processes: Indian Export of Fabrics to Bangladesh**

No.	Process	Submission of Documents
1.	Buy	Electronic and manual
2.	Obtain export permit	Electronic
3.	Contract registration and inspection	Electronic and manual
4.	Excise inspection	Electronic and manual
5.	Obtain cargo insurance	Electronic
6.	Arrange pre-shipment inspection	Electronic and manual
7.	Obtain certificate of origin	Electronic and manual
8.	Obtain SAFTA certificate	Electronic and manual
9.	Submit customs declaration	Electronic
10.	Arrange transport for loading	Electronic and manual
11.	Transfer to land customs station	Manual
12.	Parking of goods at land customs station	Manual
13.	Customs clearance at land customs station	Electronic and manual
14.	Send the goods to importer's warehouse	Manual
15.	Pay	Electronic

SAFTA = South Asian Free Trade Area.

Source: De, P. 2011c. *Trade Facilitation in India: An Analysis of Trade Processes and Procedures*. Asia-Pacific Research and Training Network on Trade Working Paper Series No 95, Bangkok: United Nations Economic and Social Commission for Asia and the Pacific.

Similar developments have been noted in some other South Asian countries, including the Maldives and Sri Lanka. Cargo insurance and payment are managed electronically in India and in many SASEC countries. Going a step further, Thai traders have been using specialized ICT applications not only for the submission of customs and other regulatory documents, but also for managing transport or vessel berthing times and loading and unloading of cargoes from vessels (UNESCAP 2011a). This suggests that the number of documents in exporting and importing is much less important than their nature (electronic versus paper) and the procedures in their preparation and submission. By making e-filing of documents mandatory, the documentary burden in the trade of goods is substantially reduced. India's electronic data interchange system, which offers valuable lessons to other South Asian countries on improving their systems, is a case in point.

<sup>12</sup> The Government of Bangladesh, in collaboration with the private sector, has taken steps toward automation of the Chittagong Customs House and the Dhaka Custom House. In addition, the introduction of automated system for custom data (ASYCUDA++) facilitates customs-related transactions.

## Current State of Trade Facilitation

### South Asian Free Trade Area and Trade Facilitation

Trade facilitation has yet to be included as part of SAFTA (Table 10.17), although it is referenced briefly under Article VIII of the agreement. In contrast, Articles V, VIII, and X of the General Agreement on Tariffs and Trade, 1994 extensively address the movement, release, and clearance of goods, including goods in transit in member countries. In the case of SAFTA, the contracting parties have agreed to trade liberalization schedules, but trade facilitation has been left in the domain of “agree to consider.” Nevertheless, under Article 8, SAFTA includes some important trade facilitation proposals, including (i) simplification and harmonization of customs clearance procedures; (ii) harmonization of national customs classification based on the Harmonized System; (iii) customs cooperation to resolve disputes at customs entry points; (iv) transit facilities for efficient intra-SAARC trade, especially for landlocked countries; and (v) development of communication systems and transport infrastructure. In addition, South Asian countries signed the Customs Action Plan in 1997 and the Agreement for Mutual Administrative Assistance in Customs Matters in 2005. There is a group on customs cooperation, comprising heads of customs organizations of South Asian countries, mandated to administer and implement customs-related cooperation initiatives. Despite these proposals and agreements for customs cooperation, South Asia has largely failed to establish the requisite institutional mechanism to advance the regional trade facilitation agenda.

**Table 10.17: Trade Liberalization in SAARC**

Period	Regional Export Trade		Trade Liberalization	Trade Facilitation
	\$ billion	(%)		
1980–1989	1.0	(3.1)	Nil	Nil
1990–1999	1.7	(4.1)	SAPTA	Nil
2000–2009	8.0	(6.0)	SAPTA, SAFTA	Nil
2010–2012	19.0	(5.8)	SAFTA + SATIS <sup>a</sup>	Nil

SAARC = South Asian Association for Regional Cooperation, SAFTA = South Asian Free Trade Area, SAPTA = SAARC Preferential Trading Arrangement, SATIS = SAARC Agreement on Trade in Services.

<sup>a</sup> To be implemented.

Source: IMF. 1993. *Direction of Trade Statistics*. Washington, DC: International Monetary Fund.

### Customs Cooperation

Serious delays in customs clearance may result from late transmission of original copies of specimen signatures and seals of officials authorized to sign SAPTA and SAFTA certificates of origin. In response, SAARC’s Committee on Economic Cooperation has agreed to accept electronic copies of such documents to save time and ensure that consignments are not held up at customs border points. In addition, the Sub-Group on Customs Cooperation is considering (i) harmonization of customs clearing procedures and documentation, (ii) interoperability of systems used by customs administrations in member countries, (iii) preparation of a simplified customs declaration form for trade in the SAARC region, (iv) harmonization of 8-digit tariff lines of member countries, and (v) capacity building. Decisions are pending regarding (i) acceptance of electronic copies of certificates of origin received from importers for clearance of consignments, (ii) the possibility of having a 7-day

workweek at customs border points where there is serious congestion of consignments, and (iii) the possibility of having a single joint customs point for the speedy movement of consignments.

### **Nontariff Measures**

The SAARC Secretariat, through the SAARC Trade Promotion Network, conducted a study on nontariff measures (Raihan et al. 2014), and is currently doing a second phase of the study to examine the notifications, responses, and counterresponses submitted by Bangladesh, India, Nepal, Pakistan, and Sri Lanka. The SAARC Secretariat is also categorizing various nontariff measures, identifying those that are compatible with WTO provisions, and identifying those that should be eliminated or reduced to facilitate intra-SAARC trade under SAFTA. The SAARC Secretariat has requested all member countries to provide notifications on nontariff measures and para-tariff measures under Article 7 (4) of the SAFTA Agreement. Transparency will enable SAARC members to review each other's nontariff measures and to take a coordinated strategy for reducing and streamlining them.<sup>13</sup>

### **Regional Transit**

Harmonization and mutual recognition of standards in the transport sector are key issues. SAARC's Inter-Governmental Group on Transport is mandated to provide advice on facilitating transport. Negotiations are ongoing with regard to a regional transport and transit agreement and a regional motor vehicles agreement. The SAARC Experts Group has finalized a text for a regional agreement on railways. The appendix presents a list of transit agreements in South Asia.

### **Border Connectivity**

Under the SASEC program, several regional connectivity projects have been undertaken in eastern South Asia with ADB support. India's integrated check posts were inaugurated in Attari and Agartala, and are soon to be implemented in Petrapole, Raxaul, and Moreh. Land customs stations in South Asia are making greater use of ICT in trade transactions and customs procedures. India-ASEAN connectivity projects, particularly the Mekong-India Economic Corridor and the India-Myanmar-Thailand Trilateral Highway, will have a strong impact on interregional connectivity.

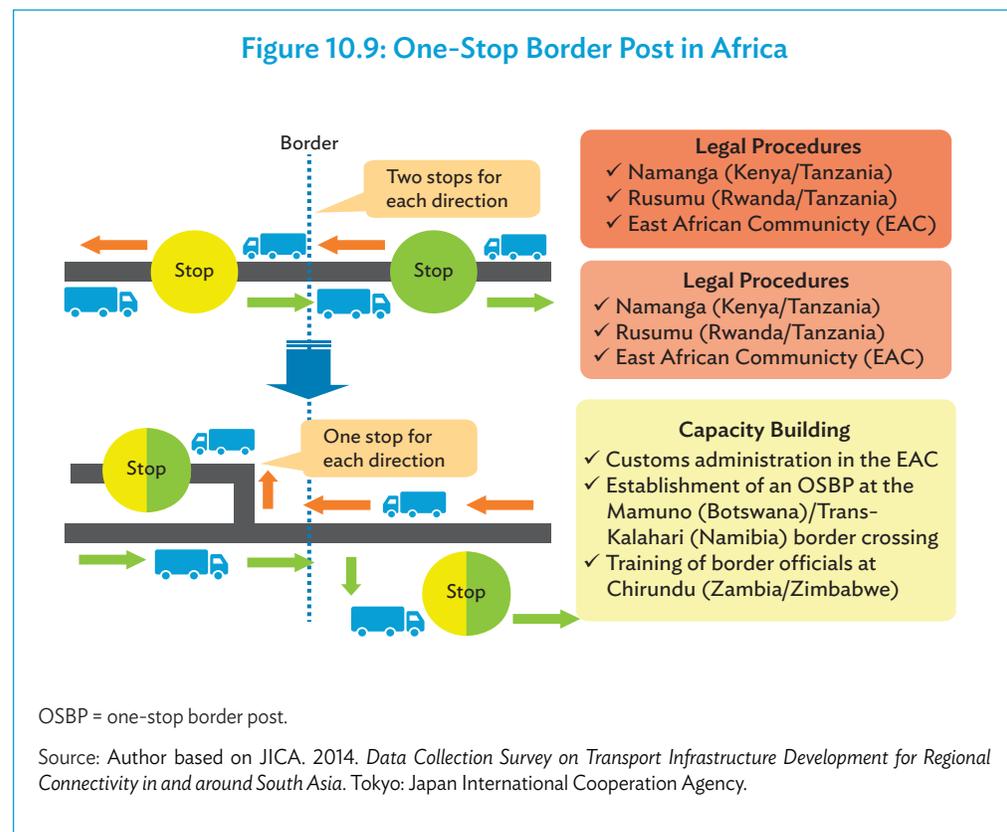
## **Toward South Asian Economic Union**

Regional trade facilitation is still in the discussion stage so is compliance with common standards. Progress has been limited largely to individual country initiatives, undertaken as part of a national agenda (e.g., e-customs). South Asia can achieve substantial productivity gains and cost reductions by streamlining policy-related nontariff trade procedures.

Realization of a South Asian Economic Union (SAEU) will require implementation of a regional trade facilitation agenda. This will need to encompass (i) coordinated border management, including collocation of facilities, close cooperation between agencies, delegation of administrative authority, cross-designation of officials, and effective

<sup>13</sup> The Eighth Meeting of the SAFTA Committee of Experts noted that under Article 7 (4) of the SAFTA Agreement, the member states are to provide annual notifications of their nontariff measures and para-tariff measures.

information sharing; (ii) a regional single window to function as a digital interface that allows traders to submit all import, export, and transit information required by regulatory agencies via a single electronic gateway (instead of submitting essentially the same information numerous times manually to different government entities); (iii) regional transit, including economic corridors with regional transport networks, to allow goods and services to move freely in compliance to certain rules and regulations in a given region; and (iv) one-stop border posts to allow coordinated import, export, and transit processes to ensure that traders are not required to duplicate regulatory formalities on both sides of the same border. Figure 10.9 illustrates a one-stop border post in Africa.



### Building Value Chains

Trade facilitation has important implications for a country’s export competitiveness and for the role of small and medium-sized enterprises (SMEs). Improved trade facilitation will enable cross-border production networks to expand and multiply, with parts and components crossing borders several times during production and distribution. SMEs, particularly in developing countries and LDCs, require efficient access to raw materials, parts and components, and services for production purposes. For landlocked LDCs, such as Afghanistan, Bhutan, and Nepal, the need for effective trade facilitation is even greater because inputs are dependent on the efficiency of the transit systems in neighboring countries. Higher transaction costs and lengthy amounts of time spent at transit points (ports and land borders) would diminish the potential of landlocked LDCs to join global or regional value chains.

### Full and Inclusive Representation of the Private Sector

Reducing the time and cost of trade transactions requires involvement of the private sector. Indeed, virtually all procedures and steps in the import–export process involve the private sector, whereas only a few involve national regulatory authorities directly. Governments should streamline the procedures over which they have direct control (such as customs and other regulatory procedures), but they also need to encourage private sector collaboration and coordination initiatives to achieve significant results. Chambers of commerce and/or industry associations play a significant role in issuing trade-related documents, such as certificates of origin and quality certificates, and the procedures they establish may not best facilitate trade or be nondiscriminatory. Some private sector intermediaries, including transport and logistics service providers and customs agents, may have an incentive to hamper trade facilitation out of concern that the services they render could become unnecessary once the import–export process has been simplified or automated. Governments should address this issue by ensuring a more inclusive representation of the private sector in national trade facilitation agencies.

### Implementation of Key Projects

South Asian countries should continue to implement trade facilitation projects that streamline border transactions and improve competitiveness. Table 10.18 lists some key projects that need to be implemented in the region.

**Table 10.18: Key Trade Facilitation Priorities in South Asia**

1. Reduction of lengthy customs and cargo handling time at ports of Chittagong, Haldia, Karachi, and Kolkata through automation and modernization
2. Faster opening of letter of credit accounts in banks with the help of information and communication technology (ICT) in Bangladesh and Nepal
3. Faster cargo insurance with the help of ICT, process reengineering, and competition among service providers in Nepal
4. Use of ICT to obtain permits and certificates in Bhutan
5. Synchronization of cross-border customs in South Asia
6. Acceptance of regional transit provisions
7. Development of border infrastructure
8. Cross-border electronic customs transit document
9. National single window for paperless trade
10. Development of one-stop border posts

Source: ADB-UNESCAP. 2014. *SASEC Trade Facilitation Report: Business Process Analysis*. Manila: Asian Development Bank. (Mimeographed)

### Develop Interior Infrastructure and Project Development Facility

South Asian connectivity and trade facilitation initiatives will be incomplete if back-end links with the interior of the region are not strengthened. Strong and multidimensional back-end links are essential for effective integration. A joint feasibility study on connectivity projects should be encouraged, together with establishment of a project development facility to plan and implement cross-border connectivity projects. Among other roles, this new facility should help mobilize financing for implementation of cross-border connectivity projects. The focus should be on high-impact regional projects in the energy, transport, ICT, education, health, and water sectors, and SMEs and special economic zones. Its major activities could include advisory services, identification of projects through technical studies, and mobilizing resources and innovative financing.

### **Paperless Trade, Including Development of National and Regional Single Windows**

The preparation of documents and exchange of information among the parties involved in trade deals account for most of the time needed for processing imports and exports. As such, the development of single-window facilities for the submission and processing of information and documents is essential. Taking into account the importance of private sector participants in the transaction chain, single-window facilities should enable the sharing of relevant information among public and private sector actors along the transaction chain. These “extended” national single windows are now operating in the Republic of Korea and some ASEAN member states. The success of India’s ICEGATE system also offers lessons for South Asian countries on how to strengthen their national single windows. More generally, increased use of ICT and development of paperless trade should be pursued vigorously in South Asia. Acceptance of electronic cross-border bills of lading and customs transit documents would lead to paperless trade and effective implementation of single windows. SAARC members should establish a dedicated agency for trade facilitation. As steps in this direction, Bhutan has acceded to the Revised Kyoto Convention on Modernization of Customs, and is establishing a national trade facilitation committee to coordinate and implement measures toward customs modernization.

### **Remove the Regulatory Burden on Exports and Imports and Streamline Nontariff Measures**

South Asian countries must remove the regulatory burden on exporting and importing and streamline nontariff measures on a priority basis. For example, Bangladesh should withdraw irrelevant nontariff measures imposed on Bhutan. Bhutan, in turn, should simplify, merge, and automate the customs processes. The requirement for a Bhutanese customs inspector to travel to Burimari and/or Changrabandha to clear imports, which often causes delays, should be ended. Similarly, documentation requirements imposed on Nepal cargo by port and customs authorities in Kolkata and Haldia must be automated.

### **Minimum Physical Inspections**

Inspection and testing procedures often account for a significant portion of the transaction time for trade. More importantly, inspections affect the timeliness and predictability of the trade transaction process, which is a serious concern for firms participating in international production networks. Inspections may be required at various times, typically at the border points or ports for imports, but also as part of the preparation of documents for exports. Inspections can be minimized through the use of appropriate risk management techniques. While customs officials may have some form of risk management system in place, other regulatory agencies often do not. Building capacity of these other agencies and developing interagency risk management systems should be considered, along with joint (multi-agency) inspections when needed. Further, certification programs, where the quality and other characteristics of goods can be ensured through control of the factory production process, should be promoted as a way to reduce the need for shipment inspections.

### **National and Regional Trade Facilitation Performance Monitoring Mechanisms**

Regulatory authorities have a limited view of the entire trade process, and are often only aware of their own internal efficiency or inefficiency. Traders also have limited awareness and information on the procedural bottlenecks. It is the intermediaries that gather and

hold information on the time and cost of specific procedures. The source and causes of inefficiency need to be assessed independently and regularly to identify reform priorities. Governments in South Asia should consider establishment of trade facilitation performance monitoring and measurement systems. Regular business process analyses of import and export procedures could be the basis for such systems, possibly in combination with the World Customs Organization's time release study methodology. A further initiative for consideration is embedding the performance measurement and monitoring function into the ICT systems being developed as part of paperless trade. These systems could provide real-time information on moving goods as well as facilitate the exchange of electronic documents. International best practices should be employed in simplifying trade-related procedures.

### **Harmonization of Documentary Requirements Across Countries**

Different documentation is needed for exports to different destinations along South Asian corridors, creating confusion and delays. In addition to simplifying documentary requirements, national procedures and documents must be aligned with international standards and conventions. It should be noted that differences in documentation stem not only from differing regulations among importing countries, but also from different requirements of individual buyers (for instance, different types of quality certificates or formats). Harmonization initiatives should involve international private sector associations.

### **Synchronization of Cross-Border Customs**

Customs operations must be synchronized. At present, there are differences in working hours. For example, the Birgunj customs office in Nepal opens at 8 a.m., whereas the Raxaul Customs office in India opens only at 10 a.m. Full automation and linkup between customs will reduce transaction times and costs.

### **All Trade Documents Including Customs to be Submitted Electronically**

Through legislation, the e-filing of documents can be made mandatory. Apart from a few initial problems, use of modern ICT for processing trade transactions is manageable. Adoption of India's ICEGATE would enable South Asian countries to progress from a semi- to a full-electronic system, thereby eliminating excessive documentation.

### **Facilitate Intra and Interregional Multimodal Transport**

Multimodal transport connectivity in South Asia would encourage production networks in the region. Further, it would provide substantial benefits to landlocked countries, such as Afghanistan, Bhutan, and Nepal, by giving them better access to South Asian markets and at lower cost. Intermodal links between maritime and land routes should also be encouraged. India is setting up several industrial corridors such as Amritsar-Delhi-Kolkata Industrial Corridor, Chennai-Bengaluru Industrial Corridor, Delhi-Mumbai Industrial Corridor, East Coast Economic Corridor, and Mumbai-Bengaluru Economic Corridor. Multimodal links would eventually build stronger and more effective industrial networks between South and Southeast Asia.

### **Process Reengineering**

Process reengineering will help exporters and importers conduct trade at much lower cost and in much less time. Harmonization of documents and their submission electronically would substantially reduce average transaction times.

### Enacting Key Policies

Obstacles to reform are significant in South Asia, and SAARC member countries must introduce certain key policies for regional trade facilitation. Table 10.19 lists some of the key policies.

**Table 10.19: Key Policies**

1. Accept subregional and subsequently regional transit.
2. Establish fast-track lane and priority of goods in transit to cross the border, and move toward one-stop border posts.
3. Set up South Asian Association for Regional Cooperation (SAARC) single window (pilot run of authorized economic operator and mutual recognition agreement).
4. Simplify and harmonize trade procedures, particularly at border.
5. Introduce modern corridor management techniques in selected corridors.
6. Promote multimodal transport (with rail transit, regular container train in the region).
7. Improve the efficiency of border corridors (both sides of the border).
8. Ensure effective project coordination among government stakeholders.
9. Strengthen institution (public-private interface) for trade facilitation.
10. Introduce on-arrival visa, and SAARC Business Travelers Card for facilitation of trade and investment.
11. Promote intermodal connectivity—Air Services Agreement (single ticket to fly between SAARC nations).
12. Enforce electronic payment system.

Source: Author.

### Engaging South Asian Association for Regional Cooperation Dialogue Partner

SAARC members should engage their partners in trade facilitation dialogue. The ASEAN Connectivity Coordinating Committee coordinates with dialogue partners in undertaking connectivity projects. Similarly, SAARC should constitute a secretariat-led committee to coordinate with dialogue partners. This would help source the necessary technology and capital to undertake connectivity projects and related training.

## Concluding Remarks

Trade facilitation measures involve interagency coordination and collaboration. Simplification, harmonization, and automation of procedures and documents and streamlining of nontariff measures require not only political and government support in terms of policy directives and human and financial resources, but also an in-depth understanding of business processes, including their related information needs, laws, rules, and regulations. Trade facilitation measures, in other words, must be focused on the sources of the problem areas, bottlenecks, and redundancies. The necessity for trade facilitation and business process analysis requires awareness-raising programs, starting at the top. Government officials and the trade and transport community must be informed about the importance of business process analysis and its potential benefits for all stakeholders.

India shares land borders with Afghanistan, Bangladesh, Bhutan, Nepal, and Pakistan, and it has sea routes with Bangladesh, the Maldives, Pakistan, and Sri Lanka. Road and rail links among these countries pass through India. Multimodal transport would be highly beneficial

for landlocked countries such as Bhutan and Nepal, or smaller island countries such as the Maldives. Ideally, geographically connected countries in South Asia can play the role of transport hubs for one another.

Further study would assist South Asian countries to improve their trade facilitation systems and advance their export goals. It would also help to improve trade efficiency by identifying capacity gaps in trade-related agencies and private sector participants, as well as addressing their capacity-building requirements.

Trade infrastructure needs to catch up and keep pace with overall growth in the region. South Asia's infrastructure facilities at present are not sufficient to meet the growing demands of the region. Failure to narrow the infrastructure gap would result in slowing of the region's growth and development. This observation indirectly indicates the high potential returns from investment in South Asia in roads, railways, and power and the associated components. The renewed agenda for South Asian regional cooperation should aim to reduce both intraregional and interregional trade facilitation gaps. The resource requirements for bridging these gaps are substantial but manageable if a concerted approach is taken to utilize the region's financial resources.

The WTO Trade Facilitation Agreement provides extensive scope for reengineering trade processes and procedures, and for moving toward a paperless trade environment. Simplification of procedures and processes is vital for facilitating trade and improving export competitiveness. LDCs alone cannot fulfill the roles needed in a globalized setting. Development organizations such as ADB, the SAARC Secretariat, UNESCAP, and the World Bank have a strong facilitating role in infrastructure investment, technical assistance, and capacity building in South Asia. The WTO Trade Facilitation Agreement is a workable agreement with promising results. It has progressive clauses dealing with customs standards, compliance, and paperless trade. South Asia has to enact its own trade facilitation process to advance the agenda of a South Asian Economic Union (SAEU).

### Appendix: Transit Agreement

Agreement	Route	Status
Bangladesh–India	No route officially announced	Not working
India–Nepal	12 routes	Working with restrictions
Bhutan–India	Four routes	Working with restrictions
Bangladesh–Nepal	Banglabandha (Bangladesh)–Phulbari (India)–Khakarbitta (Nepal)	Working
Bangladesh–Bhutan	Burimari (Bangladesh)–Changrabandha (India)–Jaigaon (India)–Phuentsholing (Bhutan)	Working
Pakistan–Afghanistan	Kabul–Torkham–Karachi Kabul–Torkham–Lahore (18 routes)	Working with restrictions

Source: De, P, and A. Kumar. 2014. *Regional Transit Agreement in South Asia: An Empirical Investigation*. Kathmandu: South Asia Watch on Trade, Economics, and Environment.

## CHAPTER XI

# Regional Integration and Poverty in South Asia

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## Introduction

South Asia is home to more than 40% of the world's extreme poor. With pockets of poverty deepening in South Asia, combating poverty is a priority development agenda issue. One of the most effective ways of reducing poverty is through regional integration and the rapid economic growth it helps facilitate (Kelegama 2011).

Regional integration impacts poverty directly and indirectly. The direct link relates to the impact of regional integration in raising incomes and generating employment opportunities (Economic Commission for Africa 2004, Kher 2012); the indirect link relates to the impact on trade, foreign direct investment (FDI), migration, social infrastructure programs, and other channels (te Velde et al. 2006). Against this backdrop, this chapter analyzes the effect of regional integration on poverty in South Asia.

## Poverty in South Asia

More than 500 million people in South Asia, or 31% of the population, live on \$1.25 or less a day (extreme poverty).<sup>1</sup> Although the number of extreme poor in South Asia has declined (from more than 600 million in 1990), its share of the world's total has increased significantly since 1990 (World Bank 2012, Olinto and Uematsu 2013). Moreover, the human development index (HDI) value for South Asia at 0.558 in 2012 is among the lowest in the world, below that of Latin America and the Caribbean, East Asia and the Pacific, and the Arab States. Only sub-Saharan Africa ranks lower, with a HDI value of 0.475 (UNDP 2013b).

Within South Asia, countries differ considerably in terms of poverty and human development (Table 11.1). Although extreme poverty has declined in all South Asian countries, it continues to be prevalent in Bangladesh (43.3%), India (32.7%), and Nepal (24.8%). The Maldives and Sri Lanka, with less than 5% of the population living below the \$1.25 a day poverty line, have the lowest poverty rates in the region; Bhutan at 10% also has a relatively low level of extreme poverty. The national poverty figures reveal a

<sup>1</sup> India accounts for about one-third the world's extreme poor. In India, about 400 million people are living on \$1.25 or less a day.

similar trend of significant declines in poverty rates during 1990–2010 across all countries, but a substantial share of the population still live below the poverty line in Afghanistan, Bangladesh, India, and Nepal.

Despite declines in Gini coefficients (a measure of inequality) in some countries (e.g., the Maldives), income inequality is of growing concern in the region. Although the Gini coefficients for most South Asian countries are in the range of 0.32 to 0.38, the share of total national income and/or consumption by the poorest quintile is still less than 10% for all the countries, indicating high degrees of inequality. Moreover, HDI values vary considerably among South Asian countries, with Afghanistan (0.374), Nepal (0.463), Bangladesh and Pakistan (0.515) having among the lowest levels of human development in the world. In contrast, Sri Lanka (0.715) ranks high in the index (UNDP 2013b).

**Table 11.1: Poverty, Inequality, and Human Development in South Asian Countries**

Country	Population below \$1.25 a day (PPP) (%)		Population below the National Poverty Line (%)		Share of Poorest Quintile in National Income / Consumption	Gini Coefficient	Human Development Index Value [Rank]
	1991–1996 <sup>a</sup>	2010 <sup>b</sup>	1991–1996 <sup>a</sup>	2010 <sup>b</sup>	2010 <sup>b</sup>	2010 <sup>b</sup>	2012 <sup>c</sup>
Afghanistan	...	...	...	36.0 (2008)	9.4 (2008)	0.278 (2008)	0.374 [175]
Bangladesh	70.2	43.3	56.6	31.5	8.9	0.321	0.515 [146]
Bhutan	26.2 (2003)	10.2 (2007)	...	12.0 (2012)	6.6 (2007)	0.381 (2007)	0.538 [140]
India	49.4	32.7	45.3	29.8	8.5	0.339	0.554 [136]
Maldives	...	1.5 (2004)	21.0 (2003)	15.0	6.5 (2004)	0.374 (2004)	0.688 [104]
Nepal	68.0	24.8	41.8	25.2 (2011)	8.3	0.328	0.463 [157]
Pakistan	64.7	21.0 (2008)	30.6 (1999)	22.3 (2006)	9.6 (2008)	0.300 (2008)	0.515 [146]
Sri Lanka	15.0	4.1	26.1	8.9	7.7	0.364	0.715 [92]

... = not available.

<sup>a</sup> Data included are for the earliest year during 1991–1996 for which data was available. Where data were not available for this period, data for the next available year were included (year in parentheses).

<sup>b</sup> Data are for 2010 unless otherwise stated (year in parentheses).

<sup>c</sup> Values are for the human development index for 2012, while the brackets provide the ranking of the 186 countries in the United Nations Development Programme (UNDP) Human Development Report 2013.

Sources: ADB. 2013b. *Key Indicators for Asia and the Pacific 2013*. Manila: Asian Development Bank. UNDP. 2013a. *Human Development Report 2013*. New York: United Nations Development Programme.

Another poverty concern in South Asia is the significant percentage of “working poor,” defined as those employed but living on \$1.25 or less a day, measured at purchasing power parity (PPP). As shown in Table 11.2, the working poor account for a significant share of the total employed population in most South Asian countries. This share is as high as 50% in Bangladesh and Nepal, and almost 40% in Afghanistan and India. However, since 1990, all countries have seen a marked decline in the proportion of working poor. The percentage of employed people living below \$1.25 a day in the Maldives and Sri Lanka is low compared with the rest of the region.

The high percentage of working poor in South Asia is explained largely by the importance of the informal sector. Informal workers tend to earn low and irregular income and lack social security benefits, such as sick leave, medical insurance, and the Employees’ Provident Fund and Employees’ Trust Fund. The World Bank (2013a) estimates that about 90% of employment in South Asian countries is informal, except in the Maldives and Sri Lanka. Further, 70% to 80 % of nonagricultural employment is informal throughout most of the region, except in Bhutan, the Maldives, and Sri Lanka. Own-account workers and contributing family workers account for a large share of the informal sector workforce in South Asia.<sup>2</sup> In Bangladesh and India, own-account workers and contributing family workers represent more than 80% of total employment. In Bhutan and Nepal, about 70% of the total employed fall in these two categories. The share of total employment accounted for by own-account and contributing family workers has increased in Bangladesh between 1996 and 2005, and in Bhutan between 2006 and 2011 (Table 11.2).

**Table 11.2: Proportion of Working Poor and Own-Account and Contributing Family Workers**

Country	Employed People Living below \$1.25 a day (PPP) (%)		Own-Account and Contributing Family Workers in Total Employment (%)	
	1991–1998	2003–2007	1990–1996	2005–2011
Afghanistan	...	38.0 (2005)	...	...
Bangladesh	55.9 (1992)	50.1 (2005)	69.4 (1996)	85.0 (2005)
Bhutan	...	26.9 (2003)	68.0 (2006) <sup>a</sup>	70.9 (2011)
India	49.1 (1994)	39.2 (2005)	83.1 (1994)	80.8 (2010)
Maldives	26.1 (1998)	1.3 (2004)	46.3 (1990)	29.6 (2006)
Nepal	63.9 (1996)	50.4 (2003)	...	71.6 (2001) <sup>b</sup>
Pakistan	57.4 (1991)	19.2 (2006)	64.9 (1995)	63.1 (2008)
Sri Lanka	13.2 (1991)	5.8 (2007)	43.0 (1990)	41.9 (2010)

... = not available.

<sup>a</sup> For Bhutan, 2006 is the earliest year for which data are available.

<sup>b</sup> For Nepal, 2001 is the most recent year for which data are available.

Source: ADB. 2013b. *Key Indicators for Asia and the Pacific 2013*. Manila: Asian Development Bank.

<sup>2</sup> In addition to own-account workers and contributing family workers, informal sector workers include employees and employers with informal arrangements.

The share of informal employment in agriculture is very high compared with the industry and services sectors. In South Asia, agriculture continues to play a key role in employment (Table 11.3). In Bangladesh, Bhutan, India, and Pakistan, between 45% and 60% of the total employed worked in agriculture in 2010. In Sri Lanka, the figure was 32.5%, while in the Maldives the share was just 4.3%.

**Table 11.3: Share of Employment by Sector in South Asian Countries (%)**

Country	Agriculture		Industry		Services	
	2000	2010	2000	2010	2000	2010
Afghanistan	...	...	...	...	...	...
Bangladesh	50.8	47.5	10	12.6	39.2	39.9
Bhutan	...	59.4	...	6.6	...	34.0
India	59.9	48.9 <sup>a</sup>	16.3	24.2 <sup>a</sup>	23.7	26.8 <sup>a</sup>
Maldives	13.7	4.3	13.4	9.4	72.9	86.3
Nepal	76.1	...	9.8	...	14.1	...
Pakistan	48.4	45.1	11.6	13.4	28.1	29.9
Sri Lanka	36.0	32.5	23.6	24.6	40.3	42.9

... = not available.

<sup>a</sup> Figures are for 2011.

Source: ADB. 2013b. *Key Indicators for Asia and the Pacific 2013*. Manila: Asian Development Bank.

## Framework of Analysis

Regional integration is directly linked to poverty reduction through the impact on economic growth and income levels (Economic Commission for Africa 2004, Kher 2012). Regional integration efforts in South Asia, including reducing the barriers to trade, stimulating competition, improving productive efficiency, and other measures, are expected to translate into more rapid economic growth (Kher 2012). Regional integration may also lead to income convergence in the region, enabling poorer countries to catch up with more developed ones (Economic Commission for Africa 2004). Further, a study by UNDP (2011) concluded that regional economic integration advances human development through the increased levels of income and employment. These developments help to empower people and improve their access to welfare-enhancing services such as health and education. The Asian Development Bank (ADB 2012e) noted that regional integration expands market access beyond national boundaries, leading to increased employment, income, and overall welfare.

Importantly, regional integration also affects poverty through indirect links (te Velde et al., 2006) provide a framework of analysis that draws together the indirect links between regional integration and poverty. This framework identifies four main channels through which regional integration indirectly impacts poverty: trade, foreign direct investment (FDI), migration, and regional social infrastructure programs. The link between regional integration and these four channels is explored in the following subsections.

## Trade–Poverty Nexus

The link between trade and poverty has been widely debated in policy circles. While many economists argue that free trade and open capital markets are critical to economic growth and poverty alleviation, others argue that they can lead to inequality and increased poverty if they are not tied to broader social objectives. The complexity arises from the heterogeneous and multidimensional nature of poverty. In addition, it is very difficult to measure the effects of trade liberalization on poverty as there are several indirect channels through which the effects are transmitted (Bandara 2008). The effects of trade on poverty may also vary depending on factors such as rural infrastructure and market structures (Bandara 2008). Following Winters et al. and their conceptual framework in identifying the trade and poverty links, economists Bannister and Thugge (2001), Hertel and Reimer (2002), and Nissanke and Thorbecke (2007), among others, have identified the main channels by which trade liberalization affects poverty.

The main channels identified are as follows:

- (i) **Prices of tradable goods.** Trade liberalization can lead to changes in the prices of imports and exports, which could affect the poor.
- (ii) **Factor prices, employment, and income.** Trade liberalization can change the relative prices of factors of production, impacting the poor via their income and employment.
- (iii) **Income and expenditure of government.** Government revenue could decline as a result of trade liberalization, which in turn could affect direct transfers to the poor.
- (iv) **Incentives for investment and innovation.** The incentive effect of trade liberalization can impact long-run economic growth.
- (v) **External shocks.** The integration that results from trade can make the economy and the poor vulnerable to external shocks.
- (vi) **Short-run risk and adjustment costs.** In the process of liberalization, economies experience adjustment costs that could affect the poor.
- (vii) **Information availability and flow.** Liberalization facilitates the flow of information and knowledge, with positive and negative impacts on the poor.
- (viii) **Institutions.** Institutions at different levels may mediate different channels and mechanisms that link trade liberalization and poverty, thereby affecting the poor.

The key to dealing with the trade–poverty nexus is to identify how the benefits offered by trade integration and globalization can best be realized. This may depend on an array of policies undertaken at the national, regional, and international levels that are relevant to poverty reduction. It is important to understand how the trade–poverty nexus changes depending on the composition of trade, the development level, and the production structure, as well as on the degree and form of the initial integration measures (UNCTAD 2004).

### Foreign Direct Investment and Poverty

Some studies show that while the direct link between FDI and poverty reduction appears to be weak, the indirect links appear to be strong (te Velde et al. 2006 and ADB 2012e). The indirect link between FDI and poverty reduction relates to the impact of FDI on strengthening economic growth and employment (Klein, Aaron, and Hadjimichael 2001, te Velde et al. 2006, and ADB 2012e). However, studies suggest that FDI is likely to contribute positively to poverty reduction only if investment includes the labor-intensive sectors of the economy (Tambunan 2008, and Kweka and Mboya 2004). Most of the poor are employed in these sectors. However, it has been noted that greater FDI is likely to increase the demand for skilled labor, possibly limiting the trickle-down benefits to the poor (te Velde et al. 2006, ADB 2012e, and te Velde and Morrissey 2002). This could exacerbate income inequality by widening the skilled–unskilled wage differential (te Velde et al. 2006). Additionally, it has also been underscored that FDI can help in reducing poverty by generating tax revenue which can be used in turn to fund safety nets for the poor (Klein, Aaron, and Hadjimichae, 2001).

### Migration and Poverty

The literature offers both optimistic and pessimistic views on the impact of migration on poverty. The optimistic view relates mostly to the positive impact of migration through remittances and the income effect (te Velde et al. 2006, Siddiqui 2012, Ping and Shaohua 2005). Migration increases the incomes of migrants and migrant households (Siddiqui 2012, Ozgen et al. 2009, Newland 2003). However, migration lifts migrants out of poverty only for as long as they continue to earn remittances (Newland 2003). Flows of remittances largely support direct consumption needs (Newland 2003, and Dahlberg 2005), and have seldom been found to translate into productive investment (Newland 2003). In addition, the impact of migrant remittances on poverty reduction is dependent to some degree on the type of migrant worker (te Velde et al. 2006). The migration of skilled workers may reduce inequality in host countries, while the migration of unskilled workers may have the opposite effect (te Velde et al. 2006). Moreover, whether the choice to migrate is made willingly by migrants plays a role in determining the degree to which poverty is reduced (Newland 2009).

### Other Routes

Other routes, such as regional social infrastructure programs, may help ensure that regional integration contributes to poverty reduction (te Velde et al. 2006). Further, regional cooperation in economic infrastructure (including transport and energy infrastructure) impacts poverty both directly and indirectly (ADB 2012e).

Given the strong empirical links between regional integration and poverty reduction, the following observations appear to support the positive effect of regional integration on poverty reduction:

- Regional integration results in an expansion of trade and income.
- Regional exports and imports include those produced and consumed by the poor.
- Regional integration leads to strengthening of industries and productivity.
- Regional integration efforts are implemented alongside complementary government policies to increase social welfare.
- Regional trade facilitation measures include labor-intensive sectors.
- Regional FDI includes labor-intensive sectors.

- Regional FDI inflows increase the demand for unskilled workers.
- Interregional migration leads to an increase in remittance income of the poor.
- Labor-receiving countries experience increased immigration of skilled labor and decreased immigration of unskilled labor, leading to reduced income inequality.
- Regional integration leads to greater regional cooperation in infrastructure and social programs.

### Regional Integration and Reducing Regional Disparities

Studies indicate that strong growth and poverty reduction in South Asia have been accompanied by increased income inequality and growing imbalances among countries and between different areas within countries, resulting in the emergence of lagging regions (Ahmed and Ghani 2008). Almost 500 million people in South Asia live in lagging areas, most of which record above-average poverty levels (Ahmed and Ghani 2008). In India, 60% of the poor live in lagging areas and 95% in Sri Lanka (Ahmed and Ghani 2008, World Bank 2014c). Nepal's Western Region has a substantially higher incidence of poverty than the Kathmandu Valley; similarly, Pakistan's North-west Frontier and Balochistan provinces have much higher levels of poverty than the Sindh or Punjab areas. Regional integration is seen as a means to reduce regional disparities both among and within countries.

Regional integration allows businesses to interact across much larger areas and in more markets. It also results in greater intensity in the exchange of goods and services and informal ideas, leading to productive advantages for businesses as well as welfare advantages for workers (Ahmed and Ghani 2008). In contrast, distance and division created by trade barriers, transport costs, and other impediments prevent economic entities from taking advantage of market integration. With its high population densities, South Asia is well positioned to draw areas close to markets and increase the multiplier effects (Ahmed and Ghani 2008). Regional integration can fuel economic growth via increased demand, economies of scale, factor mobility, and the flow of ideas and technology. Although some countries may grow more rapidly, resulting in sequential growth rather than parallel growth, integration can pull less developed countries toward income levels that would not be otherwise achievable (Ahmed and Ghani 2008). However, this will not be a spontaneous process but rather the outcome of a concerted focus on policies and initiatives designed to reap the full benefits of integration.

## Regional Integration and Poverty Reduction: Empirical Analyses

### Trade in Goods and Poverty Reduction

Developing intraregional trade is important for South Asia given the trade potential and the expected welfare benefits. All South Asian countries are trade dependent, with trade as a major driving force of their growth and development. In turn, strong economic growth is essential for reducing poverty. Intraregional trade in South Asia is among the lowest of regional groupings in the world, averaging about 5% of total South Asian trade during 2002–2011 (UNESCAP 2012b). However, despite these low overall levels, smaller economies, such as Afghanistan, Bhutan, and Nepal, are heavily dependent on trade with

other South Asian countries (Table 11.4). Static gains arise from increase in trade which results in international division of labor and specialization, and gains in production, welfare and income; these are estimated to be about \$2 billion. The dynamic gains, which include more efficient use of resources, widening of market size, increase in investments, and diversification of economic activities, are expected to be much higher.

**Table 11.4: Intra-regional Export Trade as Share of Total Trade (%)**

Country	1995	2000	2005	2010
Afghanistan	17	44	44	46
Bangladesh	3	2	3	3
Bhutan	91	93	85	92
India	5	4	5	5
Maldives	23	14	16	12
Nepal	19	40	70	74
Pakistan	3	5	11	13
Sri Lanka	3	3	10	7

Source: ESCAP. 2012. *Regional Cooperation for Inclusive and Sustainable Development*. South and South West Asia Development Report 2012-13, Bangkok: Economic and Social Commission for Asia and the Pacific.

Empirical studies have found the South Asian Free Trade Area (SAFTA) to be trade creating, leading to stronger growth and enhanced welfare (UNESCAP 2012b). They also show that the welfare effects of SAFTA are distributed equitably among poorer countries; when normalized by the size of their economies, the poorer countries are shown to experience a relatively greater share of the welfare gains. Table 11.5 provides estimates of the substantial welfare gains under SAFTA from trade liberalization and trade facilitation (after normalizing for the country's gross domestic product [GDP]). A more recent analysis (Raihan 2012) shows that full implementation of SAFTA, with trade facilitation, would result in considerable welfare gains for Nepal and Sri Lanka and significant gains for most other South Asian countries.

**Table 11.5: Welfare Effects from Trade Liberalization and Facilitation in SAFTA as a Proportion of Gross Domestic Product of the Participating Countries**

Country	Total Welfare Gain (\$ million, 2007 prices)	Gross Domestic Product (\$ million, 2007 prices)	Welfare Gains (Percentage of Gross Domestic Product)
Bangladesh	1,431.5	65,398	2.2
India	5,761.9	1,004,750	0.6
Nepal	1,769.0	8,858	20.0
Pakistan	2,887.4	122,550	2.4
Sri Lanka	2,160.4	28,064	7.7
Other South Asian countries (Afghanistan, Bhutan, and the Maldives)	1,324.8	10,842	12.2

Source: UNESCAP. 2012b. *Regional Cooperation for Food Security Fact Sheet*. New York: United Nations Economic and Social Commission for Asia and the Pacific.

Despite the welfare gains possible from deeper integration, the SAARC region represents a case of underexploited potential. Intraregional exports among SAARC member countries totaled an estimated \$16 billion in 2010, or only 43% of the estimated potential of \$37.5 billion (UNESCAP 2012b). However, informal trade was substantial. The untapped intraregional export potential is particularly high in Bangladesh (80%) and the Maldives (83%). By 2017, UNESCAP estimates that the intraregional export potential will double to \$72.4 billion (Table 11.6).

**Table 11.6: Underexploited Intraregional Export Trade Potential in South Asia**

Country or Grouping	Actual Exports to SAARC Country or Grouping (\$ million)	Export Potential in South Asia		
		Potential Export 2010 (\$ million)	Potential Export 2017 (\$ million)	Unexploited (%)
Afghanistan	271.0	718.0	1,635.7	62.3
Bangladesh	427.9	2,112.7	4,229.8	79.7
Bhutan	591.9	1,149.8	2,549.5	48.5
India	11,104.7	26,146.8	48,240.4	57.5
Maldives	48.2	285.6	585.3	83.1
Nepal	473.9	996.6	2,662.9	52.4
Pakistan	2,664.3	4,572.5	8,928.3	41.7
Sri Lanka	589.0	1,564.2	3,630.2	62.3
<b>SAARC</b>	<b>16,170.8</b>	<b>37,546.2</b>	<b>72,462.1</b>	<b>56.9</b>

SAARC = South Asian Association for Regional Cooperation.

Source: ESCAP. 2012. *Regional Cooperation for Inclusive and Sustainable Development*. South and South West Asia Development Report 2012-13, Bangkok: Economic and Social Commission for Asia and the Pacific.

Agriculture is a vital sector for most South Asian countries, and deeper regional integration of the sector could generate substantial benefits for the poor. The contribution of agriculture to overall GDP of South Asian countries is high, particularly for Nepal (37%) and Pakistan (24%). In other South Asian countries, the sector accounts for less than 20% of GDP (Table 11.7). These GDP ratios, however, understate agriculture's importance as the basis for the livelihood of much of the region's poor. In 2012, approximately 50% of the region's labor force was engaged in agriculture (Table 11.8). Although agriculture's share of employment has fallen in recent years, it continues to be the main source.

**Table 11.7: Agriculture in South Asia**

Country	Agriculture as a % of GDP in 2012	Employment in Agriculture (% of total employment)	Value Added (% of GDP)	Agriculture Value-Added per Worker (constant 2005 \$)	
				2008	2012
Bangladesh	18	48 (2005)	18 (2012)	408	492
Bhutan	16	62 (2012)	16 (2011)	654	625 (2011)
India	17	47 (2012)	17 (2012)	602	663
Nepal	37	66 (2001)	37 (2012)	263	270
Pakistan	24	45 (2008)	24 (2012)	1,057	1,063
Sri Lanka	11	39 (2012)	11 (2012)	855	999

GDP = gross domestic product.

Source: World Bank. World Development Indicators. <http://data.worldbank.org/data-catalog/world-development-indicators> (accessed 13 February 2014).

**Table 11.8: Employment Shares by Sector in South Asia and World (%)**

Region	Sector	2000	2011	2012
South Asia	Agriculture	59.5	51.0	50.8
	Industry	15.6	21.0	21.0
	Services	24.9	28.1	28.1
World	Agriculture	40.5	33.3	33.5
	Industry	20.4	22.6	22.5
	Services	39.1	44.1	44.0

Source: ILO. 2013. *Global Employment Trends 2013: Recovering from a Second Jobs Dip*. Geneva: International Labour Organization.

A feature of the agriculture sector in South Asia is that small-scale farmers, who make up most of the farmers in the region, tend to be net food buyers (Sekhar and Bhatt 2012). Given that the poor spend a larger share of their income on food, the poverty and nutritional impacts of changing food prices as a result of trade are important (World Bank 2011). Food security for the poor is of particular concern. During 2000–2010, per capita food availability in the region has failed to improve, with the exception of Bangladesh. Undernourishment in the region is well above the world average, although marginally better than in sub-Saharan Africa. Given the importance of the agriculture sector as a means of livelihood, food security, and overall well-being, enhanced intraregional trade in food and agriculture products could substantially impact the poor.

In the process of harmonizing regional standards, SAARC has identified priority food and agriculture products, including refined sugar, skimmed milk powder, biscuits, instant noodles, black tea, and vegetable ghee. During 2009–2012, cereal, sugar, and sugar confectionery were among the main intraregionally traded agriculture products (Table 11.9). Analysis of supply–demand deficits, export surpluses, and import dependency show that the region has export surpluses of rice and, to a limited extent, sugar. Most South Asian countries experience deficits, and only a few countries have export surpluses of wheat, corn, edible oils (except soya bean oil), and pulses (Table 11.10).

**Table 11.9: Top 10 Exports from SAARC Countries to Other SAARC Countries, 2009–2012**

Product Code	Product Label	Average Value 2009–2012	Average Share of Regional Exports
52	Cotton	2,038,977	14.4
27	Mineral fuels, oils, distillation products, etc.	1,614,446	11.4
87	Vehicles other than railway, tramway	1,091,809	7.7
72	Iron and steel	721,035	5.1
23	Residues, wastes of food industry, animal fodder	491,357	3.5
10	Cereals	486,050	3.4
84	Machinery, nuclear reactors, boilers, etc.	459,785	3.2
17	Sugars and sugar confectionery	438,256	3.1
29	Organic chemicals	427,488	3.0
07	Edible vegetables and certain roots and tubers	402,505	2.8

Source: Sekhar and Bhatt (2012).

**Table 11.10: Export and Trade Potential**

Product	Export and Trade Potential
Rice	Potential for export surplus in Bangladesh and Sri Lanka. Some export surplus in India and Pakistan.
Corn	Low exportable surplus of corn in the region, except in India and Pakistan. Some potential for trade between India and Nepal.
Sugar (refined)	Currently export surplus for sugar (refined) in India only. Large potential deficits emerging in Pakistan. The Maldives totally dependent on imports. Some trade potential from India and Pakistan to Afghanistan, Bangladesh, and the Maldives.
Pulses	Slight potential for exports exists only in Pakistan. All other countries in the region may face deficits or may attain self-sufficiency.

Source: Sekhar and Bhatt (2012).

There is scope for improving intraregional trade in food and agriculture products by (i) synchronizing deficits and surpluses in SAARC countries, and (ii) meeting demand and supply imbalances arising from seasonal fluctuations (Chand 2012).

Studies indicate that the favorable effects of SAFTA for participating countries will derive mainly from vertical specialization, economies of scale, enhanced FDI inflows, regional production networks, and overall strengthening of competitiveness. The textile and clothing sector in South Asia has already benefited to some extent from these developments. The following analysis examines the potential contribution of the textile and clothing sector to poverty reduction in the region.

The textile and clothing sector in South Asia is a major source of income, employment, and trade, with important implications for reducing poverty in the region. Traditionally, the sector has been an initial step for South Asian countries in the transition from agriculture to manufacturing, and to higher productivity employment and reduced poverty (Lopez-Acevedo and Robertson 2012). The sector provides direct employment to more than 55 million people, indirect employment to more than 90 million, and generates exports of more than \$60 billion (Razzaque 2012). It accounts for almost 80% of Bangladesh's export earnings and provides direct employment to about 3.6 million (Ahamed 2013). For Sri Lanka, the sector accounts for 45% of export earnings and employment for more than 1.8 million; for Pakistan, 55% of export earnings and more than 15 million jobs; and for India, about 12% of export earnings and more than 38 million jobs (Razzaque 2012).

Cross-country comparisons indicate that wages in the apparel sector are higher than those in agriculture and comparable to those in the services sector (Table 11.11). The apparel sector is also associated with lower poverty than other low-skilled sectors (Table 11.12). Moving from agriculture to apparel jobs is seen as a channel for social upgrading (World Bank 2013a). Expansion of the apparel sector prompted by regional integration could result in more people earning better wages and would likely encourage workers to shift out of lower-paid jobs, contributing to poverty reduction in the region. Women make up a large share of the workforce in the sector, which serves as an important source of empowerment for women. In 2012, 2.8 million (78%) of the total 3.6 million workers in the sector in Bangladesh were women (Mahmud 2012, Ahamed 2013). In 2008, women's share of total employment in the sector in Sri Lanka was 73% (World Bank 2013a). Women's

empowerment as a result of employment opportunities in the sector has been reinforced by the tendency of women to use their income to improve the nutrition, health, and education of household members (Krogh et al. 2009). Clearly, the textile and clothing sector is vitally important for South Asia.

**Table 11.11: Average Log Wages by Sector**

Country	Year	All Sectors	Apparel	Agriculture	Services (sales)
Bangladesh	2009	7.9	9.3	5.4	8.9
India	2007	6.4	6.4	5.9	6.5
Pakistan	2008	10.8	10.6	10.5	10.7
Sri Lanka	2008	8.9	8.9	8.7	8.9

Note: Log wage values are in domestic currency and therefore are only comparable within countries.

Source: World Bank. 2013a. *Diverse jobs agendas*. Washington, DC: World Bank.

**Table 11.12: Poverty Rates by Sector**

Country	Year	National Poverty Rate (%)	Apparel (%)	Agriculture (%)	Services (sales) (%)
Bangladesh	2000	58	39	72	37
	2005	50	45	43	57
India	2005	42	49	63	60
Pakistan	2002	36	36	58	49
	2005	23	17	44	14
Sri Lanka	2002	14	16	24	20
	2007	7	11	21	17

Notes: Percentages are the share of workers within each sector that earn less than \$1 per day (purchasing power parity). Samples are restricted to those aged 10–69 years.

Source: World Bank. 2013a. *Diverse jobs agendas*. Washington, DC: World Bank.

Various studies indicate considerable potential for intra-industry trade in the textile and apparel sector in South Asia. A UNDP study (UNDP and Commonwealth Secretariat 2010) explored the possibility of establishing regional supply chains for the sector and identified the primary inputs on a country and regional basis (Table 11.13). The study found that for the four countries heavily engaged in the sector (Bangladesh, India, Pakistan, and Sri Lanka), the main sources of imports are from outside the region, despite regional supply capacities. Intra-regional trade in the textile and clothing sector accounted for only 3.5% of South Asia's global trade (UNDP and Commonwealth Secretariat 2010). However, there is a clear division of labor in the sector composition and specialization; Bangladesh and Sri Lanka are net importers of textiles, whereas India and Pakistan are net exporters of textiles, suggesting an important role for intra-regional trade (De Mel and Jayaratne 2012). Constraints to developing intra-regional trade in the sector include (i) entrenched sourcing relations and buyer preferences for East Asian countries; (ii) higher costs compounded by bureaucratic red tape, energy and transport deficiencies, tariff and nontariff barriers, infrastructure gaps, and political economy complexities; and (iii) differences between the needs of apparel manufacturing countries and the types of textiles manufactured.

**Table 11.13: Global and Regional Imports of Identified Inputs in Potential Supply Chains**

Country	Global Imports (\$'000)	Imports from Other Three Countries of the Region (\$'000)	Global Exports of Other Three Countries in the Region (\$'000)	Imports from the Region as % of Country's Global Imports	Global Imports of a Country as a % of Global Exports of the Region
Bangladesh	493,150	146,628	2,690,257	29.7	18.3
India	4,834,969	221,657	1,380,133	4.5	350.3
Pakistan	1,166,083	202,466	15,543,371	17.3	7.5
Sri Lanka	327,176	94,808	3,623,488	28.9	9.0

Source: UNDP and Commonwealth Secretariat. 2010. *Potential Supply Chains in Textiles and Clothing Sector in South Asia: An Exploratory Study*. New York: United Nations Economic and Social Commission for Asia and the Pacific.

Despite the low overall degree of intraregional trade, intra-industry trade appears to have played a relatively important role in the following product categories: spices, chemicals and chemical products, leather, rubber manufactures, wood and paper products, base metals and mineral manufactures, and basic machinery and transport equipment (Wadhwa 2009). Reductions in tariff and nontariff barriers for these categories could have important implications for improving intraregional trade and reducing poverty in the region.

### Trade in Services

The services sector is increasingly important in the region, overtaking agriculture and industry to become the largest contributor to GDP in most South Asian economies. As such, trade in services will have important implications for the region's poor. The services sector also accounts for a growing share of employment in South Asia, contrasting with the falling share for the agriculture sector (by 9% during 2000–2012). Nevertheless, the services sector's contribution to employment has not kept pace with its contribution to output, creating concerns about the implications of services-led growth for employment generation and poverty alleviation (Chanda and Pasadilla 2011).

Construction, wholesale and retail and distribution, communications, and transport services have made the largest contributions to GDP in South Asian countries—about 12%–20% (Chanda and Pasadilla 2011). Their employment contribution has also been high. These service subsectors have therefore played a major role in the growth of region's economies. These services also illustrate the role played by factors such as deregulation and policy reforms. An analysis of the subsector composition of exports indicates a trend from traditional service exports (e.g., travel and transport) to other services (Chanda 2011). Computer and information services show the highest increase in share, with software services driving services exports. Low-cost skilled labor and government policies have boosted this subsector.

There appears to be considerable scope for mutually beneficial trade in services within the region (Kelegama and Abayasekara 2012). Table 11.14 shows potential areas for integration through labor-intensive sectors, where the revealed comparative advantages are greater than those in some South Asian countries. Integration through such labor-intensive services sectors is likely to have a positive impact on poverty reduction in the region.

**Table 11.14: Emerging Patterns of Complementarity of Services in South Asia**

Category of Service	Sector	Countries with RCA (RCA>1)
Labor and resource intensive	Transport	Pakistan, Sri Lanka
Labor and resource intensive	Travel	Maldives, Nepal
Labor intensive	Construction	Sri Lanka
Skill and technology intensive	Communications	Bangladesh, India, Nepal, Pakistan, Sri Lanka
Skill and technology intensive	Computer and information services	India, Sri Lanka
Skill and technology intensive	Financial and insurance services	Sri Lanka

RCA = revealed comparative advantage.

Note: Average RCA for 2000–2006.

Source: RIS 2008.

### Trade Facilitation

As discussed in the preceding sections, although the relationship among trade, poverty, and inequality is not beyond controversy, trade under free and competitive conditions is shown to promote growth and have a positive effect on reducing poverty. Cuts in trade costs have a significant impact on reducing poverty (Winters 2002). Trade facilitation can (i) increase the volume and range of a country's trade by reducing trade costs, leading to more competitive exports, which in turn lead to increases in employment levels and wages, and less expensive imports; (ii) boost economic growth, resulting in higher incomes and employment, leading to lower poverty levels; and (iii) increase government revenues (De and Raychaudhuri 2013).

South Asia's progress in trade facilitation has been limited, with high trade costs emanating from border and behind-the-border issues. Trade facilitation indicators reveal that South Asia is considerably behind other regions and is only marginally ahead of sub-Saharan Africa. Concrete action to address trade barriers in the region could generate substantial benefits through trade expansion both within and outside of the region (Table 11.15). It has been estimated that trade facilitation reforms and capacity building to achieve even half the standards prevalent in East Asia would increase intraregional trade by \$2.6 billion, equivalent to approximately 60% of current total intraregional trade in South Asia (Wilson and Otsuki 2007). Further, welfare gains from trade facilitation appear to be much higher than those that could be achieved through tariff cuts. With a fully functioning SAFTA and a 25% reduction in trade costs, it is estimated that all South Asian countries would experience much larger welfare gains than those from mere tariff cuts (Raihan 2012). In summary, although trade liberalization is necessary for an effective SAFTA, it is not sufficient. The region needs to develop both the software (i.e., customs procedures and efficiency) and hardware (i.e., trade infrastructure) components of trade facilitation.

**Table 11.15: Trade Gains from Unilateral and Collective Capacity Building between South Asia and the Rest of the World**  
(\$ million)

Item	Port Efficiency (Maritime and Air)		Customs		Regulation		Services Sector		Total	
	Unilateral	Partners	Unilateral	Partners	Unilateral	Partners	Unilateral	Partners	Unilateral	Partners
South Asia	8,421	1,268	3,881	755	3,809	836	15,452	1,941	27,560	4,800
Rest of the World	1,268	8,421	755	3,881	836	3,809	1,941	15,452	4,800	27,560

Note: "The rest of the world" includes a group of 76 countries excluding the South Asian countries.

Source: Wilson and Otsuki (2007).

Port efficiency, the customs and regulatory environment, and service sector infrastructure (i.e., electronic documentation and harmonizing regulations) have been identified as key trade facilitation areas that South Asia needs to focus on (Wilson and Otsuki 2007). More specifically, some of the bottlenecks and areas that need priority attention include (i) delays in acquiring necessary documents (trading systems in South Asia are only partially automated, and fully automated systems would reduce delays); (ii) land-border issues; (iii) lack of harmonization of standards, which results in delays and demands for additional checks and certification; (iv) ambiguity in related procedures; (v) lack of necessary testing centers in close proximity to ports; and (vi) lack of trade facilitation nodal points in South Asian countries (de Mel et al. 2012). Of the capacity-building requirements, it is estimated that capacity building in information technology (IT) and services sector infrastructure would result in the greatest benefits, followed by efficiency in air and maritime ports (Wilson and Otsuki 2007).

### Intraregional Investment and Poverty

Intraregional investment in South Asia has been minimal, accounting for less than 5% of total cumulative FDI in the region (Aggarwal 2008, Athukorala 2014). Although intraregional investment has increased slightly since 2000, it is still negligible, with India accounting for most of it (Aggarwal 2008, ADB 2008).

Intraregional investment under SAARC has been promoted through the general framework of regional trade integration, rather than through specific instruments for promoting regional investment (Moazzem 2013). Bilateral FTAs between SAARC member countries have been ineffective in promoting intraregional investment, a major reason for the overall low levels of intraregional investment in South Asia. In addition, political factors, structural barriers, and restrictions on outward investment have often impeded intraregional investment (Aggarwal 2008).

Given that intraregional investment in South Asia has been limited, it has not contributed much to combating poverty in the region. The impact that intraregional investment can have on poverty is determined to a great extent by the economic sectors targeted by FDI. An inflow of FDI into labor-intensive sectors would most likely reduce poverty through the employment and income effects.

As discussed in the preceding sections, the agriculture sector is the most labor-intensive sector in South Asia, and accounts for the largest share of employment in most of the countries. The services sector is the second most significant sector in the region, accounting for the largest share of employment in the Maldives and Sri Lanka and the second-largest share of employment elsewhere in the region. Industry is the least labor-intensive sector.

In examining FDI inflows to South Asia, it is evident that the services sector is the focus of most FDI, followed by the manufacturing sector; the agriculture and mining sectors attract the lowest share of FDI (Gould et al. 2013). In 2009, the services sector accounted for 72% of total FDI inflows to the region, while manufacturing accounted for 22%; agriculture and mining accounted for only 4%. It appears that the labor-intensive sectors in South Asia attract the smallest amount of FDI.

In terms of potential, however, intraregional investment in labor-intensive subsectors, such as textiles and clothing, offers opportunities for reducing poverty by providing additional employment and higher wages. For example, the Brandix Group—Sri Lanka's largest apparel exporter with 42 manufacturing facilities across Bangladesh, India, and Sri Lanka—generates direct employment for 42,000 people (Brandix 2013). The company has opened its own textiles and garments park in Visakhapatnam in Andhra Pradesh, India, which at full capacity is expected to have a turnover of \$1.2 billion and employ more than 60,000 people (Athukorala 2013). Further, MAS Fabric Park in Chintavaram, India, owned by MAS Holdings—one of Sri Lanka's key apparel exporters—is expected at full capacity to provide employment for 30,000 workers. The park has its own training college in textiles and apparel—the Asian Institute of Management and Technology.

Investing in education, health, and other social capital are vital means for reducing poverty. Several examples of intraregional investment in social services can be identified, including Apollo Hospitals, the Indian health care provider that has invested in Bangladesh and Sri Lanka. In addition, Bharti Airtel—a leading telecommunications company with operations in 20 countries across Africa and Asia—has invested in Bangladesh and Sri Lanka. The State Bank of India and the ICICI Bank, which provide banking solutions across Bangladesh, India, and Sri Lanka, are also important institutions in facilitating socially desirable investment within the region.

While overall intraregional investment in South Asia is negligible compared with other regions, it is nonetheless significant in some labor-intensive service subsectors (health care and banking) and some manufacturing subsectors (textiles and garments).

### **Migration and Labor Mobility**

In 2010, the global stock of emigrants from South Asia was 26.7 million. India was the top source country, followed by Bangladesh, Pakistan, Afghanistan, and Sri Lanka. The top five migration corridors were Bangladesh–India, Afghanistan–Iran, India–United States (US), India–Saudi Arabia, and India–United Arab Emirates (UAE) (World Bank 2011).

The first major migration outflows from South Asia occurred in the 1950s and 1960s, when highly skilled professionals migrated to more developed nations in the West. Following the oil price spikes in the 1970s, there was a surge in the migration of short-term unskilled or semiskilled

workers to oil-producing Middle East countries, notably Kuwait, Qatar, Saudi Arabia, and the UAE. In the 1980s, short-term unskilled and semiskilled migration increased to East Asian countries, including the Republic of Korea, Malaysia, and Singapore (Ozaki 2012).

The annual migration outflow from South Asia increased continuously during 2000–2008, reaching more than 2 million (Ozaki 2012), before dropping by 30% following the 2008–2009 global financial crisis (Table 11.16).

**Table 11.16: Number of Migrant Workers Deployed from Select South Asian Countries**

Country	1990	2000	2005	2008	2010
Bangladesh	103,814	222,686	252,740	875,109	390,702
India	141,816	232,182	548,853	848,601	641,356
Nepal	55,025	...	177,576	152,682	298,094
Pakistan	113,781	107,733	142,135	430,314	221,321
Sri Lanka	60,168 <sup>a</sup>	182,188	231,920	250,499	247,119 <sup>b</sup>

... = not available.

<sup>a</sup> 1994 data.

<sup>b</sup> 2009 data.

Source: UNESCAP (2013a).

All South Asian countries except Bhutan and more recently the Maldives have negative net migration rates, indicating a greater rate of emigration than immigration (Table 11.17).

**Table 11.17: Net Migration Rate per 1,000 Population, 2011**

Country	1990–1995	1995–2000	2000–2005	2005–2010
Afghanistan	52.2	(3.5)	7.7	(2.6)
Bangladesh	(1.9)	(1.5)	(2.2)	(4.0)
Bhutan	(37.5)	0.1	11.4	4.9
India	0	(0.1)	(0.4)	(0.5)
Maldives	(2.6)	(0.8)	(0.1)	0.0
Nepal	(1.0)	(0.9)	(0.8)	(0.7)
Pakistan	(2.5)	(0.3)	(2.3)	(2.4)
Sri Lanka	(2.9)	(4.3)	(1.0)	(2.5)

( ) = negative.

Source: UNESCAP. 2011b. *Statistical Yearbook for Asia and the Pacific for 2011*. Bangkok: United Nations Economic and Social Commission for Asia and the Pacific.

Table 11.18 lists the top destination countries for the migrants of selected South Asian countries during 2009 and 2010. In 2010, the UAE was the destination country for 38% of migrant workers from Bangladesh and 36% of migrant workers from India. In 2009, 31% of migrant workers from Sri Lanka went to Saudi Arabia, followed by 18% to Qatar, and 17% to Kuwait. In 2009, 39% of migrant workers from Nepal migrated to Malaysia, 22% to Saudi Arabia, and 19% to Qatar.

**Table 11.18: Top Destination Countries for Selected South Asian Countries, 2009 and 2010**

Country of Origin	Main Destination Countries
Bangladesh <sup>a</sup>	UAE: 38%, Oman: 12%, Kuwait: 12%
India <sup>a</sup>	UAE: 36%, Oman: 28%, Qatar: 12%
Nepal <sup>b</sup>	Malaysia: 39%, Saudi Arabia: 22%, Qatar: 19%
Sri Lanka <sup>b</sup>	Saudi Arabia: 31%, Qatar: 18%, Kuwait: 17%

UAE = United Arab Emirates.

<sup>a</sup> 2010 data.

<sup>b</sup> 2009 data.

Source: Ozaki (2012).

World Bank data for 2010 outline the intraregional migration stock in South Asia. About 95% of the migrants living in India are from Bangladesh, Pakistan, Nepal, and Sri Lanka. India is a major destination country for other South Asian countries. India is also an important source country in the region, with a significant number of Indians living in Bangladesh, Nepal, and Sri Lanka (World Bank 2010).

In 2009, South Asia was the second largest remittance-receiving region in the world, after East Asia and the Pacific. Formal remittance inflows to South Asia have been increasing, and amounted to \$72.5 billion in 2010. India was the world's top country for volume of remittances received in 2010; Bangladesh was ranked seventh. Most of the remittances were from Middle East countries. Qatar, Saudi Arabia, and the UAE accounted for 60% of total remittances to South Asia. Remittances constitute a large portion of GDP for Nepal (22%), Bangladesh (11%), and Sri Lanka (9%).

In terms of remittance flows within South Asia, in 2012 Indian migrant workers received \$4.1 billion from Bangladesh and \$3.2 billion from Pakistan (World Bank 2012). Remittances from South Asian countries represented almost 13% of total remittance inflows to India. In turn, Bangladesh, Nepal, and Pakistan received their highest volumes of remittances from India, indicative of its importance as a destination country for South Asian migrants.

### ***Key Issues in Migration in South Asia***

Given the importance of migration for South Asia, the region must deal with the complexities and dynamics involved, some challenges. Migration in South Asia is predominantly based on temporary contracts for low-skilled or semiskilled workers. As such, these workers are vulnerable to abuse, cheating, and exploitation (Wickramasekara 2011, Ozaki 2012). In destination countries, migrant workers face poor working and living conditions, long working hours, absence of protection for work-related accidents, nonpayment of agreed wages, and low remuneration (Wickramasekara 2011). In addition, female migrant workers are exposed to discriminatory practices and exploitation (RCM Working Group 2012). This issue is particularly relevant and important to South Asia because almost half (45.6%) of migrants from South Asia in 2010 were female (Acharya 2012).

Many migrant workers use unlicensed agents, intermediaries, friends, and family connections to engage in irregular migration, usually as a result of inadequate or complex regulatory requirements (Ozaki 2012). The high volume of remittance inflows through informal channels is a common feature in South Asia (Kelegama and Abayasekara 2012). Informal remittance inflows are estimated to account for more than 40% of total remittances in the region (Ozaki 2012). Many migrants prefer to use informal channels because these are often faster and less expensive (RCM Working Group 2012).

Remittances reduce poverty by serving as a direct source of income to households. However, the high costs associated with migration may limit the ability of migrants to support their families through remittances. Migrant workers incur high migration costs, which include open and hidden components such as visa fees, recruitment charges which are often above state-sanctioned levels, interviews (practical tests), medical tests, travel expenses, insurance and emigration clearance (Wickramasekara 2011). For example, in Bangladesh predeparture migration costs are often twice the official maximum charge, which was \$1,220 in 2009 (RCM Working Group 2012). As a result, participation in migration opportunities for lower income groups is relatively limited, creating inequalities.

### *Opportunities to Improve Migration through Regional Cooperation*

Protecting migrant workers' rights and ensuring their welfare should be a regional priority. The SAARC Social Charter was adopted in 2004 as a people-centered framework for social development within the region. However, the charter does not recognize labor as a distinctive group, and therefore workers' rights are not explicitly recognized in the document (Khatri 2010).

In contrast, the Social Charter of the Association of Southeast Asian Nations (ASEAN) requires ASEAN members to respect, ratify, and promote the Core Labor Standards of the International Labour Organization (ILO) as a minimum requirement. Of the three major international legal instruments on migrant workers—two ILO conventions and one United Nations (UN) convention—Bangladesh and Sri Lanka are the only countries in the region to have ratified the United Nations International Convention on the Protection of the Rights of All Migrant Workers and Their Families (ICMW UN convention) (Wickramasekara 2011). No country in South Asia has ratified the ILO conventions.

A comprehensive SAARC framework to protect migrant workers should require member countries to have a clearly defined migration management policy and sufficient capacity to administer it. Regional cooperation is needed to create a more uniform migration policy. SAARC initiated the Regional Consultative Process to discuss migration-related issues. The Regional Consultative Process has given rise to the Colombo Process and the Abu Dhabi Dialogue. These processes created a forum for home and host countries to consult and create partnerships on issues related to labor migration, to share experiences, and to develop a framework for the management of temporary contractual labor mobility in Asia (Kelegama and Abayasekara 2012). However, these processes have not resulted in legal instruments that meet the standards defined by the ILO and UN conventions on migrant workers.

It is important that South Asia as a region identifies the impediments to ratification of these conventions. Some of the reasons for the reluctance of SAARC member countries

to ratify the conventions include lack of information on the implications of ratifying the conventions, inconsistency of national laws with the conventions' provisions, lack of coordination among the ministries and departments relevant to labor migration, and lack of political will (Wickramasekara 2011).

In addition, the recruitment industry must be made accountable. The private sector plays a major role in the recruitment of migrant workers. Because of ineffective regulations, informal recruiters and intermediaries continue to operate in large numbers (Acharya 2012). While many countries in the region have introduced licensing systems and set penalties for agencies that engage in exploitative and unethical practices, the complexity involved in regulating such agencies makes enforcement difficult (RCM Working Group 2012). Regional cooperation is needed in providing legal assistance and enforcement in cases involving fraud and exploitation of workers.

The World Bank Global Economic Perspective Report (2006) noted that remittance inflows to Bangladesh reduced poverty by 6%. The Nepal Living Standard Survey found that poverty in Nepal was reduced by 11% during 1996–2003. However, to fully realize the multiplier effects of remittance inflows, it is important that they flow through formal channels. This is because the poverty reduction effect of remittance inflows includes the use of remittances by governments and individuals, in addition to households (Khatri 2010). Individuals' use of remittances may have a multiplier effect that adds to income generation, while the influx of foreign exchange to the government (central bank) may lead to poverty reduction through debt servicing and other benefits, provided that the remittances are through official sources.

To encourage remittance transfers through formal channels, migrants and their families need better access to banking and financial services (Acharya 2012). Informal channels, however, offer flexibility and speed compared to official banking networks (Wickramasekara 2011). To make official channels more competitive, the transfer cost of remittances should be lowered, transfer procedures simplified, and transfer delays minimized. It is also important to improve financial literacy among migrants and their households.

Further, better financial and investment products should be designed for migrants. South Asia could learn from best practices of SAARC member countries. For example, Bangladesh launched the Expatriates' Welfare Bank to serve as a credit facility for migrant workers and to provide soft loans and financial assistance for returning migrants (RCM Working Group 2012). Similarly, the Pakistan Remittance Initiative facilitates inflows through formal channels.

Irregular migration occurs for many reasons. Restrictive immigration policies in destination countries, high unemployment or instability in source countries, and the high cost of formal migration are the most common factors contributing to irregular migration (Acharya 2012). To ensure that labor migration is safe and beneficial to both the employer and migrant worker, it is important to minimize irregular migration. Bilateral and multilateral mobility agreements help ensure the orderly movement of labor (RCM Working Group 2012). However, such agreements will not eliminate irregular migration because migrating through legal channels will remain too costly and difficult for many (Kelegama and Abayasekara

2012). In addition, high taxes and regulation make employment less flexible in some countries, encouraging employers to hire irregular migrants (Ratha and William 2007). Bilateral and multilateral agreements, therefore, must address the central causes of irregular migration. Reducing the costs and bureaucracy associated with migration, and making labor markets more flexible in destination countries are essential. Financial assistance support systems for workers migrating legally would encourage regular migration. For example, in Sri Lanka, migrants are offered predeparture loans, and eligible migrants and their families are provided with free life insurance (Khatri 2010).

To minimize the “brain drain” caused by the migration of highly skilled and educated people, special incentives could be provided to returning migrants to harness the skills they acquired while working abroad. Once again, bilateral and multilateral labor agreements should be designed so that labor contracts benefit both source and destination countries. For migration policy to be sustainable as a means for development and poverty reduction, the worker’s period abroad should be long enough to acquire skills and capital but they should return while still active in the workforce.

### **Regional Integration for Food Security**

About 17% of the population of South Asia, amounting to 295 million people, is undernourished (FAO and UN 2012). South Asia has the largest number of malnourished children in the world; nearly 43% of children in South Asia are malnourished (World Bank 2014c). Food security is of paramount importance for the region.

Soil erosion, droughts, and rising sea levels caused by climate change are threats to food security in South Asia. In Bangladesh, 100 million hectares of arable land are affected by saline water intrusion caused by rising sea levels (ADB 2010b). Climate fluctuations, which cause changes in temperature and precipitation patterns, are also expected to adversely affect crop yields, particularly in semiarid and subhumid regions (Robinson 2011). Green growth policies and mitigation initiatives are needed to help counter the effects of climate change.

### ***Current Status of Food Security in South Asia***

As noted earlier, agriculture is a major sector for most South Asian countries. Agriculture accounts for 37% of Nepal’s GDP, followed by Pakistan at 24% (Table 11.7). In all other South Asian countries, agriculture accounts for less than 20%. In terms of employment, however, the shares are much higher throughout the region. Recent trends in value added per worker in the agriculture sector are of concern. Pakistan’s value added per worker in the agriculture sector is just over \$1,000 (World Bank 2013a); while low, it is the highest for the sector in the region. Most countries in the region experienced slower average annual growth rates in agriculture value added per worker during 2000–2009 than in 1990–1999 (Table 11.19). GDP per capita during 2000–2009 grew at a higher rate compared to the growth in agriculture value added per worker for the same period, indicative of the stagnation of the agriculture sector in the region (Sekhar and Bhatt 2012).

**Table 11.19: Growth Rates of Agriculture Value Added and Gross Domestic Product Per Capita (%)**

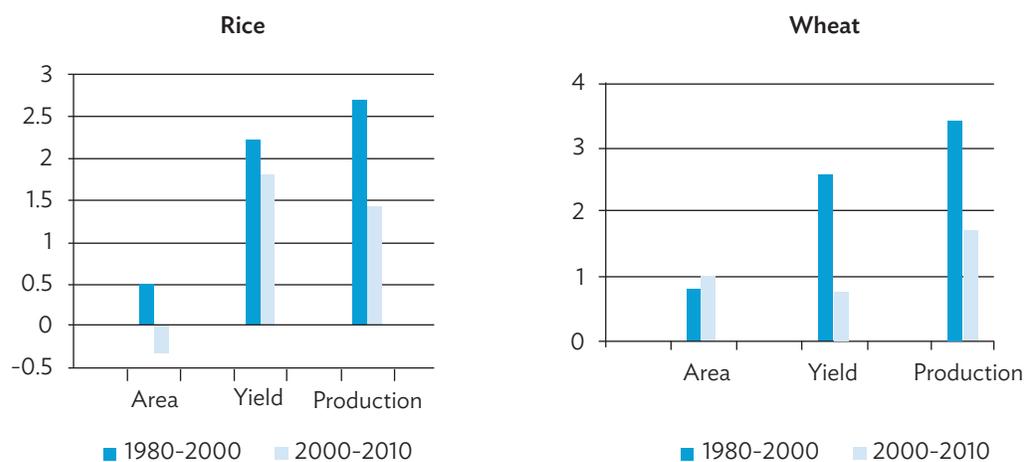
Country	Average Annual Growth Rates			
	Agriculture Value Added per Worker (in constant 2005 dollars)		GDP per Capita (in constant 2005 dollars)	
	1990–1999	2000–2009	1990–1999	2000–2009
Bangladesh	0.24	0.35	0.25	0.47
Bhutan	0.17	(0.31)	0.48	0.65
India	0.16	0.14	0.40	0.64
Nepal	(0.04)	0.00	0.22	0.22
Pakistan	0.21	0.00	0.12	0.26
Sri Lanka	0.17	0.13	0.40	0.43

( ) = negative, GDP = gross domestic product.

Source: Author calculations using World Bank. World Development Indicators. <http://data.worldbank.org/data-catalog/world-development-indicators> (accessed 20 April 2014).

The relative stagnation of agricultural production is seen in the decline in annual growth rates for rice and wheat production (Figure 11.1). South Asia earlier enjoyed rapid growth in production and yields as a result of the Green Revolution, allowing it to transform itself from a food deficient to a food self-sufficient region. However, during 2000–2009, increases in rice and wheat production slowed because of the limited availability of agricultural land for expansion and the plateauing of Green Revolution technology, slowing yield increases (Hossain 2011).

**Figure 11.1: Change in Annual Growth Rates of Rice and Wheat in South Asia, 1980–2010**



Source: FAO and UN. 2012. *The State of Food Insecurity in the World 2012*. Rome: Food and Agriculture Organization of the United Nations. Hossain, M. 2011. *Food Security in South Asia: Status, Challenges and Policy Considerations*. South Asia Economic Summit (SAES IV), Dhaka. October. 23

South Asia faces food security challenges both in terms of access and utilization. Economic barriers, notably the low level of household incomes, limit access to food by poor households. Hunger has been a persistent problem in South Asia, which accounts for 60% of Asia's hungry and 65% of its extreme poor. Child malnutrition is of particular concern for India; in 2009, 44% of Indian children under the age of 5 were reported to be underweight, and 48% stunted (ADB 2012e). India, with about 400 million living on \$1.25 a day or less, accounts for one-third of the world's poor.

Low-income households are vulnerable to food price inflation. According to the Food and Agriculture Organization's food price index, food prices rose by 14% between June 2009 and January 2010 (ADB 2012e). Rising food prices undermine poverty reduction efforts by eroding the purchasing power of low income households, in turn increasing the incidence of hunger and malnutrition in the region.

While there has been some progress in reducing undernourishment in South Asia, the progress has been slow (Table 11.20). Between 1990–1992 and 2010–2012, the absolute number of undernourished people in South Asia declined by only 8%. By comparison, the decline was more than 50% in Southeast Asia and 36% in East Asia over the same period. Most children in South Asia have also deficiencies in micronutrients such as iron, vitamin A, and iodine (ADB 2013a).

**Table 11.20: Prevalence of Undernourishment by Region**  
(%)

Region	Population Undernourished		
	1990–1992	2000–2002	2010–2012
South Asia	26.8	21.3	17.6
East Asia	20.8	14.3	11.5
Southeast Asia	29.6	19.2	10.9
Africa	27.3	25.1	22.9
Latin America and Caribbean	14.6	11.2	8.3

Source: FAO. Food Security Indicators. [http://www.fao.org/economic/ess/ess-fs/ess-fadata/en/#.VPIPi\\_yUfj8](http://www.fao.org/economic/ess/ess-fs/ess-fadata/en/#.VPIPi_yUfj8) (accessed 13 February 2014).

### *Scope for Regional Integration and Modalities of Implementation*

Food security and poverty alleviation are complex, multidimensional issues that require policy responses at the local, national, and regional levels. South Asian countries face common food security challenges, and greater regional cooperation is needed in response.

As discussed in the previous section, food grain yields have plateaued in South Asia. Land available for cultivation is extremely scarce in the region, and climate change is expected to lower yields, hence agricultural productivity must be increased through research and development (R&D) and other means. Although regional collaboration on agricultural R&D is emphasized in SAARC' Agriculture Vision 2020, to date there has been little sharing of experiences and best practices in agricultural R&D. Joint agricultural research should be undertaken with a focus on developing high-yielding crops and improving natural resource management techniques (Hossain 2011). Adapting to higher temperatures and changing

rainfall patterns through crop diversification and the introduction of stress-resistant varieties are critical. With a growing biotechnology industry, India could provide leadership in this area (Sekhar and Bhatt 2012).

Developing a strong network among national agricultural research systems is important for effective collaboration on research. The Asia-Pacific Association of Agricultural Research Institutions was established in 1991, and it has promoted the development of national agricultural research systems in the region. The Cereal Systems Initiative for South Asia is another initiative undertaken by the International Livestock Research Institute, with the broad objective of increasing food security by developing and deploying new varieties along with sustainable management practices. Similar initiatives could be facilitated by SAARC, capitalizing on the common agroclimatic ecological conditions in the contiguous regions of Bangladesh, India, and Pakistan.

Regional food reserves could be used to pool national food security risks. They could also be used as a buffer against volatile food price fluctuations (ADB 2013a). In 2007, the SAARC Food Bank (SFB) was established with the objective of providing regional support to national food security efforts and to solve regional food shortages through collective action. Initially, the SFB had a total dedicated stock of 241,580 tons of food grains. India was the largest contributor with 153,200 tons, followed by Pakistan and Bangladesh with 40,000 tons each. Sri Lanka and Nepal contributed 4,000 tons each. In 2009, the SFB board decided to double the reserves to 486,000 tons. However, the SFB has yet to be utilized, and the amount available is inadequate to effectively address a large-scale food shortage situation (Al Amin 2013).

Enhanced cooperation and coordination among member countries is vital to successful implementation of a food bank. The ASEAN Plus Three Emergency Rice Reserve (APTERR) has been successfully implemented by the ASEAN members following the success of the 3-year East Asia Emergency Rice Reserve pilot project (UNESCAP 2012b). The APTERR is intended to be used as a buffer against threats to food security caused by disasters and to act as a cushion against market volatility caused by calamities (ADB 2013a). The scheme has two reserves: an earmarked reserve and a stockpile reserve, which consists of voluntary donations in cash or rice by members. Stocks are released when a member state's national reserves are not sufficient in an emergency.

While the APTERR has its limitations, with critics pointing to the small pledges made by ASEAN members relative to the pledges made by the Plus Three members, it has been a marked improvement over previous attempts to implement a regional food reserve program in Southeast Asia. The APTERR emphasizes regional management of stockpiles and monitoring of stock releases, whereas under the previous ASEAN Emergency Rice Reserve scheme the release of stocks was negotiated on a strictly bilateral basis (Trethewie 2013).

The APTERR has been utilized on numerous occasions to meet acute and urgent demands for food for humanitarian aid (Tier 3 release), such as in the Philippines and the Lao People's Democratic Republic following typhoons in 2010, and in drought-affected Indonesia in 2012 (Trethewie 2013). In addition, 10,000 tons were released from Viet Nam to the Philippines through commercial contracts (Tier 1 release).

The trigger and release procedure for a food bank should be designed to minimize market distortions. The procedure should be guided by a food security information system. The ASEAN Food Security Information System was established in 2003 with the objective of “facilitating food security planning, implementation, monitoring, and evaluation in ASEAN through the systematic collection, organization, management, analysis, and dissemination of food security data and information.” In order for the SFB to be effective, food-related information and data are essential. The SAARC Agriculture Centre is mandated to provide timely and relevant information on production patterns of major food grains but the center lacks the capacity to deal with large scale data systems (Al Amin 2013). Sufficient capacity must be established within SAARC to produce uniform and useable data for the effective functioning of the SFB.

The success of the SFB will also depend on the level of political commitment by member countries. There is a higher level of political cohesion and economic coordination in ASEAN compared with SAARC (Sekhar and Bhatt 2012). The challenge for South Asia is to reduce protectionist tendencies (particularly when food prices are volatile) and to create avenues and platforms for engagement at the regional level, similar to the APTERR program in Southeast Asia.

### Energy Cooperation in South Asia

Energy endowments differ markedly among South Asian countries but energy trade in the region is limited. Greater cooperation in the energy sector would help strengthen national energy security, reduce the cost of energy supply, and reduce the negative effects of price volatility in the energy market. In addition, promoting energy cooperation would be an effective climate change mitigation mechanism where cross-border energy trade would minimize the need to build new generation capacity in each country. For example, the electricity interconnection system in the European Union (EU) has resulted in an estimated 7%–10% drop in generation capacity costs (Zhao 2011). Regional cooperation in energy in the Greater Mekong Subregion (GMS) in Southeast Asia could lower energy costs by an estimated 20% during 2005–2025 (ADB 2008).

SAARC is one of the fastest growing regions in the world, yet it contains the highest number of people without access to electricity (612 million) (IEA 2010). Many SAARC member countries face electricity shortages and extensive electricity outages (Table 11.21, Zhao 2011). Upward social mobility associated with economic growth is expected to put further pressure on the demand for energy.

**Table 11.21: Electricity Capacity Shortage in South Asia**

Country	Estimated Capacity Shortage (megawatts)	Percentage of Total Installed Capacity
Bangladesh	1,900	31.7
India	10,296	12.0
Nepal	336	43.6
Pakistan	5,230	44.5

Source: Zhao, X. 2011. *Energy Trade in South Asia*. Manila: Asia Development Bank.

As seen in Table 11.22, India is by far the largest user of commercial energy among SAARC member countries, followed by Pakistan, Bangladesh, and Sri Lanka. The energy consumption mix shown in the table illustrates that, with the exception of India and Pakistan, most SAARC member countries rely on a single commercial energy form. Heavy reliance on a single energy source limits the options for meeting diverse energy needs and raises energy security concerns. As noted earlier, there is wide variation in energy resource endowments within the region, especially relating to hydroelectric, natural gas, and coal.

**Table 11.22: Commercial Energy Consumption in South Asia**

Country	Total (quadrillion British thermal units)	Petroleum (%)	Natural Gas (%)	Coal (%)	Nuclear (%)	Hydroelectric (%)	Other (%)
Bangladesh	0.57	31	66	1	0	2	0
Bhutan	0.02	13	0	7	0	80	0
India	13.99	32	7	55	2	5	0
Maldives	0.01	100	0	0	0	0	0
Nepal	0.06	55	0	15	0	31	1
Pakistan	1.83	43	41	5	1	10	0
Sri Lanka	0.19	82	0	0	0	17	0
<b>Total</b>	<b>16.67</b>	<b>34</b>	<b>12</b>	<b>46</b>	<b>1</b>	<b>6</b>	<b>0.30</b>

Source: UNEP. Energy Statistics Database. <http://unstats.un.org/unsd/energy/edbase.htm> (accessed 13 February 2014).

India has abundant coal, with the third largest coal reserves in the world, after the United States (US) and the People's Republic of China (PRC); India's power sector is highly carbon-intensive. Bangladesh and Pakistan rely on a combination of petroleum and natural gas, while Sri Lanka relies heavily on petroleum. Increasing energy consumption in South Asia has resulted in a rapid increase in greenhouse gas emissions by 3.3% annually since 1990 (World Bank 2009).

Given these challenges, intraregional trade in energy has become urgent. Greater regional cooperation would help SAARC member countries augment their energy supply and diversify their fuel sources. In addition, it would enable them to develop crucial energy infrastructure and thereby optimize the use of scarce energy resources and cut energy transport costs.

Currently, intraregional energy trade is largely limited to electricity trade between Bhutan and India (hydropower constitutes 45% of Bhutan's total exports to India) and between India and Nepal (Bisht 2011). Petroleum products are traded between India and Bangladesh, Nepal, Bhutan, and Sri Lanka (India imports and refines crude oil and exports petroleum products). In addition, the Nepal Oil Corporation, together with the Indian Oil Corporation, has agreed to build a petroleum pipeline linking the two countries and reducing Nepal's fuel transport costs by as much as 50% (Singleton 2013). A transmission

grid between Bangladesh and India is expected to facilitate cross-border electricity transfer of up to 500 megawatts (MW).

Given the energy shortfalls faced by SAARC member countries and the expected rise in demand for energy, it is important that they continue to cooperate in improving cross-border energy exchanges through intraregional integration. This is particularly important given that Sri Lanka and some other countries have exhausted their potential capacity. Initially, the focus should be on projects at the subregional level. For example, Bhutan and Nepal have large hydropower potentials, with an estimated 30,000 MW capacity in Bhutan and 43,000 MW in Nepal. This could be exploited and exported to India and Pakistan (Das 2009). Despite their huge hydropower resources, Bhutan and Nepal face energy shortfalls. However, to reap the benefits of subregional power projects, it is important to expand and develop the regional electricity grid. The success of the India–Nepal power exchange should be replicated by other SAARC member countries. Bangladesh would be an important benefactor of linking its power grid with India. India's eastern and northeastern regional grids have periods of surplus power, while western Bangladesh struggles to meet its power demand, and would benefit by importing power from India (Das 2009).

There are opportunities to cooperate in harnessing the renewable wind energy potential in South Asia. India is the fifth-largest wind energy producer in the world. As a result, wind power technology is readily available in India. This should be extended to other South Asian countries. Pakistan, which has 346,000 MW of potential wind energy, would be one of the biggest benefactors of collaboration. However, the political trust deficit between the two countries has stifled progress (AEDB 2013).

To move beyond subregional integration and create region-wide energy cooperation, SAARC member countries must be willing to commit to an agreement on promoting energy trade. Even though SAARC has taken some initiatives to move toward such an agreement, like the Energy Ring Concept (a program designed to harness surplus energy), little or no concrete progress has been made toward cooperation and trade in energy (Powell 2012).

The policy objectives for energy trade agreed upon by countries in the GMS provide a possible foundation for a regional energy trade agreement. Development of a regional power market for the GMS was initially led by the Subregional Electric Power Forum, established as part of the GMS governance structure. Some of the central policy objectives adopted by the GMS member states through the forum are to

- promote efficient development of the regional power sector and regional power trade to boost economic growth,
- promote extended cooperation between GMS members in the field of energy,
- facilitate the implementation of priority energy sector projects, and
- protect and improve the environment through the use of appropriate technologies and plans.

In addition, a set of guiding principles were identified by all GMS members (ECA 2010). These include

- recognizing international power trade as an integral part of energy policies,
- recognizing the importance of technical harmonization of transmission standards to facilitate interconnection, and
- promoting foreign direct investment (FDI) and private sector participation in the power sector.

Similar to the GMS, a regional power trade operating agreement should be designed by SAARC member countries, clearly establishing the power trade actions required by all participants. The agreement should include provisions to develop an energy trade treaty to minimize the risk involved in energy-related regional investment. In addition, the legal and regulatory framework for the energy sector of each SAARC member country should be harmonized to minimize coordination issues.

## Lessons from the Association of Southeast Asian Nations

ASEAN gained momentum with the ASEAN Free Trade Area (AFTA) in 1992 and accelerated again after the Asian financial crisis in 1997. Movement toward an ASEAN Economic Community was initiated based on AFTA, the ASEAN Framework Agreement on Services (AFAS), and the ASEAN Investment Area. South Asia can draw lessons from ASEAN's experience in regional integration, some of which are discussed in the following paragraphs.

### AFTA Complemented by Other Arrangements

Tariff reductions offered by AFTA were complemented by other arrangements, such as the ASEAN Investment Area, the AFAS, the e-ASEAN Framework Agreement, and the ASEAN Dispute Settlement Mechanism. These boosted integration in priority sectors, facilitated the movement of people, and strengthened institutional mechanisms. Similarly, SAARC needs to have the necessary complementary arrangements in support of SAFTA and investment.

### Member Countries' Economic Policies

The economic policies of ASEAN governments have played a major role in boosting trade and attracting investment to the region. Currencies have been allowed to devalue (with the exception of Singapore), monetary policy has been conservative, inflation has been moderate, and proper debt management has prevented member countries from accumulating unsustainable amounts of debt. Macroeconomic stability has added to the locational advantages of these countries. Further, the governments of Singapore and some other ASEAN member countries have played a proactive role in creating dynamic comparative advantage and in moving the economies toward advanced manufacturing and high-value segments. In contrast, macroeconomic stability has not been a strong point in South Asia, with price uncertainties, high inflation, and currency fluctuations prevalent in the region.

### Clear Road Map to Develop Integration

The adoption of the ASEAN Economic Community Blueprint in 2007 provided a clear road map for deepening economic integration and achieving the blueprint's goals by 2015.

### ASEAN Investment Area for Promoting Investment in the Region

Binding clauses oblige member countries to eliminate investment barriers and liberalize their investment rules and policies. Moreover, the ASEAN Investment Area has increased its scope by moving beyond manufacturing to include sectors such as agriculture, mining, and services. Lifting long-established constraints on foreign investment, such as restricted investment areas, restricted foreign shareholding, and operational controls, have resulted in impressive FDI flows to the region. However, there are concerns that extra-ASEAN investment has been much more robust than intra-ASEAN investment, and that FDI flows have been concentrated in the more developed member countries.

### Lessening Regional Disparities through the Initiative for ASEAN Integration

The more advanced nations of ASEAN have used the “prosper thy neighbor approach” to address poverty and other developmental issues in the less developed member countries (Thuzar 2012). Also, to ensure that regional disparities do not hamper integration, the more developed countries have provided technical and other assistance to Cambodia, the Lao People's Democratic Republic, Myanmar, and Viet Nam.

## Conclusion

Complementary policies to trade liberalization are key to easing the adjustment strains and helping households avoid poverty (Winters 2000). Policies that refer specifically to ensuring benefits and avoiding the costs of trade liberalization include infrastructure support, credit access, and assisting in the establishment of new businesses (Winters 2000). Infrastructure deficiencies in South Asia are very serious, with estimates of the investment needed to bridge the gap as high as \$2.5 trillion (Andres et al. 2013). The lack of critical infrastructure hampers potential opportunities for producers, and limits the benefits of relaxed retailing regulations and the availability of cheaper products for urban and peri-urban areas (Winters 2000). As concluded by Andres et al. (2013), it is imperative that South Asian governments (i) rehabilitate and maintain existing infrastructure; (ii) ensure the financial and operational sustainability of service providers; (iii) establish solid legal, policy, and regulatory frameworks; and (iv) decentralize service provision appropriately.

Access to credit is important for enabling producers to take advantage of the opportunities presented by trade liberalization. Setting up a business or increasing production to take advantage of export opportunities, for example, may require more funds than can be raised by low-income business people. Better access to credit for the poor can lead to improved economic performance and overall welfare.

Furthermore, trade liberalization is not limited to trade reform or other trade-related instruments; rather, it should include many other factors that affect trade and business practices (Raihan 2011). South Asian countries have used trade-related instruments over the years to liberalize trade, but institutional reforms are also needed. Further, to boost

trade and investment, it is necessary to establish efficient, predictable, and transparent policies that reduce bureaucracy and corruption and create a good business environment. Access to utilities, transparent labor regulations, and clarity in enforcing contracts are some of the areas that need attention in South Asia.

Liberalization of trade, services, and investment can pose significant challenges for some of the more vulnerable groups in South Asian society. Transitional unemployment or negative consumption shocks are examples of possible ways in which the poor might be adversely affected. The poor have few assets to carry them through the transition period, even if the spells of unemployment or consumption shocks are short. General compensatory policies— often referred to as safety nets—can facilitate adjustment. Sensibly designed safety nets do not demand huge expenditure, are less distortionary, and can be targeted to respond to evidence of poverty due to trade liberalization (Winters 2000).

# Priority Products for Fast-Track Trade Liberalization in South Asia: Focus on Related Nontariff Measures in South Asia

*Selim Raihan, Mostafa Abid Khan, and Shaquib Quoreshi*

This chapter identifies priority products for fast-track trade liberalization in South Asia.<sup>1</sup> There are different methodologies for identifying priority products. Chapter 3 identified some products to be excluded from the sensitive lists. The Asian Development Bank (ADB) (2012a) has identified priority products (based on their active trade) in its efforts to harmonize regional standards. The priority products identified under each sector include (i) food and agriculture products—refined sugar, skimmed milk powder, biscuits, instant noodles, black tea, and vegetable ghee; (ii) jute, textile, and leather—hessian and jute tarpaulin fabric, jute bags for packing of various commodities, jute twins, jute carpet fabrics, jute yarn, cotton drill fabric, and cotton twill fabric; (iii) building materials—steel tubes for structural purposes, portland cement, steel bars for ceramic reinforcement, and ceramic tiles; (iv) electrical, electronics, telecom, and information technology (IT) related electric cables and double-capped fluorescent lamps; and (v) chemical and chemical products—towels and toweling fabric, toilet soap, and shampoo.

This chapter uses the methodology developed by Raihan et al. (2014) to identify priority products for fast-track trade liberalization in South Asia and to pinpoint the nontariff measures that appear to be blocking or impeding intraregional trade in these products.

## Methodology for Identifying Priority Products

The methodology for identifying priority products for fast-track trade liberalization for each member country of the South Asian Association for Regional Cooperation (SAARC) involves the following steps or criteria:

- **Identify imported products with significant effective domestic demand.** Each SAARC member country identifies imported products with a domestic demand amounting to more than \$1 million annually.

<sup>1</sup> This chapter draws from Raihan, S., M. A. Khan, and S. Quoreshi. 2014. NTMS in South Asia: Assessment and Analysis. Kathmandu: SAARC. SAARC-Trade Promotion Network

- **Identify products with significant export capacity.** Each SAARC member country identifies products with export capacity amounting to more than \$1 million annually.
- **Limited or no intra-SAARC trade.** Intra-SAARC trade in the product is limited or nil, indicating trade potential for the product within SAARC.
- **Possible reasons related to nontariff measures.** If the above criteria were satisfied, and if the product was not included in the country's sensitive list or subject to a prohibitive customs duty, possible reasons related to nontariff measures for limited or no intra-SAARC trade are identified.
- **Nontariff measures and their rationale.** The rationale for the identified nontariff measures are examined, and attempts are made to determine the economic or noneconomic basis behind their imposition. Nontariff measures are classified using the United Nations Conference on Trade and Development (UNCTAD) 2012 classification (Annex). Depending on the outcome of this analysis, the product could be selected for inclusion in the list of priority products for fast-track trade liberalization.
- **Exceptions.** Some products included in the priority products list are identified by the SAARC business community and trade bodies. In such cases, the above steps are not fully followed.

## Priority Products for South Asian Countries

Raihan et al. (2014) identified the following as priority products for Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka. The products have substantial potential for intraregional trade but are traded in insignificant volumes largely because of nontariff measures.

### Priority Products for Afghanistan

#### **Harmonized Commodity Description and Coding System (HS) Code 151620:**

#### **Vegetable fats and oils and fractions hydrogenated, inter- or re-esterified, refined.**

These products, totaling \$189 million in 2011, were imported to Afghanistan but none were imported from SAARC countries. Among SAARC countries, India had exports of these same products totaling more than \$87 million in 2011, and Pakistan had exports totaling more than \$118 million.<sup>2</sup> Afghanistan imposes a temporary geographic prohibition (A11) on imports of these products (and all other products) from Japan out of concern for possible radiation content, but no restrictive measures were identified for imports of these products from SAARC countries. Hence, SAARC-based exporters of these products have the opportunity to explore the trade potential in Afghanistan.

**HS Code 110100: Wheat or meslin flour.** Under this category, products worth \$335 million were imported by Afghanistan in 2011, of which imports from SAARC countries accounted for only \$23 million, or 6% of the total amount of this category of imports. In 2011, India exported \$32 million worth of these products, Pakistan \$352

<sup>2</sup> Data on trade volumes by HS category are from the International Trade Centre. Trade Map Database. <http://www.trademap.org> (accessed 20 November 2013).

million, and Sri Lanka \$140 million. In Afghanistan, three technical barriers to trade (TBTs) pertain to the importation of flour: labeling (B31), testing (B82), and certification (B83). Apparently, it is difficult for exporters in other SAARC countries to comply with these measures.

**HS Code 300490: Medicament nes, in dosage.** Afghanistan imported products in this category worth \$50 million in 2011, but none were from SAARC countries. For the same year, global exports from the SAARC region of medicines under this HS code amounted to \$5.4 billion. India alone exported over \$5.2 billion of medicines in 2011, Pakistan \$45 million, and Bangladesh more than \$26 million. In Afghanistan, as in most other countries, imports of medicines are subject to strict regulatory TBT-related requirements. However, SAARC-based exporters of medicines should be able to comply easily with the registration and licensing requirements in Afghanistan and find market opportunities.

**HS Code 070190: Potatoes, fresh or chilled nes.** Afghanistan imported \$61 million of these products in 2011, none of which were from SAARC countries. Among SAARC member countries, Bangladesh's exports in 2011 under this code amounted to \$14 million, India's were \$35 million, and Pakistan's were \$102 million. Imported potatoes are required to pass through specific ports of customs (C3) for quarantine inspection. However, unless there are some other reasons, producers in the SAARC region should be able to export potatoes to Afghanistan without difficulty.

### Priority Products for Bangladesh

**HS Code 040221: Milk and cream powder unsweetened exceeding 1.5% fat.**

Bangladesh's imports of these products amounted to \$143 million in 2011, of which no imports were from SAARC countries. Among SAARC countries, Pakistan's exported more than \$6 million of these products in 2011. Bangladesh has several measures (B31, B32, B83) related to certification, labeling, and marking requirements for imported milk powder, which exporters from Pakistan may have difficulty complying with.

**HS Code 520503: Cotton yarn, >/=85%, single, combed, 232.56 >dtex>/=192.31, not put up.** In 2011, Bangladesh's imports under this category amounted to \$221 million, of which most (\$202 million) was from SAARC countries. Among SAARC countries in 2011, India exported globally more than \$858 million and Pakistan more than \$42 million worth of products in this category. Bangladesh imposes a C3 measure, requiring imports in this category to pass through a specific customs port (Chittagong Port) under the bonded warehouse system. Indian exporters find it easier and more cost-effective to use various land ports to access the Bangladesh market.

**HS Code 210690: Food preparations, nes.** In this category, products worth \$25 million were imported by Bangladesh in 2011, with no record of imports from SAARC countries. However, in 2011, exports globally by SAARC countries of the same category of products amounted to \$192 million, mostly from India (\$116 million), Pakistan (\$15 million), and Sri Lanka (\$58 million). In Bangladesh, imports under this HS code are subject to several TBT-related measures and certification (B83) requirements, which are difficult for exporters in other SAARC countries to comply with.

**HS Code 090830: Cardamoms.** In 2011, Bangladesh imported products in this category worth almost \$20 million, but there is no record of imports from SAARC countries. In the same year, SAARC countries had global exports of cardamoms worth \$119 million, of which Nepal accounted for \$31 million and India \$80 million. Imports of cardamoms to Bangladesh are subject to various certification requirements (B83), which exporters from SAARC countries find difficult to comply with. Large informal trade with bordering India could also be a possible reason why there are no official data on cardamom imports.

#### Priority Products for Bhutan

**HS Code 252329: Portland cement, nes.** In 2011, Bhutan imported products under this category worth more than \$6 million, of which only \$190,000 worth (2010 figure) was imported from SAARC countries. This was the case despite significant exports of these products by SAARC countries, including almost \$200 million by Bangladesh, more than \$190 million by India, and more than \$424 million by Pakistan. This study did not find any particular import restriction in Bhutan regarding portland cement, nor does there appear to be any nontariff measure restricting imports of this product from SAARC countries. The SAARC business community should explore the potential for exporting portland cement to Bhutan.

**HS Code 070110: Potato Seeds.** Bhutan faced difficulty in accessing the Bangladesh market until very recently, when potato seeds were included in the list under bilateral agreement. Bangladesh is a net importer of first generation potato seeds from Europe (the Netherlands), but exporters of the same products from Bhutan faced licensing and inspection-related regulations, which they found difficult to meet. The trade impact of this recent development is yet to be seen.

**HS Code 200919: Orange Juice in Tetra Pak.** Bhutan exports considerable volumes of fruit juices to Bangladesh under duty-free conditions. However, only bottled and canned juice is allowed for such duty-free access.<sup>3</sup> Orange juice in Tetra Pak packages is subject to a 25% customs duty, which makes the Bhutanese product uncompetitive in the market. A different duty structure for the type of packaging should be considered.

**HS Code 640299: Footwear, outer soles/uppers of rubber or plastics, nes.** In 2011, Bhutan imported products in this category amounting to almost \$2 million, of which only \$3,000 (2010 figure) worth was imported from SAARC countries. Global exports by SAARC countries under this category amounted to \$14 million for Bangladesh, \$32 million for India, and \$425 million for Pakistan. For environmental reasons, imports of plastic packaging materials need special permission from Bhutan's Ministry of Economic Affairs. However, industries using plastic packaging materials as raw material are allowed to import without hindrance.

#### Priority Products for India

**HS Code 071340: Lentils dried, shelled, whether or not skinned or split.** In 2011, India's imports of products under this category amounted to \$68 million, but only \$0.6 million worth was imported from SAARC countries. In the same year, global exports

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<sup>3</sup> This particular issue was identified during a discussion with the Bhutanese diplomat stationed in Dhaka, and was verified with the officials of the Bangladesh Tariff Commission.

of lentils were worth \$24 million for Nepal, \$8 million for Sri Lanka, and \$2 million for Afghanistan. For this category, India imposes sanitary and phytosanitary (SPS)-related (A14) special authorization requirements, in accordance with import permits granted under India's plant quarantine regulations. SAARC exporters of lentils find it difficult to comply with these requirements.

**HS Code 610910: T-shirts, singlets, and other vests, of cotton, knitted.** Imports of products in this category were relatively limited. Goods worth \$18 million were imported by India in 2011, of which only \$3 million were imported from SAARC countries. For SAARC countries, global exports of this product are very significant: exports amounted to \$4 billion by Bangladesh, \$266 million by Pakistan, and \$257 million by Sri Lanka. For this category of products, India imposes B31 and B82 measures, or testing, certification, and labeling requirements. These products do not fall under the South Asian Free Trade Area (SAFTA) sensitive list. In addition, Bangladeshi apparel products are subject to 12.4% countervailing duty in the Indian market. These are possible reasons for the limited exports of these products to India from other SAARC countries.

**HS Code 090240: Black tea (fermented) and partly fermented tea in packages exceeding 3 kg.** In this category, products worth \$37 million were imported by India in 2011, of which imports from SAARC countries accounted for only \$13 million. Among the SAARC countries, Sri Lanka's global exports of products under this HS code were \$744 million in 2011, and Nepal's were \$18 million. In India, imports of products under this HS code are subject to SPS-related (A14) special authorization requirements, in accordance with import permits granted under India's plant quarantine regulations, which SAARC exporters of black tea find it difficult to comply with.

**HS Code 340119: Soap and orgn surf prep, shapd, nes; papers and nonwovens impreg w/soap/prep, nes.** India's imports of products under this category amounted to almost \$10 million in 2011, of which less than \$0.5 million was imported from SAARC countries. In 2011, global exports of these products by Bangladesh were almost \$2 million, by Nepal \$3 million, and by Pakistan \$13 million. In India, this category of products is labeled cosmetics, and falls under regulations concerning drugs and cosmetics. These products must pass through specific ports of customs (C3), and thus imports from SAARC countries are restricted.

### Priority Products for the Maldives

**HS Code 210690: Food preparations, nes.** In 2011, the Maldives imported products in this category worth \$5.5 million, of which imports from SAARC countries amounted to only \$1.6 million. SAARC countries' global exports of these products amounted to \$192 million in 2011: \$116 million from India, \$15 million from Pakistan, and \$58 million from Sri Lanka. In the Maldives, SPS- and TBT-related measures are few, except for restrictions related to haram (forbidden by Islamic law) foods. SAARC countries could explore opportunities to export products under this HS category to the Maldives.

**HS Code 040229: Milk and cream powder sweetened exceeding 1.5% fat.** In 2011, the Maldives imported products under this category amounting to \$13 million, of which less than \$2 million was imported from SAARC countries. Total global exports of these products from SAARC countries amounted to \$9 million in 2011, including \$6 million by Pakistan and

\$2 million by India. This study could not identify any particular nontariff measure limiting imports to the Maldives of milk products from SAARC countries.

**HS Code 610349: Mens/boys trousers and shorts, of other textile materials, knitted.**

The Maldives imported products under this category amounting to \$1.5 million in 2011, of which little more than \$0.1 million was imported from SAARC countries. Total global exports of these products by SAARC countries in 2011 amounted to \$120 million, of which India accounted for \$11 million, Pakistan \$85 million, and Sri Lanka \$20 million. This study could not identify any particular nontariff measure in the Maldives for limiting imports of apparel products under this category from SAARC countries.

**HS Code 950300: Tricycles, scooters, pedal cars, and similar wheeled toys; dolls' carriages.**

Imports to the Maldives of products in this category were \$1.4 million in 2011, of which only \$0.2 million worth was imported from SAARC countries. Global exports by SAARC countries of products in this category totaled \$41 million in 2011, mainly from India (\$19 million), Sri Lanka (\$18 million), and Bangladesh (\$3 million). No particular nontariff measure in the Maldives was identified as limiting the import of light engineering products from SAARC countries.

**Priority Products for Nepal**

**HS Code 300490: Medicament nes, in dosage.** While global imports by Nepal of these products amounted to \$20 million in 2011, only \$7 million was attributable to imports from SAARC countries. For the same year, global exports from SAARC countries of medicines under this HS code were \$5.4 billion; India alone exported more than \$5.2 billion in medicines but only \$6 million worth were exported to Nepal. Pakistan had more than \$45 million in global exports of medicines and Bangladesh more than \$26 million; in both cases, almost no exports were made to Nepal. As in most other countries, the importation of medicines in Nepal is subject to strict regulatory requirements under the Drug Act, 1978. Enforcement of industrial property rights in respect of pharmaceuticals is the responsibility of the Department of Industry under the Ministry of Industry.

**HS Code 620322: Mens'/boys' ensembles, of cotton, not knitted.** In 2011, Nepal imported products under this category worth \$15 million, of which only \$64,000 was imported from SAARC countries. For the same year, global exports of these products from the SAARC region amounted to \$98 million, mainly from Bangladesh (\$2 million), India (\$14 million), and Pakistan (\$82 million). Despite their global trade in this HS category, SAARC countries exported very little to Nepal. There are some AZO<sup>4</sup> testing requirements in Nepal for textile products, but garment-exporting countries in the region have adequate testing and certification capability; this requirement should not pose a barrier to exports to Nepal. There appears to be trade potential with Nepal for this category of products.

**HS Code 220290: Non-alcoholic beverages nes, excluding fruit or vegetable juices of heading No. 20.09.** In 2011, Nepal's imports under this category amounted to \$12

<sup>4</sup> AZO dyes are the name of the group of synthetic dyestuffs based on nitrogen that are often used in textile industry.

million, of which only \$1.4 million was imported from SAARC countries. Global exports of this category of products from the SAARC region were \$15.5 million in 2011; the main sources were Bangladesh (\$5 million), Bhutan (\$3 million), India (\$5 million), Pakistan (\$1.7 million), and Sri Lanka (\$3 million). These countries exported very small amounts of this category of products to Nepal. No significant nontariff measures restricting regional trade in this product were identified, except that most SAARC countries have difficulty complying with the differing quality standards and parameters in the region.

**HS Code 210690: Food preparations, nes.** In 2011, Nepal imported products under this category valued at \$31 million, of which only \$10 million was attributable to products from other SAARC countries. This was despite global exports of \$192 million, mostly by India (\$116 million), Pakistan (\$15 million), and Sri Lanka (\$58 million). In Nepal, imports of products under this HS code are subject to several SPS- and TBT-related measures. The differentiated SPS and TBT standards are difficult for exporters of other SAARC countries to comply with.

### Priority Products for Pakistan

**HS Code 252329: Portland cement, nes.** This is a major product that, until recently, was subject to quality standards and other TBT restrictions on exports to India. In November 2012, India and Pakistan successfully reached the first ever product-specific mutual recognition agreement on quality standards for cement. However, the desired positive impact for trade in this product has yet to be seen because of other complications. Following signing of the agreement, the Bureau of Indian Standards issued a notice to all suppliers of cement to India to submit a performance bank guarantee of \$10,000. This is an additional measure that has increased the cost for Pakistani exporters of doing business with India. Moreover, the Pakistani business community has reported that the Indian customs authorities at the Attari-Wagah land port have implemented a stringent customs checking and documentation procedure for cement from Pakistan, whereas strictness is not observed in the case of exports of gypsum (a raw material for cement manufacturing) to India. Pakistani business interests note that at least 30 to 40 truckloads of gypsum are processed by the Indian authorities at the customs post on a daily basis, compared to 1 to 2 truckloads of cement. Pakistan's major market for cement is Afghanistan, where demand has been increasing steadily. Also, local demand for cement has increased sharply in 2013. Both factors have resulted in enhanced profit margins for cement manufacturers in the domestic as well as the Afghan market. The measures imposed by India, coupled with improving domestic and Afghan market conditions, have resulted in a downward trend in cement exports to India.

**HS Code 090411: Pepper of the genus Piper, ex cubeb pepper, neither crushed nor ground.** In 2011, Pakistan imported \$11 million worth of products under this HS category, of which only \$0.5 million was imported from SAARC countries. Among SAARC countries, India globally exported more than \$13 million, and Sri Lanka more than \$29 million. Pakistan imposes a B83 certification measure requiring an aflatoxin report attesting that import consignments are free from any pests or diseases. The report must be certified by the Department of Plant Protection. India and Sri Lanka, the two major exporters of peppers in the region, are yet to develop adequate facilities to comply with the requirement; hence their exports to Pakistan of this product are limited.

**HS Code 210690: Food preparations, nes.** In 2011, Pakistan imported products in this category amounting to \$36 million, of which imports from SAARC countries constituted less than \$0.2 million. Global exports by SAARC countries of these products were \$192 million in 2011. In Pakistan, imports under this HS code are subject to several SPS and TBT measures: (i) The products must be fit for human consumption. (ii) The products should be free of any haram element or ingredients. (iii) Edible products must have at least 50% of the shelf life remaining, calculated from the date of filing of the imported products. These requirements are difficult for exporters in other SAARC countries to comply with.

**HS Code 300490: Medicament nes, in dosage.** Medicinal products amounting to \$226 million were imported by Pakistan in 2011, of which only \$12 million was imported from SAARC countries. However, in 2011, global exports by SAARC countries of medicines under this HS Code amounted to \$5.4 billion. India alone exported globally more than \$5.2 billion worth of medicines, but only \$12 million to Pakistan. Bangladesh had global exports in this category of more than \$26 million, but none to Pakistan. Imports of medicines to Pakistan are subject to strict regulatory requirements stipulating that (i) imports shall be permissible strictly according to registration of drugs under Section 7 of the Drugs Act, 1976 (XXXI of 1976), and subject to the condition that the drugs shall have at least 75% of the shelf life remaining, calculated from the date of filing; and (ii) all imported packaged medicines or drugs shall display the name and prescription materials.

#### Priority Products for Sri Lanka

**HS Code 071340: Lentils dried, shelled, whether or not skinned or split.** Sri Lanka's imports of products in this category amounted to \$70 million in 2012, of which less than \$0.2 million was from SAARC countries. India's global exports of these goods in 2012 exceeded \$8 million, and Nepal's were more than \$24 million. Sri Lanka has imposed special authorization for imports of this category of products, in compliance with SPS (A14) and certification (A83) requirements, in the form of approval by the Chief Food Authority. Exporters also require certification by the competent authorities of the country of origin, attesting that the food has been inspected. India and Nepal, the major exporters of lentils in the SAARC region, find these requirements difficult to comply with.

**HS Code 252329: Portland cement, nes.** Although Sri Lanka imported substantial quantities of portland cement in 2012, most imports were from outside the region. In the same year, SAARC countries had global exports in this category amounting to \$670 million—\$547 million by Pakistan (\$43 million of exports were to Sri Lanka), \$107 million by India (all exports were to Sri Lanka), and \$16 million by Bangladesh (none of which was to Sri Lanka). In Sri Lanka, imports of products under this HS code are subject to several technical measures, certification requirements, differential value-added tax treatment, and some para-tariffs. These pose difficulties for exporters from other SAARC countries.

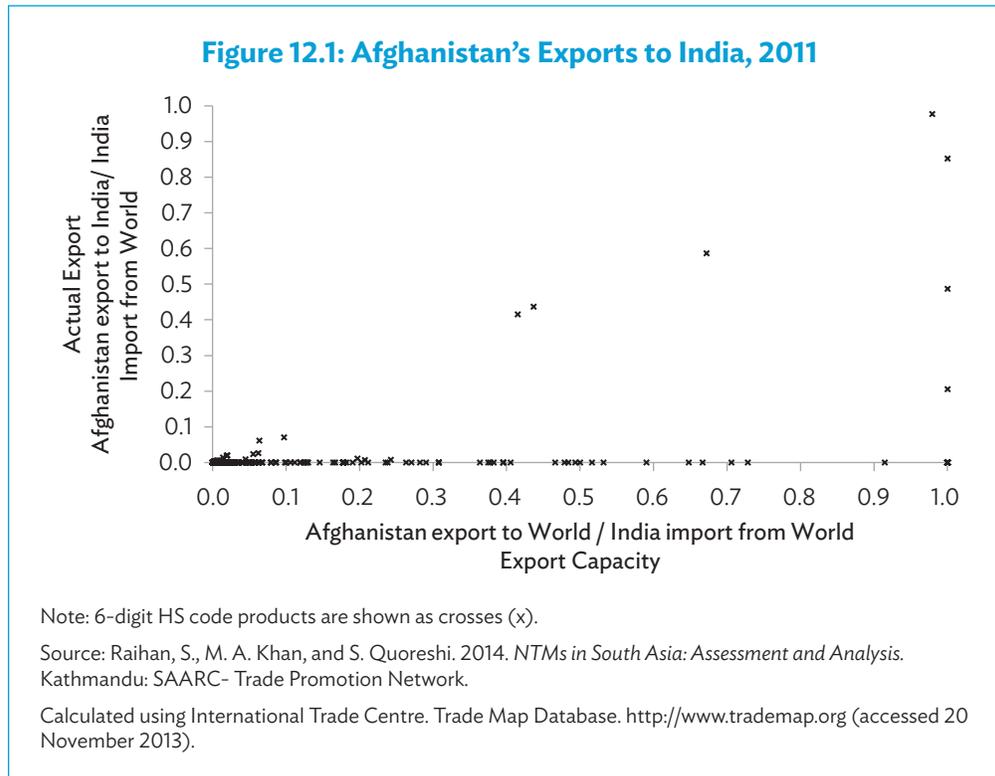
**HS Code 210690: Food preparations, nes.** In 2012, Sri Lanka's imports of products under this category amounted to \$25 million, of which only \$8 million was from other SAARC countries, even though their global exports in this category amounted to \$198 million. India's global exports in this category amounted to \$130 million and Pakistan's totaled \$21 million. In Sri Lanka, imports of products under this HS code are subject to several SPS-

and TBT-related measures, and some para-tariffs, which are difficult for exporters in other SAARC countries to comply with.

**HS Code 30049: Medicament nes, in dosage.** In 2012, Sri Lanka imported goods in this category amounting to \$274 million, more than 60% of which was imported from other SAARC countries. Global exports by SAARC countries of medicines under this HS code amounted to \$6.7 billion in 2012: \$6.6 billion by India, with exports to Sri Lanka of \$95 million; \$53 million by Pakistan, but only \$6 million in exports to Sri Lanka; and \$23 million by Bangladesh but with exports of only \$1 million to Sri Lanka. Like most other countries, imports of medicines in Sri Lanka are subject to strict regulatory measures related to TBTs, such as the registration requirement. The region’s medicine exporters find it difficult to comply with the differentiated and complex registration requirements in SAARC countries.

## Analysis of Export Capacity versus Actual Export in South Asia

Raihan (2013) compared the export capacity of South Asian countries with their actual exports, in the context of bilateral trade among the South Asian countries. For example, at the 6-digit HS code level, Afghanistan’s export capacity to the Indian market is defined as the ratio between Afghanistan’s export to world markets and India’s import from world markets. There are cases in which such ratios could be higher than 1. For simplicity, the



maximum value of this ratio is considered to be 1. On the other hand, Afghanistan's actual export to India is defined as the ratio between Afghanistan's export to India and India's import from world markets. The maximum value of this ratio is also 1.

Figure 12.1 shows the graphical representation of this exercise. The 6-digit HS code products are shown as crosses (x). The slope of this graph is the ratio between Afghanistan's export to India and Afghanistan's export to world markets, which can take a maximum value of 1. At the 6-digit level, Afghanistan exported 866 products to world markets in 2011, and exported only 100 products to India. However, some products shown as crosses (x) that lie at or near the horizontal line but are approaching 1.0 on the x-axis can be considered the products for which Afghanistan had some export capacity, but actual export was very low or zero.

This comparative exercise was undertaken for South Asian countries in relation to India only, because India is by far the largest trading partner in SAARC and, for some products, the largest trading partner globally. However the exercise can be extended to assess the captive trade potential between all SAARC countries. Once the products with full or some export capacity are identified, a list is made of the top 50 products for which South Asian countries have full or some export capacity but zero actual export as far as the bilateral trade between India and other South Asian countries are concerned. The corresponding nontariff measures are also noted. Due to data limitations, however, this study cannot explain whether nontariff measures are the major reason for zero or very low intraregional trade in the products considered.

Table 12.1 lists the top 50 products in which Afghanistan had full or some export capacities but zero exports to India. Of these 50 products, 42 would be subject to nontariff measures in India.

**Table 12.1: Top 50 Products in which Afghanistan had Full or Some Export Capacity but Zero Exports to India, with Corresponding Nontariff Measures in India**

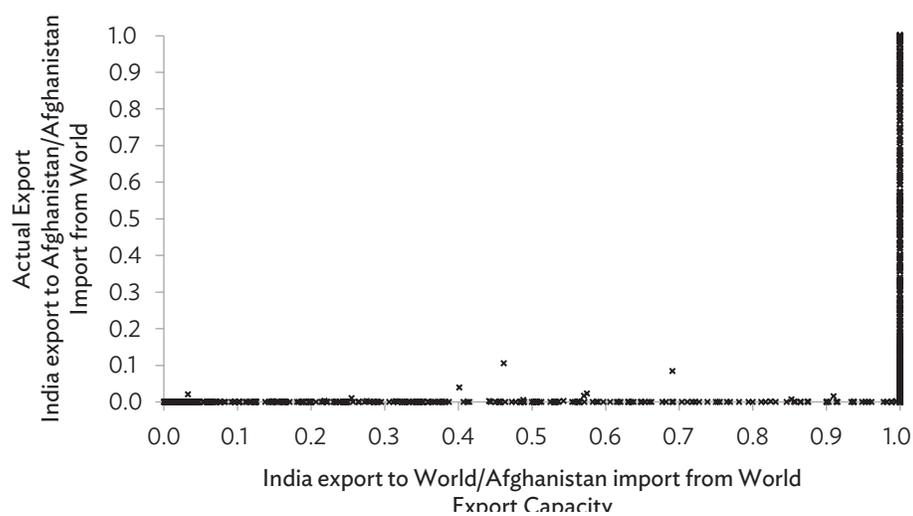
HS Code	HS Code Description	Nontariff Measure Code
010619	Live mammals (excl. primates, whales, dolphins and purposes "mammals")	A14, A26
030749	Cuttle fish and squid, shelled or not, frozen, dried, salted or in brine	A14, A84
050690	Bones & horn-cores degelatinisd, unwk, defattd or simply prepr, powder&waste	E329
070200	Tomatoes, fresh or chilled	A14
070519	Lettuce, fresh or chilled nes	A14
070951	Mushrooms, fresh or chilled	A14
080231	Walnuts in shell, fresh or dried	A14
080232	Walnuts, fresh or dried, shelled or peeled	A14
080520	Mandarins(tang & sats)clementines&wilkg &sim citrus hybrids, fresh/drid	A14
080540	Grapefruit, fresh or dried	A14

*continued on next page*

Table 12.1 continued

HS Code	HS Code Description	Nontariff Measure Code
080550	Fresh or dried lemons "Citrus lemon, Citrus lemonum" and limes "Citrus	A14
080711	Watermelons, fresh	A14
080719	Melons, fresh, other than watermelons	A14
081040	Cranberries, bilberries and other fruits of the genus Vaccinium, fresh	A14
081090	Fruits, fresh nes	A14
081350	Mixtures of edible nuts or dried fruits of this chapter	A14
081400	Peel of citrus fruit/melons (watermelons) fresh, frz, drid/prov presvd	A14
091020	Saffron	A14
121120	Ginseng roots used primarily in pharm, perf, insecticide, fungicide/sim purp	A14
121299	Vegetable products nes used primarily for human consumption	A14
240130	Tobacco refuse	A14
251511	Marble and travertine, crude or roughly trimmed	E112, E119
252610	Natural steatite, not crushed/powdered	
410150	Whole raw hides and skins of bovine "incl. buffalo" or equine animals,	A14, A84
410210	Sheep or lamb skins, raw, with wool on, nes	A14, A84
430130	Raw Persian and similar lamb fur skins, whole	A14, A84
430310	Articles of apparel and clothing accessories of fur skin	
481720	Cards, letter or correspondence, plain postcards, of paper	
510211	Hair of Kashmir "cashmere" goats, neither carded nor combed	B83 or B82
510219	Fine animal hair, neither carded nor combed (excl. wool and hair of Ka)	B83 or B82
510220	Coarse animal hair, not carded or combed	B83 or B82
510810	Yarn of carded fine animal hair, not put up for retail sale	B83 or B82
551429	Woven fabrics of oth synthetic staple fib, 170g/m <sup>2</sup> , dyd	B83 or B82
570110	Carpets of wool or fine animal hair, knotted	B83 or B82
570210	Kelem, Schumacks, Karamanie, and similar textile hand-woven rugs	B83 or B82
570291	Carpets of wool or fine animal hair, woven, made up, nes	B83 or B82
610419	Womens/girls suits, of other textile materials, knitted	B83 or B82
611594	Full-length or knee-length stockings, socks and other hosiery, incl. f	B83 or B82
620322	Mens/boys ensembles, of cotton, not knitted	B83 or B82
630260	Toilet & kitchen linen, of terry towel or similar terry fab, of cotton	B83 or B82
711320	Articles of jewellery & pts thereof of base metal clad w precious metal	
711719	Imitation jewellery nes of base metal whether or not platd w prec metal	
841122	Turbo-propellers of a power exceeding 1100 KW	
870120	Road tractors for semi-trailers (truck tractors)	B19, C3, B82, B83
870421	Diesel powered trucks with a GVW not exceeding five tons	B19, C3, B82, B83
871130	Motorcycles with reciprocating piston engine displacg > 250 cc to 500 cc	B19, C3, B82, B83
930591	Parts and accessories of military weapons of heading 9301, nes	E111
970200	Original engravings, prints, and lithographs	

**Figure 12.2: India's Exports to Afghanistan, 2011**



Note: 6-digit Harmonized System code products are shown as crosses (x).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Calculated using International Trade Centre. Trade Map Database. <http://www.trademap.org> (accessed 20 November 2013).

HS Code	HS Code Description	Nontariff Measure Code
970500	Coll & coll pce zoo,bot,mineral,hist,anatom,archaeo,palaeont,ethno/num	E111
970600	Antiques of an age exceeding one hundred years	

HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Figure 12.2 compares India's export capacity and actual exports to Afghanistan in 2011. At the 6-digit HS code level, India exported 4,109 products to world markets, including 908 products to Afghanistan. It is evident that there were many products where India had substantial export capacity, but actual exports of these products to Afghanistan were very low or zero. Table 12.2 lists the top 50 products in which India had full export capacity, but exports to Afghanistan were zero. Of these 50 products, 11 would be subject to nontariff measures in Afghanistan.

**Table 12.2: Top 50 Products in which India had Full Export Capacity but Zero Exports to Afghanistan, with Corresponding Nontariff Measures in Afghanistan**

HS Code	HS Code Description	Nontariff Measure Code
030741	Cuttle fish and squid, shelled or not, live, fresh or chilled	A110, A310, A810, A820, A830
090111	Coffee, not roasted, not decaffeinated	A110, B310, B820, B830
110630	Flour, meal & powder of edible fruits & nuts & peel of citrus fruit or melons	A110, B310, B820, B830
120220	Ground-nuts shelled, whether or not broken, not roasted or otherwise cooked	A110, A820, B310, B830, C300, E111, P130, P610
120300	Copra	A820, B310, B830, C300, E111, P130, P610
120740	Sesamum seeds, whether or not broken	A110, A820, B310, B830, C300, E111, P130, P610
120750	Mustard seeds, whether or not broken	A110, A820, B310, B830, C300, E111, P130, P610
120799	Oil seeds and oleaginous fruits, nes, whether or not broken	A110, A820, B310, B830, C300, E111, P130, P610
151800	Animal/veg fats & oils & fract boild oxid, etc,& ind mix/ prep nes ex 15.16	A110, B310, B820, B830, B420
220710	Undenaturd ethyl alcohol of an alcohol strgth by vol of 80% vol/higher	A110, B310, B820, B830
220830	Whiskies	A110, B310, B820, B830
230400	Soya-bean oil-cake&oth solid residues,whether or not ground or pellet	
251690	Monumental or building stone nes	
260111	Iron ores&concentrates,oth than roasted iron pyrites,non-agglomerated	
270400	Coke&semi-coke of coal,lignite o peat,agglomeratd o not,retort carbon	
280300	Carbon (carbon blacks and other forms of carbon, nes)	
280519	Alkali metals nes	
290410	Derivs of hydrocarbons cntg only sulpho groups,thr salts&ethyl esters	
290949	Ether-alcohols nes; derivatives of ether-alcohols	
291590	Saturated acyclic monocarboxylic acids and their derivatives, nes	
293100	Organo-inorganic compounds, nes	

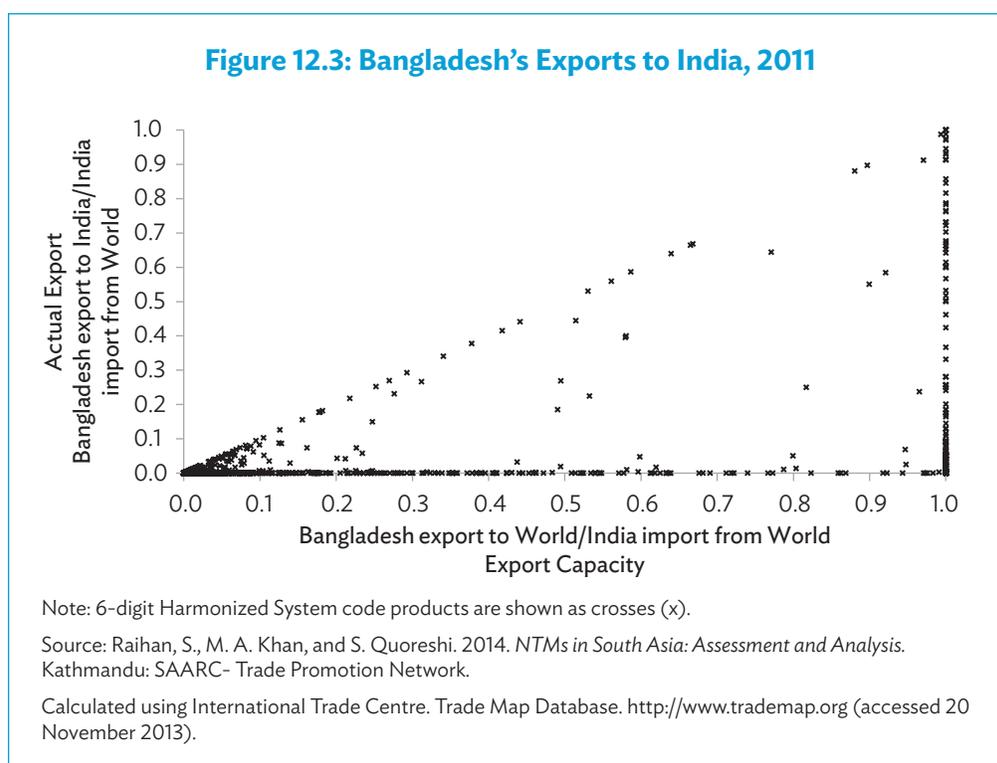
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Table 12.2 continued

HS Code	HS Code Description	Nontariff Measure Code
293399	Heterocyclic compounds with nitrogen hetero-atom[s] only (excl. those	
320412	Acid and mordant dyes and preparations based thereon	
320415	Vat dyes and preparations based thereon	
320416	Reactive dyes and preparations based thereon	
320649	Inorganic coloring matter nes and preparations based thereon	
330129	Essential oils, nes	
382370	Industrial fatty alcohols	
420310	Articles of apparel of leather or of composition leather	
481092	Multi-ply paper and paperboard, coated on one or both sides with kaoli	
481099	Paper, in rolls or sheets, clay coated, nes	
520100	Cotton, not carded or combed	
520513	Cotton yarn, >/=85%,single,uncombed,232.56>dt ex>/=192.31, not put up	
551513	Woven fab of polyester staple fibres mixd w/wool/fine animal hair,nes	
560749	Twine nes, cordage, ropes and cables, of polyethylene or polypropylene	
581091	Embroidery of cotton, in the piece, in strips, or in motifs, nes	
610711	Mens/boys underpants and briefs, of cotton, knitted	
630251	Table linen, of cotton, not knitted	
630391	Curtains/drapes/interior blinds&curtain/bd valances,of cotton,not knit	
690210	Refractory bricks etc >50% Mg,Ca o Cr expressd as MgO,CaO o Cr2O3 o mx	
721123	Cold roll iron/steel,	
721129	Flat rolled prod, i/nas, hr,	
721914	Flat rolld prod,stainless steel,hr in coil,w>/=600mm,thk< 3mm	
722100	Bars & rods, stainless steel, hot rolled in irregularly wound coils	
722220	Bars & rods, stainless steel, nfw than cold formed or cold finished	
730441	Tube,pipe&hollow profile,stain steel,smls,cd/cr of circ cross sect,nes	
844820	Pts & access of mach of hdg No 84.44 or of their auxiliary machinery	
845590	Parts of metal rolling mills & rolls	
900150	Spectacle lenses of other materials	
960330	Artists', writing and similar brushes for the application of cosmetics	

HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).



Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Figure 12.3 compares Bangladesh's export capacity and actual export to India in 2011. At the 6-digit HS code level, Bangladesh exported 1,782 products to world markets but only 581 to India. It is evident that there were many products for which Bangladesh had substantial export capacity, but actual exports of these products to India were very low or zero. Table 12.3 lists the top 50 products meeting these criteria. All except one product were subject to nontariff measures in India.

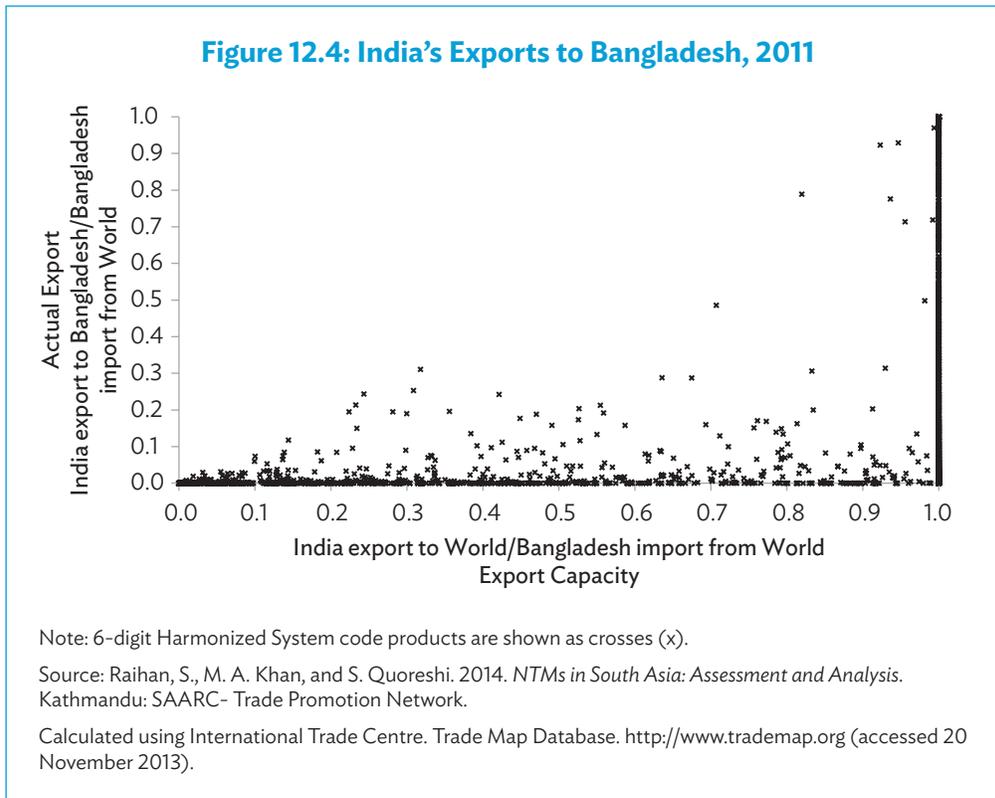
**Table 12.3: Top 50 Products in which Bangladesh had Full Export Capacity but Zero Exports to India, with Corresponding Nontariff Measures in India**

HS Code	HS Code Description	Nontariff Measure Code
030199	Fish live, nes	E11, A14, A84
030329	Salmonidae, nes, frozen, excluding heading No 03.04, livers and roes	A14, A84
070820	Beans, shelled or unshelled, fresh or chilled	A14
070960	Peppers of the genus <i>Capsicum</i> or of the genus <i>Pimenta</i> , fresh or chilled	A14
080550	Fresh or dried lemons "Citrus lemon, <i>Citrus lemonum</i> " and limes "Citrus"	A14
160520	Shrimps and prawns, prepared or preserved	A22, A82
240130	Tobacco refuse	A14

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Table 12.3 continued

HS Code	HS Code Description	Nontariff Measure Code
410712	Grain splits leather "incl. parchment-dressed leather", of the whole h	A87
410792	Grain splits leather "incl. parchment-dressed leather", of the portion	A87
530390	Jute and other tex bast fib, not spun, nes; tow and waste of these fibres	
560741	Binder or baler twine, of polyethylene or polypropylene	B83 or B82
580219	Terry toweling & similar woven terry fab of cotton, o/t unbl&o/t nar fab	B83 or B82
610120	Mens/boys overcoats, anoraks etc, of cotton, knitted	B83 or B82
610220	Womens/girls overcoats, anoraks etc, of cotton, knitted	B83 or B82
610230	Womens/girls overcoats, anoraks etc, of man-made fibres, knitted	B83 or B82
610322	Mens/boys ensembles, of cotton, knitted	B83 or B82
610323	Mens/boys ensembles, of synthetic fibres, knitted	B83 or B82
610341	Mens/boys trousers and shorts, of wool or fine animal hair, knitted	B83 or B82
610423	Womens/girls ensembles, of synthetic fibres, knitted	B83 or B82
610443	Womens/girls dresses, of synthetic fibres, knitted	B83 or B82
610461	Womens/girls trousers and shorts, of wool or fine animal hair, knitted	B83 or B82
610520	Mens/boys shirts, of man-made fibres, knitted	B83 or B82
610711	Mens/boys underpants and briefs, of cotton, knitted	B83 or B82
610722	Mens/boys nightshirts and pyjamas, of man-made fibres, knitted	B83 or B82
610821	Womens/girls briefs and panties, of cotton, knitted	B83 or B82
610831	Womens/girls nightdresses and pyjamas, of cotton, knitted	B83 or B82
611012	Jerseys, pullovers, cardigans, waistcoats and similar articles, of hai	B83 or B82
611241	Womens/girls swimwear, of synthetic fibres, knitted	B83 or B82
611300	Garments made up of impreg, coatd, coverd or laminatd textile knitted fab	B83 or B82
611420	Garments nes, of cotton, knitted	B83 or B82
611430	Garments nes, of man-made fibres, knitted	B83 or B82
620192	Mens/boys anoraks and similar articles, of cotton, not knitted	B83 or B82
620213	Womens/girls overcoats&sim articles of man-made fibres, not knitted	B83 or B82
620292	Womens/girls anoraks and similar article of cotton, not knitted	B83 or B82
620323	Mens/boys ensembles, of synthetic fibres, not knitted	B83 or B82
620423	Womens/girls ensembles, of synthetic fibres, not knitted	B83 or B82
620722	Mens/boys nightshirts and pyjamas, of man-made fibres, not knitted	B83 or B82
620821	Womens/girls nightdresses and pyjamas, of cotton, not knitted	B83 or B82
620891	Womens/girls panties, bathrobes, etc, of cotton, not knitted	B83 or B82
620892	Womens/girls panties, bathrobes, etc, of man-made fibres, not knitted	B83 or B82
621111	Mens/boys swimwear, of textile materials not knitted	B83 or B82
621133	Mens/boys garments nes, of man-made fibres, not knitted	B83 or B82
621142	Womens/girls garments nes, of cotton, not knitted	B83 or B82
621230	Corselettes and parts thereof, of textile materials	B83 or B82
630222	Bed linen, of man-made fibres, printed, not knitted	B83 or B82
630231	Bed linen, of cotton, nes	B83 or B82
630232	Bed linen, of man-made fibres, nes	B83 or B82



HS Code	HS Code Description	Nontariff Measure Code
630260	Toilet & kitchen linen, of terry toweling or similar terry fab,of cotton	B83 or B82
630391	Curtains/drapes/interior blinds & curtain/bd valances, of cotton, not knit	B83 or B82
630622	Tents, of synthetic fibres	B83 or B82

HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

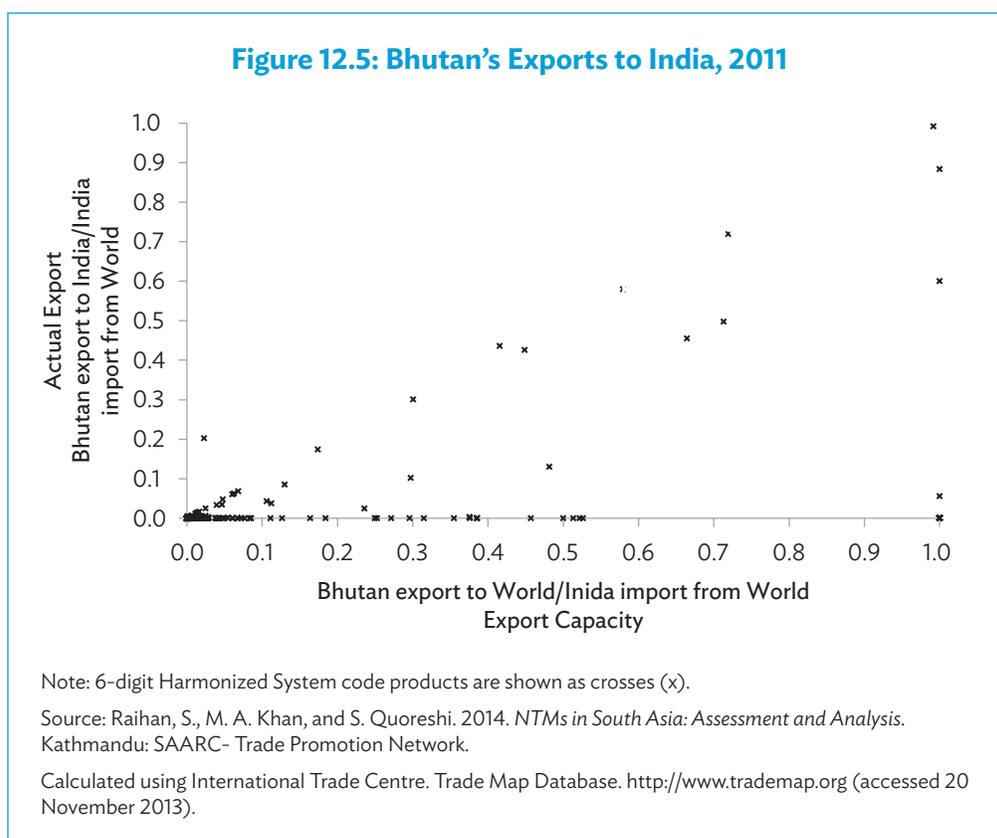
India's export capacity and actual exports to Bangladesh in 2011 is depicted in Figure 12.4. At the 6-digit HS code level, India exported 4,109 products to world markets, including 2,654 products to Bangladesh. India had substantial export capacity in many products imported by Bangladesh from other countries. Table 12.4 lists the top 50 products in which India had full export capacities, but exports of these products to Bangladesh were zero. Of these 50 products, 34 would be subject to nontariff measures in Bangladesh.

**Table 12.4: Top 50 Products in which India had Full Export Capacity but Zero Exports to Bangladesh, with Corresponding Nontariff Measures in Bangladesh**

*continued on next page*

Table 12.4 continued

HS Code	HS Code Description	Nontariff Measure Code
020421	Sheep carcasses and half carcasses, fresh or chilled	A3, A83
030333	Sole, frozen, excluding heading No 03.04, livers and roes	A83
030349	Tunas nes, frozen, excluding heading No 03.04, livers and roes	A83
030499	Frozen fish meat whether or not minced (excl. swordfish, toothfish and	A83
071080	Vegetables, frozen nes	A83
080232	Walnuts, fresh or dried, shelled or peeled	A22, A82, A83
090111	Coffee, not roasted, not decaffeinated	A22, A82, A83
090220	Green tea (not fermented) in packages exceeding 3 kg	A22, A82, A83
120740	Sesamum seeds, whether or not broken	A15, A86
160510	Crab, prepared or preserved	A22, A31, A82, A83, C1
160590	Molluscs and other aquatic invertebrates prepared or preserved	A22, A31, A82, A83, C1
170191	Refined sugar, in solid form, containing added flavour or colour matter	
170310	Cane molasses	
200110	Cucumbers and gherkins, prepared or preserved by vinegar or acetic acid	A22, A31, A33, A82, A83
261900	Slag, dross (exc granulated slag), scaling & other waste etc.	
271099	Other waste oils	E112, H11
290211	Cyclohexane	
290243	P-xylene	
290715	Naphthols and their salts	
293371	6-hexanelactam (epsilon-caprolactam)	
390220	Polyisobutylene	
441400	Wooden frames for paintings, photographs mirrors, or similar objects	
570310	Carpets of wool or fine animal hair, tufted	
610520	Mens/boys shirts, of man-made fibres, knitted	F69
610590	Mens/boys shirts, of other textile materials, knitted	F69
610610	Womens/girls blouses and shirts, of cotton, knitted	F69
610620	Womens/girls blouses and shirts, of man-made fibres, knitted	F69
610721	Mens/boys nightshirts and pyjamas, of cotton, knitted	F69
610821	Womens/girls briefs and panties, of cotton, knitted	F69
610831	Womens/girls nightdresses and pyjamas, of cotton, knitted	F69
610891	Womens/girls bathrobes, dressing gowns, etc, of cotton, knitted	F69
620331	Mens/boys jackets and blazers, of wool or fine animal hair, not knitted	F69
620341	Mens/boys trousers and shorts, of wool or fine animal hair, not knitted	F69
620444	Womens/girls dresses, of artificial fibres, not knitted	F69
620461	Womens/girls trousers & shorts, of wool or fine animal hair, not knitted	F69
620463	Womens/girls trousers and shorts, of synthetic fibres, not knitted	F69
620640	Womens/girls blouses and shirts, of man-made fibres, not knitted	F69
620711	Mens/boys underpants and briefs, of cotton, not knitted	F69
630251	Table linen, of cotton, not knitted	F69
630391	Curtains/drapes/interior blinds&curtain/bd valances, of cotton, not knit	F69
640320	Footwear, outsole/uppr of leathr, strap across the instep/arnd big toe	F69
710231	Diamonds non-industrial unworked or simply sawn, cleaved or bruted	F69
710399	Precious/semi-precious stones nes further workd than sawn/rough shapd	
711311	Articles of jewellery&pts therof of silver w/n platd/clad w/o prec met	



HS Code	HS Code Description	Nontariff Measure Code
722100	Bars & rods, stainless steel, hot rolled in irregularly wound coils	
722220	Bars & rods, stainless steel, nfw than cold formed or cold finished	
760310	Powders, aluminium, of non-lamellar structure	
854511	Carbon or graphite electrodes, of a kind used for furnaces	
890520	Floating or submersible drilling or production platforms	
890590	Floating docks and vessels which perform special functions	

HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

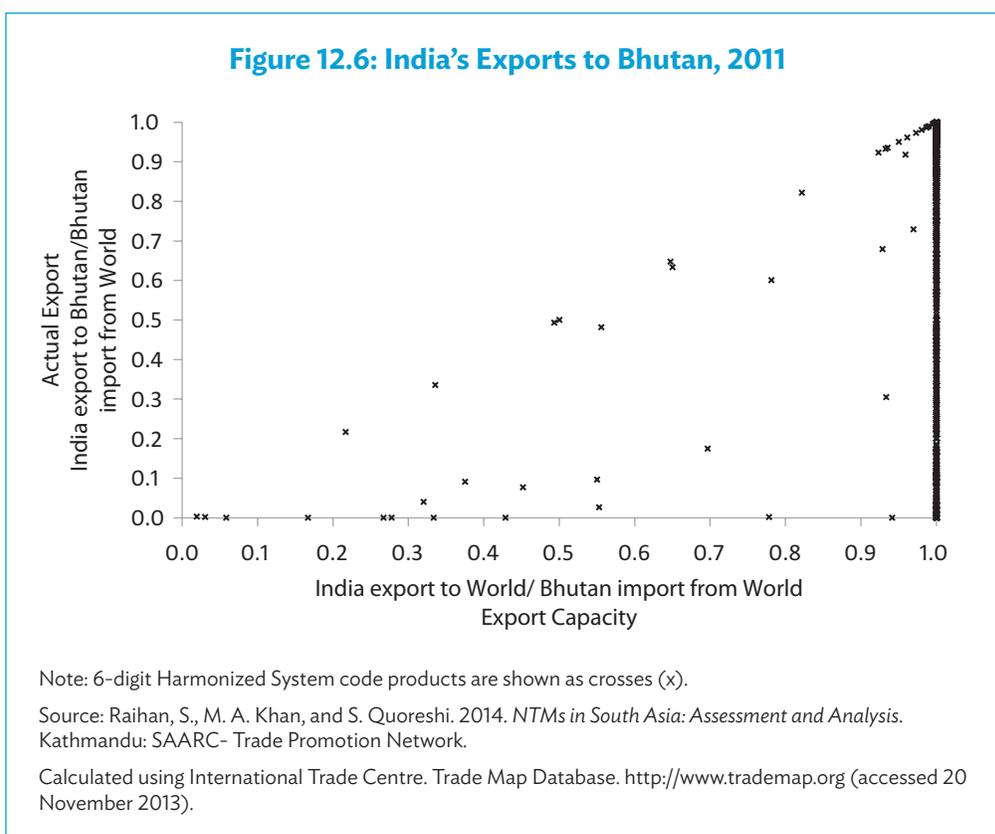
Figure 12.5 compares Bhutan's export capacity and actual exports to India in 2011. At the 6-digit HS code level, the country exported 221 products to world markets, including 54 products to India. Bhutan had export capacity in some other products imported by India, but actual exports by Bhutan of these products were very low or zero. Table 12.5 lists the top 50 products in Bhutan meeting these criteria. Of the 50 products, 26 were subject to nontariff measures in India.

**Table 12.5: Top 50 Products in which Bhutan had Full or Some Export Capacity but Zero Exports to India, with Corresponding Nontariff Measures in India**

*continued on next page*

Table 12.5 continued

HS Code	HS Code Description	Nontariff Measure Code
040120	Milk not concentrated & unsweetened exceeding 1% not exceeding 6% fat	A14, A84
070690	Salad beet root, salsif,celeriac,radish&sim edibl roots, fresh/chilld nes	A14
070820	Beans, shelled or unshelled, fresh or chilled	A14
070960	Peppers of the genus Capsicum or of the genus Pimenta,fresh or chilled	A14
071239	Dried mushrooms and truffles, whole, cut, sliced, broken or in powder	A14
080510	Oranges, fresh or dried	A14
090830	Cardamoms	A14
100630	Rice, semi-milled or wholly milled, whether or not polished or glazed	H11
110100	Wheat or meslin flour	
120100	Soya beans	
120750	Mustard seeds, whether or not broken	A14, E112
140190	Vegetable materials nes, used primarily for plaiting	
150790	Soya-bean oil and its fractions, refined but not chemically modified	A82
190211	Uncooked pasta not stuffed or otherwise prepared, containing eggs	A12
200560	Asparagus preparad or preservd,o/t by vinegar or acetic acid, not frozen	A31,A33, A41, A82
200591	Bamboo shoots, prepared or preserved otherwise than by vinegar or acet	A31, A33, A41, A82
200710	Homo prep (jams,fruit jellies etc) ckd prep whether/nt sugard/sweetend	A31, A33, A41, A82
200791	Citrus fruit (marmalades,purée,etc) ckd prep wther/nt sugard/sweetend	A31, A33, A41, A82
200919	Orange juice&nes,unfermentd not spiritd,whether or not sugard or sweet	A31, A33, A41, A82
200950	Tomato juice unfermented&not spirited,whether or not sugared or sweet	A31, A33, A41, A82
210320	Tomato ketchup and other tomato sauces	A31, A33, A41, A82
210610	Protein concentrates and textured protein substances	A31, A33, A41, A82
220110	Mineral&aerated waters not cntg sugar or sweeteng matter nor flavored	A81
220300	Beer made from malt	A31, A33, A41, A82
220840	Rum and tafia	
220900	Vinegar and substitutes for vinegar obtained from acetic acid	
230110		
230210	Maize (corn) bran, sharps and other residues, pelleted or not	
230230	Wheat bran, sharps and other residues, pelleted or not	
250620	Quartzite, merely cut, by sawing or otherwise, in blocks or slabs of a	
251400	Slate, whether or not roughly trimmed or merely cut	E111
251690	Monumental or building stone nes	
251749	Granules, chippings & powder nes,of 25.15 or 25.16 heat-treated or not	E111
251810	Dolomite not calcined	
252010	Gypsum; anhydrite	
252020	Plasters (consisting of calcined gypsum or calcium sulphate)	
252310	Cement clinkers	
252610	Natural steatite, not crushed/powdered	
252620	Natural steatite, crushed or powdered	
261800	Granulated slag (slag sand) from the manufacture of iron or steel	
261900	Slag, dross, (exc granulated slag) scaling & other waste	E111
270112	Bituminous coal, whether or not pulverised but not agglomerated	
391729	Tubes, pipes and hoses, rigid; of plastics nes	
482020	Exercise books of paper	
551090	Yarn of artificial staple fibres, not put up, nes	B83 or B82
740313	Billets, copper, unwrought	



HS Code	HS Code Description	Nontariff Measure Code
800200	Tin waste and scrap	
811100	Manganese and articles thereof, including waste and scrap	
852380	Gramophone records and other media for the recording of sound or of ot	D12
920590	Wind musical instruments nes	

HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

India's export capacity and actual exports to Bhutan in 2011 are compared in Figure 12.6. At the 6-digit HS code level, the country exported 4,109 products to world markets, including 2,253 products to Bhutan. India had substantial export capacity in many products imported by Bhutan but not from India. Table 12.6 lists the top 50 products meeting these criteria. All of these products were subject to nontariff measures in Bhutan.

**Table 12.6: Top 50 Products in which India had Full Export Capacity but Zero Exports to Bhutan, With Corresponding Nontariff Measures in Bhutan**

*continued on next page*

Table 12.6 continued

HS Code	HS Code Description	Nontariff Measure Code
020442	Sheep cuts, bone in, frozen	A14, A84, E129, G32, I1
071080	Vegetables, frozen nes	A14, A83, E129, G32, I1
071290	Vegetables and mixtures dried, but not further prepared nes	A14, A83, E129, G32, I1
080232	Walnuts, fresh or dried, shelled or peeled	E129, G32, I1
081190	Fruits & edible nuts uncook, steam/boil (water) sweetend/not frozen, nes	E129, G32, I1
100700	Grain sorghum	E129, G32, I1
160520	Shrimps and prawns, prepared or preserved	E129, G32, I1
210111	Coffee extracts, essences, concentrates	B14, B31, E129, G32, I1
210120	Tea or maté extracts, essences & concentrates & preparations thereof	B14, B31, E129, G32, I1
270900	Petroleum oils and oils obtained from bituminous minerals, crude	B14, E111, E129, G32, I1
291590	Saturated acyclic monocarboxylic acids and their derivatives, nes	E129, G32, I1
321290	Pigment dspr in a n-aqueous media f mfg of paint; dyes packd f retail	E129, G32, I1
390190	Polymers of ethylene nes, in primary forms	B14, E111, E129, G32, I1
390799	Polyesters nes, in primary forms	B14, E111, E129, G32, I1
401320	Inner tubes of rubber for bicycles	E129, G32, I1
420291	Containers, with outer surface of leather, nes	E129, G32, I1
540246	Filament yarn of polyester, incl. monofilament of < 67 decitex, single	E129, G32, I1
560749	Twine nes, cordage, ropes and cables, of polyethylene or polypropylene	E129, G32, I1
570110	Carpets of wool or fine animal hair, knotted	E129, G32, I1
610329	Mens/boys ensembles, of other textile materials, knitted	E129, G32, I1
610462	Womens/girls trousers and shorts, of cotton, knitted	E129, G32, I1
610610	Womens/girls blouses and shirts, of cotton, knitted	E129, G32, I1
610819	Womens/girls slips and petticoats, of other textile materials, knitted	E129, G32, I1
610821	Womens/girls briefs and panties, of cotton, knitted	E129, G32, I1
610831	Womens/girls nightdresses and pyjamas, of cotton, knitted	E129, G32, I1
610839	Womens/girls nightdresses & pyjamas of other textile materials, knitted	E129, G32, I1
620342	Mens/boys trousers and shorts, of cotton, not knitted	E129, G32, I1
620442	Womens/girls dresses, of cotton, not knitted	E129, G32, I1
620449	Womens/girls dresses, of other textile materials, not knitted	E129, G32, I1
620462	Womens/girls trousers and shorts, of cotton, not knitted	E129, G32, I1
620610	Womens/girls blouses and shirts, of silk or silk waste, not knitted	E129, G32, I1
620891	Womens/girls panties, bathrobes, of cotton, not knitted	E129, G32, I1
620920	Babies garments and clothing accessories of cotton, not knitted	E129, G32, I1
621210	Brassieres and parts thereof, of textile materials	E129, G32, I1
621420	Shawls, scarves, veils & the like of wool or fine animal hair, not knitted	E129, G32, I1
621790	Parts of garments or of clothg accessories nes, of tex mat, not knitted	E129, G32, I1
640299	Footwear, outer soles/uppers of rubber or plastics, nes	E129, G32, I1
640359	Footwear, outer soles and uppers of leather, nes	E129, G32, I1
640420	Footwear with outer soles of leather and uppers of textile materials	E129, G32, I1
711719	Imitation jewellery nes of base metal whether o not platd w prec metal	E129, G32, I1
810199	Tungsten (wolfram) and articles thereof nes	E129, G32, I1
820900	Plates, tips & the like for tools of sintered metal carbides or cermets	E129, G32, I1
830160	Lock parts, includg parts of clasps o frames w clasps of base metal, nes	E129, G32, I1

**Figure 12.7: Maldives' Exports to India, 2011**

Note: 6-digit Harmonized System code products are shown as crosses (x).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Calculated using International Trade Centre. Trade Map Database. <http://www.trademap.org> (accessed 20 November 2013).

HS Code	HS Code Description	Nontariff Measure Code
830250	Hat-racks, hat-pegs, brackets and similar fixtures, of base metal, nes	E129, G32, I1
841939	Non-domestic, non-electric dryers nes	B14, E111, E129, G32, I1
851120	Ignition magnetos, magneto-generators and magnetic flywheels	B14, E111, E129, G32, I1
852340	Optical media for the recording of sound or of other phenomena (excl.	B14, E111, E129, G32, I1
871494	Bicycle brakes, including coaster braking hubs, and parts thereof	E129, G32, I1
940599	Lamps and lighting fittings, parts of nes	E129, G32, I1
970110	Paintgs, drawgs & pastels executd by hand exc hd 4906&h-p&h-d mfd art	E129, G32, I1

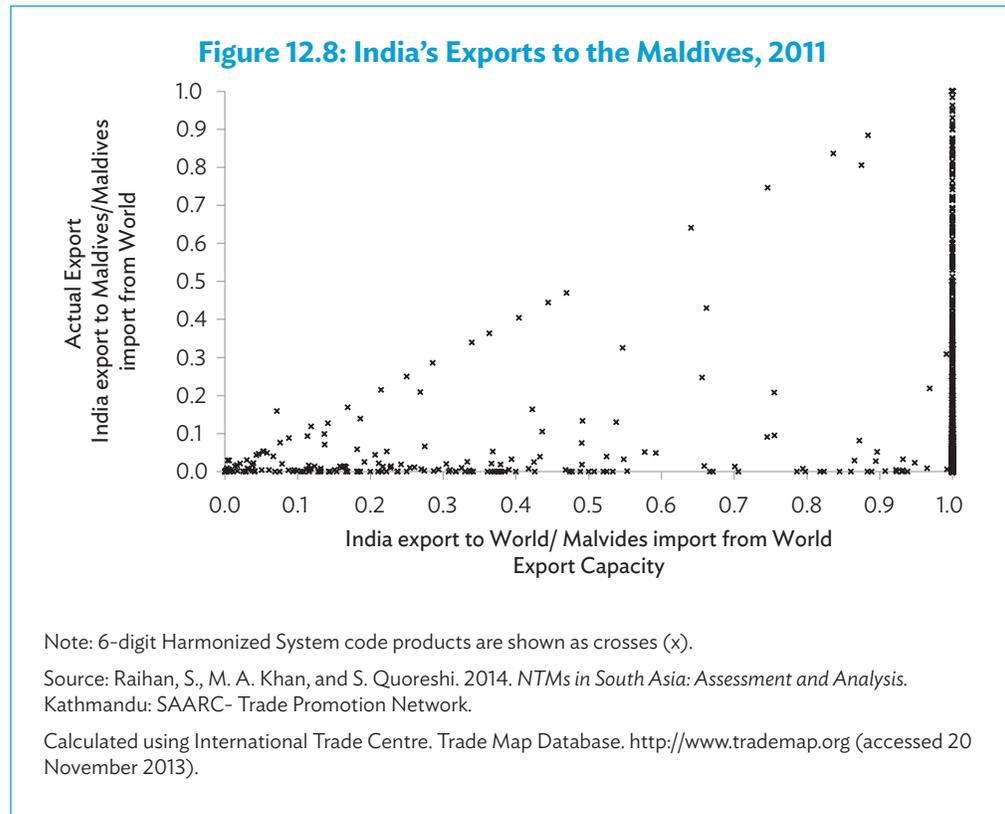
HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Figure 12.7 compares the Maldives' export capacity and actual exports to India in 2011. At the 6-digit HS code level, the country exported 65 products to world markets, including 45 products to India. There were a few products for which the Maldives had export capacity, but the actual exports of these products to India was very low or zero. Table 12.7 lists the eight products meeting these criteria. All eight products were subject to nontariff measures in India.

**Table 12.7: 7 Products in which the Maldives had Full Export Capacity but Zero Exports to India, with Corresponding Nontariff Measures in India**



HS Code	HS Code Description	Nontariff Measure Code
030110	Ornamental fish, live	A14, A84
030199	Fish live, nes	A14, A84, E11
030419	Fresh or chilled fillets and other fish meat whether or not minced (ex	A14, A84
030549	Fish nes, smoked including fillets	A14, A84
030559	Fish nes, dried, whether or not salted but not smoked	A14, A84
030799	Molluscs nes, shelld o not & aquatic invert nes,fz,drid,saltd o in brine	A14, A84
160414	Tunas, skipjack&Atl bonito,prepard/preservd,whole/in pieces,ex mincd	A22, A82

HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

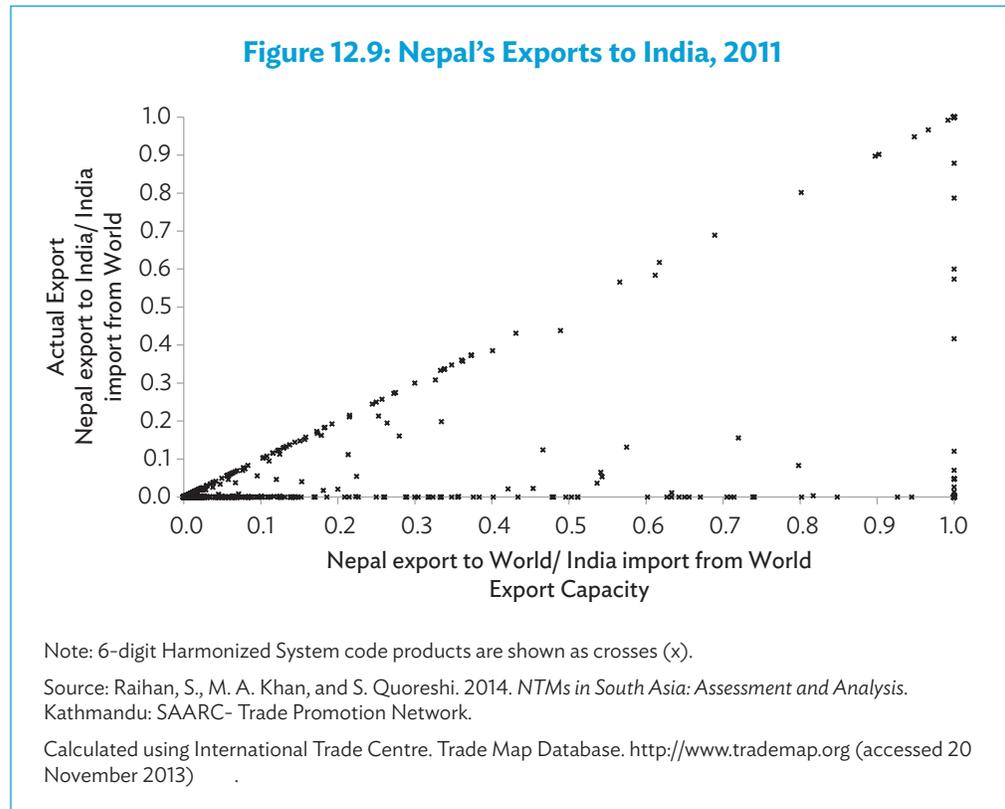
At the 6-digit HS code level, India exported 4,109 products to world markets, including 1,323 products to the Maldives in 2011 (Figure 12.8). India had substantial export capacity in many products imported by the Maldives from other countries. Table 12.8 lists the top 50 products in which India had full export capacity but zero exports to the Maldives. All 50 products would be subject to nontariff measures in the Maldives.

*continued on next page*

Table 12.8 continued

**Table 12.8: Top 50 Products in which India had Export Capacity but Zero Exports to the Maldives, with Corresponding Nontariff Measures in the Maldives**

HS Code	HS Code Description	Nontariff Measure Code
080119	Coconuts, excluding desiccated	C4
100510	Maize (corn) seed	C4
120740	Sesamum seeds, whether or not broken	C4
160420	Fish prepared or preserved, except whole or in pieces	C4
270119	Coal nes, whether or not pulverised but not agglomerated	C4
281820	Aluminium oxide nes	C4
281830	Aluminium hydroxide	C4
282300	Titanium oxides	C4
283329	Sulphates of metal nes	C4
290220	Benzene	C4
291631	Benzoic acid, its salts and esters	C4
292142	Aniline derivatives and their salts	C4
292249	Amino-acids nes, and their esters; salts thereof	C4
293229	Lactones, nes	C4
320419	Synthetic organic colour matter nes, prep of syn orgn colour matter	C4
380893	Herbicides, anti-sprouting products and plant-growth regulators	C4
391690	Monofilaments >1 mm, profile shapes etc of plastics nes	C4
401012	Conveyor belt textile reinforced vulcanised rubber	C4
420221	Handbags with outer surface of leather	C4
420231	Articles carried in pocket or handbag, with outer surface of leather	C4
420310	Articles of apparel of leather or of composition leather	C4
420329	Gloves mittens&mitts,o/t for sport,of leather o of composition leather	C4
481159	Paper and paperboard, surface-coloured, surface-decorated or printed,	C4
550320	Staple fibres of polyesters, not carded or combed	C4
610443	Womens/girls dresses, of synthetic fibres, knitted	C4
610520	Mens/boys shirts, of man-made fibres, knitted	C4
611011	Jerseys, pullovers, cardigans, waistcoats and similar articles, of woo	C4
611430	Garments nes, of man-made fibres, knitted	C4
620333	Mens/boys jackets and blazers, of synthetic fibres, not knitted	C4
620442	Womens/girls dresses, of cotton, not knitted	C4
620452	Womens/girls skirts, of cotton, not knitted	C4
620462	Womens/girls trousers and shorts, of cotton, not knitted	C4
620463	Womens/girls trousers and shorts, of synthetic fibres, not knitted	C4
620610	Womens/girls blouses and shirts, of silk or silk waste, not knitted	C4
620640	Womens/girls blouses and shirts, of man-made fibres, not knitted	C4
620822	Womens/girls nightdresses and pyjamas, of man-made fibres, not knitted	C4
621142	Womens/girls garments nes, of cotton, not knitted	C4
621143	Womens/girls garments nes, of man-made fibres, not knitted	C4
710391	Rubies, sapphires and emeralds further worked than sawn or rough shaped	C4
711419	Articl of gold/silversmith&pts of prec met w/n plat/clad w/o prec met	C4
722020	Flat rolled prod, stainless steel, <600mm wide, cold rolled or reduced	C4



HS Code	HS Code Description	Nontariff Measure Code
722090	Flat rolled prod, stainless steel, cr <600mm wide, nes	C4
731811	Screws, coach, iron or steel	C4
780110	Lead refined unwrought	C4
840732	Engines, spark-ignition reciprocating, displac >50 cc but nt more 250cc	C4
840890	Engines, diesel nes	C4
841940	Distilling or rectifying plant	C4
850421	Liquid dielectric transformers havg a power handlg capa </= 650 KVA	C4
890690	Vessels, incl. lifeboats (excl. warships, rowing boats and other vesse	C4
970190	Collages and similar decorative plaques	C4

HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Figure 12.9 compares Nepal’s export capacity and actual exports to India in 2011. At the 6-digit HS code level, Nepal exported 840 products to world markets, including 385 products to India. Nepal had export capacity in some products imported by India, but actual exports of these products by Nepal to India were very low or zero. Table 12.9 lists

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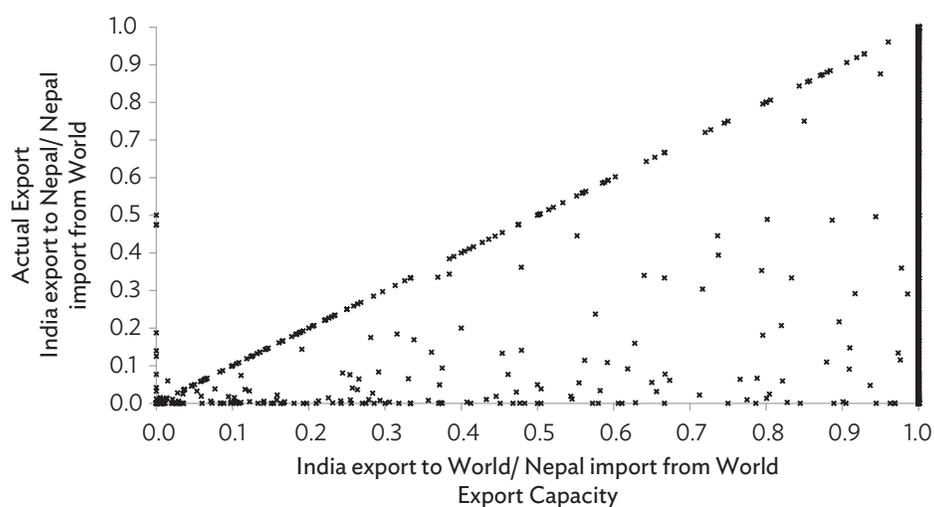
Table 12.9 continued

the top 50 products in Nepal meeting these criteria. Of the 50 products, 41 were subject to nontariff measures in India.

**Table 12.9: Top 50 Products in which Nepal had Full or Some Export Capacity but Zero Exports to India, With Corresponding Nontariff Measures in India**

HS Code	HS Code Description	Nontariff Measure Code
020423	Sheep cuts, boneless, fresh or chilled	A3, A14, A84
060220	Trees, edible fruit or not, shrubs and bushes, grafted or not	A14
071231	Dried mushrooms of the genus "Agaricus", whole, cut, sliced, broken or	A14
090190	Coffee husks and skins, coffee substitutes	A14
120740	Sesamum seeds, whether or not broken	A14, E112
121120	Ginseng roots used primarily in pharm, perf, insecticide, fungicide/sim purp	A14
121490	Swedes, mangold, fodder root, hay, clover, sainfoin, forage kale	A14
240210	Cigars, cheroots and cigarillos, containing tobacco	A31, A33
490400	Music, printed or in manuscript, whether or not bound or illustrated	
521221	Woven fabrics of cotton, weighing more than 200 g/m <sup>2</sup> , unbleached, nes	B83 or B82
530210	True hemp fibre (Cannabis sativa L), raw or retted	
530290	True hemp fibre otherwise processed but not spun; tow & waste of true hemp	
551349	Woven fab of oth syn staple fib,	
560221	Felt o/t needleloom of wool or fine animal hair, not impreg,ctd,cov etc	B83 or B82
560290	Felt of textile materials, nes	B83 or B82
570190	Carpets of other textile materials, knotted	B83 or B82
580110	Woven pile fabrics of wool/fine animal hair,o/t terry&narrow fabrics	B83 or B82
580220	Terry towellg & sim woven terry fab of oth tex mat,o/t narrow fabrics	B83 or B82
600610	Fabrics, knitted or crocheted, of a width of > 30 cm, of wool or fine	B83 or B82
610120	Mens/boys overcoats, anoraks etc, of cotton, knitted	B83 or B82
610210	Womens/girls overcoats, anoraks,of wool or fine animal hair, knitted	B83 or B82
610230	Womens/girls overcoats, anoraks, of man-made fibres, knitted	B83 or B82
610290	Womens/girls overcoats, anoraks,of other textile materials, knitted	B83 or B82
610331	Mens/boys jackets and blazers, of wool or fine animal hair, knitted	B83 or B82
610341	Mens/boys trousers and shorts, of wool or fine animal hair, knitted	B83 or B82
610413	Womens/girls suits, of synthetic fibres, knitted	B83 or B82
610431	Womens/girls jackets, of wool or fine animal hair, knitted	B83 or B82
610442	Womens/girls dresses, of cotton, knitted	B83 or B82
611011	Jerseys, pullovers, cardigans, waistcoats and similar articles, of woo	B83 or B82
611019	Jerseys, pullovers, cardigans, waistcoats and similar articles, of fin	B83 or B82
611594	Full-length or knee-length stockings, socks and other hosiery, incl. f	B83 or B82
611691	Gloves, mittens and mitts, nes, of wool or fine animal hair, knitted	B83 or B82
620291	Womens/girls anoraks & similar article of wool/fine animal hair, not knit	B83 or B82
620411	Womens/girls suits, of wool or fine animal hair, not knitted	B83 or B82
620419	Womens/girls suits, of other textile materials, not knitted	B83 or B82
620431	Womens/girls jackets, of wool or fine animal hair, not knitted	B83 or B82
620452	Womens/girls skirts, of cotton, not knitted	B83 or B82
620610	Womens/girls blouses and shirts, of silk or silk waste, not knitted	B83 or B82

Figure 12.10: India's Exports to Nepal, 2011



Note: 6-digit Harmonized System code products are shown as crosses (x).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Calculated using International Trade Centre. Trade Map Database. <http://www.trademap.org> (accessed 20 November 2013)

HS Code	HS Code Description	Nontariff Measure Code
620721	Mens/boys nightshirts and pyjamas, of cotton, not knitted	B83 or B82
621141	Womens/girls garments nes, of wool or fine animal hair, not knitted	B83 or B82
621142	Womens/girls garments nes, of cotton, not knitted	B83 or B82
621490	Shawls, scarves, veils & the like, of other textile materials, not knitted	B83 or B82
630120	Blankets (o/t electric) & travelling rugs, of wool or fine animal hair	B83 or B82
630520	Sacks and bags, for packing of goods, of cotton	B83 or B82
650590	Hats & other headgear, knitted or made up from lace, or other textile mat	
650699	Headgear nes, of other materials	
741811	Pot scourers, gloves, polishing pads, of copper	
920210	String musical instruments played with a bow	
920510	Brass-wind instruments	
930700	Swords, cutlasses, bayonets, lances & sim arms & parts, scabbards & sheaths	E111

HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Figure 12.10 compares India's export capacity and actual exports to Nepal in 2011. At the 6-digit HS code level, India exported 4,109 products to world markets, including 3,568 products to Nepal. There were many products imported by Nepal in which India has substantial export capacity, but actual exports of these products by India

*continued on next page*

Table 12.10 continued

to Nepal were zero. Table 12.10 lists the top 50 products in India meeting these criteria. All of these products would be subject to nontariff measures in Nepal.

**Table 12.10: Top 50 Products in which India had Export Capacity but Zero Exports to Nepal, with Corresponding Nontariff Measures in Nepal**

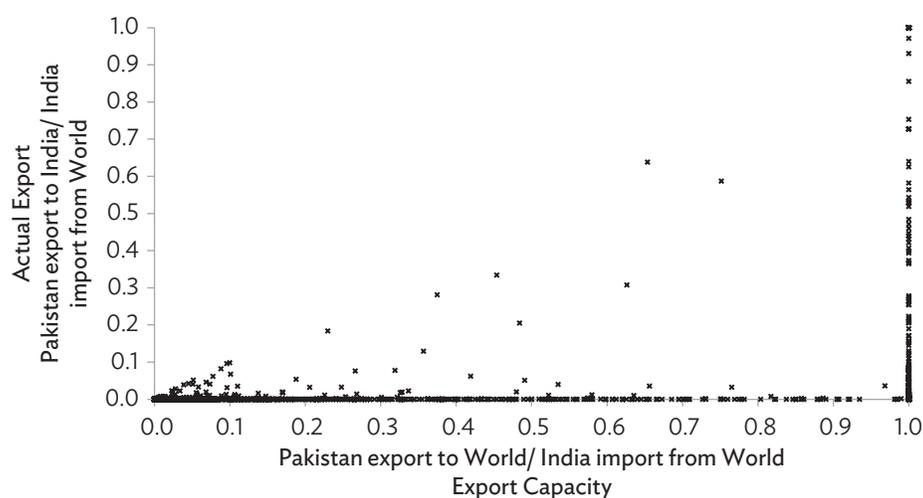
HS Code	HS Code Description	Nontariff Measure Code
071151	Mushrooms of the genus "Agaricus", provisionally preserved, e.g., by s	A14, A83, B80, F61, F64, F65, F7, F71, G39, G4
160300	Extracts&juices of meat,fish,or crust,molluscs/oth aquatic invertebr	B14, B80, F61, F64, F65, F7, F71, G39, G4
290211	Cyclohexane	A31, A64, B14, B80, E111, C1, F61, F64, F65, F7, F71, G39, G4
290420	Derivs of hydrocarbons cntg only nitro or only nitroso groups	B14, B80, E111, C1, A31, A64, F61, F64, F65, F7, F71, G39, G4
291249	Aldehyde-ethers,aldehyde-phenols&aldehydes w oth oxygen function,nes	B14, E111, C1, A31, A64, F61, F64, F65, F7, F71, G39, G4, B80
291300	Derivatives of aldehydes,of cyclic poly of aldehyde&of paraformaldehyde	B14, B80, E111, C1, A31, A64, F61, F64, F65, F7, F71, G39, G4
292149	Aromatic monoamines nes, and their derivatives; salts thereof	B14, B80, E111, C1, A31, A64, F61, F64, F65, F7, F71, G39, G4
391590	Plastics waste and scrap nes	B80, F61, F64, F65, F7, F71, G39, G4
441520	Pallets, box pallets and other load boards, wooden	B80, F61, F64, F65, F7, F71, G39, G4
520542	Cotton yarn,>/=85%,multi,combed,714.29 >dtex>/=232.56,nt put up,nes	B80, F61, F64, F65, F7, F71, G39, G4
520831	Plain weave cotton fabric,>/=85%, not more than 100 g/m2, dyed	B80, F61, F64, F65, F7, F71, G39, G4
520843	Twill weave cotton fabric,>/=85%, not more than 200 g/m2, yarn dyed	B80, F61, F64, F65,F7, F71, G39, G4
520852	Plain weave cotton fabric,>/=85%, >100 g/m2 to 200 g/m2, printed	B80, F61, F64, F65, F7, F71, G39, G4
520912	Twill weave cotton fabric,>/=85%, more than 200 g/m2, unbleached	B80, F61, F64, F65, F7, F71, G39, G4
521142	Denim fabrics of cotton,	B80, F61, F64, F65, F7, F71, G39, G4
540752	Woven fabrics,>/=85% of textured polyester filaments, dyed, nes	B80, F61, F64, F65, F7, F71, G39, G4
540754	Woven fabrics,>/=85% of textured polyester filaments, printed, nes	B80, F61, F64, F65, F7, F71, G39, G4
540810	Woven fabrics of high tenacity filament yarns of viscose rayon	B80, F61, F64, F65, F7, F71, G39, G4
551012	Yarn,>/=85% of artificial staple fibres, multiple, not put up, nes	B80, F61, F64, F65, F7, F71, G39, G4
570231	Carpets of wool/fine animl hair,of wovn pile constructn,nt made up nes	B80, F61, F64, F65, F7, F71, G39, G4
610432	Womens/girls jackets, of cotton, knitted	B80, F61, F64, F65, F7, F71, G39, G4
610433	Womens/girls jackets, of synthetic fibres, knitted	B80, F61, F64, F65, F7, F71, G39, G4
610442	Womens/girls dresses, of cotton, knitted	B80, F61, F64, F65, F7, F71, G39, G4
610452	Womens/girls skirts, of cotton, knitted	B80, F61, F64, F65, F7, F71, G39, G4
610712	Mens/boys underpants and briefs, of man-made fibres, knitted	B80, F61, F64, F65, F7, F71, G39, G4
610719	Mens/boys underpants and briefs, of other textile materials, knitted	B80, F61, F64, F65, F7, F71, G39, G4

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Table 12.10 continued

HS Code	HS Code Description	Nontariff Measure Code
610819	Womens/girls slips and petticoats, of other textile materials, knitted	B80, F61, F64, F65, F7, F71, G39, G4
610822	Womens/girls briefs and panties, of man-made fibres, knitted	B80, F61, F64, F65, F7, F71, G39, G4
610831	Womens/girls nightdresses and pyjamas, of cotton, knitted	B80, F61, F64, F65, F7, F71, G39, G4
611430	Garments nes, of man-made fibres, knitted	B80, F61, F64, F65, F7, F71, G39, G4
611693	Gloves, mittens and mitts, nes, of synthetic fibres, knitted	B80, F61, F64, F65, F7, F71, G39, G4
620452	Womens/girls skirts, of cotton, not knitted	B80, F61, F64, F65, F7, F71, G39, G4
640212	Ski-boots, snow-board boots, all rubber/plastic	B80, F61, F64, F65, F7, F71, G39, G4
670420	Articles of human hair, nes	B80, F61, F64, F65, F7, F71, G39, G4
721914	Flat rolled prod, stainless steel, hr in coil, w > / = 600mm, thk < 3mm	B80, F61, F64, F65, F7, F71, G39, G4
790700	Articles of zinc, nes	B80, F61, F64, F65, F7, F71, G39, G4
820770	Tools for milling	B80, F61, F64, F65, F7, F71, G39, G4
845110	Dry-cleaning machines o/t hdg No 84.50	B80, F61, F64, F65, F7, F71, G39, G4
851150	Generators and alternators	B80, F61, F64, F65, F7, F71, G39, G4
853090	Parts of electrical signalling, safety or traffic control equipment	B80, F61, F64, F65, F7, F71, G39, G4
854160	Mounted piezo-electric crystals	B80, F61, F64, F65, F7, F71, G39, G4
854310	Electrical particle accelerators for electrons, protons, etc. (excl. i)	B80, F61, F64, F65, F7, F71, G39, G4
860110	Rail locomotives powered from an external source of electricity	B80, F61, F64, F65, F7, F71, G39, G4
860400	Railway maintenance-of-way service vehicles	B80, F61, F64, F65, F7, F71, G39, G4

Figure 12.11: Pakistan's Exports to India, 2011



Note: 6-digit Harmonized System code products are shown as crosses (x).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Calculated using International Trade Centre. Trade Map Database. <http://www.trademap.org> (accessed 20 November 2013).

HS Code	HS Code Description	Nontariff Measure Code
860729	Brakes nes and parts thereof for railway rolling stock	B80, F61, F64, F65, F7, F71, G39, G4
870821	Safety seat belts for motor vehicles	B80, F61, F64, F65, F7, F71, G39, G4
871420	Wheelchair parts nes	B80, F61, F64, F65, F7, F71, G39, G4
871495	Bicycle saddles	B80, F61, F64, F65, F7, F71, G39, G4
880310	Aircraft propellers and rotors and parts thereof	B80, F61, F64, F65, F7, F71, G39, G4
880390	Parts of balloons, dirigibles, and spacecraft nes	B80, F61, F64, F65, F7, F71, G39, G4

HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Figure 12.11 compares Pakistan's export capacity and actual exports to India in 2011. At the 6-digit HS code level, Pakistan exported 2,830 products to world markets but only 431 to India. Pakistan had substantial export capacity in some products imported by India, but actual exports of these products by Pakistan to India were very low or zero. Table 12.11 lists the top 50 products in which Pakistan had full export capacity, but exports to India were zero. Of the 50 products, 45 would be subject to nontariff measures in India.

**Table 12.11: Top 50 Products in which Pakistan had Export Capacity but Zero Exports to India, with Corresponding Nontariff Measures in India**

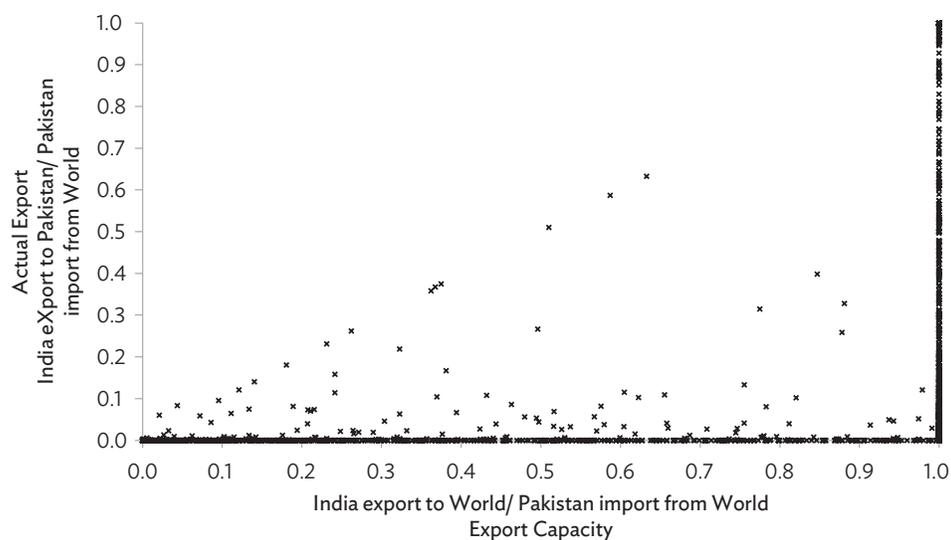
HS Code	HS Code Description	Nontariff Measure Code
030329	Salmonidae, nes,frozen,excluding heading No 03.04, livers and roes	A14, A84
030569	Fish nes, salted and in brine, but not dried or smoked	A14, A84
040120	Milk not concentrated & unsweetened exceeding 1% not exceeding 6% fat	A14, A84
040390	Buttermilk,curdled milk & cream,kephir & ferm or acid milk & cream nes	A14, A84
070200	Tomatoes, fresh or chilled	A14
071080	Vegetables, frozen nes	A14
080300	Bananas including plantains, fresh or dried	A14
080520	Mandarins(tang&sats)clementines&wilkg& sim citrus hybrids,fresh/drid	A14
080590	Citrus fruits, fresh or dried, nes	A14
100190	Wheat nes and meslin	
100630	Rice, semi-milled or wholly milled, whether or not polished or glazed	H11
110100	Wheat or meslin flour	
160415	Mackerel, prepared or preserved, whole or in pieces, but not minced	A22, A82
260120	Roasted iron pyrites	
520210	Cotton yarn waste (including thread waste)	B83 or B82
520521	Cotton yarn,>/=85%, single, combed,>/=714.29, not put up	B83 or B82
520532	Cotton yarn,>/=85%,multi,uncombed,714.29 >dtex>/=232.56,nt put up,nes	B83 or B82
520542	Cotton yarn,>/=85%,multi,combed,714.29 >dtex>/=232.56,nt put up,nes	B83 or B82
520543	Cotton yarn,>/=85%,multi,combed,232.56 >dtex>/=192.31,nt put up,nes	B83 or B82
520624	Cotton yarn, dtex>/=125, not put up	B83 or B82
520911	Plain weave cotton fabric,>/=85%, more than 200 g/m2, unbleached	B83 or B82
521119	Woven fabrics of cotton,	B83 or B82
521222	Woven fabrics of cotton, weighing more than 200 g/m2, bleached, nes	B83 or B82

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Table 12.11 continued

HS Code	HS Code Description	Nontariff Measure Code
521225	Woven fabrics of cotton, weighing more than 200 g/m <sup>2</sup> , printed, nes	B83 or B82
551030	Yarn of artificial staple fibres mixed with cotton, not put up, nes	B83 or B82
551312	Twill weave polyest stapl fib fab	B83 or B82
551349	Woven fab of oth syn staple fib	B83 or B82
551411	Plain weave polyest staple fib fab,170g/m <sup>2</sup> ,unbl/bl	B83 or B82
551641	Woven fabrics of artificial staple fib,	B83 or B82
551644	Woven fabrics of artificial staple fib,	B83 or B82
551691	Woven fabrics of artificial staple fibres, unbleached or bleached, nes	B83 or B82
580211	Terry towelg & similar woven terry fab of cotton,o/t narrow fab,unbl	B83 or B82
580219	Terry towelg&similar woven terry fab of cotton,o/t unbl&o/t nar fab	B83 or B82
580220	Terry towelg&sim woven terry fab of oth tex mat,o/t narrow fabrics	B83 or B82
610322	Mens/boys ensembles, of cotton, knitted	B83 or B82
610323	Mens/boys ensembles, of synthetic fibres, knitted	B83 or B82
610413	Womens/girls suits, of synthetic fibres, knitted	B83 or B82
610590	Mens/boys shirts, of other textile materials, knitted	B83 or B82
610719	Mens/boys underpants and briefs, of other textile materials, knitted	B83 or B82
620323	Mens/boys ensembles, of synthetic fibres, not knitted	B83 or B82
620422	Womens/girls ensembles, of cotton, not knitted	B83 or B82
630210	Bed linen, of textile knitted or crocheted materials	B83 or B82
630222	Bed linen, of man-made fibres, printed, not knitted	B83 or B82

Figure 12.12: India's Exports to Pakistan, 2011



Note: 6-digit Harmonized System code products are shown as crosses (x).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Calculated using International Trade Centre. Trade Map Database. <http://www.trademap.org> (accessed 20 November 2013).

HS Code	HS Code Description	Nontariff Measure Code
630251	Table linen, of cotton, not knitted	B83 or B82
630253	Table linen, of man-made fibres, not knitted	B83 or B82
630260	Toilet&kitchen linen, of terry towellg or similar terry fab, of cotton	B83 or B82
630391	Curtains/drapes/interior blinds&curtain/bd valances, of cotton, not knit	B83 or B82
843221	Disc harrows	
860610	Railway tank cars, not self-propelled	
30700	Swords,cutlasses,bayonets,lances&sim arms&parts,scabbards&sheaths	E111

HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

India's export capacity and actual exports to Pakistan in 2011 are depicted in Figure 12.12. At the 6-digit HS code level, India exported 4,109 products to world markets, including 950 products to Pakistan. Pakistan imported many products in which India had substantial export capacity, but actual exports of these products by India to Pakistan were very low or zero. Table 12.12 lists the top 50 products in which India had full export capacity, but exports to Pakistan were zero. Seven of these products would be subject to nontariff measures in Pakistan. All other products faced restrictions.

**Table 12.12: Top 50 Products in which India had Export Capacity but Zero Exports to Pakistan, with Corresponding Nontariff Measures in Pakistan**

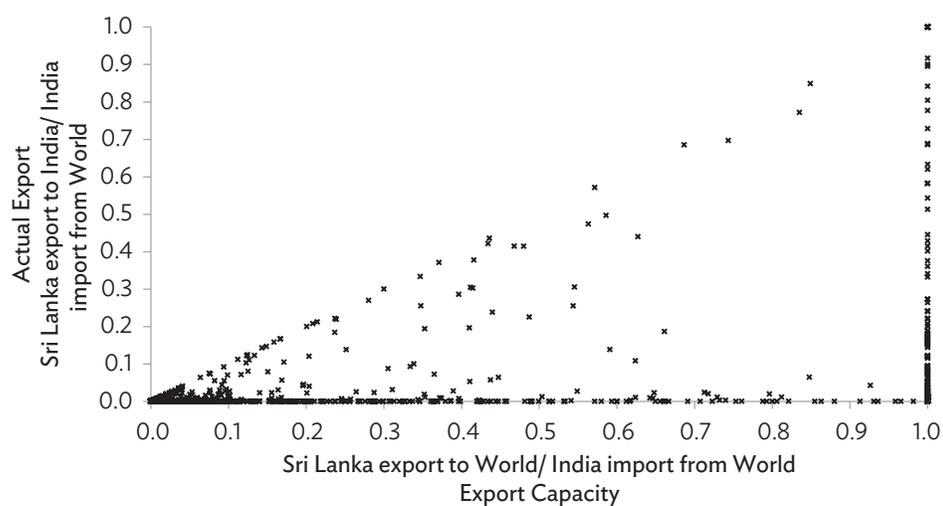
HS Code	HS Code Description	Nontariff Measure Code
030559	Fish nes, dried, whether or not salted but not smoked	A85
080232	Walnuts, fresh or dried, shelled or peeled	A83
080450	Guavas, mangoes and mangosteens, fresh or dried	A83
090111	Coffee, not roasted, not decaffeinated	
120740	Sesamum seeds, whether or not broken	A82
151530	Castor oil&its fractions,whether/not refind,but not chemically modified	
160590	Molluscs and other aquatic invertebrates prepared or preserved	B31, B83
170111	Raw sugar, cane	
200110	Cucumbers and gherkins,prepared or preserved by vinegar or acetic acid	B31, B83
251611	Granite, crude or roughly trimmed	
251690	Monumental or building stone nes	
252100	Limestone flux;limestone & other calcareous stone,for lime or cement	
290211	Cyclohexane	
390461	Polytetrafluoroethylene	
551512	Woven fabrics of polyester staple fibres mixd w man-made filaments,nes	
600621	Unbleached or bleached cotton fabrics, knitted or crocheted, of a widt	
610432	Womens/girls jackets, of cotton, knitted	
610442	Womens/girls dresses, of cotton, knitted	
610610	Womens/girls blouses and shirts, of cotton, knitted	

*continued on next page*

Table 12.12 continued

HS Code	HS Code Description	Nontariff Measure Code
610831	Womens/girls nightdresses and pyjamas, of cotton, knitted	
611420	Garments nes, of cotton, knitted	
611430	Garments nes, of man-made fibres, knitted	
620412	Womens/girls suits, of cotton, not knitted	
620413	Womens/girls suits, of synthetic fibres, not knitted	
620432	Womens/girls jackets, of cotton, not knitted	
620442	Womens/girls dresses, of cotton, not knitted	
620443	Womens/girls dresses, of synthetic fibres, not knitted	
620452	Womens/girls skirts, of cotton, not knitted	
620461	Womens/girls trousers & shorts, of wool or fine animal hair, not knitted	
620463	Womens/girls trousers and shorts, of synthetic fibres, not knitted	
620610	Womens/girls blouses and shirts, of silk or silk waste, not knitted	
620630	Womens/girls blouses and shirts, of cotton, not knitted	
620791	Mens/boys bathrobes, dressing gowns, etc of cotton, not knitted	
621132	Mens/boys garments nes, of cotton, not knitted	
621142	Womens/girls garments nes, of cotton, not knitted	
621143	Womens/girls garments nes, of man-made fibres, not knitted	
630221	Bed linen, of cotton, printed, not knitted	E329
630222	Bed linen, of man-made fibres, printed, not knitted	
630291	Toilet and kitchen linen, of cotton, nes	
640351	Footwear, outer soles and uppers of leather, covering the ankle, nes	
640391	Footwear, outer soles of rubber/plast uppers of leather covg ankle nes	

Figure 12.13: Sri Lanka's Exports to India, 2011



Note: 6-digit Harmonized System code products are shown as crosses (x).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Calculated using International Trade Centre. Trade Map Database. <http://www.trademap.org> (accessed 20 November 2013).

HS Code	HS Code Description	Nontariff Measure Code
710239	Diamonds non-industrial nes excluding mounted or set diamonds	
710510	Diamond dust or powder	
711419	Articl of gold/silversmith&pts of prec met w/n plat/clad w/o prec met	
732510	Cast articles of non-malleable cast iron nes	
740811	Wire of refin copper of which the max cross sectional dimension > 6mm	
741819	Table, kitchen, other household articles of copper nes	
761410	Stranded wire,cables,plaited bands,etc,alum,steel core,not elect insul	
830910	Corks, crown, of base metal	
930510	Parts&accessories of revolvers or pistols of headg Nos 93.01 to 93.04	

HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Figure 12.13 compares Sri Lanka's export capacity and actual exports to India in 2011. At the 6- digit HS code level, Sri Lanka exported 2,023 products to world markets, including 637 products to India. There were some products in which Sri Lanka had substantial export capacities, but actual exports to India were very low or zero. Table 12.13 lists the top 50 products in which Sri Lanka has export capacity, but for which there were no exports to India. Of the 50 products, 42 would be subject to nontariff measures in India.

**Table 12.13: Top 50 Products in which Sri Lanka had Export Capacity but Zero Exports to India, with Corresponding Nontariff Measures in India**

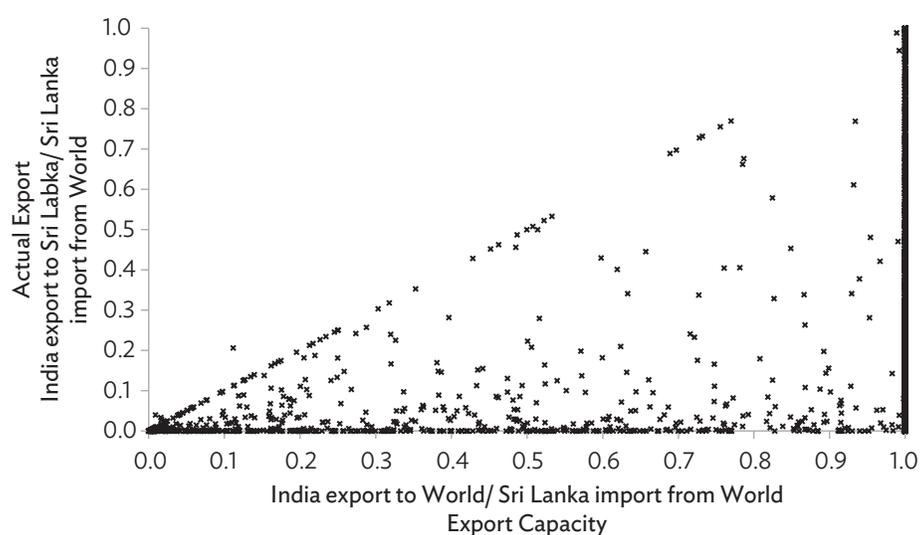
HS Code	HS Code Description	Nontariff Measure Code
030110	Ornamental fish, live	A14, A84
030329	Salmonidae, nes,frozen,excluding heading No 03.04, livers and roes	A14, A84
030342	Tunas, yellowfin, frozen excluding heading No 03.04, livers and roes	A14, A84
030349	Tunas nes, frozen, excluding heading No 03.04, livers and roes	A14, A84
030419	Fresh or chilled fillets and other fish meat whether or not minced (ex	A14, A84
030623	Shrimps & prawns,not frozen,in shell or not,including boiled in shell	A14, A84
060210	Cuttings and slips, unrooted	A14
060314	Fresh cut chrysanthemums and buds, of a kind suitable for bouquets or	A14
060491	Foliage,branch&pts of plant w/o flo/bud,grass,for bouquets&orn purp,fr	A14
070959	Fresh or chilled edible mushrooms (excl. mushrooms of the genus "Agari	A14
080119	Coconuts, excluding desiccated	A14
080300	Bananas including plantains, fresh or dried	A14
080430	Pineapples, fresh or dried	A14
080550	Fresh or dried lemons "Citrus limon, Citrus limonum" and limes "Citrus"	A14
100190	Wheat nes and meslin	
120810	Soya bean flour and meals	A14
160415	Mackerel, prepared or preserved, whole or in pieces, but not minced	A82

continued on next page

Table 12.13 continued

HS Code	HS Code Description	Nontariff Measure Code
200110	Cucumbers and gherkins, prepared or preserved by vinegar or acetic acid	A31, A33, A41, A82
230230	Wheat bran, sharps and other residues, pelleted or not	
240130	Tobacco refuse	A14
240310	Smokg tobacco, whether or not cntg tobacco substitutes in any proportion	A31, A33
250610	Quartz (other than natural sands)	
401193	Pneumatic tyres, new, of rubber, of a kind used on construction or ind	
482050	Albums for samples or for collections, of paper	
520542	Cotton yarn, >/=85%, multi, combed, 714.29 > dtex > /=232.56, nt put up, nes	B83 or B82
520543	Cotton yarn, >/=85%, multi, combed, 232.56 > dtex > /=192.31, nt put up, nes	B83 or B82
551011	Yarn, >/=85% of artificial staple fibres, single, not put up	B83 or B82
610413	Womens/girls suits, of synthetic fibres, knitted	B83 or B82
610422	Womens/girls ensembles, of cotton, knitted	B83 or B82
610520	Mens/boys shirts, of man-made fibres, knitted	B83 or B82
610721	Mens/boys nightshirts and pyjamas, of cotton, knitted	B83 or B82
610722	Mens/boys nightshirts and pyjamas, of man-made fibres, knitted	B83 or B82
610892	Womens/girls bathrobes, dressing gowns, etc, of man-made fibres, knitted	B83 or B82
611231	Mens/boys swimwear, of synthetic fibres, knitted	B83 or B82
611594	Full-length or knee-length stockings, socks and other hosiery, incl. f	B83 or B82
611691	Gloves, mittens and mitts, nes, of wool or fine animal hair, knitted	B83 or B82

Figure 12.14: India's Exports to Sri Lanka, 2011



Note: 6-digit Harmonized System code products are shown as crosses (x).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Calculated using International Trade Centre. Trade Map Database. <http://www.trademap.org> (accessed 20 November 2013).

HS Code	HS Code Description	Nontariff Measure Code
620119	Mens/boys overcoats&sim articles of oth textile materials,not knitted	B83 or B82
620292	Womens/girls anoraks and similar article of cotton, not knitted	B83 or B82
620411	Womens/girls suits, of wool or fine animal hair, not knitted	B83 or B82
620419	Womens/girls suits, of other textile materials, not knitted	B83 or B82
620620	Womens/girls blouses & shirts,of wool or fine animal hair, not knitted	B83 or B82
620811	Womens/girls slips and petticoats, of man-made fibres, not knitted	B83 or B82
620819	Womens/girls slips & petticoats, of other textile materials, not knitted	B83 or B82
620891	Womens/girls panties, bathrobes, etc, of cotton, not knitted	B83 or B82
621142	Womens/girls garments nes, of cotton, not knitted	B83 or B82
630253	Table linen, of man-made fibres, not knitted	B83 or B82
650510	Hair-nets of any material	
870421	Diesel powered trucks with a GVW not exceeding five tonnes	B19, B82, B83, C3
880400	Parachutes and parts and accessories thereof	
950621	Sailboards	

HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).

Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

Figure 12.14 shows the comparison between India's export capacity and actual exports to Sri Lanka in 2011. At the 6-digit HS code level, India exported 4,109 products to world markets, including 3,074 products to Sri Lanka. India had substantial export capacity in many products that were imported by Sri Lanka from other countries. Table 12.14 lists the top 50 products in which India had full export capacity, but exports to Sri Lanka were zero. Of the 50 products, 15 would be subject to nontariff measures in Sri Lanka.

**Table 12.14: Top 50 Products in which India had Full Export Capacity but Zero Exports to Sri Lanka, with Corresponding Nontariff Measures in Sri Lanka**

HS Code	HS Code Description	Nontariff Measure Code
020230	Bovine cuts boneless, frozen	A9, A11, A14, A22, A31, A83, E121
020629	Bovine edible offal, frozen nes	A9, A11, A14, A22, A31, A83, E121
040811	Egg yolks dried	A9, A14, A83
060499	Foliage,branch,etc w/o flowers/buds&grass for bouquet/orn purp exc fr	
070990	Vegetables, fresh or chilled nes	A22
080232	Walnuts, fresh or dried, shelled or peeled	A22
080450	Guavas, mangoes and mangosteens, fresh or dried	A31, A83
091091	Mixtures of two/more of the prods of different headgs to this chapter	
160590	Molluscs and other aquatic invertebrates prepared or preserved	
200110	Cucumbers and gherkins,prepared or preserved by vinegar or acetic acid	A83
251400	Slate, whether or not roughly trimmed or merely cut etc	

*continued on next page*

Table 12.14 continued

HS Code	HS Code Description	Nontariff Measure Code
261400	Titanium ores and concentrates	
270740	Naphthalene	
271099	Other waste oils	
290220	Benzene	
290242	M-xylene	
291100	Acetals and hemiacetals and their derivatives	
291221	Benzaldehyde	E129
291249	Aldehyde-ethers, aldehyde-phenols & aldehydes w oth oxygen function, nes	E129
292144	Diphenylamine and its derivatives; salts thereof	E129
292229	Amino-naphthols & oth amino-phenols, nes, thr ethers & esters; salts thereof	E129
293354	Derivatives of malonylurea "barbituric acid" and salts thereof (excl.)	E129
300190	Heparin&its salts;human/animal substances f therap/prophlct uses, nes	E129
360500	Matches	
390461	Polytetrafluoroethylene	
420100	Saddlery and harness for any animal, of any material	
530500	Coconut, abaca Manila hemp or Musa textilis Nee, ramie, agave and other vegetable textile fibers	
540331	Yarn of viscose rayon filaments, single, untwisted, nes, not put up	
540784	Woven fabrics of synthetic filaments	
570110	Carpets of wool or fine animal hair, knotted	
570210	Kelem, Schumacks, Karamanie and similar textile hand-woven rugs	
570310	Carpets of wool or fine animal hair, tufted	
610329	Mens/boys ensembles, of other textile materials, knitted	
610444	Womens/girls dresses, of artificial fibres, knitted	
610520	Mens/boys shirts, of man-made fibres, knitted	
611030	Pullovers, cardigans and similar articles of man-made fibres, knitted	
611430	Garments nes, of man-made fibres, knitted	
620341	Mens/boys trousers and shorts,of wool or fine animal hair, not knitted	
630491	Furnishing articles nes, of textile materials, knitted or crocheted	
701010	Ampoules of glass conveyance or packing	
711419	Articl of gold/silversmith&pts of prec met w/n plat/clad w/o prec met	

HS Code	HS Code Description	Nontariff Measure Code
720719	Semi-fin prod, iron or non-alloy steel, cntg by wght	
720826	Hot roll steel, coil, pickled >600mm x 3-4.75mm	
722410	Ingots & other primary forms of alloy steel, o/t stainless	
810520	Cobalt mattes and other intermediate products of cobalt metallurgy; un	
854511	Carbon or graphite electrodes, of a kind used for furnaces	
860110	Rail locomotives powered from an external source of electricity	
880390	Parts of balloons, dirigibles, and spacecraft nes	E129
890400	Tugs and pusher craft	
930510	Parts&accessories of revolvers or pistols of headg Nos 93.01 to 93.04	E129

HS = Harmonized System.

Note: Nontariff measure code follows the United Nations Conference on Trade and Development 2012 classification (see Annex).

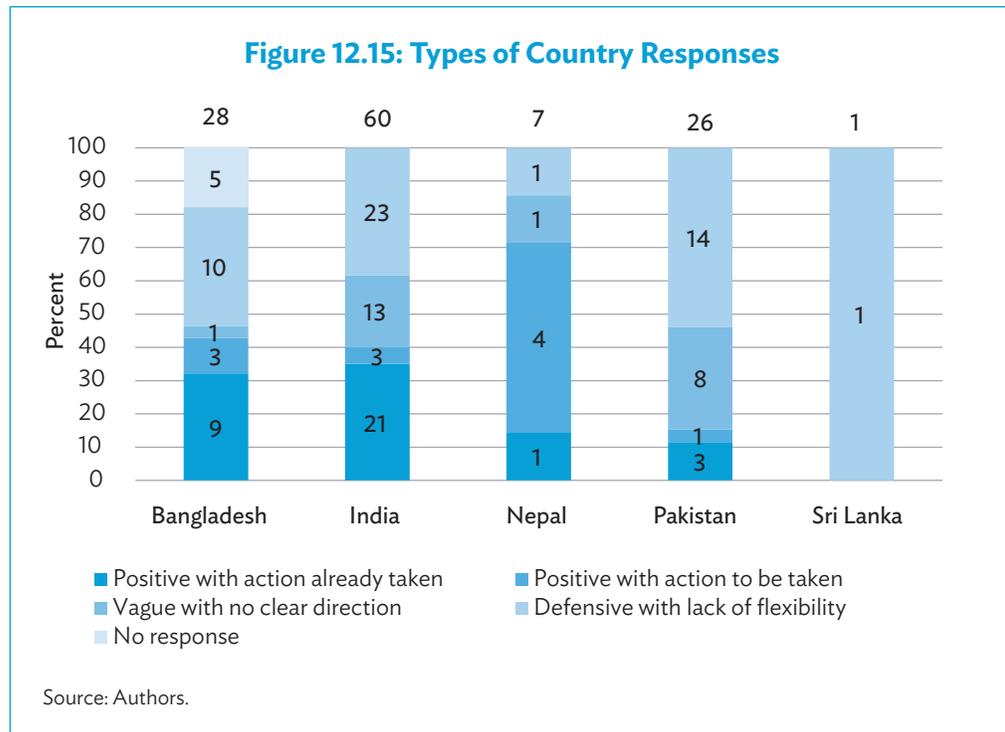
Source: Raihan, S., M. A. Khan, and S. Quoreshi. 2014. *NTMs in South Asia: Assessment and Analysis*. Kathmandu: SAARC- Trade Promotion Network.

## Nontariff Measure Notifications and Responses under SAFTA

Soon after the South Asian Free Trade Area (SAFTA) came into operation, the member countries were asked to submit nontariff measure notifications and respond to those notifications. Table 12.15 summarizes the number of notifications and responses. India received the highest number of notifications (60) followed by Bangladesh (28) and Pakistan (26). Nepal received 7 notifications, Sri Lanka 1 notification. Bhutan and the Maldives did not receive any notifications.

**Table 12.15: Nontariff Measure Notifications and Responses under SAFTA**

Notified by	Notification received by						
	Bhutan	Bangladesh	India	Maldives	Nepal	Pakistan	Sri Lanka
Bhutan		3 (Jan 2008) No response					
Bangladesh			15 (Aug 2006) Responded		1 (Aug 2006) Responded	1 (Aug 2006) Responded	
India		14 (Mar 2008) Responded			6 (Mar 2008) Responded	23 (Mar 2006) Responded	
Maldives							1 (Feb 2007) Responded
Nepal		2 (Nov 2006) No response	13 (Nov 2006) Responded			2 (Nov 2006) Responded	



Pakistan	9 (Mar 2008) Responded	32 (Feb 2007) Responded
Sri Lanka		

Source: South Asian Association for Regional Cooperation Secretariat.

A close look at the types of notifications suggests that Bangladesh received notifications mostly related to import bans, certification, value-added tax, sanitary and phytosanitary (SPS) measures, restrictions on land routes, testing, pre-shipment inspection (PSI), and public procurement. India received notifications mostly related to testing, licensing, anti-dumping, SPS measures, restricted port entry, import permits, problems of the laboratory being far away from customs points, labeling, certification, and countervailing duty. Nepal received notifications related to agriculture development fund (ADF), border check points, and registration. Pakistan received notifications related to registration, letter of credit, restrictions on land routes, SPS measures and licenses, sales taxes, and excise duties. Sri Lanka received a notification related to SPS measures.

Figure 12.15 classifies the country responses to the notifications into five groups: (i) positive with action already taken, (ii) positive with action to be taken, (iii) vague with no clear direction, (iv) defensive with lack of flexibility, and (v) no response. Of Bangladesh’s 28 responses, 12 were positive with action already taken or to be taken (43%), one was vague, 10 were defensive, and five were no response. Of India’s 60 responses, 24 were positive with action already taken or to be taken (40%), 13 were vague, and 23 were defensive. Of Nepal’s 7 responses, 5 were positive with action already taken or to be taken (71%), one was vague, and 1 was defensive. Of Pakistan’s 26 responses, only 4 were positive with action already taken or to be taken (15%), 8 were vague, and 14 were defensive. Finally, Sri

Lanka's sole response was defensive. The aforementioned analysis indicates interesting regional political economy perspective. The fact that majority of the responses of most of the countries were either defensive or vague shows that the agenda of removing nontariff measures in South Asia to promote intraregional trade is very critical and challenging. Also, no further notifications happened after 2008.

## Conclusion

The SAARC Secretariat should review the nontariff measure inventory for the SAARC members as provided in Raihan et al. (2014) report, and undertake or endorse initiatives by others, including the private sector and development partners, to make the inventory more comprehensive and to ensure that it is periodically updated. In particular, the SAARC Secretariat should oversee the following tasks:

- Review and analyze core nontariff measures, e.g., SPS, TBTs, port entry restrictions, and para-tariffs, for their trade-restricting effects, and take appropriate steps to address them at the SAARC level.
- Strengthen the SAARC Secretariat's capacity to establish a mechanism to deal with the reports and complaints generated by the business community and received from the SAARC Chamber of Commerce and Industry (SCCI) and apex trade bodies.
- Encourage governments to review the detailed country-specific list of products indicating export capacity but zero or limited intraregional trade, and determine the possible reasons for their limited regional trade in order to devise strategies for trade promotion and development and to remove trade barriers.
- Harmonize TBT and SPS measures, particularly for animals and animal products (HS chapters 1 and 2), and plants and plant products (HS chapters 6–12). Harmonization will prepare the way for acceptance of certificates issued by the competent authority of the exporting SAARC country, thereby facilitating entry, instead of requiring inspection to be conducted at border points or at facilities in the interior.
- To reduce or eliminate the trade-impeding effects of nontariff measures and nontariff barriers, SAARC member governments or authorized organizations should endorse mutual recognition agreements for specific products or industrial sectors.
- In the absence of formal mutual recognition agreements, resolve non-acceptability of any particular product, if and when this issue arises, through mutual cooperation programs without restricting trade.
- Allocate adequate human and financial resources to the South Asian Regional Standards Organisation (SARSO). While waiting for the lengthy and time-consuming harmonization of standards, SAARC countries should consider accepting certificates issued by competent laboratories of other SAARC countries.
- Encourage accreditation bodies or agencies of partner countries to set up accreditation centers, in collaboration with a designated national agency, to

## Annex

### United Nations Conference on Trade and Development Classification of Nontariff Measures, 2012

facilitate mutual cooperation with necessary capacity building under technical and financial assistance from multilateral or bilateral development partners.

- Assess the value of imported products only on the basis of the World Trade Organization (WTO) Customs Valuation Agreement.
- Accept certificates issued by the designated national institutions in all ports of entry.
- Accord national treatment to all products in respect of registration, labeling, and testing requirements, along with charges and fees thereof.
- Levy fees on the basis of the cost of services rendered and not for fiscal purposes or as protection for domestic products.
- Initiate structured programs, endorsed by the SAARC Secretariat (in case of third-party initiatives), to increase the interaction between the business community and key government officials in each SAARC country, for and to discuss regularly the reduction or elimination of procedural obstacles and duplication of documents.
- Expedite and prioritize increased automation of SAARC members' customs clearance procedures under the harmonized ASYCUDA system. The resources for customs automation should be mobilized with support from multilateral development agencies under aid-for-trade schemes.

**A. Sanitary and Phytosanitary Measures**

- A1 Prohibitions/restrictions of imports for sanitary and phytosanitary (SPS) reasons
- A2 Tolerance limits for residues and restricted use of substances
- A3 Labelling, marking, and packaging requirements
- A4 Hygienic requirements
- A6 Other requirements on production or post-production processes
- A8 Conformity assessment related to SPS
- A9 SPS measures, not elsewhere specified (nes)
- A11 Temporary geographic prohibitions for SPS reasons
- A12 Geographical restrictions on eligibility
- A13 Systems approach
- A14 Special authorization requirement for SPS reasons
- A15 Registration requirements for importers
- A19 Prohibitions/restrictions of imports for SPS reasons, nes
- A21 Tolerance limits for residues of or contamination by certain (non-microbiological) substances
- A22 Restricted use of certain substances in foods and feeds and their contact materials
  
- A31 Labelling requirements
- A32 Marking requirements
- A33 Packaging requirements
  
- A41 Microbiological criteria of the final product
- A42 Hygienic practices during production
- A49 Hygienic requirements, nes
- A51 Cold/heat treatment
- A52 Irradiation
- A53 Fumigation
- A59 Treatment for elimination of plant and animal pests and disease-causing organisms in the final product, nes
- A61 Plant-growth processes
- A62 Animal-raising or -catching processes
- A63 Food and feed processing
- A64 Storage and transport conditions
- A69 Other requirements on production or post-production processes, nes
- A81 Product registration requirement
- A82 Testing requirement
- A83 Certification requirement
- A84 Inspection requirement
- A85 Traceability requirements
  - A85.1 Origin of materials and parts
  - A85.2 Processing history
  - A85.3 Distribution and location of products after delivery
  - A85.9 Traceability requirements, nes
- A86 Quarantine requirement
- A89 Conformity assessment related to SPS, nes

**B. Technical Barriers to Trade**

- B1 Prohibitions/restrictions of imports for objectives set out in the technical barriers to trade (TBT) agreement
- B2 Tolerance limits for residues and restricted use of substances
- B3 Labelling, marking, and packaging requirements
- B4 Production or post-production requirements
- B6 Product identity requirement
- B7 Product-quality or -performance requirement
- B8 Conformity assessment related to TBT
- B9 TBT measures, nes
- B11 Prohibition for TBT reasons
- B14 Authorization requirement for TBT reasons
- B15 Registration requirement for importers for TBT reasons
- B19 Prohibitions/restrictions of imports for objectives set out in the TBT agreement, nes
- B21 Tolerance limits for residues of or contamination by certain substances
- B22 Restricted use of certain substances
- B31 Labelling requirements
- B32 Marking requirements
- B33 Packaging requirements
- B41 TBT regulations on production processes
- B42 TBT regulations on transport and storage
- B49 Production or post-production requirements, nes
- B81 Product registration requirement
- B82 Testing requirement
- B83 Certification requirement
- B84 Inspection requirement
- B85 Traceability information requirements
- B851 Origin of materials and parts
- B852 Processing history
- B853 Distribution and location of products after delivery
- B859 Traceability requirements, nes
- B89 Conformity assessment related to TBT, nes

**C. Pre-Shipment Inspection and Other Formalities**

- C1 Pre-shipment inspection
- C2 Direct consignment requirement
- C3 Requirement to pass through specified port of customs
- C4 Import-monitoring and -surveillance requirements and other automatic licensing measures
- C9 Other formalities, nes

**D. Contingent Trade-Protective Measures**

- D1 Antidumping measure
- D2 Countervailing measure
- D3 Safeguard measures
- D11 Antidumping investigation
- D12 Antidumping duty

- D13 Price undertaking
- D21 Countervailing investigation
- D22 Countervailing duty
- D23 Undertaking
- D31 General (multilateral) safeguard
- D311 Safeguard investigation
- D312 Safeguard duty
- D313 Safeguard quantitative restriction
- D314 Safeguard measure, other form
- D32 Agricultural special safeguard
- D321 Volume-based agricultural special safeguard
- D322 Price-based agricultural special safeguard
- D39 Safeguard, nes

**E. Non-Automatic Licensing, Quotas, Prohibitions, and Quantity-Control Measures Other Than for SPS or TBT Reasons**

- E1 Non-automatic import-licensing procedures other than authorizations for SPS or TBT reasons
- E2 Quotas
- E3 Prohibitions other than for SPS and TBT reasons
- E5 Export-restraint arrangement
- E6 Tariff-rate quotas (TRQ)
- E9 Quantity control measures, nes
- E11 Licensing for economic reasons
- E111 Licensing procedure with no specific ex ante criteria
- E112 Licensing for specified use
- E113 Licensing linked with local production
- E119 Licensing for economic reasons, nes
- E12 Licensing for non-economic reasons
- E121 Licensing for religious, moral, or cultural reasons
- E122 Licensing for political reasons
- E129 Licensing for non-economic reasons, nes
- E21 Permanent
- E211 Global allocation
- E212 Country allocation
- E22 Seasonal quotas
- E221 Global allocation
- E222 Country allocation
- E23 Temporary
- E231 Global allocation
- E232 Country allocation
- E31 Prohibition for economic reasons
- E311 Full prohibition (import ban)
- E312 Seasonal prohibition
- E313 Temporary prohibition, including suspension of issuance of licences
- E314 Prohibition of importation in bulk
- E315 Prohibition of products infringing patents or other intellectual property rights

E316	Prohibition of used, repaired or remanufactured goods
E319	Prohibition for economic reasons, nes
E32	Prohibition for non-economic reasons
E321	Prohibition for religious, moral, or cultural reasons
E322	Prohibition for political reasons (embargo)
E329	Prohibition for non-economic reasons, nes
E51	Voluntary export-restraint arrangements
E511	Quota agreement
E512	Consultation agreement
E513	Administrative cooperation agreement
E59	Export-restraint arrangements, nes
E61	World Trade Organization (WTO)-bound TRQs, included in WTO schedules (concessions and commitments under WTO negotiations)
E611	Global allocation
E612	Country allocation
E62	Other TRQs included in other trade agreements.
E621	Global allocation
E622	Country allocation

#### **F. Price-Control Measures, Including Additional Taxes, and Charges**

F1	Administrative measures affecting customs value
F2	Voluntary export-price restraints (VEPRs)
F3	Variable charges
F4	Customs surcharges
F5	Seasonal duties
F6	Additional taxes and charges levied in connection to services provided by the government
F7	Internal taxes and charges levied on imports
F8	Decreed customs valuations
F9	Price-control measures, n.e.s
F11	Minimum import prices
F12	Reference prices
F19	Other administrative measures affecting the customs value, nes
F31	Variable levies
F32	Variable components
F39	Variable charges n.e.s
F61	Custom-inspection, -processing and -servicing fees
F62	Merchandise-handling or -storing fees
F63	Tax on foreign exchange transactions
F64	Stamp tax
F65	Import licence fee
F66	Consular invoice fee
F67	Statistical tax
F68	Tax on transport facilities
F69	Additional charges, nes
F71	Consumption taxes
F72	Excise taxes

- F73 Taxes and charges for sensitive product categories
- F79 Internal taxes and charges levied on imports, nes

#### **G. Finance Measures**

- G1 Advance payment requirement
- G2 Multiple exchange rates
- G3 Regulation on official foreign exchange allocation
- G4 Regulations concerning terms of payment for imports
- G9 Finance measures, nes
- G11 Advance import deposit
- G12 Cash margin requirement
- G13 Advance payment of customs duties
- G14 Refundable deposits for sensitive product categories
- G19 Advance payment requirements, nes
- G31 Prohibition of foreign exchange allocation
- G32 Bank authorization
- G33 Authorization linked with non-official foreign exchange
- G331 External foreign exchange
- G332 Importers' own foreign exchange
- G339 Licence linked with non-official foreign exchange, nes
- G39 Regulation on official foreign exchange allocation, nes

#### **H. Measures Affecting Competition**

- H1 State-trading enterprises, for importing; other selective import channels
- H2 Compulsory use of national services
- H9 Measures affecting competitions, nes
- H11 State-trading enterprises, for importing
- H19 Other selective import channels, nes
- H21 Compulsory national insurance
- H22 Compulsory national transport
- H29 Compulsory national service, nes

#### **I. Trade-Related Investment Measures**

- I1 Local content measures
- I2 Trade-balancing measures
- I9 Trade-related investment measures, n.e.s

#### **J. Distribution Restrictions**

- J1 Geographical restriction
- J2 Restriction on resellers

**K. Restrictions on Post-Sales Services**

**L. Subsidies (Excluding Export Subsidies under P7)**

**M. Government Procurement Restrictions**

**N. Intellectual Property**

**O. Rules of Origin**

**P. Export-Related Measures**

- P1 Export-license, -quota, -prohibition, and other quantitative restrictions
- P2 State-trading enterprises, for exporting; other selective export channels
- P3 Export price-control measures
- P4 Measures on re-export
- P5 Export taxes and charges
- P6 Export technical measures
- P7 Export subsidies
- P8 Export credits
- P9 Export measures, nes
- P11 Export prohibition
- P12 Export quotas
- P13 Licensing- or permit requirements to export
- P14 Export registration requirements
- P19 Export quantitative restrictions, nes
- P21 State-trading enterprises, for exporting
- P29 Other selective export channels, nes
- P61 Inspection requirement
- P62 Certification required by the exporting country
- P69 Export technical measures, nes

## CHAPTER XIII

# Quantitative Assessment of Phases of Regional Economic Integration in South Asia

*Selim Raihan*

Since the early 1990s, there has been increased interest in regional economic integration in South Asia. With the stalemate of the World Trade Organization (WTO) negotiations, it is expected that the interest in regional trading arrangements will increase further. Regional integration in South Asia has been slow but momentum has picked up, first in 1993, when the South Asian Association for Regional Cooperation (SAARC) Preferential Trading Arrangement (SAPTA) was signed, and subsequently in early 2004, when the SAARC member countries agreed to form the South Asian Free Trade Area (SAFTA). SAFTA came into force in January 2006, with the aim of boosting intraregional trade among the seven SAARC members (Afghanistan became a member of SAARC in April 2007). It has become a parallel initiative to the multilateral trade liberalization commitments of the South Asian countries.

Critics have pointed out some factors that could undermine the potential benefits of SAFTA. For example, it is argued that there are limited complementarities in the region. Therefore, even under a free trade arrangement, the expansion of intraregional trade would not be substantial. Further, South Asian countries trade very little among themselves; their major trading partners are external to the region. Critics also contend that SAFTA could lead to substantial trade diversion for some member countries, rather than trade creation. And, finally, SAFTA could act as a stumbling block for multilateral trade liberalization. These concerns have been supported by some studies on the potential impact of SAFTA for the member countries.

However, there have been strong arguments for regional economic integration in South Asia, based on the view that integration would generate significant intraregional trade and welfare gains. Policy makers and business community leaders in South Asia expect SAFTA to positively impact the economies in the region. It is anticipated that the SAFTA agreement, when fully implemented, will provide the member countries with improved market access, help boost their exports to the region, and markedly improve intraregional trade. SAFTA is expected to enhance the existing trade—the so-called static gains. The dynamic gains could exceed the static gains, because businesses in the region will gain access to the markets of the relatively larger member countries and expand their scale of operations accordingly.

It is important to understand the implications of full implementation of SAFTA (with and without the sensitive list) and the impact of deeper regional integration in South Asia. There are concerns about how the next phases of regional integration, such as customs union, trade in services, or trade facilitation, will impact on SAARC members. This chapter provides quantitative assessments of different scenarios related to deeper regional integration in South Asia.

## Methodology

The global computable general equilibrium modelling framework of the Global Trade Analysis Project (GTAP) (Hertel 1997) is the best methodological tool for ex ante analysis of the economic and trade consequences of multilateral or bilateral trade agreements. The GTAP model is a comparative static model and is based on neoclassical theories. It is a linearized model and uses a common global database for the analysis. The model assumes perfect competition in all markets, constant returns to scale in all production and trade activities, profit-maximizing behavior of firms, and utility-maximizing behavior by households. The model is solved using the software GEMPACK (Harrison and Pearson 1996).

In the GTAP model, each region has a single representative household, termed the regional household. The income of the regional household is generated through factor payments and tax revenues (including export and import taxes) net of subsidies. The regional household allocates expenditure over private household expenditure, government expenditure, and savings according to a Cobb Douglas per capita utility function. Thus, each component of final demand maintains a constant share of total regional income.

The private household buys commodity bundles to maximize utility subject to its expenditure constraint. The constrained optimizing behavior of the private household is represented in the GTAP model by a constant difference of elasticity expenditure function. The private household spends its income on consumption of both domestic and imported commodities and pays taxes. The consumption bundles are constant elasticity of substitution (CES) aggregates of domestic and imported goods, where the imported goods are also CES aggregates of imports from different regions. Taxes paid by the private household cover commodity taxes for domestically produced and imported goods, and income taxes net of subsidies.

The government also spends its income on domestic and imported commodities and pays commodity taxes for domestically produced and imported commodities. Like the private household, government consumption is a CES composition of domestically produced goods and imports.

The GTAP model considers the demand for investment in a particular region as savings-driven. In the multi-country setting, the model is closed by assuming that regional savings are homogenous and contribute to a global pool of savings (global savings). This is then allocated among regions for investment in response to changes in the expected rates of return in different regions. If all other markets in the multiregional model are in equilibrium, if all firms earn zero profits, and if all households are on their budget constraint, such a treatment of savings and investment will lead to a situation where global investment must equal global savings, and Walras' Law will be satisfied (i.e., values of excess market demands, or excess market supplies, must sum to zero).

In the GTAP model, producers receive payments for selling consumption goods and intermediate inputs both in the domestic market and to the rest of the world. Under the zero-profit assumption in the model, these revenues must be precisely exhausted by spending on domestic intermediate inputs, imported intermediate inputs, factor income, and taxes paid to regional household (taxes on both domestic and imported intermediate inputs and production taxes net of subsidies).

The GTAP model considers a nested production technology with the assumption that every industry produces a single output and that constant returns to scale prevail in all markets. Industries have a Leontief production technology to produce their outputs. Industries maximize profits by choosing two broad categories of inputs: a composite of factors (value added) and a composite of intermediate inputs. The factor composite is a CES function of labor, capital, land, and natural resources. The intermediate composite is a Leontief function of material inputs, which are in turn a CES composition of domestically produced goods and imports. Imports are sourced from all regions.

The GTAP model employs the Armington assumption, which provides the possibility to distinguish imports by their origin and explains intra-industry trade of similar products. Following the Armington approach, import shares of different regions depend on relative prices and the substitution elasticity between domestically and imported commodities.

This study uses version 8.2 of the database of the GTAP global general equilibrium model. Version 8.2 has 2007 as the base year and covers 57 commodities, 129 regions and countries, and five factors of production. Pre-simulations were done to reflect the base scenario close to 2014. The current study has kept the 57-commodity classification, as shown in Table 13.13.1, but has aggregated 140 regions into 17, as shown in Table 13.13.2.

**Table 13.1: Classification of Sectors**

No.	Sector	No.	Sector	No.	Sector	No.	Sector
1	Paddy rice	16	Oil	31	Paper products, publishing	46	Construction
2	Wheat	17	Gas	32	Petroleum, coal products	47	Trade
3	Cereal grains nec	18	Minerals nec	33	Chemical, rubber, plastic	48	Transport nec
4	Vegetables, fruit, nuts	19	Meat	34	Mineral products nec	49	Sea transport
5	Oil seeds	20	Meat products nec	35	Ferrous metals	50	Air transport
6	Sugar cane, sugar beet	21	Vegetable oils	36	Metals nec	51	Communication
7	Plant-based fibers	22	Dairy products	37	Metal products	52	Financial services nec
8	Crops nec	23	Processed rice	38	Motor vehicles and parts	53	Insurance
9	Cattle	24	Sugar	39	Transport equipment nec	54	Business services nec

*continued on next page*

Table 13.1 *continued*

No.	Sector	No.	Sector	No.	Sector	No.	Sector
10	Animal products nec	25	Food products nec	40	Electronic equipment	55	Recreation and other
11	Raw milk	26	Beverage and tobacco	41	Machinery and equipment	56	Public administration, defense, health, and education
12	Wool, silkworm cocoons	27	Textiles	42	Manufactures nec	57	Dwellings
13	Forestry	28	Wearing apparel	43	Electricity		
14	Fishing	29	Leather products	44	Gas manufacture, distribution		
15	Coal	30	Wood products	45	Water		

nec = not elsewhere classified.

Source: Global Trade Analysis Project. Global Trade Analysis Project database 8.2. <https://www.gtap.agecon.purdue.edu/> (accessed 1 March 2014).

Table 13.2: Classification of Regions

No.	Code	Country/Region
1	BGD	Bangladesh
2	IND	India
3	NPL	Nepal
4	PAK	Pakistan
5	LKA	Sri Lanka
6	XSA	Rest of South Asia
7	CHN	People's Republic of China
8	USA	United States
9	EU_25	European Union 25
10	Oceania	Australia, New Zealand
11	OthEastAsia	East Asia excluding the People's Republic of China
12	SEAsia	Southeast Asia
13	OthNAmerica	North America
14	LatinAmer	Latin America
15	MENA	Middle East and North Africa
16	SSA	Sub-Saharan Africa
17	ROW	Rest of World

Source: Global Trade Analysis Project. Global Trade Analysis Project database 8.2. <https://www.gtap.agecon.purdue.edu/> (accessed 1 March 2014).

The study involved two closures in the model: (i) the GTAP standard closure of full employment of labor; and (ii) a modified closure of fixed wage rate of unskilled labor in the South Asian countries, allowing for unemployment of unskilled labor.

## The Scenarios

Eight simulations considering eight different scenarios were run through the model, as outlined in the following:

- Scenario 1: SAFTA zero tariffs with no sensitive list; South Asian countries reduce their bilateral tariffs to zero; GTAP standard closure of full employment
- Scenario 2: SAFTA zero tariffs with no sensitive list; South Asian countries reduce their bilateral tariffs to zero; closure of fixed wage rate of unskilled labor in the South Asian countries
- Scenario 3: SAFTA zero tariffs with sensitive lists; South Asian countries reduce their bilateral tariffs to zero, except for products in the sensitive list; GTAP standard closure of full employment
- Scenario 4: SAFTA zero tariffs with sensitive lists; South Asian countries reduce their bilateral tariffs to zero, except for products in the sensitive list; closure of fixed wage rate of unskilled labor in the South Asian countries
- Scenario 5: Reduction in bilateral tariffs among the South Asian countries to 0%–5%; all bilateral tariffs of South Asian countries (among themselves) are reduced to 5%, leaving most favored nation (MFN) tariffs unaffected; also unaffected are tariffs that are already zero, or tariff rates that are less than 5% but higher than zero
- Scenario 6: Reduction in trade costs; reduction in bilateral trade costs among South Asian countries by 10%; closure of fixed wage rate of unskilled labor in the the South Asian countries
- Scenario 7: Customs union in South Asia; no SAFTA sensitive list in the base simulation (base is updated after SAFTA simulation); closure of fixed wage rate of unskilled labor in the South Asian countries
- Scenario 8: Customs union in South Asia; SAFTA sensitive lists in the base simulation (base is updated after SAFTA simulation); closure of fixed wage rate of unskilled labor in the South Asian countries

## Simulations Results

### Scenario 1: SAFTA zero tariffs with no sensitive list; GTAP standard closure of full employment

Table 13.3 presents the welfare effects of scenario 1. It appears that under the standard GTAP closure, only Bangladesh would experience some losses in welfare, whereas all other South Asian countries would experience increases in welfare. Bangladesh's welfare loss would be driven by the loss in terms of trade (Table 13.4).

Table 13.3: Welfare Effects of Scenario 1

Country/Region	Equivalent Variation (\$ million)	Equivalent Variation as % of GDP
Bangladesh	(106.1)	(0.2)
India	1,061.8	0.1
Nepal	314.3	3.1
Pakistan	441.8	0.3
Sri Lanka	12.5	0.0
Rest of South Asia <sup>a</sup>	209.3	1.7

( ) = negative, GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

Table 13.4: Decomposition of Welfare Effects of Scenario 1  
(\$ million)

Country/Region	Allocative Efficiency	Endowment Effect	Technical Change	Terms of Trade	Investment Savings	Total
Bangladesh	0.7	0.0	0.0	(100.7)	(6.0)	(106.1)
India	786.6	0.0	0.0	206.7	68.5	1,061.8
Nepal	53.0	0.0	0.0	88.7	172.6	314.3
Pakistan	34.7	0.0	0.0	327.8	79.3	441.8
Sri Lanka	(7.1)	0.0	0.0	4.4	15.2	12.5
Rest of South Asia <sup>aa</sup>	43.6	0.0	0.0	96.4	69.3	209.3

( ) = negative.

Notes: Under standard Global Trade Analysis Project (GTAP) closure, there is no endowment effect, given that endowments are held fixed and also effect through technical change is zero because no shock is introduced for technology.

Numbers may not sum precisely because of rounding.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

Table 13.4 suggests that India's welfare gain would be driven mostly by an increase in allocative efficiency. The largest welfare effect, in terms of percentage share of gross domestic product (GDP), would be observed for Nepal, mainly as a result of the positive investment-savings effect.

Table 13.5 suggests that the largest increase in total exports would be observed for Nepal (32%) and that Nepal would also experience a 0.5 percentage point increase in real GDP. Total exports would increase by 1.2% for India, 5.3% for Bangladesh, 4.8% for Pakistan, 2.2% for Sri Lanka, and 11.5% for the rest of South Asia.

**Table 13.5: Impacts on Exports, Imports, and Real Gross Domestic Product of Scenario 1**

Country/Region	% Change in Exports	% Change in Imports	% Change in Real GDP
Bangladesh	5.3	4.8	0.0
India	1.2	1.0	0.1
Nepal	32.1	23.2	0.5
Pakistan	4.8	2.7	0.0
Sri Lanka	2.2	3.0	0.0
Rest of South Asia <sup>a</sup>	11.5	8.8	0.4

GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

### Scenario 2: SAFTA zero tariffs with no sensitive list; closure of fixed wage rate of unskilled labor in the South Asian countries

The GTAP standard closure of full employment of unskilled labor may not be consistent with the structures of the economies in South Asia. Scenario 2 provides for an alternative closure of fixed wage rate of unskilled labor, which would allow for a change in the supply of unskilled labor. Under this closure, full execution of the SAFTA agreement would lead to increases in welfare for all South Asian countries. In terms of volume, the largest gain would be observed by India; as a percentage of GDP, the largest gain would be observed by Nepal. Bangladesh's welfare gain would be equivalent to 0.2% of its GDP.

**Table 13.6: Welfare Effects of Scenario 2**

Country/Region	Equivalent Variation (\$ million)	Equivalent Variation as % of GDP
Bangladesh	173.1	0.2
India	1,950.4	0.2
Nepal	595.1	5.8
Pakistan	433.3	0.3
Sri Lanka	284.7	0.9
Rest of South Asia <sup>a</sup>	294.1	2.4

GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

Decomposition of the welfare effects suggests that for most South Asian countries the large welfare gains would result from the positive endowment effects (Table 13.7). Also, these countries would experience allocative efficiency gains. Pakistan is shown as benefiting from significant terms-of-trade gains.

**Table 13.7: Decomposition of Welfare Effects of Scenario 2**  
(\$ million)

Country/Region	Allocative Efficiency	Endowment Effect	Technical Change	Terms of Trade	Investment Savings	Total
Bangladesh	56.5	219.1	0.0	(105.7)	3.2	173.1
India	902.2	824.2	0.0	170.9	53.1	1,950.4
Nepal	93.8	233.6	0.0	87.6	180.0	595.1
Pakistan	34.2	(8.7)	0.0	328.1	79.8	433.3
Sri Lanka	41.9	242.8	0.0	(2.7)	2.8	284.7
Rest of South Asia <sup>a</sup>	81.5	63.2	0.0	89.9	59.5	294.1

( ) = negative.

Notes:

1. Effect through technical change is zero because no shock is introduced for technology.

2. Numbers may not sum precisely because of rounding.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

Under scenario 2, the positive effects on total exports of the South Asian countries would be larger than those under scenario 1 (Table 13.8). Again, Nepal would experience the largest positive impact on total exports, imports, and real GDP.

**Table 13.8: Impacts on Exports, Imports, and Real Gross Domestic Product of Scenario 2**

Country/Region	% Change in Exports	% Change in Imports	% Change in Real GDP
Bangladesh	5.5	5.3	0.4
India	1.3	1.1	0.1
Nepal	32.7	26.1	3.1
Pakistan	4.8	2.7	0.0
Sri Lanka	2.6	3.9	0.9
Rest of South Asia <sup>a</sup>	12.4	9.4	1.2

GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

### Scenario 3: SAFTA zero tariffs with sensitive lists; GTAP standard closure of full employment

This scenario takes into account the presence of sensitive lists in tariff liberalization.

Table 13.9 presents the coverage of sensitive lists under SAFTA, as collected from United Nations Commodity Trade Statistics Database (UN Comtrade) and International Trade Centre bilateral trade data at the 6-digit Harmonized System (HS) code for the South Asian countries. The latest lists of sensitive products are used to identify the commodities that fall under the sensitive lists. Table 13.9 suggests that the sensitive list for India is relatively open, whereas the sensitive lists for Bangladesh and other South Asian countries are still very restrictive.

**Table 13.9: Coverage of Sensitive Lists under South Asian Free Trade Area**  
(% share of imports of sensitive products in total imports)

Country/ Region	Imports from					
	Bangladesh	India	Nepal	Pakistan	Sri Lanka	Rest of South Asia <sup>a</sup>
Bangladesh		47.7	97.6	52.9	40.2	52.4
India	0.0		0.0	17.1	11.2	0.1
Nepal	0.0	45.4		9.7	45.9	0.0
Pakistan	5.2	9.5 <sup>b</sup>	20.8		46.8	8.9
Sri Lanka	18.3	31.6	0.0	12.8		72.4
Rest of South Asia <sup>a</sup>	63.5	52.6	71.9	80.3	54.2	

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

<sup>b</sup> This figure could be higher, given that Pakistan has not yet granted most favored nation status to India.

Source: Author's calculation from the United Nations. UNCOMTRADE Database. <http://comtrade.un.org> (accessed 1 March 2014) and International Trade Centre. Trade Map Data. <http://www.trademap.org> (accessed 1 March 2014).

In the GTAP model simulation, sensitive lists were treated in the following manner:

(i) import data at the 6-digit HS code level were aggregated to GTAP 42 goods sectors using the concordance table; (ii) for bilateral trade among six South Asian countries, the shares of imports of sensitive products in total imports were calculated for all GTAP 42 sectors; and (iii) the shares were used to simulate SAFTA tariff liberalization after adjusting for the sensitive lists.

The welfare effects of scenario 3 (under the standard GTAP closure) suggest that the presence of sensitive lists would hurt India, Pakistan, and the rest of South Asia (Table 13.10). Decomposition of the welfare effects shows that much of the negative impact for India would derive from the adverse terms of trade development (Table 13.11). However, the presence of sensitive lists would favor Bangladesh and Nepal.

**Table 13.10: Welfare Effects of Scenario 3**

Country/Region	Equivalent Variation (\$ million)	Equivalent Variation as % of GDP
Bangladesh	33.8	0.1
India	(42.1)	0.0
Nepal	784.9	7.6
Pakistan	376.3	0.3
Sri Lanka	(4.4)	0.0
Rest of South Asia <sup>a</sup>	533.3	4.4

( ) = negative, GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

**Table 13.11: Decomposition of Welfare Effects of Scenario 3**  
(\$ million)

Country/Region	Allocative Efficiency	Endowment Effect	Technical Change	Terms of Trade	Investment Savings	Total
Bangladesh	31.0	0.0	0.0	(5.6)	8.5	33.8
India	360.2	0.0	0.0	(390.4)	(11.9)	(42.1)
Nepal	84.7	0.0	0.0	298.7	401.6	784.9
Pakistan	14.9	0.0	0.0	303.0	58.4	376.3
Sri Lanka	(17.8)	0.0	0.0	17.2	(3.9)	(4.4)
Rest of South Asia <sup>a</sup>	108.4	0.0	0.0	247.3	177.6	533.3

( ) = negative.

Notes:

Under standard GTAP closure, there is no endowment effect, because endowments are held fixed and also effect through technical change is zero because no shock is introduced for technology.

Numbers may not sum precisely because of rounding.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

In terms of effects on trade and real GDP, scenario 3 suggests that there would be smaller positive effects for the largest economies in South Asia (India, Pakistan, Bangladesh, and Sri Lanka) and somewhat more positive effects for the smaller economies (Nepal and the rest of South Asia) (Table 13.12).

**Table 13.12: Impacts on Exports, Imports, and Real Gross Domestic Product of Scenario 3**

Country/Region	% Change in Exports	% Change in Imports	% Change in Real GDP
Bangladesh	1.8	1.8	0.1
India	1.2	1.0	0.0
Nepal	41.8	39.5	0.8
Pakistan	4.5	2.5	0.0
Sri Lanka	0.7	1.2	(0.1)
Rest of South Asia <sup>a</sup>	16.0	14.6	0.9

( ) = negative, GDP = gross domestic product..

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

#### Scenario 4: SAFTA zero tariffs with sensitive lists; closure of fixed wage rate of unskilled labor in the South Asian countries

Scenario 4 is the same as scenario 3 except the GTAP closure now takes into account the flexible supply of unskilled labor in the South Asian countries. Comparison of the results of scenario 4 with those of scenario 2 suggests that, because of the sensitive lists, the larger economies (Bangladesh, India, Pakistan, and Sri Lanka) would experience more limited effects on their welfare, exports, and real GDP than the smaller economies (Afghanistan, Bhutan, the Maldives, and Nepal), which would benefit more (Tables 13.13, 13.14, and 13.5).

**Table 13.13: Welfare Effects of Scenario 4**

Country/Region	Equivalent Variation (\$ million)	Equivalent Variation as % of GDP
Bangladesh	81.0	0.1
India	1,072.2	0.1
Nepal	1,201.3	11.7
Pakistan	335.5	0.2
Sri Lanka	65.9	0.2
Rest of South Asia <sup>a</sup>	656.1	5.5

GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

**Table 13.14: Decomposition of Welfare Effects of Scenario 4**  
(\$ million)

Country/ Region	Allocative Efficiency	Endowment Effect	Technical Change	Terms of Trade	Investment Savings	Total
Bangladesh	40.6	37.0	0.0	(6.6)	10.0	81.0
India	608.7	906.4	0.0	(414.4)	(28.5)	1,072.2
Nepal	145.6	346.5	0.0	294.3	414.8	1,201.3
Pakistan	13.1	(28.5)	0.0	292.4	58.5	335.5
Sri Lanka	(5.1)	62.4	0.0	15.6	(7.0)	65.9
Rest of South Asia <sup>a</sup>	164.9	93.7	0.0	236.7	160.7	656.1

( ) = negative.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Note: Numbers may not sum precisely because of rounding.

Source: Global Trade Analysis Project simulation.

**Table 13.15: Impacts on Exports, Imports, and Real Gross Domestic Product of Scenario 4**

Country/Regions	% Change in Exports	% Change in Imports	% Change in Real GDP
Bangladesh	1.8	1.8	0.1
India	1.3	1.1	0.1
Nepal	42.0	43.7	4.6
Pakistan	4.5	2.4	0.0
Sri Lanka	0.8	1.4	0.2
Rest of South Asia <sup>a</sup>	17.3	15.3	2.1

GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

### Scenario 5: Reduction in bilateral tariffs among the South Asian countries to 0%–5%; no sensitive lists; closure of fixed wage rate of unskilled labor in the South Asian countries

This scenario considers reduction in bilateral tariffs among the South Asian countries to 0%–5%, instead of the complete elimination of tariffs as in scenarios 1 and 2. As noted in Section B, all bilateral tariffs among South Asian countries are reduced to 5%, leaving most favored nation (MFN) tariffs unaffected. In this case, tariffs that are already zero and tariff rates that are less than 5% but higher than zero, are not affected.

The welfare effects of scenario 5 are presented in Table 13.16. The simulation results suggest that even if South Asian countries reduce their bilateral tariffs to 0%–5%, there would be significant welfare gains, and these would be driven mainly by allocative efficiency and positive endowment effects (Table 13.17). There would also be positive effects on exports, imports, and real GDP (Table 13.18). However, the effects of this scenario would be relatively less than under a full SAFTA scenario, as in scenario 2.

**Table 13.16: Welfare Effects of Scenario 5**

Country/Region	Equivalent Variation (\$ million)	Equivalent Variation as % of GDP
Bangladesh	163.0	0.2
India	1,191.8	0.1
Nepal	589.9	5.7
Pakistan	306.7	0.2
Sri Lanka	176.5	0.5
Rest of South Asia <sup>a</sup>	231.6	1.9

GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

**Table 13.17: Decomposition of Welfare Effects of Scenario 5**

Country/Region	Allocative Efficiency	Endowment Effect	Technical Change	Terms of Trade	Investment Savings	Total
Bangladesh	78.7	116.9	0.0	(42.8)	10.2	163.0
India	611.5	657.1	0.0	(76.8)	0.1	1191.8
Nepal	96.4	202.6	0.0	103.8	187.1	589.9
Pakistan	41.1	(44.1)	0.0	258.9	50.7	306.7
Sri Lanka	41.3	134.2	0.0	(1.3)	2.3	176.5
Rest of South Asia <sup>a</sup>	68.3	38.9	0.0	72.2	52.2	231.6

( ) = negative.

Notes:

1. Effect through technical change is zero because no shock is introduced on technology.
2. Numbers may not sum precisely because of rounding.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

**Table 13.18: Impacts on Exports, Imports, and Real Gross Domestic Product of Scenario 5**

Country/Region	% Change in Exports	% Change in Imports	% Change in Real GDP
Bangladesh	2.9	2.9	0.3
India	0.9	0.7	0.1
Nepal	24.1	22.1	2.9
Pakistan	2.7	1.4	0.0
Sri Lanka	1.5	2.1	0.5
Rest of South Asia <sup>a</sup>	6.7	5.8	0.9

GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

### Scenario 6: Reduction in trade costs; closure of fixed wage rate of unskilled labor in the South Asian countries

Studies have shown that high trade costs, due to different nontariff barriers and lack of trade facilitation, are a major hindrance to intraregional trade in South Asia (Raihan et al. 2014). Scenario 6 simulates a cut in bilateral trade costs in South Asia. In the GTAP model, shocks are introduced on the parameters *ats* and *ams*. The parameter *ats* is the transport technology parameter. The transport technical progress of a country means the improvement ratio of its transport technology compared with all its trade partner countries. Here, it is considered that the transport technology between South Asian countries and all their trade partner countries is improved by 10%. The parameter *ams*(*i,r,s*) has been introduced to handle efficiency-enhancing measures that serve to reduce the effective price of imports of goods and services. Shocks to *ams*(*i,r,s*) represent the rate of decay on imports of commodities or services *i* from region *r* imported by region *s*. When *ams*(*i,r,s*) is shocked by 10%, then 10% more of the product becomes available to domestic consumers, given the same level of exports from the source country. To ensure that producers still receive the same revenue on their sales, effective import prices (*pms*) are reduced by 10%. The introduction of this variable facilitates simulation of efficiency improvements such as customs automatization or e-commerce.

The welfare effects of scenario 6 are presented in Table 13.19. The results suggest that large welfare effects would be gained from a 10% reduction in trade costs. In terms of volume, India is shown to experience the largest welfare effect, equivalent to 0.3% of India's GDP. In terms of percentage share of GDP, Nepal would experience the largest effect.

**Table 13.19: Welfare Effects of Scenario 6**

Country/Region	Equivalent Variation (\$ million)	Equivalent Variation as % of GDP
Bangladesh	939.0	1.4
India	3,148.3	0.3
Nepal	669.2	6.5
Pakistan	771.3	0.5
Sri Lanka	1,386.3	4.3
Rest of South Asia <sup>a</sup>	472.7	3.9

GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

The decomposition of the welfare effects under scenario 6 indicates that large welfare effects would derive from the technical change effect, in addition to the allocative efficiency and endowment effects (Table 13.20).

**Table 13.20: Decomposition of Welfare Effects of Scenario 6**  
(\$ million)

Country/Region	Allocative Efficiency	Endowment Effect	Technical Change	Terms of Trade	Investment Savings	Total
Bangladesh	182.9	235.9	386.7	69.0	64.6	939.0
India	962.9	565.4	291.9	1,118.8	209.2	3,148.0
Nepal	97.4	197.6	170.1	50.3	153.8	669.2
Pakistan	88.4	120.1	284.7	142.9	135.2	771.2
Sri Lanka	157.1	462.2	460.0	198.8	108.1	1,386.3
Rest of South Asia <sup>a</sup>	83.7	92.2	181.3	57.3	58.3	472.7

Note: Numbers may not sum precisely because of rounding.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

The reduction in trade costs would also lead to increased exports, imports, and real GDP for all South Asian countries (Table 13.21).

**Table 13.21: Impacts on Exports, Imports, and Real Gross Domestic Product of Scenario 6**

Country/Region	% Change in Exports	% Change in Imports	% Change in Real GDP
Bangladesh	2.0	3.0	1.1
India	1.3	1.0	0.1
Nepal	9.9	15.1	4.4
Pakistan	3.0	2.4	0.3
Sri Lanka	2.3	3.2	3.2
Rest of South Asia <sup>a</sup>	3.4	6.0	2.8

GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

### Scenario 7: Customs union in South Asia; no SAFTA sensitive list in the base simulation; closure of fixed wage rate of unskilled labor in the South Asian countries

One of the important issues in South Asia, as far as the next stage of regional integration is concerned, is the impact of a customs union for SAARC member countries. Identification of a common external tariff (CET) is a problem in the GTAP model, as it applies tariffs for different countries and regions. However, the following approach was applied for inclusion of a South Asia customs union in the GTAP model. First, for six South Asian countries and for each sector, the import-weighted average tariff was calculated for the tariffs of all external trading partners, excluding tariffs for intraregional trade among South Asian

countries. The import-weighted tariffs for the six South Asian countries and 42 sectors were then compared, and the lowest tariff for each sector was considered as the CET.

The welfare effects of the CET with no SAFTA sensitive list in the base simulation suggest that, unlike the welfare effects of SAFTA where in general all the member countries would experience positive welfare gains, the customs union would generate mixed results. Bangladesh, India, and Sri Lanka would experience positive welfare gains, and Nepal, Pakistan, and the rest of South Asia would incur welfare losses (Table 13.22). The welfare gains for India would be huge (2.2% of its GDP).

**Table 13.22: Welfare Effects of Scenario 7**

Country/Region	Equivalent Variation (\$ million)	Equivalent Variation as % of GDP
Bangladesh	811.7	1.2
India	26,986.8	2.2
Nepal	(180.2)	(1.5)
Pakistan	(922.6)	(0.6)
Sri Lanka	374.8	1.1
Rest of South Asia <sup>a</sup>	(206.9)	(1.6)

( ) = negative, GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

Decomposition of the welfare effects suggests that the large welfare gains for Bangladesh, India, and Sri Lanka would be driven by positive allocative efficiency gains and the endowment effects (Table 13.23). However, all South Asian countries, except Sri Lanka, would experience negative terms-of-trade effects. Nepal would experience negative effects across all subcomponents. Pakistan's negative welfare effect would be mainly due to the negative terms-of-trade and investment-savings effects.

**Table 13.23: Decomposition of Welfare Effects of Scenario 7**  
(\$ million)

Country/Region	Allocative Efficiency	Endowment Effect	Technical Change	Terms of Trade	Investment Savings	Total
Bangladesh	409.5	483.7	0.0	(142.9)	61.4	811.7
India	16,063.4	20,943.2	0.0	(8,096.2)	(1,879.5)	27,031.0
Nepal	(6.5)	(19.0)	0.0	(23.5)	(131.2)	(180.2)
Pakistan	445.3	442.8	0.0	(907.3)	(903.5)	(922.6)
Sri Lanka	119.6	222.9	0.0	86.6	(54.3)	374.9
Rest of South Asia <sup>a</sup>	(12.1)	(9.6)	0.0	(65.5)	(119.7)	(206.9)

( ) = negative.

Notes:

1. Effect through technical change is zero because no shock is introduced on technology.
2. Numbers may not sum precisely because of rounding.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

The impacts on exports, imports, and real GDP for Bangladesh, India, Pakistan, and Sri Lanka are positive. India would experience a significant increase in real GDP (by 3%).

**Table 13.24: Impacts on Exports, Imports, and Real Gross Domestic Product of Scenario 7**

Country/Region	% Change in Export	% Change in Import	% Change in Real GDP
Bangladesh	9.5	9.6	1.3
India	13.0	12.4	3.0
Nepal	(10.2)	(8.9)	(0.2)
Pakistan	10.2	4.5	0.6
Sri Lanka	1.5	1.9	1.0
Rest of South Asia <sup>a</sup>	(5.1)	(5.0)	(0.2)

( ) = negative, GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

### Scenario 8: Customs union in South Asia; SAFTA sensitive lists in the base simulation; closure of fixed wage rate of unskilled labor in the South Asian countries

Scenario 8 is exactly the same as scenario 7, except that it considers SAFTA sensitive lists in the base simulation. The welfare effects would be smaller than those under scenario 7, indicating the restricting effects of SAFTA sensitive lists (Table 13.25). The decomposition of the welfare effects is similar to that under scenario 7 (Table 13.26).

**Table 13.25: Welfare Effects of Scenario 8**

Country/Region	Equivalent Variation (\$ million)	Equivalent Variation as % of GDP
Bangladesh	729.6	1.1
India	27,325.4	2.2
Nepal	(453.4)	(3.1)
Pakistan	(900.1)	(0.6)
Sri Lanka	361.0	1.1
Rest of South Asia <sup>a</sup>	(505.0)	(3.7)

( ) = negative, GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

**Table 13.26: Decomposition of Welfare Effects of Scenario 8**  
(\$ million)

Country/Region	Allocative Efficiency	Endowment Effect	Technical Change	Terms of Trade	Investment Savings	Total
Bangladesh	392.9	500.1	0.0	(220.5)	57.0	729.6
India	16,158.6	20,881.4	0.0	(7,818.3)	(1,854.1)	27,367.6
Nepal	(41.3)	(79.6)	0.0	(93.8)	(238.7)	(453.4)
Pakistan	444.9	446.3	0.0	(893.3)	(898.1)	(900.2)
Sri Lanka	129.0	230.1	0.0	56.7	(54.1)	361.6
Rest of South Asia <sup>a</sup>	(75.1)	(41.1)	0.0	(191.7)	(197.4)	(505.3)

( ) = negative.

Notes:

1. Effect through technical change is zero because no shock is introduced on technology.
2. Numbers may not sum precisely because of rounding.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

The presence of SAFTA sensitive lists would reduce the export growth of India by a small margin (Table 13.27). For other countries, the effects would be mixed. Bangladesh would experience larger positive effects, whereas Nepal and the rest of South Asia would experience larger negative effects.

**Table 13.27: Impacts on Exports, Imports, and Real Gross Domestic Product of Scenario 8**

Country/Region	% Change in Exports	% Change in Imports	% Change in Real GDP
Bangladesh	10.9	10.8	1.3
India	12.9	12.3	3.0
Nepal	(11.5)	(12.3)	(0.8)
Pakistan	10.3	4.5	0.6
Sri Lanka	2.1	2.4	1.1
Rest of South Asia <sup>a</sup>	(9.1)	(9.0)	(0.8)

( ) = negative, GDP = gross domestic product.

<sup>a</sup> Comprises Afghanistan, Bhutan, and the Maldives.

Source: Global Trade Analysis Project simulation.

## Conclusion

The simulation results suggest that, in general, SAFTA is welfare creating for the SAARC member countries. A full elimination of tariffs under SAFTA with no sensitive list would be most desirable. However, even a reduction of tariffs to 0%–5% would generate significant gains for the member countries. Clearly, sensitive lists have a restraining effect on intraregional trade in South Asia. A customs union in South Asia would not generate welfare gains for all member countries, and it would generate large imbalances in the distribution of gains. A 10% reduction in trade costs would generate large welfare gains in South Asia, and the magnitude of the gains would be larger than the gains from tariff cuts. Therefore, full implementation of SAFTA accompanied by a reduction in nontariff barriers and improvements in trade facilitation should be the priority for the next phases of regional integration in South Asia.

## CHAPTER XIV

# Integrating South Asia into Regional and Global Value Chains

*Rashmi Banga*

The South Asian economies grew at an average annual rate of 7% during 2000–2012, compared to 5% annually during the 1990s, with the faster growth experienced by almost all countries. However, despite this growth, South Asia is among the least integrated regions in the world. Intraregional exports in South Asia were only 8% of total exports in 2012, compared with 63% in the European Union (EU), 26% in the Association of Southeast Asian Nations (ASEAN), and 21% in the East African Community. Intraregional investment accounts for about 5% of total foreign direct investment (FDI) in the region.

The fast-changing realities of the global economy, with shrinking northern markets, rising south–south trade and investment, and the emergence of global value chains (GVCs), provide new opportunities for South Asia. These new realities also challenge South Asia to integrate more closely the economic structure of the region and to increase the cost competitiveness of its exports. The region can initiate its own regional value chains (RVCs) to gainfully link into GVCs at the higher end and realize South Asia’s untapped trade potential. In addition to boosting economic growth in the largest economies in the region, initiatives to build a network of RVCs linked to GVCs would open new opportunities for the least developed countries (LDCs) to supply RVC-related components and services.

However, to realize these opportunities, a strategic approach is needed both at the national and regional levels. South Asian countries need to identify the products and services for linking into RVCs and GVCs, as well as the final products where cost competitiveness could be improved by sourcing from within the region. Constraints to linking into value chains need to be identified and the required capacities built.

This chapter discusses the strategic interventions that are required at both the national and regional levels to initiate RVCs and link into GVCs.

## Regional Value Chains in the Era of Global Value Chains

GVCs first emerged as RVCs in East Asia, with Japanese investors taking the lead and triggering a “flying geese” pattern of investments and trade.<sup>1</sup> Japanese investors established production bases in several countries in East Asia, and later in Southeast Asia, to access locational advantages and develop export platforms for components in the supply chain. Final assembly took place in a third country from where the finished products were exported either back to the home country or to global markets under the Japanese brand. This fragmentation of production improved the cost competitiveness of the final products, which were then able to compete with products from Western countries. Multinational corporations from Western countries followed this strategy and invested heavily in the region, soon spreading to other regions as well. What emerged from this transformation were GVCs, with production of a product spread across many countries, regions, and continents, gathering cost advantages at each stage to become globally competitive.

RVCs differ from GVCs, as the end product (finished product) is exported by a country in the region (either globally or regionally), while its intermediate products and raw materials are sourced from within the region, rather than globally. RVCs offer opportunities for countries in the region to link into GVCs or to initiate their own. They also offer opportunities for gaining higher value-added compared to GVCs, as the participating countries may be able to link into the higher end of RVCs which may be more difficult to achieve in GVCs. Well-established RVCs would provide the opportunity for South Asian countries to link into GVCs and to increase their bargaining power with the lead firms.

With the emergence of GVCs, the focus of policy makers in South Asia has been on linking into them. However, linking into GVCs may not result in automatic gains in higher value-added in export products, or increased industrialization and employment generation. On the contrary, linking in at the lower end of GVCs could be counterproductive for developing countries and LDCs as it could lead to “hollowing-out”<sup>2</sup> of their manufacturing sectors. Countries could get stuck at the bottom of the value chain, limited to exporting low-end value-added inputs that offer lower gains in terms of domestic value addition.

The distribution of value-added in GVCs is asymmetrical and biased toward countries at the upper end of the value chain. Studies have pointed out the “smiley curve”<sup>3</sup> in GVCs, which shows that value captured by services in GVCs is much higher than that for manufacturing. Countries contributing pre-manufacturing and post-manufacturing

<sup>1</sup> Akamatsu’s third flying geese paradigm is a model for international division of labor in East Asia based on dynamic comparative advantage. The paradigm postulates that Asian nations will catch up with the West as part of a regional hierarchy where the production of commoditized goods would continuously move from the more advanced countries to the less advanced ones. The underdeveloped nations in the region could be considered to be “aligned successively behind the advanced industrial nations in the order of their different stages of growth in a wild-geese-flying pattern”.

<sup>2</sup> It is the deterioration of a country’s manufacturing sector when producers opt for low-cost facilities overseas.

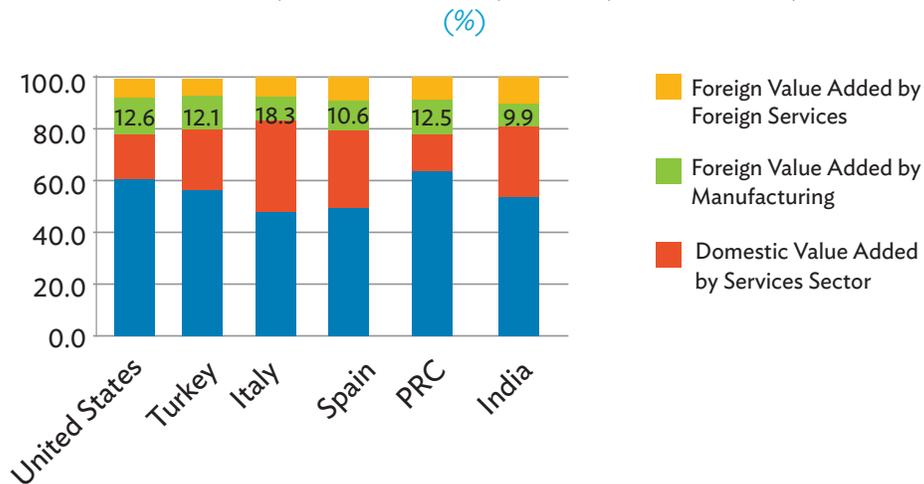
<sup>3</sup> The deepening smile curve shows where the value is captured in today’s GVCs—value is high in the design and conceptual stage of the value chain, falls at the manufacturing section, then climbs up in the final sales and marketing end of the GVC. However, most developing countries are in the lower value manufacturing section of the GVC, and even then, this is true for some but not all developing countries.

services, such as designing, branding, and marketing, are able to capture a much higher value in GVCs compared to countries that provide inputs and manufacture the products. Banga (2014) has shown that 67% of total value created through GVCs accrues to members of the Organisation for Economic Co-operation and Development (OECD), while the share for newly industrialized countries and BRIC countries<sup>4</sup> is only 25%. More dramatically, only 8% of total value-added is shared among all other developing countries and LDCs.

Figure 14.1 shows the structure of gross value-added for selected exports in textiles, textile products, and leather and footwear industry categories for the top six exporting countries in the sector—the People’s Republic of China (PRC), India, Italy, Spain, Turkey, and the United States (US). This type of analysis can help assess the extent of imports and exports that takes place within GVCs. Domestic manufacturing contributes 50% of the total value-added of Italy’s gross exports in this sector, while domestic services contribute 35%. Foreign services contribute 7% of foreign value-added, while foreign manufactures contribute only 8% of the value-added of Italy’s exports in this sector. In the top six exporters for this sector, foreign value-added by the manufacturing sector contributes less than 13% of total value-added. This implies that if developing countries want to link into GVCs formed by Italy or the US, they can at best expect to contribute about 10%–12% of the total value of gross exports in this sector.

Further, the 10%–12% of foreign value-added for this sector is shared among many countries. The total value-added created in global exports of this sector is determined

**Figure 14.1: Contribution of Manufacturing and Services in Global Value Chains of Textiles, Textile Products, Leather, and Footwear, 2009**



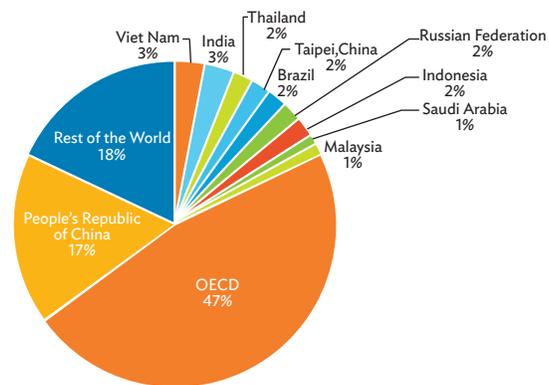
PRC = People’s Republic of China.

Source: Author’s estimate based on the World Trade Organization–Organisation for Economic Co-operation and Development dataset on Trade in Value-Added. <http://www.oecd.org/industry/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm> (accessed 5 May 2013).

<sup>4</sup> BRIC comprises Brazil, the Russian Federation, India, and the People’s Republic of China.

by adding the backward linkages (i.e., foreign value-added in gross exports) and forward linkages (domestic value-added in gross exports of other countries) of all countries. Estimates of the shares of each country in the total value-added created show that the OECD accounts for 47% of total value-added traded in this industry, including 7% by the US. The PRC's share is the largest at 17%. Africa, Latin America, South Asia (other than BRICS countries), and other East and Southeast Asian countries share about 18% of total value-added in this industry (Figure 14.2).

**Figure 14.2: Participation in Global Value Chains of Textiles, Textile Products, and Leather and Footwear Industry**

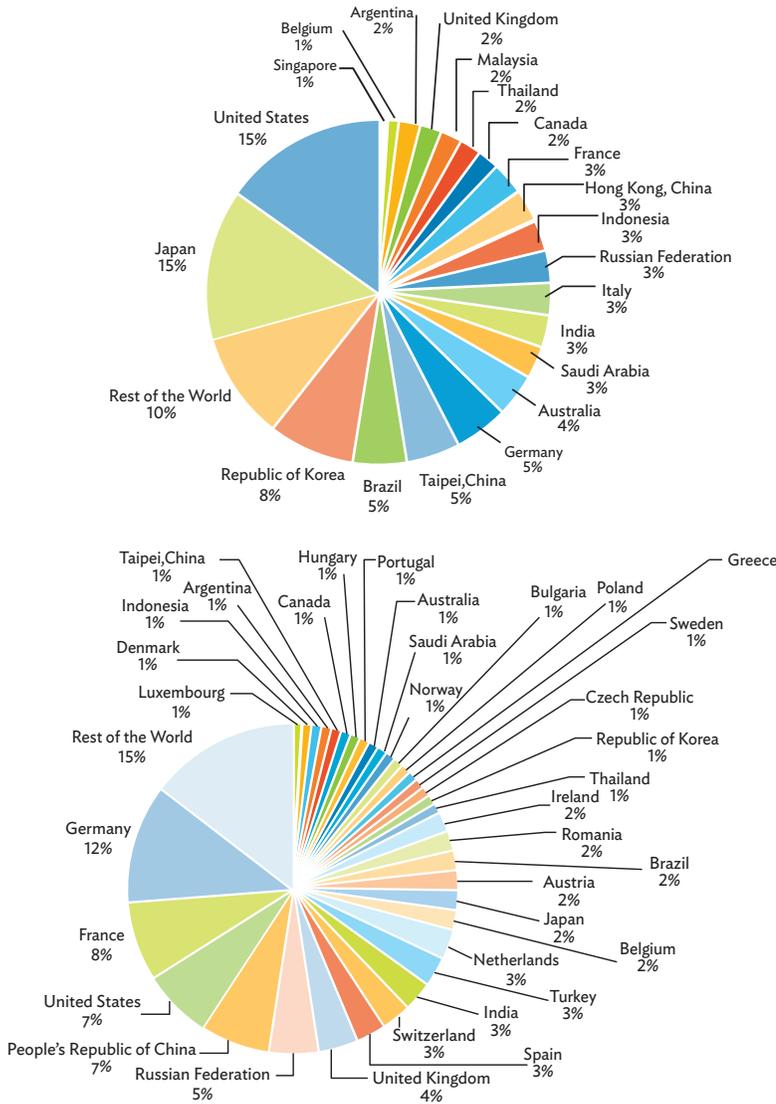


OECD = Organisation for Economic Co-operation and Development.

Source: Author's estimate based on the World Trade Organization–OECD dataset on Trade in Value-Added. <http://www.oecd.org/industry/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm> (accessed 5 May 2013).

Figure 14.3 shows the direct and indirect contributions of different countries through foreign value-added in the gross exports of the PRC and Italy in the textiles, textile products, and leather and footwear industries. With the exception of India, South Asian countries are not covered separately by the dataset; they are grouped under “rest of the world.” Given that the share of foreign value-added by manufacturing does not exceed 13%, it is clear that the extent to which any South Asian country, including India, can gain by adding value in exports of final products is limited.

**Figure 14.3: Global Value Chain in Textiles, Textile Products, Leather, and Footwear of the People’s Republic of China and Italy**



Source: Author’s estimate based on the World Trade Organization–Organisation for Economic Co-operation and Development dataset on Trade in Value-Added. <http://www.oecd.org/industry/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm> (accessed 5 May 2013).

## South Asia's Untapped Potential for Regional Trade and Regional Value Chains

Given the limited scope of capturing value in GVCs, South Asian countries may be able to benefit more by linking into or initiating their own RVCs. As they develop their capacities and capabilities, these RVCs will help them link more beneficially into GVCs. While there is a high potential for intraregional trade in South Asia, the current low level of regional trade poses a challenge in forming RVCs. If the scope of this potential is better understood, however, interest in RVCs will increase.

To estimate the potential for intraregional trade, a gravity model-based analysis for the region was undertaken. Originally utilized by Tinbergen (1962) for international trade, the gravity model predicts bilateral trade flows between any two countries as a positive function of their size and as a negative function of the distance between them. Gravity is expected to explain a major portion of intra-country trade and, therefore, can be used to estimate the potential trade in any sector between two countries or in a region.

The potential for intraregional trade was estimated for 2000–2010 using dynamic panel data estimations, i.e., generalized method of moments (GMM) (Arellano and Bond 1991). Earlier studies have used a static model, which may yield biased results as trade is a dynamic process.<sup>5</sup> The trade data are from the United Nations Commodity Trade Statistics Database (UN Comtrade), whereas size variables are from the World Bank World Development Indicators. Distance variables are from the CEPII database. Afghanistan was not included in the analysis because of the lack of data on critical variables. Estimates of potential intraregional trade based on the gravity model involved the following steps:

$$\ln T_{ijt} = \beta_0 + \beta_1 \ln T_{ijt-1} + \beta_2 \ln(\text{POP}_i \times \text{POP}_j) + \beta_3 \ln(\text{GDP}_i \times \text{GDP}_j) + \beta_4 (\text{Distance}_{ij}) + \beta_5 (\text{Tariff}_j) + e_{ijt}$$

where

$T_{ijt}$  = bilateral exports between countries  $i$  and  $j$  in time  $t$ ,

$\text{GDP}_i$  = gross domestic product (GDP) of country  $i$  at point  $t$ ,

$\text{GDP}_j$  = GDP of country  $j$  at point  $t$ ,

$\text{POP}_i$  = population of country  $i$  at point  $t$ ,

$\text{Pop}_j$  = population of country  $j$  at point  $t$ ,

$\text{Tariff}_{jt}$  = simple average of tariffs in the importing country, and

$e_{ijt}$  = error term.

<sup>5</sup> For detailed discussion, see Eichengreen and Irwin (1997) and Bun and Klaassen (2002).

South Asia has high tariffs in some sectors, especially in agriculture products (e.g., coffee and tea) and non-agriculture products (automobiles, clothing, and leather products).

All the estimated coefficients in the model show expected signs, and are statistically significant. The results show that actual trade in the region has been much lower than the potential trade (Table 14.1). During 2000–2010, intraregional exports averaged \$8.8 billion annually, whereas potential annual intraregional exports were estimated to have been about \$26.6 billion. This shows that South Asia realized only one-third of its potential trade. In 2010, intraregional trade amounted to \$16.6 billion, while the potential was about \$48.6 billion.

RVCs could be an important means for tapping the potential for intraregional trade. The United Nations Conference on Trade and Development (UNCTAD) has identified three sectors for forming RVCs in South Asia: textiles and clothing, leather and leather products, and processed foods (UNCTAD 2014a). The criteria adopted are simple: (i) Using the broad economic categories, Harmonized System (HS) 6-digit products were categorized as inputs and outputs. (ii) Products that have available outputs (final products) and inputs (raw materials and intermediate products) within the region were selected. (iii) From this list, products that have both exporters of inputs and exporters of associated outputs within the region were selected. Additional criteria adopted were the employment-generating nature of the products and the scope for many countries to link into the RVC.

To identify how South Asian countries could link into RVCs in these sectors, three lists were developed for each country for each of the identified sectors: (i) potential outputs of exports to the region where intraregional demand exists, or global exports where regional demand is lower than supply; (ii) potential intraregional imports of inputs from the region that can be sourced at a cost lower than existing costs, also taking into account that the region has the supply capacity; and (iii) potential regional investment sectors in which the

**Table 14.1: Potential and Actual Intraregional Exports in South Asia, 2000–2010 (\$ million)**

Year	Estimated Potential Intraregional Exports	Actual Intraregional Exports	Potential Trade Gap
2000	12.6	2.9	9.7
2001	13.9	3.3	10.6
2002	15.2	3.7	11.5
2003	17.5	5.6	11.9
2004	20.5	6.9	13.6
2005	24.2	9.1	15.1
2006	28.4	10.0	18.4
2007	33.3	12.0	21.3
2008	36.7	15.2	21.5
2009	42.2	11.7	30.5
2010	48.6	16.6	32.0
<b>Total</b>	<b>293.1</b>	<b>97.0</b>	<b>196.1</b>
<b>Average</b>	<b>26.6</b>	<b>8.8</b>	<b>17.8</b>

Source: Author's estimation.

country is competitive but lacks supply capacity, and where there is a country in the region that is capable of investing.

However, although South Asian countries may be sufficiently competitive to link into RVCs, this will not happen automatically and cannot be left to market processes. Targeted and strategic policy interventions are needed at both the regional and national levels. These include short-term actions for increasing intraregional trade and investment as well as long-term planning to address domestic constraints and improve the capacity of the country to productively integrate with the region. The next two sections discuss the actions required at the regional level and the required capacity-building at the country level for linking into and initiating RVCs.

## Strategies for Initiating Potential Regional Value Chains

Although many initiatives have been undertaken at the regional level in South Asia to promote intraregional trade in goods and services, forming RVCs requires additional efforts and strategies combined with a targeted approach and political will. The private sector in the region needs to be drawn more closely together and the dynamism of intraregional trade and investment unlocked. Some of the policies and strategies that are needed include (i) boosting regional investment, (ii) forming industry-specific regional associations, (iii) promoting common regional labels, (iv) supporting the setup of regional design studios and joint research and development (R&D) in the identified industries, (v) accelerating trade facilitation, (vi) deepening intraregional trading arrangements, (vii) improving telecommunication infrastructure, (viii) mobilizing regional resources, and (ix) collaborating in setting common policy directions for the identified industries as having the potential to form RVCs.

### Intraregional Investment Agreement in South Asia

Intraregional FDI is almost nonexistent in the textiles and clothing, leather and leather products, and food processing industries. A regional investment agreement for South Asia is needed to attract intraregional and interregional FDI in these industries. The ASEAN Comprehensive Investment Agreement, 2009 could serve as a model as it covers both FDI and portfolio investment. The agreement provides for national treatment to investors with respect to admission, establishment, acquisition, expansion, management, conduct, operation, and sale or disposition of investments. Other protection to investors includes clauses prohibiting a requirement for senior management positions to be filled by people of a particular nationality, and the right of entry and temporary stay for foreign personnel associated with the investment. A regional investment agreement for South Asia would go a long way in promoting intraregional FDI and RVCs.

### Setting Up Regional Industry-Specific Associations

The way forward in promoting regional integration and RVCs depends critically on the sharing of information and knowledge within the region. The textiles and clothing, leather and leather products, and food processing industries are traditional industries in South Asia. They employ a large proportion of the workforce in both the organized and unorganized sectors and engage micro- and small and medium-sized enterprises (SMEs). These

industries, therefore, have been a policy focus for boosting development in the region. While a lot of effort at the national level is being invested in modernizing the industries and to strengthen their export performance, attention is also needed at the regional level. High interregional tariffs still prevail, especially for leather products and clothing. Protection of domestic markets against competition has resulted in a large untapped potential for intraregional trade. It has also prevented these industries from taking advantage of large pools of low-cost resources within the region. Investors in the region have been hesitant to enter these industries. This has led to declining cost competitiveness and lack of supply capacities within the region, even to fulfill regional demand, leading to a surge in imports of finished products from other countries.

Regional industry associations should be established for the three identified industries with potential for forming RVCs. Associations, such as a South Asia textiles and clothing association, can play an important role in promoting intraregional investment, and information and technology (IT) sharing. They can also play pivotal roles in harmonizing technical standards within the region, thereby facilitating intraregional trade in intermediate products as well as final products.

Examples of industry associations in other regions could be useful as a basis for discussing the appropriate structure and administrative arrangements for similar associations in South Asia. A good example of this is the COMESA Leather and Leather Products Institute, which is a regional industry association for Eastern and Southern Africa. Another example is COTANCE, a nonprofit organization founded to represent the interests of the European leather industry, especially for the tanning subsector. The members of COTANCE meet twice a year to exchange information and identify areas of cooperation and collaboration. South Asia is in the process of establishing the Leather Industry Association of South Asia, which was initiated under a project supported by UNCTAD and the Asian Development Bank (ADB) (2014a).

Regional industry associations in South Asia could help in voicing common interests and concerns of their industries in international forums and in improving their bargaining power in multilateral, bilateral, and other free trade agreements. Collaboration and discussion among private sector representatives in the region could lead to important decisions on nontariff barriers and links to GVCs. Further, regional industry associations would help in building the much-needed trust and confidence among the private sectors in the region.

### **Regional Branding and Common Label**

Common labels for branding regional products, especially leather products, would help in forming RVCs in South Asia. Common labels have proved to be very beneficial in Brazil and Turkey. These countries have positioned themselves in global markets through branding and product differentiation, especially in leather garments, leading to the creation of niche markets. Labels such as Ecotox, which indicates the quality and eco-friendliness of the product, have proved effective in promoting the products. Such labeling should be explored in South Asia. Regional industry associations could help in establishing common brands for the region's products.

Design studios need to be established in the region for the clothing, leather, and other industries, drawing on expertise from the PRC, Italy, and other countries. Regional

cooperation in services could generate tremendous gains, given that pre-manufacturing services such as R&D as well as design and post-manufacturing services such as branding and marketing are so important in adding value to exports. This could lead to the formation of successful RVCs through which would enable South Asian countries to capture much higher value than they could from participating in GVCs.

### **Technology Sharing and Joint Research and Development**

There are many successful projects in Bangladesh, India, Pakistan, and other countries in the region involving the innovative use of technology in the textiles and clothing, tannery, and food processing industries. For example, the Central Leather Research Institute in Chennai has successfully developed a biorefinery to produce biodiesel, bioethanol, biohydrogen, and biomethane from tannery solid waste. The University of Veterinary and Animal Sciences, Lahore and the Pakistan Tanners Association have signed a research project for the identification of skin diseases in animals and the geographical patterns of these diseases. Bangladesh has upgraded its textile machinery. Joint ventures help promote R&D, and collaborative efforts help develop synergies among different projects. Intraregional investment could lead to technology interchanges, which could be instrumental in promoting RVCs in these industries.

### **Accelerating Customs and Logistics Procedures**

Trade facilitation measures are critical for generating intraregional trade momentum and forming RVCs. Many studies have highlighted the gains possible from more rapid and streamlined customs and logistics procedures. Reduced transit time leads to lower production costs, which are vitally important for countries and regions seeking to participate in value chains. According to the Wilson and Otsuki (2007), the category of trade facilitation that will produce the greatest gains is service sector infrastructure, followed by efficiency in air and maritime ports. South Asia requires upgraded ports and communication infrastructure, together with continued reforms in customs clearance procedures and regulatory harmonization. Many countries in the region have undertaken substantive trade facilitation measures, but further measures are required.

Under the WTO Trade Facilitation Agreement, India could help LDCs in the region build capacity for trade facilitation. South Asian countries should identify their hard and soft infrastructure priorities and expedite improvements in regional infrastructure. Harmonization of customs regulations under the agreement will help facilitate the movement of intermediate goods and the formation RVCs.

### **Accelerating and Deepening Intraregional Trading Arrangements**

Intraregional value chains require intraregional cooperation and trade agreements. A large number of sensitive products (negative list) and nontariff barriers prevent the South Asian Free Trade Area (SAFTA) agreement from having a greater impact on trade integration in the region, especially with regard to the identified industries with potential for RVCs. Harmonization of regulations and procedures, along with lower tariffs and reduced nontariff trade barriers, are some of the measures critical for reducing transit costs and time at border points. Mutual recognition agreements and targeted policy reforms, especially sanitary and phytosanitary (SPS) standards and technical barriers to trade, are important for regional trade in agriculture. Although there is a system under SAFTA whereby

members are required to report on their nontariff barriers, there is no adequate monitoring mechanism.

### **Improvements in Telecommunication Infrastructure**

Efficient road and rail infrastructure is imperative for reducing transport time and direct costs, and maintaining the quality of intermediate and final products. Ports and cargo-handling facilities are an important part of the infrastructure, as are inexpensive and reliable communication networks for ensuring that the correct goods are shipped at the correct time between production nodes in a value chain. Therefore, reducing the transaction costs of trade includes improving the means of communication within and across national borders. These services entail positive externalities, underscoring the significant benefits of regional cooperation (Brooks 2008). FDI, especially from India, could play a catalytic role in expanding and strengthening telecommunication infrastructure in the region.

### **Mobilization of Regional Resources**

The development and expansion of RVCs requires capital investment in establishing or expanding firms. Sources of investment capital could be internal or external. For LDCs, the main source of external investment capital is FDI. It is important that South Asian countries define (and emphasize) their comparative advantages and provide the necessary information to potential investors. Increased production is likely to result from firms located in the more advanced economies in the region. Therefore, attention needs to be paid to the regional flow of FDI and to improving the investment environment in the LDCs. Another source of finance that can be tapped is intra-firm trade credit. Larger or better-financed firms may be able to provide trade credit to less well-financed firms within their network if given the right incentives, such as tax concessions, insurance, and limited guarantees.<sup>6</sup> This could have the added benefit of making production within value chains more attractive to nascent firms. ADB, the World Bank, and other development partners can be expected to support the formation of RVCs.

### **Common Policy Goals for Industries with Potential for Regional Value Chains**

Other regions are now moving toward common industrial policies, for example, the Economic Community of West African States has adopted the West African Common Industrial Policy. While this may be too advanced a step for the South Asian Association for Regional Cooperation (SAARC) at this stage, SAARC should pursue common goals and policies for industries with the potential for forming RVCs. For the food processing, textiles and clothing, and leather industries, common goals for the region should be set and policies and incentives adopted for promoting regional integration through trade and investments. Special regional initiatives could be taken to integrate South Asia's LDCs into RVCs for these industries, including special incentives for sourcing raw materials or intermediate products from the LDCs. Special incentives could also apply to FDI if production bases are established in LDCs.

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<sup>6</sup> Inter-firm financing through trade credit was an important tool in the early industrialization of Japan.

### Linking into Global Value Chains in Textiles and Clothing: Experience of Bangladesh and Sri Lanka

Regional initiatives and incentives can help countries link into RVCs or GVCs, but this will only be effective if the required capacities and capabilities are established at the national level. Many developing countries that have linked into GVCs find themselves “locked-in” at the bottom of the chain, unable to add value to their exports or in reality “locked-out” of the GVC. Commodity exporters, especially in Africa, appear to be trapped in such situations. Middle-income and newly industrialized countries—Indonesia, Malaysia, the Philippines, and Thailand—are finding their trade figures increasing but with little growth in domestic value-added. They are unable to graduate to more sophisticated, higher-end exports and move out of the middle-income trap. Many other developing countries and LDCs, especially in Africa, Latin America, and South Asia, are finding themselves locked-out of GVCs.

Some countries have, however, been able to respond to the changing patterns of trade and link selected sectors into GVCs, leading to increased exports, production, employment, and overall economic growth. Many external as well as internal factors have contributed to these highly beneficial links, including access to quotas, preferential trade agreements, specific policies with respect to FDI and trade, formation of clusters, and complementary efforts to improve the trade infrastructure and environment for investment. Much can be learned from these experiences, even if the initial conditions of South Asian countries differ. The following sections describe how Bangladesh and Sri Lanka have been able to link into GVCs in the textile and clothing sector and how Chile and the PRC have linked into GVC in the food processing industries.

## Bangladesh: Success Story in Linking into Global Value Chains and Developing Backward Linkages

### Emergence of Bangladesh’s Textiles and Clothing Industry

The textiles and clothing industry was not a traditional export-oriented industry of Bangladesh, and exports were virtually nonexistent until the early 1980s. Rapid development of the industry began in the late 1980s and early 1990s, boosted by the available quotas under the Multi Fibre Agreement (MFA) and preferences under the Generalized Scheme of Preferences (GSP). The industry has developed very rapidly since 2000, and its share in total GDP increased from 4.0% in 2001–2002 to 5.6% in 2009–2010. In 2009–2010, it accounted for about 46% of total capital formation in the manufacturing sector. The industry is exclusively owned and managed by the private sector, both foreign and domestic.

The importance of the industry can be judged from the fact that in 2010, the garments sector accounted for 76% of Bangladesh’s total exports and textiles accounted for another 8%. Further, the industry provided employment for 7.5% of the total workforce and accounted for 75% of employment in the formal manufacturing sector. Some 4 million people—mainly women—are employed in the garment and textile industry, with wages

135% higher than the national average.<sup>7</sup> The industry has not only increased women's employment, but has also had important socioeconomic implications. A factory job has become one of the few socially acceptable ways for uneducated and low-skilled women to earn a living. In 2010, Bangladesh's exports of ready-made garments totaled \$15 billion, and the WTO declared Bangladesh to be the second-largest exporter in the world, after the PRC. Bangladesh retained its position in 2012 with exports of ready-made garments worth \$19 billion.

### **Initiating Links to Global Value Chains through Foreign Direct Investment Attracted by Quotas and Preferences**

The textiles and clothing industry in Bangladesh has been a quota- and preferences-induced industry. In the mid-1980s, foreign investors set up production bases in Bangladesh to access its abundant supply of low-cost labor and to take advantage of quotas and preferences available under the MFA and GSP schemes of the European Union (EU) and the United States (US). Investors from the PRC (including Hong Kong, China), Japan, the Republic of Korea, Malaysia, and Taipei, China were instrumental in helping to build the industry in Bangladesh.

The industry was linked into GVCs mainly through the clothing or apparel industry, providing a classic example of a buyer-driven GVC in contrast to a producer-driven GVC. Profits in this kind of chain are generated largely from services, such as designing, branding, and marketing.<sup>8</sup> Some of the lead firms that established links with Bangladesh's textile and clothing industry were European, Japanese, and US firms, such as JC Penney, The Gap, Levi Strauss, H&M, Marks and Spencer, and Uniqlo. The entry of foreign firms was mainly in the assembly line of the clothing sector. The apparel manufacturer is responsible for cutting, sewing, trimming, and/or shipping the ready-made garment. The buyer purchases the fabric and supplies it to the manufacturer, along with detailed manufacturing specifications. The contract manufacturer has a variety of customers and does business on an order-by-order basis.

### **Encouraging Clusters through Economic Processing Zones**

The entry of foreign investors into the assembly stage of the textile and clothing industry was accompanied by government efforts to harness domestic capabilities and resources. Industry clusters were encouraged to promote synergies and increase collective efficiency. The Bangladesh Export Processing Zone Authority was established in 1980, and the first export processing zone (EPZ) was created in 1983 in Chittagong; this was followed by another EPZ in Dhaka in 1993. EPZs provided competitive advantages to firms, including tax holidays, exemption from dividend tax, and duty-free imports. In 2009, 48 of the 65 largest projects in EPZs in Bangladesh were in the textiles and garments value chain (BEPZA Annual Report 2008–2009).

In addition to the large number of foreign investors in Bangladesh that were attracted by low-cost labor and quotas and preferences, domestic investors were a major presence, encouraged by the same factors. Of 1,654 investment projects registered during 2003–2011, only 181 (11%) were foreign-owned; however, because of their large scale,

<sup>7</sup> These figures are taken from UNCTAD (2012).

<sup>8</sup> See Greffi and Memedovic (2003).

the foreign-owned projects constituted a major share of employment and capital formation. None of the 25 biggest plants in Bangladesh was domestically owned.

### **Foreign Direct Investment Policies to Encourage Backward Linkages**

One of the important lessons from the experience of Bangladesh in developing its textile and clothing industry is the emphasis on backward linkages. Until 2005, EPZ regulations required FDI to be associated with backward-linkage industries (spinning and/or weaving, and/or knitting, dyeing, and finishing). As a result, 18 of the 25 largest investment projects by foreign firms were in textiles and only 7 were in garments. In knitwear, about half of the mills were composite mills that integrate the entire production process, while the other half specialized in one or more steps. About 65% of the fabric and yarn for woven garments is imported. In the 1980s, the apparel industry of Bangladesh was concentrated mainly in the manufacturing and export of woven garments. In the early 1990s, the knit section of the industry emerged, surpassing woven exports by the mid-2000s.

The Government of Bangladesh offers many incentives to encourage backward linkages and develop the textiles sector. Imports of capital machinery, some spare parts, and dyes and chemicals are granted a concessionary rate of duty; imports of cotton are duty-free. A subsidy of 5% (of the free on board export price) for garment exports is offered conditional upon meeting a local content requirement. Many of the government's support policies target the use of locally produced fabrics in the garment industry.

Backward linkages led to industrial upgrading in the textiles and clothing industry, and are primarily associated with favoring the producers, rather than the buyers and suppliers. Through the emphasis on FDI-related backward linkages, the textile industry in Bangladesh has developed rapidly, giving a competitive edge to domestic producers and increasing their bargaining power.

### **Public Sector Investments in Backward Linkages: Growing the Textiles Sector**

Not only has the Government of Bangladesh designed FDI policies to encourage backward linkages, it has also invested in textile mills. Both the public and private sectors are active in textiles. All public sector mills come under the control and regulation of the Bangladesh Textile Mills Corporation, which is more important as a regulator than as a producer. The traditional textile industry (targeting the domestic market) was not linked to the export-oriented garments sector. However, over time, due to emphasis on backward linkages, a new textile sector has emerged, which is directly linked to the export-oriented knitwear and woven garments sectors as part of the full value chain.

Nevertheless, there is still potential for supplying additional fabric to the garments sector, as less than 40% of woven garments are based on domestically produced yarns and fabrics (Leishman and Hussain 2010). The textile sector is itself subdivided into a number of activities, including spinning, weaving, and fabric processing. Most, if not all, private sector firms are members of the Bangladesh Textile Mills Association. According to the association, more than €4 billion has been invested in these mills. The growth of the textile spinning subsector has been exceptional: in 2011, 385 spinning units were registered with the association, with a combined capacity of 8.7 million spindles, compared to only 84

spinning units and 1.7 million spindles in 1995. This has resulted in a fourfold increase in yarn production and a threefold increase in cloth production during 1995–2010.

However, a new opportunity and challenge now confronts the Bangladesh textiles industry. In 2011, the EU's rules of origin (RoO) changed from two stages to one stage of the production process, to allow imports under the GSP facility. This has provided additional momentum for Bangladesh's exports of garments. Bangladeshi exporters that use imported fabrics to produce garments in Bangladesh and then export them to the EU market are generally eligible for GSP benefits under this new rule. This has increased Bangladesh's export volume to the EU and may also help diversify the range of garment products exported. However, it is a negative development for Bangladesh's textiles sector because domestic garments producers do not need to source textiles domestically to benefit from the EU GSP preferences.

### **Development of Workforce Skills: Role of Private Sector**

According to the Bangladesh Garment Manufacturers and Exporters Association (BGMEA), Bangladesh lacks skilled workers and textile technologists in the apparel sector at both the machine operator and mid-management levels. At the operator level, the skills gap is about 25%. By 2015, it is estimated that the entire textile and apparel complex will need 70,654 textile technologists, which is 65,000 fewer than the current number of degree holders in the industry. Workforce initiatives to close this gap have been implemented by buyers, local firms, the education sector, and the government.

Formal training for skills development of the workforce began toward the end of the 1980s at the initiative of the BGMEA and the Bangladesh Knitwear Manufacturers and Exporters Association, with the support of donor agencies. In the 1990s, foreign firms were providing in-house training programs through technical assistance provided by buyers (Elmer 2010). Foreign buyers also established small-scale training academies and technical assistance projects financed in part by their preferred suppliers. In 1995, the public sector started technical and vocational education and training programs to supply the garment industry with qualified workers at both the operator and mid-management levels (Elmer 2010). These workers were subsequently trained on-the-job by their supervisors. Mid-management positions were filled by foreign workers from countries such as India and Sri Lanka.

Not only did the industry associations provide training to improve skills, they also developed new skills, particularly in design and fashion. The BGMEA Institute of Fashion and Technology (BIFT) was established in 1999; its courses focused on market-oriented skills needed by mid-management professionals and fashion designers for the garments industry. Graduates were absorbed almost entirely by the garments industry. BGMEA initially hired a team of foreign lecturers with support from the International Finance Corporation, but the BIFT has since become a self-financing institution with revenues collected from student fees. The BIFT has maintained collaboration with the London College of Fashion (the United Kingdom [UK]), Nottingham Trent University (UK), and Niederrhein University (Germany). It has been accredited as a university, becoming the BGMEA University of Fashion and Technology, which aims to produce technically competent graduates for the garments industry.

## Sri Lanka: Success Story in Upgrading and Climbing the Global Value Chain

### Textiles and Clothing Industry of Sri Lanka

Sri Lanka's experience in linking the textiles and clothing industry into GVCs is similar to that of Bangladesh. Growth in the industry was triggered by a wave of FDI to take advantage of the quotas and preferences that Sri Lanka enjoyed. Ready-made garments were more dominant in the case of Sri Lanka, as most FDI was in the clothing sector. However, unlike Bangladesh, Sri Lanka has not been able to develop backward linkages to strengthen its textiles sector, and is still heavily dependent on imports of textiles from Bangladesh, the PRC, India, and Pakistan. Although the government has tried to develop backward linkages by attracting FDI in the textiles sector, the sector remains underdeveloped mainly because of the high cost of machinery, nonavailability of local raw materials (cotton or synthetic), and the high cost of electricity, which is the highest in the region.<sup>9</sup>

Since the early 1980s, the apparel sector has developed rapidly in Sri Lanka, with both foreign and domestic investments benefiting from the available quotas and preferences. In 2011, the apparel industry employed 283,000 workers, and total exports of apparel were \$4.2 billion, accounting for about 40% of the country's exports. Although FDI initiated growth in the industry in Sri Lanka, the domestic private sector soon caught up and is now dominant.

### Product and Functional Upgrading: Role of Foreign Direct Investment, Government, and the Private Sector

Sri Lanka's apparel sector has strengthened greatly during 2000s and 2010s, with the result of creating niche markets for its products. Transformation of the sector has involved product upgrading (production of more complex and sophisticated products) as well as functional upgrading (upgrading into apparel designs). Conscious efforts were made to graduate to high value-added and complex products, such as women's undergarments. These new products experienced exceptional export growth. FDI, the government, and the domestic private sector all contributed to the process of upgrading. However, the phasing out of MFA quotas in 2005, the possible loss of the GSP, and the expiry of the PRC's safeguards drove innovation in the industry. Fear of losing market shares in the EU and the US led to proactive initiatives to improve the competitiveness of the industry.

An initial facilitating factor for product upgrading was the link developed with major global buyers, primarily The Gap, Marks and Spenser, Victoria's Secret, and Nike. These buyers provided guarantees for future orders and facilitated asset-specific investments.<sup>10</sup> These four buyers accounted for about half of Sri Lanka's apparel exports in the early 2000s. Guaranteed orders propelled domestic investment in complex products, with support in designing and branding from the foreign investors. Domestic investors set up in-house design teams for product development and established marketing offices in Delhi, London,

<sup>9</sup> See Fernando (2002).

<sup>10</sup> See Stark et al. (2011).

New York, and other key markets to reduce lead time, work closely with brand owners, and access the customers directly.<sup>11</sup>

Workforce development has been high on the government's agenda. In collaboration with foreign institutes, the government has initiated industry-specific training and professional institutes focused on creating a specialized professional workforce that can cater to all industry requirements, including designing, marketing, and branding. The industry has also been very active in taking initiatives to increase its competitiveness, with support from the government. The industry, represented by the Joint Apparel Association Forum (JAAF), is helping firms to become total service providers, and to develop their own brands. JAAF initiatives include facilitating intra-industry technology transfers, contracting arrangements, and sourcing of inputs from India and Pakistan. The success of these initiatives is reflected in domestic firms such as MAS and Brandix, which now have their own brands, design centers, and in-house product development expertise. The JAAF has also initiated many design and fashion institutions in collaboration with foreign institutions.

As a result of this progress, the industry has been able to upgrade its position in GVCs. During 2000–2008, it transitioned from having 80% of its production in low-value products to having 50% of its products in higher value items for specialty and department stores. A significant portion of apparel sector now provides full manufacturing services, input sourcing, and product development and design services. To date, there has been only limited success in product branding.

## Linking into Global Value Chains in Food Processing Industries: Experience from Chile and the People's Republic of China

### Shaping-Up of Global Value Chains in Food Processing Industries

With rising incomes, changing diets, increasing urbanization, and heightened awareness of health and safety measures, the demand for fresh fruits and vegetables (FFV) is growing. In turn, the mode of trading in this sector is changing rapidly. With the evolution of GVCs and the spread of supermarkets, the traditional wholesale markets are losing their importance in many developing countries, and fewer and larger firms are slowly dominating the food supply chain. Countries that are important horticulture producers and exporters must develop regional and global links with large marketing entities. The continuously increasing demand for FFV is also driving the large retail chains to source from multiple countries to exploit the advantages of differences in climatic zones and growing seasons around the globe. These dynamics have made GVCs in FFV mostly buyer-driven. The chain has three main nodes: production for export, packaging and cold storage, and processing.

The FFV export industry provides an important source of employment and income for low-skilled labor in developing countries. However, increasing competition among suppliers in developing countries and growing enforcement of stringent standards have made it extremely difficult to link gainfully into GVCs. Nevertheless, some developing countries

<sup>11</sup> See Wijayasiri and Dissanayake (2008).

have been able to use RVCs to improve their competitiveness and source the services they lack, such as packaging, to be able to supply their products to big retailers. The experience of Chile and the PRC in linking into GVCs is instructive. Chile offers lessons on how to link to and upgrade in GVCs and meet the challenge of rising standards for exports of FFV. The PRC offers experience in the use of clusters for linking small growers to GVCs. Both countries provide important lessons on the role of innovation and institutions.

### **Chile's Experience in Linking into Global Value Chains for Fresh Fruits and Vegetables**

Chile has rapidly developed its FFV subsector, and its horticulture industry has been able to link into and upgrade its position in GVCs. The industry comprises 7,800 growers and has 630 companies that export about 80% of the country's total production of FFV. In 2012, exports of FFV reached £5 billion. Chile is the world's largest exporter of grapes and the second-largest exporter of kiwi fruit and avocados. The country's primary Southern Hemisphere competitors are Argentina, Australia, New Zealand, and South Africa. Chile has surpassed Argentina in terms of its share of the European market.

The public and private sectors have worked together proactively to generate the success of Chile's FFV industry, with the private sector taking the lead. Some of the key lessons from Chile are the roles played by the government and industry in facing the challenge of rising private and global standards.

#### *Rising Sanitary and Phytosanitary Regulations in Key Markets and Chile Good Agriculture Practices*

Since the mid-1990s, one of the key challenges facing exporters in developing countries has been the increasingly strict sanitary and phytosanitary (SPS) standards, which define the new safety and quality standards imposed by global buyers. In response, the Government of Chile and the private sector, through the Chilean Fresh Fruit Association, worked together to proactively implement Chile's safety and quality standards and good agricultural practices. In the 1980s, Chile foresaw the emergence of SPS standards, and efforts in this direction started early. Fundacion Chile, a nonprofit institution, had started introducing and disseminating related innovations. By 1983, it was inspecting one-quarter of all fruit exports, and it was able to rapidly increase its services. A Chile Good Agriculture Practices (GAP) certificate was developed in 2003. This private certification program harmonizes the most widely accepted requirements of international markets—notably those in Europe and the US. The certificate was recognized and accredited by GlobalGAP in 2008. The creation of this certificate was followed by targeted government initiatives to lower the cost of compliance for the growers. A public–private strategic council was set up in 2004 to help transfer and disseminate related knowledge, improve worker productivity, and advance fruit genetics and safety.

#### *Private Voluntary Standards and Role of the Public Sector*

The Government of Chile helped growers to comply with the rising private and global standards by first examining foreign regulations regarding fertilizers, pesticides, post-harvest treatment, and labeling standards, and then disseminating the information to exporting companies and growers. Chemical residue and labeling standards that meet the regulations of importing countries were recommended. By helping growers and exporters

conform to international regulations, the government facilitated fruit exports even though it has no direct role in certifying compliance with these requirements.<sup>12</sup> In 1995, a fund was created to support and promote agriculture exports through international market development, capability-building for exporters, and participation in international GVCs. The fund was managed by a public-private strategic council.

### *Cold Storage Innovations in Chile*

Another challenge faced by the FFV industry in Chile was packaging and storage of perishable fruits and vegetables. Chile's private sector began to innovate in these areas as early as the 1970s. Government research and extension services were also important in the development and adoption of new temperate fruit varieties in Chile. In the late 1970s, packing and cold storage units were established throughout Chile. Highways and ports were improved and the private sector, through the Chilean Fresh Fruit Association, in collaboration with the Ministry of Agriculture, developed a protocol for shipping FFV to the US. The private sector played a proactive role in entering the US market. The government assisted by providing low-interest production credits, subsidies on production infrastructure and material inputs, and grants and low-interest loans for processing and storage facilities.<sup>13</sup>

## **Experience of the People's Republic of China in Linking into Global Value Chains for the Fresh Fruit and Vegetable Industry**

### *Fuji Apples*

In sharp contrast to Chile, where small farmers sold their farms and production was consolidated in big farms, the experience of the PRC as an exporter of Fuji apples by small farmers stands out. In just 2 decades, the PRC has become the world's largest apple producer and exporter. In the early 1980s, the PRC produced less than 3 million tons of apples per year. By 2007, it produced more than 42% of all apples produced in the world (FAO 2007) and its share surpassed that of other large apple exporters, including Chile, France, Italy, and the US. What is most noteworthy is that the PRC has been able to gainfully connect a large number of small-scale apple producers to GVCs. These producers are mainly in clusters in Shandong and Shaanxi provinces. Shandong Province supplies almost half of the PRC's total exports of apples. The major markets for its apples are Southeast Asia (Indonesia, the Philippines, Singapore, and Thailand) and the EU (France, the Netherlands, Spain, and the UK), where the GlobalGAP certificate is required. Phytosanitary restrictions have prevented the PRC apples from gaining access to Japanese and the US markets.<sup>14</sup>

### *Initiating Apple Production in Shandong Province*

In the mid-1980s, following the PRC reforms, the commune system in Shandong Province was phased out and individual households were encouraged to develop apple orchards with no controls imposed over prices. Because of the high domestic prices for apples, which were considered a luxury product, more and more farmers planted apple trees.

<sup>12</sup> See OECD. 2005. Working Party on Agricultural Policies and Markets. Paris: Organisation for Economic Co-operation and Development.

<sup>13</sup> See Jaffe (1993).

<sup>14</sup> See Zhang, Qiu and Huang (2009).

This expansion was also encouraged by the government, which provided CNY2 million in subsidies for the purchasing of young apple trees.

The PRC's entry into the World Trade Organization (WTO) in 2001 was another significant event for the apple industry. By this time, the apple trees planted in the mid-1980s and early 1990s were in full production, the PRC apple markets were no longer in short supply, and new markets were required to keep the price of apples up. The potential for increased trade provided an incentive for seeking new markets. However, the PRC apples were not price competitive. The appreciation of the yuan during 2007–2008 and higher packing and transport costs made the PRC prices almost equal to the US prices in Southeast Asian markets. In response, the PRC exporters explored regional markets like India, where consumers were willing to pay premium prices. Eventually, exporters realized that domestic markets fetched them even higher prices than export markets, and they increasingly began to supply foreign chains in domestic supermarkets.

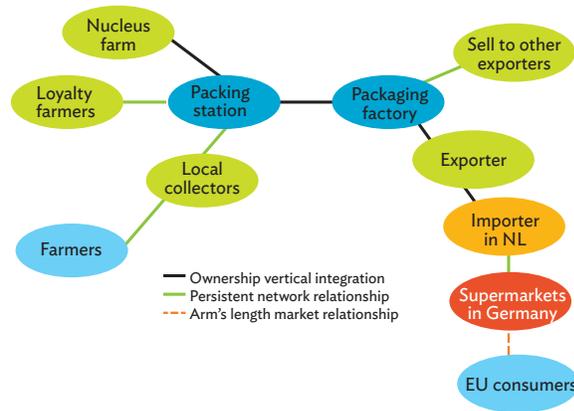
#### *Role of Technological Innovation*

In the 1990s, researchers in Yantai City, Shandong Province, developed a new variety of apples, called Fuji apples, by cross-breeding Japanese Fuji with local varieties. These apples were sweeter and redder and by 2007 they accounted for 80% of the total production of apples. Along with the new varieties, the producers also invested in cultivation innovations. In 1990, a special pruning technique was developed in Qixia District of Jiangsu Province aimed at stimulating flowering, which was later adopted in the rest of the PRC. In 1993, experiments in paper bagging of apples started, which greatly improves the quality, color, and surface shine of the apples and reduced the level of pesticide residue in the fruit. Further, investments in transport machinery and irrigation and spraying equipment were made by the farmers, along with efforts to improve the soil quality by applying more organic matter such as soya cakes. Continuous efforts were made by the Government of the PRC as well as growers to improve the quality of the produce. In addition, improvements in storage facilities contributed substantially to providing high-quality apples year-round. In 1984, there were only three cold storage facilities with a total capacity of less than 10,000 tons. By 2006, there were more than 200 cold storage facilities with a total capacity of 360,000 tons. Some of these facilities used highly advanced atmosphere control systems.

#### *Standards and Certification through Incentives*

To help farmers meet international food quality and safety standards, in 2001 the government introduced a special 10-year Pollution-Free Food Action Plan, under which most apple regions in Shandong Province, including Qixia District of Jiangsu Province, were certified as National Ecological Demonstration Zones. Farmers were encouraged to minimize the use of chemical pesticides and increase the use of organic fertilizers. This improved prices of apples from the demonstration zone, as they were considered safe. In 2005, an apple company from Qixia District was the first company to achieve EurepGAP certification, enabling it to export to Europe. To encourage more companies to export to the EU, the government provided subsidies equal to 40% of the cost of EurepGAP certification, and by 2008 most export-oriented companies in Qixia District had achieved this certification.

**Figure 14.4: Linking Small Farmers to Global Value Chains**



EU = European Union, NL = Netherlands.

Source: Zhang, X., H. Qiu, and Z. Huang. 2009. "Linking Small Scale Farmers in China with the International Markets: A Case of Apple Export Chains." *International Food and Agribusiness Management Review* 12 (3): 89 -110.

### *Small Farmers in Supply Chains*

To link small farmers into GVCs, a highly integrated and centralized supply chain was developed. Figure 14.4 illustrates how a small farmer was linked through an export company to the EU consumers. The Government of the PRC and the EU regulations required all apple exporters to register their orchards and packaging factories. The most efficient way to do this was to centralize and have one packaging factory and one packing station. The process was carried out for the export company by its loyal farmers and by other small-scale farmers linked through collectors. Exporters extended their control over various stages of the chain by owning a nucleus farm, a packing station, and a packaging factory. The function of the packing station was sorting and grading. All packaging materials, such as boxes and pallets, were provided by the packaging factory. This led to upward integration by exporters, who in many cases also integrated downward by setting up joint ventures with European trading partners.

While the PRC's apple market chain is very competitive, the PRC farmers have received much larger price margins (20% of what consumers pay at supermarkets) than small farmers in other countries have. For example, Dolan et al. (1999 and 2000) presented a detailed cost structure for African FFV exports to the UK. Their analysis indicated that farmers received only 12% of the final prices in Zimbabwe and 14% in Kenya. Highest margins were found to be in the final stages of the chain, in the supermarkets. In line with this, only 10% of Qixia District total produce was for export because of the higher returns from selling domestically.

### *Role of Institutions and Regulations*

Many institutions were established to support the smooth functioning of the supply chain. These included the PRC Entry-Exit Inspection and Quarantine Services (CIQ), which performed quality control. The CIQ at the local level frequently inspects fields and orchards. It certifies packaging materials produced in factories to guarantee food safety

and to meet phytosanitary requirements. When apples are ready for export, the CIQ tests a sample of every shipment. Customs check the consistency between the customs paperwork and the products. Food safety regulations are strictly followed. Both the PRC and the EU have clear standards for the grades of apples to ensure quality. Further, most traders have their own private standards, which are often stricter than the compulsory standards. Corporate and cooperative laws are also in place.

The PRC's success story with Fuji apples provides two important lessons. First, the fact that only 10% of the PRC's apple production is exported and a large share of this is exported to Asian markets indicates that farmers are fully aware of the margins they may achieve in global markets versus the domestic market. Second, growth of the industry has not led to the exclusion of small-scale producers or to the consolidation of the farms. Kenya has often been cited as a success story in horticulture; however, the rapid growth of its exports has been accompanied by rapidly declining smallholder participation in FFV chains, from 75% in 1992 to about 8% in 1998. One large company, Homegrown, has increasingly dominated exports, with the EU markets accounting for some 85% of Kenya's total exports of apples. Small-scale producers find it difficult to export to the EU and are slowly being excluded from the value chains.<sup>15</sup>

## Linking into Value Chains: Constraints and Capacities Needed

### Constraints to Linking into Global or Regional Value Chains

The successful experiences of profitably linking into GVCs demonstrate that the process is not automatic. Well-targeted policies and strategies are needed, mainly because of the existing constraints, especially in developing countries and LDCs. The major constraints faced by producers in South Asian countries fall into three broad categories: production-related, market-access related, and policy-related constraints.

Production-related constraints stem from limited backward technologies, leading to low productivity, low yields, and low-quality outputs. Most small-scale producers are at a disadvantage because they have limited capital to invest, they use traditional techniques of production, and they depend largely on family members for labor. Low productivity and poor product quality hamper their participation in value chains.

Constraints related to market access stem from lack of information and awareness of markets and consumer preferences. Market access also critically depends on the technical capabilities of producers and the available infrastructure. The more heterogeneous the end markets, the more market-oriented activities are expected to take place at the higher end of value chains. However, this becomes increasingly competitive and difficult. Both production-related and market-access-related constraints are closely linked to financial constraints, which include not just access to investment resources but also the limited capacity to maximize productive use of such resources.

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<sup>15</sup> See Stichele et al. (2005).

Policy-related constraints may reflect the inability or lack of willingness of policy makers to focus on key industries and act strategically. In initiating value chains, policy makers need to encourage innovation, enhance the knowledge and awareness of producers, create a facilitating environment, provide the necessary infrastructure and networks, and help access markets by negotiating regional and international agreements. The government also needs to be proactive in helping to coordinate the different players in value chains.

To overcome the constraints and proactively address the requirements, all players in the value chains need to give full support, as any one weak link can diminish the gains to be made from forming value chains.

### Capacities Needed for Linking into Global or Regional Value Chains

Based on the successful experiences discussed, six basic capacities are needed to beneficially link into GVCs. These are highlighted in Figure 14.5 as a “chain of capacities” or linked capabilities required to establish and promote GVCs.

Well-informed producers are an important basic capacity, capable of technical innovations and skills development. To gain the real value from skills development, adequate infrastructure and finance are required. Further, if the appropriate institutions and domestic regulations are not in place, the gains will be appropriated by foreign investors and other players in the chain, and very little will trickle down to the producers. These institutions and regulations are fundamental to strengthening the market orientation and market intelligence of the producers.

The experience of regions around the world shows that the requirements for successfully linking into GVCs are sector specific and, therefore, a sector approach is needed. Products

**Figure 14.5: Chain of Required Capacities in Global Value Chains**



R&D = research and development.

Source: Author's assessment.

that have high potential for forming or linking into value chains need first to be identified and then a targeted approach undertaken by the private and public sectors, development banks, and multilateral agencies to foster successful value chains. In the case of South Asia, the low intraregional trade but high availability of inputs and outputs within the region may indicate the potential for forming industry-specific RVCs, or for linking into GVCs. Based on the cases reviewed, the following actions are identified.

#### *Provide Information to Producers*

Products with the potential for global consumers need to be identified and producers provided information and support to improve their competitiveness and ability to reach global consumers. Entrepreneurial skills must be coordinated to enable the building of value chains. The experience of Sri Lanka highlights the importance of informed producers in linking into GVCs and climbing the value-added ladder. The textiles and clothing producers in Sri Lanka took initiatives to develop their capacities and capabilities, especially when they realized that they would lose their preferential access to markets in developed countries when the MFA expired. Although they lacked the backward linkages and essential inputs needed in their products, they developed the forward linkages by building their capacities to provide associated services such as designing, packaging, and branding. They also developed regional linkages and regional supply chains by procuring textiles from India and Pakistan.

Entering niche markets and developing complex products helped Sri Lankan producers gain access to Western markets even after the expiry of the MFA. The role played by JAAF in Sri Lanka is a good example of industry collaboration in upgrading the sector. For FFV GVCs, the Chilean Fresh Fruit Association played a proactive role in upgrading the capacity of farmers to adopt good agricultural practices so as to meet global quality standards, as well as those set by private entities. This greatly helped the farmers to access the markets and increase their competitiveness. In both cases, industry associations played a key role in informing and assisting the producers. The following targeted actions are recommended:

- (i) Develop and strengthen product-specific industry and farmers' associations, especially to identify products with the potential for forming regional supply chains and linking into GVCs.
- (ii) Governments should work closely with the farmers to make them better informed about international standards. The case of the PRC is exemplary; the government created demonstration zones to educate farmers on good practices, meeting quality standards, and reducing chemical and pesticide use.
- (iii) Collect and disseminate timely market information on prices, demand, and other factors, thereby helping small producers in FFV chains to make strategic decisions concerning production and sales.

#### *Undertake Technical Innovations and Research and Development*

Technical innovation and R&D are critical to help producers link into and move up value chains. Cold storage innovations in Chile and the development of Fuji apples in the PRC demonstrate that technical innovation can greatly increase the gains from value chains. However, it may not be realistic to expect technical innovation and R&D by micro and small enterprises and farmers. If a country can develop a critical mass of informed producers, the

next step is to provide technical support, including through R&D. Two important sources for this are the public sector and FDI.

The experiences of other countries show that big farmers and producers can also be important sources of technological change. For example, in Mossoró, Rio Grande do Norte, Brazil, two innovative and risk-prone entrepreneurs increased the participation of small and medium-sized melon farmers in national and foreign-led value chains for the fruit from 9% in 1990 to 27% in 1997. The government did not play a direct role in this but it provided subsidized loans through development banks to two large producers. These producers proved that the region had a favorable environment for growing melons, identified suitable varieties, established domestic and export marketing channels, and trained hundreds of field workers and agronomists. As a result, a cluster of local producers evolved, engaged in national and foreign-led value chains.

Some recommended targeted actions are as follows:

- (i) Close ties should be promoted between public sector research and extension agencies, producers and manufacturers, and buyers and input suppliers. Support for technical innovation and R&D should be increased. Technical innovation is needed along the entire value chain, linking producers and input suppliers.
- (ii) Product-specific industry associations at the regional level should play an important role in sharing information and harmonizing standards. Industry associations can provide the minimum critical threshold of research for spurring technical innovation. The pooling of resources and capabilities at the regional level can be a win-win situation for countries that want to form regional supply chains to improve their global competitiveness.
- (iii) The public sector should provide direct and indirect incentives to promote innovation, including subsidized credits, tax exemptions, and access to research and innovation, to all producers irrespective of size and scale.
- (iv) The government should devise FDI policies to induce technological spillovers. One such policy is encouraging joint ventures in identified industries. Bangladesh encouraged FDI in backward linkages of the garments industry to strengthen the full value chain.
- (v) The government should promote quality standardization across products. Subregional arrangements can develop certification processes, such as the COMESA certificates for the quality of sugar produced by member countries. Such certificates can make it easier for small and medium-sized industries to understand the distinctions between international, regional, and national standards, and bridge the gaps.

#### *Pursue Skills Development*

Skills development is an integral part of the process of developing value chains. Informed producers need to develop their skills to take forward R&D and technical innovations to the next stage. The experiences of Bangladesh and Sri Lanka show the importance the two countries placed on skills development in the textile and clothing sector and the vital role played by both the public and private sectors. In the case of the food processing industry, the Government of the PRC set up demonstration farms to teach farmers new ways of

growing apples. Infusing technical innovation into the production process required training and skills development for the producers. Some targeted actions that can be taken on this front are as follows:

- (i) Set up training institutes, design studios, demonstration farms, and other such initiatives to upgrade skills and capabilities of the producers and workforce.
- (ii) Provide public sector support for training in farming technology and post-harvest treatment. Other areas of skills development include creating or enhancing awareness of the benefits of GAP among producers, assistance in identifying new sites for competitive FFV production, training in the registration of crop products, and training in meeting standards for seed quality and the use of agrochemicals. Further, the government needs to work with industry representatives in developing national legislation for environmental protection and workers' health and safety. These measures are important for increasing the capacity of smallholders to meet the standards required for participating in FFV value chains.
- (iii) Collaborate regionally in skills development in the identified sectors to maximize the benefits of regional supply chains and upgrade GVCs.
- (iv) Emphasize the critical role of foreign firms in skills development and training the workforce in value chains. In Sri Lanka, complex products were developed by garment manufacturers that were trained by foreign firms to cater to niche markets. Although external sources of knowledge are essential, the creation and improvement of technical capabilities require firm-level efforts.

#### *Provide Adequate Infrastructure and Finance*

The importance of adequate infrastructure and finance in linking with and forming value chains is well known. However, these requirements may be very difficult to meet for developing countries and LDCs, given their limited resources. It is therefore important to identify critical areas where investing in related infrastructure would result in maximum socioeconomic gains. Careful assessment of industry potential and competitiveness is essential. In some cases, foreign and regional investors can be encouraged to provide the necessary investments in infrastructure.

The experience of Bangladesh and Sri Lanka demonstrates how FDI was drawn to investing in garments by the availability of market access through preferences and quotas. An enabling environment was provided to foreign investors, compensating for deficiencies in domestic infrastructure and financial constraints. The countries benefitted and were able to spur growth in their domestic sector. In both countries, domestic firms soon surpassed foreign firms in the number and size of investments. The category of trade facilitation that produces the greatest gains is services sector infrastructure, followed by efficiency in air and maritime ports (Wilson and Otsuki, 2007). The region requires upgraded ports and information infrastructure and continued reforms in customs clearance procedures and regulatory harmonization. The following targeted actions are therefore recommended:

- (i) Encourage FDI in infrastructure, especially telecommunication infrastructure. Low-cost, reliable communication networks are a necessary part of ensuring that the correct goods are shipped at the right time between production nodes in a supply chain. Reducing the transaction costs of trade includes improving the

means of communication within and across national borders. Regional cooperation can achieve large positive externalities in this area.

- (ii) Provide the necessary infrastructure for compliance; for example, by facilitating accreditation of laboratories to ISO 17025 or an equivalent standard for testing.
- (iii) Create an enabling environment for micro- and small-scale producers and exporters. Improvement of infrastructure, including roads and utilities (water and electricity), is vital, especially for post-harvest handling of FFV. Support in this regard can reduce costs and improve competitiveness.
- (iv) Promote FDI in new firms and capital investment. The development and expansion of regional supply chains requires the development and/or expansion of new firms. For many LDCs, the main source of investment capital is FDI. It is important that countries define their comparative advantages and provide this information to potential investors.
- (v) Monitor and influence the regional flow of FDI. With respect to regional supply chains, increased production is likely to come primarily from the expansion of firms within the region.
- (vi) Facilitate intra-firm trade credit. Larger or better-financed firms may be able to provide trade credit to less well-financed firms within their network if they are given the right incentives, such as tax concessions, insurance, or limited guarantees.<sup>16</sup> This may have the added benefit of making production within supply chains more attractive to nascent firms.
- (vii) Promote the participation of development banks and export-import banks in the establishment of regional supply chains. Targeted financing policies are needed to strengthen and promote intraregional value chains.

#### *Put in Place Appropriate Institutions and Domestic Regulations*

To benefit fully from RVCs and GVCs, it is important to have proper institutions and domestic regulations in place. In large part, the PRC's success in developing value chains in apples was due to the many institutions that were set up to help link small growers to the value chains. These included institutions to ensure that growers followed the production norms and produced high-quality apples. Food safety regulations were strictly followed, and the PRC farmers had clear standards to ensure quality.

Compliance with stringent international standards is a major challenge for producers of FFV; the existence of these standards also provides opportunities for greater market access for countries that can comply. Establishing institutions and laboratories to test the quality and standards compliance of products has become an important element of trading. Accreditation of these institutions and laboratories is vital. The most significant binding constraint to meeting private standards for horticulture produce is the upfront costs necessary to upgrade the industry in line with GAP. This can include buildings for storage of chemicals, changing rooms, and upgrading of packing and washing facilities. These costs will vary according to the standard adopted, and the initial conditions of farming and the industry more generally. Recurrent audit and certification costs make up only a small part of the sales price of the product. The following targeted actions are recommended:

<sup>16</sup> Inter-firm financing through trade credit was a very important tool in the early industrialization of Japan.

- (i) Assist domestic producers in meeting international standards. Different countries impose different standards, especially in the European and the US markets. To meet double or triple certification requirements, Chile developed its own GAP standards, which made it easy for exporters to meet the different standards in global markets. Domestic regulations and standards should be used to enable exporters to meet international standards.
- (ii) Tailor FDI policies and domestic regulations to help producers expand their participation in value chains. For example, Bangladesh encouraged FDI in the textiles sector and benefitted from development of backward linkages to strengthen the apparel value chains. Other policies that can be linked to FDI are domestic content requirements, encouraging joint ventures, and formulating technology-sharing agreements.
- (iii) Ensure FDI results in knowledge and technology transfers. FDI provides significant opportunities to transfer knowledge and technologies that are relatively low-cost, adaptable, and transferable. FDI from other tropical regions can also provide additional technical know-how. For example, important lessons can be drawn from agro-industrial businesses operating in similar agro-climatic zones. However, appropriate land laws and blueprints for contract farming should apply to foreign investors.
- (iv) Develop an intraregional investment agreement. The ASEAN Comprehensive Investment Agreement, 2009 could be a good model, as it covers both FDI and portfolio investment.

#### *Undertake Market Orientation and Market Intelligence*

Market intelligence can help not only in linking with and climbing GVCs, but also forming and governing value chains. One of the perceived advantages of GVCs is the higher returns for exports. However, this will not necessarily follow. Higher per-unit returns may be possible in regional supply chains, especially if the high costs entailed in meeting the quality standards set by the lead firms in GVCs can be avoided. Current export structures, outside those of large companies, do not provide small producers with enough bargaining power, storage facilities, and price management techniques to enable them to receive fair prices. Moreover, lack of awareness of markets and other barriers may increase their costs.

The Fuji apple success story in the PRC provides an important lesson: it is not where to export that matters but, rather, at what returns. Most of the PRC's Fuji apples are sold to foreign-owned domestic supermarkets rather than exported, as the producers realized that the PRC consumers are willing to pay high prices for assured quality. In many cases, regional importers pay more than global importers. Awareness of markets for both outputs and inputs is important in linking and forming competitive value chains.

Market intelligence and orientation can also have a major bearing on trade and FDI policies. Bilateral and regional trade and investment agreements that encourage formation of a trade-investment nexus and value chains need to be pursued. The experience of many countries shows how domestic producers benefitted from negotiated agreements leading to the development of successful value chains. ASEAN is a prime example. Some recommended targeted actions are as follows:

- (i) Governments and associations should provide market information to small and medium-sized enterprises (SMEs), as they lack the capacity to undertake market intelligence studies on their own.
- (ii) Establish EPZs. If pursued with proper regulations, EPZs can increase the collective efficiencies of SMEs and help in forming value chains and attracting FDI. Governments should encourage clusters with appropriate incentive structures in identified sectors and provide market information and training.
- (iii) Help develop close links between EPZs and the domestic private sector. If proper links with domestic producers are not encouraged, EPZs run the risk of becoming enclaves of the PRC and other investors. Domestic firms may lose out on shares of quotas and preferences in Western markets, as in the case of the textiles and apparel industry. Domestic employment in EPZs should be facilitated.
- (iv) Ensure learning opportunities and technology transfers. Local investors in the EPZs must be able to take advantage of skills development and to draw upon R&D institutes.
- (v) Mobilize financial resources. EPZs can attract FDI and to some extent lessen the financial constraint on investment in developing countries. EPZs can also attract intraregional investment in light manufacturing industries to form regional supply chains.
- (vi) The six capacities discussed are necessary for developing, linking into, upgrading, and governing value chains. Success stories from developing countries and LDCs show that these capacities are built up over time, supported by targeted assistance from the government and industry associations.

## Conclusions

South Asia has experienced relatively strong economic growth since 2000 but intraregional trade remains low. Analysis presented in this chapter shows that intraregional trade has been much lower than the potential trade. During 2000–2010, intraregional exports captured only one-third of potential exports to the region, averaging \$8.8 billion annually compared with an estimated potential of \$26.6 billion. Initiating RVCs would be an important step for tapping the potential for regional trade, especially for the textiles and clothing, leather and leather products, and food processing industries.

However, RVCs in South Asia will not form automatically as a result of market process. Targeted and strategic policy interventions are needed at both the regional and the national levels. These include short-term actions for increasing intraregional trade and investment as well as long-term planning to address domestic constraints and improve the capacity of the country to productively integrate with the region.

The chapter identifies the strategies and actions needed at the regional level to promote RVCs. These include more closely integrating the private sectors of SAARC members and unlocking the dynamism of regional trade and investment. Specific initiatives include (i) forming regional industry associations; (ii) promoting common regional labels; (iii) setting up regional design studios and joint R&D in the identified industries; (iv) accelerating trade facilitation; (v) deepening intraregional trading arrangements;

(vi) improving telecommunication infrastructure, mobilizing regional resources; and (vii) encouraging a common policy direction for industries that have the potential for forming RVCs.

The chapter discusses the experience of some developing countries and LDCs that have successfully linked into RVCs and GVCs and have benefitted from increased exports, production, and employment. The countries referred to include Bangladesh and Sri Lanka in the textiles and clothing industry, and Chile and the PRC in the food processing industry. Many external and internal factors have contributed to these countries' success with RVCs and GVCs, including access to quotas, preferential trade agreements, specific policies with respect to FDI and trade, formation of clusters, and complementary efforts to improve infrastructure and provide a facilitating environment for trade and investment.

Based on these success stories, the chapter identifies the constraints for South Asian countries in linking into RVCs or GVCs. These include (i) production-related constraints, leading to low productivity and low-quality outputs; (ii) market-access-related constraints, which stem from lack of information and awareness of markets and consumer preferences; and (iii) policy-related constraints, which stem from lack of commitment and capabilities of policy makers. Important roles to be played by policy makers for establishing successful value chains include encouraging innovation, improving knowledge and awareness of producers, creating a facilitating environment, providing the necessary infrastructure and networks, and negotiating agreements on market access.

This chapter identifies a chain of capacities required to successfully link into RVCs and GVCs. Informed producers, capable of undertaking or requesting technical innovations, are important. This, in turn, leads to skills development. However, this must be accompanied by adequate infrastructure and finance, and appropriate institutions and domestic regulations. Otherwise the gains will be appropriated by foreign investors and other players in the chain, with very little trickling down to the producers. Targeted actions are identified for building each of these six capacities.

The emergence of GVCs has triggered new ways of producing and trading in South Asia. To be globally competitive and to capture more value for their exports, it is important for South Asian countries to collaborate more closely. Forming RVCs would give them a competitive edge in global markets. The region must realize that, in the near future, forming RVCs will no longer be a choice but a necessity to be globally competitive.

## CHAPTER XV

# Integration of South Asian Capital Markets

*Jennifer Romero-Torres, Stephen Wells, and Susan Selwyn-Khan*

This chapter examines the potential for harmonization and integration among the capital markets of South Asian Association for Regional Cooperation (SAARC) member countries: Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka.<sup>1</sup> It reviews the benefits to be gained from harmonization and identifies the major obstacles that need to be addressed. It also identifies lessons from other regions, including the Association of Southeast Asian Nations (ASEAN) and the European Union (EU). It discusses all areas of capital markets, but emphasizes those where greater harmonization would facilitate the flow of capital within the region. All SAARC members, except Afghanistan, have functioning equity markets, but India is the only country with a functioning derivatives or bond market.<sup>2</sup> Therefore, while not denying the potential longer-term importance of bond market development, the main emphasis here is on equity markets.

The integration of capital markets entails three areas of regional cooperation: market regulation, issuer regulation, and macroeconomic regulation. Market regulation includes the regulatory structure and degree of independence, intermediary regulation and market abuse, and investor protection. Issuer regulation relates to ownership and location restrictions, issuer requirements, and corporate governance and accounting standards. Macroeconomic regulation addresses issues relating to currency regulations and taxation.

The methodology for this analysis of capital markets involved a survey of regulators, fieldwork involving extensive interviews with market participants, and desk research.

## Issues of Capital Market Integration

### Meaning of Capital Market Integration

This section focuses on harmonization as a step toward the integration of capital markets, where there are no barriers to the movement of capital and the provision of investment services within a geographic region.<sup>3</sup> For investors, integration implies that they can

<sup>1</sup> This chapter draws from ADB. 2013c. *Development of Capital Markets in Member Countries of the South Asian Association for Regional Cooperation*. Manila: Asian Development Bank.

<sup>2</sup> India has a corporate bond market, but it is largely a market for private placements among a limited number of investors rather than a market for public issues, which are relatively rare.

<sup>3</sup> This section is a shortened version of the original report. For a fuller discussion, see ADB (2013c).

operate across borders; that is, domestic investors can invest in other countries and foreign investors can invest in domestic securities knowing that they will encounter broadly similar regulations, information, trading systems, settlement systems, accounting standards, and governance standards throughout the region. For issuers, it implies that domestic issuers can raise capital in foreign markets and foreign issuers can raise capital in domestic markets, again knowing that they will encounter broadly similar regulations, information, trading systems, settlement systems, accounting standards, and governance standards across the region. Finally, integration means that investment service providers can operate across the region without facing restrictions on their access.

### **Benefits of Integration**

Integration increases competition, deepens capital markets, and widens the range of investments. These changes, in turn, lead to more efficiency and innovation in the provision of services to investors and issuers. They also lead to increased liquidity in the trading of financial assets. Enhanced efficiency leads to lower costs for investors and issuers with a consequent reduction in the cost of capital. Greater liquidity also reduces the costs of trading with positive effects on the cost of capital. Gains in innovation extend the range of products, thereby attracting a wider range of participants and promoting greater financial inclusion.

However, the benefits of capital market integration would not be equally shared among SAARC countries. The less developed and smaller markets, such as in Bhutan and the Maldives, have more to gain from integration than the more developed markets, such as in India, which have already realized many of the gains by developing their own internal capital markets.

### **Opportunities and Challenges**

Opportunities and challenges exist for all types of market participants. It is likely that the more innovative and efficient participants will be the most successful in the new environment. The likely impacts, both beneficial and less beneficial, will affect different groups of participants in different ways. Domestic institutional investors will gain access to a wider range of investment opportunities. Retail investors will benefit as costs are reduced and innovative providers compete for their business. Issuers will gain by being able to issue securities to a wider investor group. There will be a challenge for smaller issuers who risk not being heard in the bigger market; but, as in integrated capital markets elsewhere, specialists in small companies are likely to emerge to fill market niches. Brokers will have new opportunities to diversify their business across borders, either by establishing links with other brokers or by opening branches. Exchanges and other infrastructure providers will gain potential new users from outside the country. They will also have a wider range of possibilities for products to support cross-border business. Individual countries will benefit from more efficient, more liquid, broader, and lower-cost capital market services. Easier, lower-cost capital raisings will encourage companies to raise money for investment through public issues, leading to reduced reliance on bank borrowing. More equity issuance develops corporate profiles so companies can further diversify their issuance.

### **Barriers**

There are many potential barriers to capital market integration. Among the most common barriers, besides lack of political will and opposition from vested interests who profit

from the fragmented markets, are formal barriers and fairness barriers. The principal formal barriers are regulatory, taxation, and monopolistic. Regulatory barriers prevent the movement of capital to its most efficient use and so constrain development. Taxation barriers complicate economic comparisons between different activities or participants. Monopolistic structures prevent access to parts of the market, or restrict activities in the market by law or other means to a specified group. Fairness barriers, on the other hand, exist when there is explicit discrimination against certain participants or a perception that such discrimination exists. Similarly, information barriers result when one group of participants is (or is perceived to be) better informed about asset valuations. The effect is to deter the less well-informed from participating in the market.

## Models of Capital Market Integration

### Europe

European capital markets are broadly integrated. There are no barriers to the movement of capital, and, in particular, there are no exchange controls. Within the EU, regulations are harmonized on common baseline standards to which countries can add if they choose. There is mutual recognition of intermediary regulations so that one license gives brokers the right to operate in all EU markets. There is mutual recognition of issuer regulations so a single prospectus is valid across the region. Finally, trading system providers can enter the market freely and compete with each other without restrictions. While there is a measure of agreement in Europe that the ultimate goal might be full integration with a single regulator, for example, the likelihood is slim. An important lesson for capital market integration is to set feasible goals. For SAARC members, with their significant national differences, this is a critical consideration as reflected in the concluding recommendations of this chapter.

### ASEAN

Currently, the ASEAN countries are planning for capital market integration. There is some movement toward mutual recognition but the main thrust of activity has been the ASEAN Common Exchange Gateway, which aims to establish electronic links between the stock exchanges. Recent announcements have suggested that the gateway will initially open for the more developed markets of the ASEAN region. However, there are some doubts about this approach. Several electronic links that were set up or proposed in the 1990s have generated disappointing amounts of trading. The Australian and Singapore stock exchanges (ASX–SGX) link was set up in 2001 and later abandoned in 2005. There are several reasons why the link was dysfunctional, which largely stemmed from the lack of incentives for the participants to share business. First, there was little motivation for the management of stock exchanges to route trading to a competing stock exchange. If there was significant local demand for foreign stocks, then the stock exchange would prefer to establish its own offshore market for trading in foreign securities. Such offshore markets have not generally been successful, but the managements of some stock exchanges continued to try to attract trading of foreign securities. Second, securities brokers did not use the link; if there was significant local demand, then brokers were likely to already have their own mechanisms for routing business into foreign markets, either through their own branch networks or through correspondent links. Third, settlement for business routed from a foreign stock exchange had to be through a member of the local clearing system. This was problematic because of the high charges usually levied by the local clearing members. Finally, investors gained

relatively little from the link, as without harmonization of rules, such as on disclosure, national investors were unlikely to want to invest in the stocks of other countries in the region. Electronic links did not address their concerns. Global investors typically use global brokers, which tend to already have interbranch links.

#### *Bottom-Up Harmonization*

The approaches described so far could be described as de jure harmonization, where an agreement at the government level is the driving force or at least a major driving force.<sup>4</sup> An alternative approach, which could be described as de facto, is bottom-up harmonization. This approach progresses by means of localized initiatives toward the harmonization of standards and regulations. This has appeal in regions like SAARC, where there is little central drive for or interest in integration. Under this approach, regulators and other standard setters, such as the Organisation for Economic Co-operation and Development (OECD) and the International Organization of Securities Commissions (IOSCO), endeavor to ensure that their regulations are harmonized with those of their regional peers, or at least that they avoid setting regulations and standards that are inconsistent with those of their neighbors.<sup>5</sup>

Such harmonization does not address the issue of regional integration. However well harmonized the regional markets are, if major barriers remain, such as exchange controls, there will be no movement of investment capital within the region. Nonetheless, bottom-up harmonization has advantages. First, it prepares for the time when major barriers are removed. This may be relevant for cases where significant barriers, such as exchange controls or barriers to foreign ownership, are being gradually relaxed. Second, it presents the markets of the region as more homogeneous for investors outside the region. This particularly benefits small markets that might not be able to attract international investors if they strongly retain their local characteristics. Third, this form of harmonization is achievable by low-level agreements between regulators and does not require intergovernment treaties. Finally, it raises standards because harmonized standards are more likely to reflect international best practice than the preexisting ones. This has largely been the case in SAARC, where members have adopted standards that approximate international standards, although there remain significant differences in implementation and enforcement.

### **Capital Market Integration and Stock Exchanges**

There is an important distinction between the integration of capital markets and the integration of stock exchanges. Capital market integration is possible with single or multiple stock exchanges. The People's Republic of China (PRC), India, and the United States (US) are examples of countries with integrated internal capital markets but with more than one stock exchange. In India and the US, various stock exchanges trade the same stocks. The market is integrated because capital can move freely, and any discrepancies in prices on the stock exchanges are rapidly arbitrated away. In many countries, there is a predisposition

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<sup>4</sup> In the EU the initial impetus was largely a consequence of various private initiatives (nongovernment driven) to increase trading and raise awareness. The later stages were very much government led because of the need for intergovernment agreement on directives.

<sup>5</sup> IOSCO publishes principles for regulation, which have become an international standard. Similarly, the OECD publishes a standard for corporate governance.

favoring contestability or competition in the provision of trading services. It is argued that competition leads to lower costs, better service, and more innovation. The single European capital market explicitly recognizes and encourages a proliferation of trading venues competing for business in the same stocks. In August 2013, the EU had 267 licensed entities that offer some form of trading facility, and many investment firms have internal matching facilities.<sup>6</sup>

Stock exchanges are increasingly complex businesses. They offer a combination of trading, regulation, data, information technology (IT), settlement, and other services. They may also own other stock exchanges. Their activities can easily straddle markets, so the fact that the business is transacted on a particular stock exchange group does not mean that the market is integrated. An example is NYSE Euronext, operating in Europe and the US, which are not integrated into a single capital market. The European arm runs its business through a series of national subsidiaries to accommodate the sensitivities of national regulators, but the subsidiaries share a common technology platform, marketing, and management.

Capital markets allow users to choose from an array of financial structures to achieve their individual objectives. Historically, company issuers have sought to gain access to a wider shareholder base by listing their shares on foreign stock exchanges. In the 1980s and 1990s, this was a major part of the corporate strategy of many large companies and was an area of competition for stock exchanges. However, it was rare for an active, offshore market to develop in the country of the secondary listing. Usually, most trading, professional expertise, information, and liquidity remained in the home country. Foreign investors generally prefer to route their orders to the home market by using the network of global brokers or correspondent links between local brokers.

Discussions on regional integration have often concentrated on cross-listing (and cross-platform trading), but the presence or absence of cross-listings does not give any indication of the level of integration. However, an absence of cross-listings along with other features such as restrictions on capital movements, as there are in SAARC countries, can indicate a lack of integration.

In conclusion, capital market integration and stock market integration are not necessarily linked. It is possible to have an integrated capital market with multiple stock exchanges and multiple regulators.

## Overview of Market Size and Regulation in SAARC Countries

SAARC is not a well-integrated economic region. Despite its cultural links, the SAARC region is not generally seen as an investment destination by SAARC member countries. Interest in investing abroad is usually directed toward traditional investment destinations, such as Europe; Hong Kong, China; India; Singapore; and the US. Limited interest in

<sup>6</sup> MiFID. Markets in Financial Instruments Directive databases. <http://mifidatabase.esma.europa.eu/> (accessed 1 March 2014).

investing elsewhere in SAARC reflects the low degree of interregional trade and the underdeveloped state of many of the markets. This is likely to change as the markets develop. However, the lack of trade links remains a factor to consider when evaluating strategies for encouraging greater capital market integration.

A further consideration is the general lack of knowledge by market participants of the status of the capital markets in other SAARC countries. It is not surprising that participants lack even readily available information, because they are generally excluded from accessing other SAARC markets. SAARC regulators and stock exchanges are better informed, probably as a result of the efforts of international organizations such as IOSCO, the World Federation of Exchanges, and the South Asian Federation of Exchanges (SAFE) to foster relationships through which information can be exchanged.<sup>7</sup>

A yet further consideration is the barriers to movement of citizens among SAARC countries. In some cases, the visas required are no more than an entry tax, but in others they are a significant hindrance. SAARC has facilitated a waiver scheme for government officials, and it would be beneficial to extend this to finance sector professionals.

Table 15.1 provides key equity market size statistics for 2012 for SAARC member countries.

**Table 15.1: Equity Market Size of SAARC Member Countries, 2012**

SAARC Member	Listed Companies (number)	Market Value (\$ million)	Brokers (number)	Stock Exchanges (number)	Equity Turnover Value (\$ million)
Bangladesh	229	17,479	357	2	10,693.0
Bhutan	20	322	3	1	4.0
India	5,191	1,263,335	1,269	2	690,216.0
Maldives	6	504	4	1	0.1
Nepal	216	4,160	60	1	51.0
Pakistan	573	43,676	261	3	13,675.0
Sri Lanka	287	17,046	29	1	1,565.0
Total	6,522	1,346,523	1,983	11	716,204.0

SAARC = South Asian Association for Regional Cooperation.

Notes:

1. India has other stock exchanges, but only the Bombay Stock Exchange and the National Stock Exchange have significant trading volumes. Consistent and comparable statistics are not easy to obtain for the SAARC region.
2. Exchange rates used for computation: Bhutan \$0.018/Nu, Maldives \$0.065/Rf, and Pakistan \$0.01/PRe. Exchange rates are end of period and from the International Monetary Fund's International Financial Statistics.

Sources: World Bank Data; World Federation of Exchanges Statistics; individual country stock exchanges; regulator websites; and analyses compiled by ISC consultants's Capital Market Development Authority Annual Report (2012), and Maldives Monetary Authority Financial Stability Review (2012).

<sup>7</sup> SAFE was founded at the initiative of the Chittagong Stock Exchange. It is a voluntary body funded by subscriptions. Its headquarters are now in Islamabad, where it has a small permanent staff. Members include SAARC and other stock and commodity exchanges (e.g., Abu Dhabi and Kazakhstan), associated entities such as regulators and depositories, and other commercial entities (e.g., a systems vendor). SAFE has conducted some First Initiative funded projects on exchange-listing regimes, regional harmonization, and cross-listing.

## Bangladesh

### Overview

Indicator	Description
Market size	The Bangladesh market is of significant size with 229 listed companies valued at \$17.5 billion at the end of 2012 and a turnover of \$10.7 billion in 2012.
Brokers, stock exchanges, and key institutions	There are 357 brokerage firms and two stock exchanges, the Chittagong Stock Exchange and the Dhaka Stock Exchange. Many firms are members of both stock exchanges. The stock exchanges are both mutual organizations. <sup>8</sup> There is a government-led initiative toward demutualization, but no legislation has been drafted.
Listed companies	The two stock exchanges cover the same stocks (issuers are required to list on both).
Investors	Mutual funds exist but penetration is not deep. Other conventional institutional investors are not important, but banks are permitted to invest up to 3% of assets, including margin loans. Foreign investors are permitted, but few have yet entered the market.
Settlement and margin trading	Stock exchange trading and settlement systems are not linked. Settlement is T+3 but currently not Delivery versus Payment. <sup>9</sup> The Central Depository of Bangladesh is the only central depository. Margin trading is permitted and margin loans can be up to 200% of collateral. In practice, firms have lent beyond collateral limits and moral suasion from the regulator has prevented them from selling collateral of defaulting clients.
Derivatives	There are no derivatives.
Corporate bonds	The corporate bond market is undeveloped. There are five licensed local credit rating agencies (CRAs). Foreign CRAs cannot be licensed, but local CRAs are required to have technical links with foreign CRAs.

### Market Regulation

Indicator	Description
Regulatory structure and independence	The Bangladesh Securities and Exchange Commission (BSEC) covers securities and mutual funds. It is attached to the Ministry of Finance and is mainly financed by government grants and listing fees for initial public offerings (IPOs). Staff members have no legal immunity. <sup>10</sup>
Intermediary regulation	Foreign brokers are permitted to operate through a local subsidiary, which can be 100% foreign owned. There are currently no foreign-owned brokers. Brokers are restricted in the research they can offer. Until recently, brokers were prohibited from providing investment recommendations to clients. The BSEC is considering draft professional standards qualification requirements for licensing of brokers.
Market abuse and investor protection	Trading outside the stock exchange is permitted, but it requires BSEC permission. BSEC regulations prohibit market abuse. <sup>11</sup> The stock exchanges each have a surveillance system although there is little coordination of investigations across the market. Recent events and practitioner comments suggest that abuse, particularly manipulation, is not uncommon. The BSEC is in the process of procuring a surveillance system. The market has been subject to sharp fluctuations in prices and volumes. The main regulatory response to date has concentrated on efforts to support the market by, for example, requiring directors to maintain minimum holdings. The BSEC has been involved in encouraging participants to support the market.

<sup>8</sup> Traditionally, stock exchanges were structured as mutual organizations—not-for-profit companies owned and managed by their members. During the past 30 years, most major stock exchanges have restructured themselves as for-profit corporations (often with outside shareholders)—a process known as demutualization. Demutualization is said to improve the business focus and efficiency of stock exchanges.

<sup>9</sup> In T+3 (trade date plus three days), the settlement is three business days after the transaction (e.g., a transaction on Monday is settled on Thursday). In Delivery versus Payment, the transaction is settled upon delivery.

<sup>10</sup> Legal immunity means that the staff members of the regulator, when doing their job in good faith, are protected from legal suits brought by those under investigation.

<sup>11</sup> Market abuse covers a range of prohibited activities designed to allow the perpetrator to unfairly take advantage of other participants. The most common forms of prohibition are those against insider dealing and market manipulation.

*Issuer Regulation*

Indicator	Description
Ownership and location restrictions	Subsidiaries of foreign companies operating in Bangladesh can be listed; 11 are currently listed. Listings of foreign subsidiaries must comply with free float requirements described below. There is no provision to list foreign companies as such. Local companies can be taken over by foreign companies.
Information and disclosure	Issuers are required to release a minimum free float at IPO. For large companies, the minimum is 10%. Issuers are required to publish a prospectus. The BSEC can impose sanctions on issuers and their advisors and, as an extreme measure, cancel an IPO. Issuers are required to provide annual financial statements and unaudited quarterlies. They are also required to provide monthly reports of shareholdings by sponsors and directors. Issuers are required to make prompt (e.g., within 30 minutes of board decision) announcements of a wide and comprehensive list of events that may affect the stock price. Disclosure compliance (and compliance with governance and accounting standards) is generally seen as poor, especially in companies outside the top 50.  Companies can have complex voting structures with differing rights. Protection of minorities is generally regarded as weak and inadequate. Strategies to allow directors to overrule other shareholders at company meetings are common.  Corporate bonds are required to be rated by a local CRA, but are not required to be listed.
Corporate governance	The stock exchanges regulate corporate governance. The code is not explicitly based on an internationally accepted code of governance, but is being developed locally. It is described as a work-in-progress and is at an early stage of development. Companies are required to publish their levels of compliance in their annual reports.
Accounting standards	Bangladesh accounting standards conform to international accounting standards (IAS) with no substantive differences. Standards and accounting firms are currently regulated by the Institute of Chartered Accountants of Bangladesh. Foreign accountancy firms are not permitted to operate.

*Macroeconomic Regulations*

Indicator	Description
Currency flows	The capital account is nonconvertible for all types of domestic investor, so investment outflows are prohibited. Foreign portfolio investors can move funds into and out of the country without restriction.
Taxation	The tax system is neutral between foreign and domestic entities.

**Bhutan***Overview*

Indicator	Description
Market size	The market is very small, with 20 listed companies with a total market value of \$322 million at the end of 2012. Trading is rare, with total trading value of \$4 million in 2012.
Brokers and stock exchanges	There are three broker firms; two are subsidiaries of banks and one is a subsidiary of an insurance company. Securities trading are a minor activity within the conglomerates. There is one stock exchange, the Royal Securities Exchange of Bhutan, which is owned by the three broking firms.
Listed companies	Financial companies, including banks, are required to have a listing. Most significant nonfinancial companies are owned by the government, and privatization is not seen as likely. Larger companies that might list see the market as too small to support their listing. Nonfinancial listed companies tend to be small and not in the major sectors of the Bhutanese economy.
Investors	There is only one significant institutional investor, the National Pension and Provident Fund. The fund is moving toward a funded scheme but is constrained by the small size of the domestic market. The fund is permitted to invest abroad (and has done so in the past) but requires central bank approval of the central bank Royal Monetary Authority (RMA) for each investment, which it is unlikely to get for exchange control reasons.

Indicator	Description
Settlement and margin trading	The settlement system and depository are run by the stock exchange.
Derivatives	There are no derivatives.
Corporate bonds	Bonds are required to be listed but current conditions (bank interest higher than bond interest) mean that only the National Pension and Provident Fund—the only institutional investor—invests. There is no trading. There is also no CRA.

### Market Regulation

Indicator	Description
Regulatory structure and independence	The securities market is regulated by a department of the RMA, which also regulates insurance, banks, pensions, and nonbank financial institutions. The RMA's board is government-appointed. The RMA department levies charges on securities industry participants and is self-funded within the overall RMA budget. Staff have legal immunity.
Intermediary regulation	There is a prohibition on non-Bhutanese ownership of Bhutanese companies, including stockbrokers. Foreign brokers are not allowed to become joint venture partners with local brokers or to set up local subsidiaries.
Market abuse and investor protection	Trading is restricted to the stock exchange. The RMA and the stock exchange have joint responsibility for monitoring and enforcement.

### Issuer Regulation

Indicator	Description
Ownership and location restrictions	Foreign companies cannot be listed in Bhutan, and are rarely allowed to operate in the country. Exceptions include the joint venture Druk PNB Bank. Companies with a track record of less than 3 years are required to issue at face (book) value. In the absence of a pricing process for IPOs (e.g., book-building or auction), shares of companies with longer track records tend also to be issued at book price. In both cases, the shares go to a substantial post-IPO premium, which deters listings.
Information and disclosure	Listing rules and company law require accurate prospectuses. Noncompliant companies and their directors can be fined. Companies are required to produce semiannual financial statements for investors. Price-sensitive information must be published within 24 hours of the company officials or directors becoming aware of the information. <sup>12</sup> There are no provisions to protect the rights of minority shareholders.
Corporate governance	The RMA has issued a code of corporate governance with which companies are expected to comply, but there is no requirement to publish details in their annual reports.
Accounting standards	Bhutan has adopted Indian Accounting Standards but is developing Bhutanese standards, which will conform to international financial reporting standards (IFRS) and IAS. Practitioners are regulated by the Accounting and Auditing Standards Board of Bhutan.

### Macroeconomic Regulations

Indicator	Description
Currency flows	There are no provisions for inflows or outflows of capital for portfolio investment purposes.
Taxation	As foreign companies are not permitted, the question of differential taxation does not arise.

<sup>12</sup> Price-sensitive information is information about the company that is likely to affect the share price. Some listing rules attempt to specify the types of information that might be price-sensitive, e.g., information about sales or merger approaches. In countries with English law practices, most regulators now favor a catch all phrase defining price-sensitive information as any information that a reasonably well-informed market participant would expect to have an impact on the share price.

## India

### Overview

Indicator	Description
Market size	India is by far the largest capital market in the region with more than 5,000 listed companies, a total market value of more than \$1.3 trillion, and turnover of \$690 billion at the end of 2012. There are regional stock exchanges (17 at end 2012), but almost all the trading is conducted on the two stock exchanges that operate nationwide: the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The total trading is split approximately 80/20 between the NSE and BSE.
Brokers and stock exchanges	Both BSE and NSE are private companies owned by major financial institutions. The BSE demutualized in 2005, and the NSE has always been a private company. <sup>13</sup> There are also 17 regional exchanges.  There are a large number of licensed brokers. The NSE currently has 1,423 and the BSE has 1,376. Most brokers are members of both stock exchanges.  The key institutions are the National Securities Clearing Corporation, the National Securities Depository, the Clearing Corporation of India, and the Central Depository Services (India).
Listed companies	It is not mandatory for companies to list on both national stock exchanges (although companies are required to list on their regional stock exchange), but most are listed on both.
Investors	Mutual funds have developed with total assets of \$138 billion at the end of 2012. Some 30 private sector fund managers offer a wide range of funds covering different assets and risk categories. Private sector funds represent more than 80% of total assets under management. Other institutional investors are less well developed, with many pension schemes and insurance companies being restricted to government stock and bank deposits.
Settlement and margin trading	Each national stock exchange operates its own settlement system so there is not complete fungibility (stock bought on one stock exchange must be sold on that stock exchange). <sup>14</sup> Trading and settlement systems are of international standards.
Derivatives	India is the only country in the region to have a significant derivatives market. The NSE has almost all of the financial derivative market, and trades a wide range of stock, stock index derivatives, and interest rate derivatives. Trading volumes are very high.
Corporate bonds	India has a large and active government bond market with a sophisticated electronic trading and settlement system. The corporate bond market is substantial, but few bonds are publicly issued. Most bonds are issued as private placement among a small group. Corporate bond trading is mainly over the counter, but trades are reported and summary data are published by the Securities and Exchange Board of India (SEBI). Corporate bond holdings are dematerialized. <sup>15</sup> Ratings are required and there are five domestic CRAs. Securitizations were increasingly common before the global financial crisis of 2007–2009 but have not yet recovered to precrisis levels.
Other	Both the BSE and the NSE also offer a wide range of other products including indexes, exchange-traded funds, stock borrowing, and lending.

<sup>13</sup> In 2008, the Securities and Exchange Board of India (SEBI) mandated demutualization for all stock exchanges at the same time as it cancelled the licenses of four regional exchanges.

<sup>14</sup> Fungibility means that one share in a company is identical with any other share. The practical implication is that a share bought on one exchange can be sold on another exchange in the country. This is not the case in India: shares bought on the NSE have to be sold on the NSE, and shares bought on the BSE have to be sold on the BSE.

<sup>15</sup> It describes a situation where holdings of shares or bonds are maintained on an electronic register in electronic form (like money in a bank account). The electronic record is proof of ownership; there are no paper certificates.

### Market Regulation

Indicator	Description
Regulatory structure and independence	India has a single securities regulator, the SEBI, which also regulates mutual funds. Insurance and banks are regulated by other entities. The SEBI board is appointed by the Ministry of Finance, and all of the (nonexecutive) members are government officials. SEBI is funded by fees on intermediaries and investment income. SEBI staff members have legal immunity when carrying out their functions in good faith.
Intermediary regulation	Foreign brokers can and do operate in India. They are required to set up a SEBI-licensed subsidiary which can be 100% owned by the foreign broker.
Market abuse and investor protection	Trading must be carried out on a licensed stock exchange. Securities law supplemented by SEBI regulations prohibits all forms of market abuse. Both SEBI and the stock exchanges have surveillance systems with the stock exchanges responsible for real-time surveillance and SEBI responsible for off-line surveillance and for cases which are outside the regulatory jurisdiction of the stock exchanges. SEBI has direct access to bank accounts and can prosecute cases. There are a range of sanctions, and SEBI is permitted to conduct plea bargaining. SEBI currently investigates about 80 cases a year. SEBI's annual report provides extensive information on initiated and completed cases.

### Issuer Regulation

Indicator	Description
Ownership and location restrictions	<p>Subsidiaries of foreign companies operating in India can be listed. They are required to comply with the same rules as domestic companies, including the requirement that 25% of the company must be issued to investors.</p> <p>There is also a provision for foreign companies to list as Indian depository receipts (IDRs). With an IDR, the whole company is listed, not just the part that operates in India. To date only one company, Standard Chartered, has issued IDRs. To issue an IDR, a foreign company must have a track record of being listed and complying with its home stock exchange as well as with Indian listing rules. The benefits from an integration viewpoint have been weakened by the requirement to raise capital when an IDR is issued and the central bank's requirement that the IDRs must be kept separate from other shares of the company. There is no fungibility as there is with an American depository receipt.</p> <p>Companies listed in countries that are signatories to the International Organization of Securities Commissions (IOSCO) multilateral memorandum of understanding (MOU) can list an IDR with a simplified procedure under which the company's compliance with its home market requirements for continuous obligations are taken as being equivalent to compliance with India requirements (a form of mutual recognition). Many countries are signatories, but in the SAARC region only India, the Maldives, Pakistan, and Sri Lanka are signatories.</p> <p>Foreign investors are limited to a certain total percentage of ownership in some sectors. A general limit of 24% also applies, but this can be increased at the discretion of the issuer. There are no additional barriers to foreign takeovers.</p> <p>All listed companies are required to issue and maintain at least 25% of their shares in public hands.</p>
Information and disclosure	<p>Companies are required to provide detailed prospectuses to comply with the listing requirements. The company law proscribes misstatement or misrepresentation on pain of civil or criminal penalties. In addition, SEBI has powers to pass directions against any persons involved in the issue if the prospectus contains improper disclosures.</p> <p>Listed companies are required to provide quarterly updates to the stock exchanges. In addition, companies are required to disclose price-sensitive information immediately.</p> <p>SEBI regulations provide extensive protection for minorities in the event of a takeover or other event likely to affect minority holders. In general, companies are required to offer minorities the opportunity to participate in transactions at the same price and to disclose to them the same information relating to the company as other shareholders.</p> <p>Bonds are required to have ratings from a local agency, and India has five domestic agencies. Bonds are not required to be listed, and most are private placements. The prospectus requirement for a public bond issued by a listed company is less than that for an unlisted company.</p>

Indicator	Description
Corporate governance	Listed companies are required to comply with the corporate governance requirements of the listing agreement. Noncompliance can lead to delisting or fines, although it rarely does. Companies must publish a detailed statement of compliance in their annual report and also quarterly updates. Auditors must issue compliance certificates. The current code is based on, and compliant with, the Organisation for Economic Co-operation and Development (OECD) principles.
Accounting standards	Indian generally accepted accounting principles are the local standard. They are broadly consistent with international standards. India has adopted a convergence route for adoption of IFRS, but the date of final implementation is yet to be announced by the Ministry of Finance. The Institute of Chartered Accountants of India has the statutory responsibility for standards, subject to government oversight. Foreign firms can operate in partnership with local firms.

### Macroeconomic Regulations

Indicator	Description
Currency flows	India retains a complex structure of exchange control administered by the Reserve Bank of India. This has gradually been relaxed, which has added to the complexity. However, most Indian market participants still regard exchange controls as a major barrier to integration of the Indian market globally and with other SAARC countries. The main relaxations have been: <ul style="list-style-type: none"> <li>• Foreign entities can be designated as foreign institutional investors (FIIs)—of which 1,755 are listed by SEBI, although designation is reputed to be sometimes a slow process—and can trade in equities and derivatives without restriction. Investments in government securities and corporate bonds are restricted within an aggregate figure that has been steadily increased.</li> <li>• Indian residents are permitted to remit up to a total of \$200,000 per annum for a range of purposes, including investment in securities. However, the regulations specifically exclude remittances to three SAARC member countries—Bhutan, Nepal, and Pakistan—and to Mauritius.</li> <li>• Indian mutual funds can invest abroad within an aggregate total of \$7 billion.</li> </ul>
Taxation	India has a complex taxation structure. The main points are: <ul style="list-style-type: none"> <li>• Corporate FIIs pay different rates from noncorporate FIIs.</li> <li>• Domestic investors pay different taxes and different rates from FIIs.</li> <li>• Foreign companies operating in India pay different rates from domestic companies.</li> </ul>

## The Maldives

### Overview

Indicator	Description
Market size	The market is small with six listed companies. Trading is infrequent totaling more than \$63,000 in 2012.
Brokers and stock exchanges	Stock trading commenced in 2002. The Maldives Stock Exchange, which was licensed in 2008, is a private company owned by its users.
Listed companies	Government policy favors further privatizations, although the current listed stocks include companies that have a majority state shareholding and there are questions regarding their compliance with disclosure and governance.
Investors	A national pension scheme, which is intended to be a fully funded defined-contribution scheme, has recently been instituted. However, the lack of investable assets in the local market is difficult for the pension fund's managers. In principle, the fund can invest abroad, but foreign exchange limitations render this impossible in the current circumstances of foreign currency shortage.
Settlement and margin trading	The central depository conducts clearing on a T+2 cycle, i.e., the settlement is 2 days after the transaction date. It was operated by the Capital Market Development Authority (CMDA), the regulator, until January 2008. It is now a private company sharing a chief executive officer with the stock exchange, which owns 90% of [what?] (the Maldives Stock Exchange is required by law to own at least 51%).

Indicator	Description
Derivatives	There are no derivatives.
Corporate bonds	There are no corporate bonds, although there is some interest in issuing them. There is a series of Treasury bills of various maturities issued by the central bank on behalf of the Ministry of Finance. The Indian rating agency Credit Analysis and Research (CARE) has a local office.
Other	There is an Islamic bank and an Islamic insurance company. The CMDA has a sharia advisory committee. Policy makers are looking at the possibility of amending the company law to facilitate incorporation of special purpose vehicles for developing new products.

### Market Regulation

Indicator	Description
Regulatory structure and independence	<p>The CMDA regulates the securities market. It is also tasked with the supervision of the Maldives Retirement Pension Scheme administered by the Maldives Pension Administration Office. Its regulation of the securities market encompasses dealers, dealers' representative, CRAs, custodians, principal advisors, the stock exchange, and the securities depository.</p> <p>The current strategy for capital market development is to introduce new licensing categories such as asset managers, investment advisers, sharia advisers, collective investment schemes, and unit trusts.</p> <p>The regulator is structured to fund itself from industry fees, but at current levels of activity a government subsidy is required.</p>
Intermediary regulation	Foreign-owned brokers are permitted to set up wholly or partially owned subsidiaries (although none have yet done so). Foreign brokers have higher capital requirements than domestic brokers. There is no restriction on repatriation of profits. There are no requirements for professional qualifications for brokers.
Market abuse and investor protection	All trading of equities must be done on the stock exchange. Market abuse is prohibited by law, and the CMDA is responsible for monitoring and enforcement.

### Issuer Regulation

Indicator	Description
Ownership and location restrictions	Foreign incorporated companies can list, although none have yet done so. Foreigners are generally permitted to own shares in domestic companies (unless specifically prohibited by, for example, the Land Act), and two listed companies have majority foreign ownership. Such companies are required to comply fully with local requirements.
Information and disclosure	<p>Issuers are required to produce a prospectus that complies with the Companies Act, the CMDA's rules, and the stock exchange's listing rules. The CMDA has the power to suspend or cancel a noncompliant prospectus. Companies are required to provide quarterly and annual reports as well as updates of price-sensitive information.</p> <p>Multiple voting structures are permitted, and protection of minorities is not mandated but is subject to each company's articles.</p> <p>While the Maldives has company and securities legislation, it lacks bankruptcy procedures, consumer protection laws, and trust laws. Corporate structures are complex with cross-holding structures. Listed companies have complex share structures and make frequent changes to share structures such as through large bonus share issues. Dividend payments are large and are the main reason shares are held. The shareholder base is mainly retail.</p>
Corporate governance	Listed companies are required to conform to the CMDA's Corporate Governance Code and to publish their compliance. The code is modeled on the OECD principles of corporate governance. However, Maldivian companies tend to have complex ownership structures including cross-ownerships and pyramid structures. In addition, there are significant government holdings in some of the larger listed companies.
Accounting standards	The Maldives follows IFRS and IAS, and there is no separate local standard. Supervision of standards is the responsibility of the auditor general. Most accountancy firms operating in the Maldives are foreign owned.

### Macroeconomic Regulations

Indicator	Description
Currency flows	There are no formal restrictions on outflows for portfolio investment. Individuals can invest abroad. There is widespread hoarding of foreign currency, and many transactions related to the tourism industry are conducted in US dollars.
Taxation	The tax treatment of foreign and domestic companies is the same. Foreign investors are required to pay an administration fee as part of their approval and when the foreign investor agreement is renewed or amended.

## Nepal

### Overview

Indicator	Description
Market size	The Nepalese market has a substantial number of listed companies—216 with a value of \$4,160 million at the end of 2012. The market is illiquid and volatile. Turnover in 2012 was \$51 million, a turnover to market value ratio of 1.2%, which is very low compared with most other markets.
Brokers and stock exchanges	There are 60 brokers. Their activities are restricted to executing orders on the stock exchange. The Government of Nepal, Nepal Rastra Bank (the central bank), Nepal Industrial Development Corporation, and members are the shareholders of the Nepal Stock Exchange (NEPSE). The trading system was installed in 2007. NEPSE is looking for a replacement (funded by development assistance). The securities law now permits competing stock exchanges, and it is reported that there are four applicants for licenses. There are discussions about demutualization, but there is no progress. There are concerns among brokers that progress in developing the market is slow.
Listed companies	Most of the listed companies are financial companies, which are required by law to have a listing. The financial companies make up about 85% of the listed companies and about 75% of total paid-up value.
Investors	The government has recently enacted the Mutual Fund Regulations, and the Securities Board of Nepal (SEBON) has provided licenses to two institutions for the operation of mutual funds. There is an inherent problem in that most of the listed companies are finance related with extensive cross-holdings, so mutual funds will, to a considerable extent, be investing in their parent companies.
Settlement and margin trading	Settlement was paper-based and slow, but a new depository (owned by NEPSE and developed with Indian assistance) has recently been established. Appropriate legislation has been passed, and SEBON has approved the Central Depository System bylaws. However, the cash side of settlement will continue to be manual and hence will lag behind the movement of stock.
Derivatives	There are no derivatives.
Corporate bonds	There were 16 government bonds listed and 13 listed corporate debentures at the end of 2012. ICRA Nepal, in a joint venture with ICRA India (an Indian credit rating agency), was granted a license to operate a credit rating agency in Nepal in October 2012.

### Market Regulation

Indicator	Description
Regulatory structure and independence	SEBON regulates the securities market including mutual funds. Board members are appointed by the government. SEBON is entirely self-financing, the grant from the government having ceased in 2010–2011. The Ministry of Finance has day-to-day involvement in the management and operation of the exchange.
Intermediary regulation	Stock brokers are limited to executing client orders on the stock exchange. They cannot manage funds, trade for their own account, publish research, or advertise for business. Foreign brokers would be permitted to set up local subsidiaries if they desired, but repatriation of profits would be difficult or even impossible. SEBON is considering a professional education system for brokers.
Market abuse and investor protection	Trading must be carried out on the stock exchange. Both the NEPSE and SEBON have systems to detect market abuse, which is prohibited.

### Issuer Regulation

Indicator	Description
Ownership and location restrictions	There are no provisions for the listing of foreign companies, but local subsidiaries of foreign companies can list. With the exception of banks, there are no restrictions on foreign ownership of domestic companies. Sponsors are required to hold 51% of their companies, which segments the market and the already small liquidity. New companies are required to have 500 shareholders at issue.
Information and disclosure	<p>IPO pricing is controlled so that the issue price cannot exceed net worth. IPOs are usually heavily oversubscribed and tend to trade at a sustained premium to the issue price.</p> <p>Prospectuses are regulated by SEBON, which can fine companies for noncompliance. Listed companies are required to publish quarterly updates, although a significant number do not comply. Companies are required to announce price-sensitive information within a week of the decision.</p> <p>The listed finance companies have no desire to attract investors and are generally poor in terms of compliance.</p> <p>Minorities receive some protection in the Companies Act, but there are no specific SEBON rules for takeovers and mergers.</p> <p>Corporate bonds do not have to be rated as there are no domestic rating agencies as yet. CARE is establishing a presence. Issuers of bonds must be listed.</p>
Corporate governance	Corporate governance standards are contained in the Companies Act, but the provisions are weak and not strongly enforced. Companies may publish their annual report but are not required to do so.
Accounting standards	The current Nepalese standards are not significantly different from international standards. Nepal is in the process of aligning financial reporting with international practice by adopting IFRS. <sup>16</sup> The adoption involves the replacement of existing Nepal accounting standards with IFRS-compliant Nepal accounting standards by the Accounting Standards Board of Nepal. Regulation of audit is the responsibility of the National Accounting Standards Board, and practitioners are regulated by the Institute of Chartered Accountants of Nepal. Only Nepalese firms can conduct audits. Some Nepalese firms have links to international firms.

### Macroeconomic Regulations

Indicator	Description
Currency flows	There are exchange controls. In practice, it is not possible to move money outside the country for investment purposes, although expatriate Nepalese can invest their foreign earnings outside the country.
Taxation	This is not relevant as foreign companies cannot list in Nepal.

<sup>16</sup> In April 2001, the International Accounting Standards Board adopted all IAS and continued their development, calling the new standards IFRS. IFRS are considered a principles-based set of standards in that they establish broad rules and dictate specific accounting treatments.

## Pakistan

### Overview

Indicator	Description
Market size	The Pakistan capital market is of significant size with 573 listed companies, a total market value of \$43.7 billion at the end of 2012, and a turnover of \$14 billion in 2012. Turnover is currently much depressed because of political uncertainty, but it is recovering.
Brokers and stock exchanges	There are three stock exchanges—the Karachi Stock Exchange (KSE), the Lahore Stock Exchange, and the Islamabad Stock Exchange, with the KSE being the largest. The stock exchanges are in competition for business and are mutually owned. A demutualization law was passed in March 2012, more than 12 years after the matter was first discussed. At current volumes, the smaller stock exchanges are facing a business challenge and have responded mainly by trying to attract trade rather than through listing or developing new products. Each stock exchange has its own membership with some overlap—the KSE has 134 members, the Lahore Stock Exchange 74, and the Islamabad Stock Exchange 53.
Listed companies	Companies are not required to list on all stock exchanges.
Investors	The mutual fund sector is dominated by the government-owned National Investment Trust (NIT). Equity funds only represent about 16% of the total assets of mutual funds; the rest are mainly money-market funds, which are used by corporate treasurers. The NIT represents 78% of the equity mutual fund assets. The NIT is now a net asset value fund. In 2008, the NIT, using government guaranteed loans, set up funds to support the stock market and this remains part of their mission.
Settlement and margin trading	Settlement is centralized, dematerialized, and operated by the National Clearing Company of Pakistan and the Central Depository Company of Pakistan. The settlement period is T+3. The Margin Trading System allows margin trading (up to 400% of collateral) and stock borrowing.
Derivatives	There are index derivatives on the KSE, although trading has yet to become substantial.
Corporate bonds	Major companies are sophisticated users of multiple finance sources including bond finance. Most bonds are issued as private placements and not listed. However, there have been issues aimed at retail investors.

### Market Regulation

Indicator	Description
Regulatory structure and independence	The Securities and Exchange Commission of Pakistan (SECP) has jurisdiction over the capital market including mutual funds, insurance, and private pensions. It has considerable legal powers to do this but is not permitted to prosecute cases. Banks, which are regulated by the central bank, also have some capital market activities. The SECP has legal independence, but there is a strong perception that there is external influence evidenced by the length of time taken to appoint commissioners. SECP staff members have legal immunity.  The regulator is adequately funded by a combination of industry fees and levies, particularly the fees associated with company registration.
Intermediary regulation	Licensed brokers must be incorporated in Pakistan. There are no limits to foreign ownership of licensed brokers, although currently no foreign brokers are active in Pakistan.  A recent initiative by the SECP aims to substantially increase the net capital requirement for brokers. This is seen by brokers as a way of driving out weaker and less compliant brokers, but the proposed high levels would exclude all but a few of the current licensed brokers.
Market abuse and investor protection	The market has experienced some challenges in recent years. It was effectively closed for 110 days in 2008. <sup>17</sup> Manipulation has been a problem, but the regulator believes the problem has diminished. The regulator has been active in trying to address manipulation, but industry sentiment suggests that there is an excess of interventions and that these are conducted without much industry consultation.  Market abuse is prohibited and monitoring is split. The stock exchanges are responsible for frontline monitoring and applying sanctions to members or issuers, and the SECP takes cases that are more serious or that involve entities outside the stock exchanges' regulatory remit.

<sup>17</sup> In 2008, there was strong downward pressure on the market with a one-third fall between April and July. In August, the regulator set a floor on stock prices below which they were not permitted to fall. There were repeated attempts to reopen the market, but on opening, the market immediately fell below the floor level and so the market was closed again. On 15 December 2008, the floor was removed and trading resumed. See Info About Stock Market 2009. <http://infoworldstock.blogspot.co.uk/2009/04/2008-karachi-stock-exchange-crisis.html> (accessed 5 April 2014).

### Issuer Regulation

Indicator	Description
Ownership and location restrictions	Local subsidiaries of foreign companies can be listed, and several are listed. There are no requirements for subsidiaries to issue a minimum percentage to local investors. There are no limits on foreign ownership of listed companies, nor are there barriers to takeovers of domestic companies by foreign companies.
Information and disclosure	<p>Companies are required to publish a prospectus for an IPO. The SECP can impose sanctions for failure to make adequate disclosures. Listed companies are required to publish quarterly and annual results and financials. Companies are required to notify the stock exchange of any decisions or developments likely to affect the stock price before releasing such information to other persons or media.</p> <p>Companies are permitted to have complex voting structures. There is protection for minority holders in the KSE's listing rules to ensure they are not disadvantaged when the company is sold at a premium to the current price.</p> <p>Bond issuers are required to have ratings above a minimum from a CRA that is registered with the SECP. Foreign CRAs can operate and be registered in Pakistan. Listing of bonds or their issuers is not mandatory, although it is normal for bonds issued to retail investors.</p>
Corporate governance	The listing regulations of the stock exchanges contain a code of corporate governance. The code is based on the OECD code and is currently being revised to bring it closer to international best practice. A Revised Code of Corporate Governance was launched as part of the listing regulations of the stock exchanges in April 2012; and as part of the SECP's efforts to reach out to the stakeholders, awareness sessions were conducted for chief executive officers, chief financial officers, company secretaries, and international auditors of the listed companies. The stock exchanges are responsible for enforcement, but companies are also required to publish audited statements of compliance.
Accounting standards	Pakistan follows IFRS with no significant variations. The SECP regulates standards, while the Institute of Chartered Accountants of Pakistan regulates practitioners. Foreign accountancy firms can operate through local affiliates and associates.

### Macroeconomic Regulations

Indicator	Description
Currency flows	<p>Domestic companies can remit payments to foreign shareholders without restriction provided they are remitted to the investor's Special Convertible Rupee Account (SCRA). Inward portfolio investment is also unrestricted provided it is carried out through the SCRA. Any funds in SCRA can be transferred to other accounts by the holder.</p> <p>Domestic investors are permitted to invest abroad through mutual funds. Mutual funds can hold up to 30% of their assets (to a maximum of \$15 million) in foreign assets. However, each transaction requires the approval of the central bank. Approvals are very rarely, if ever, granted. Similar regulations apply to pension and insurance funds.</p>
Taxation	There is no difference in treatment between foreign and domestic entities, except for a 10% withholding tax that foreign investors face.

## Sri Lanka

### Overview

Indicator	Description
Market size	Sri Lanka has a long-standing but small capital market with 287 listed companies and total market value of nearly \$17 billion at the end of 2012. Trading is illiquid totaling \$1.6 billion in 2012, giving a turnover to market value ratio of less than 10%.
Brokers and stock exchanges	There are 29 licensed brokerage firms that are members of the stock exchange. Brokerage commissions are fixed.  The Colombo Stock Exchange (CSE) is the only stock exchange. It is a member-owned mutual association. There has been discussion of demutualization for many years but there are legal barriers. The Securities and Exchange Commission of Sri Lanka (SEC) is in the final stages of drawing up a draft bill for demutualization. <sup>18</sup>
Listed companies	Sri Lanka has a large number of listed companies for the size of its economy, with 287 listed companies and a gross domestic product (GDP) of \$67 billion (World Bank 2013).
Investors	Mutual funds are developing. Currently, the Unit Trust Association of Sri Lanka reported seven companies with 23 funds available. They have struggled to attract retail investors, and much of the business is tax-avoidance trading by companies. The government pension fund mainly invests in government stock, as do the private provident funds. Insurance companies—there are about 20 life companies—are permitted to invest up to 33% in equities. They mainly invest in the 25 largest companies.
Settlement and margin trading	The CSE runs the settlement system which has a T+2 cycle. A central counterparty was planned for 2012 as part of an overall upgrading of information technology (IT). Foreign investors are active participants in the market, representing about 20% of trading. Unregulated margin lending by brokers against stock collateral is widespread—estimates give a total of \$6 billion. The SEC has required brokers to set up separate subsidiaries to handle margin lending.
Derivatives	There are, as yet, no derivatives.
Corporate bonds	The government bond market is significant with an active issuance calendar. Bonds are issued out to 10 years maturity. Corporate bonds are much rarer with only some 5-year bank issues.
Other	The CSE has developed exchange-traded funds.

### Market Regulation

Indicator	Description
Regulatory structure and independence	The capital market is regulated by the SEC. This covers markets, brokers, and fund managers. The commissioners are appointed by the Minister of Finance or by virtue of their government position. The SEC has income sources, but most of its revenues come from government transfers to cover operating expenses.
Intermediary regulation	Licensed brokers must be incorporated in Sri Lanka. There are no barriers to foreign ownership and control of local broking subsidiaries. A number of brokers are foreign controlled, some by Indian firms.
Market abuse and investor protection	Trading must be carried out on the CSE. Market abuse is prohibited. The CSE has frontline monitoring responsibility, and the SEC has offline responsibility. The SEC is empowered to make settlements in abuse cases. There are plans to permit civil actions.

<sup>18</sup> Nalaka Godahewa, the Chairman of SEC, said that the demutualization bill was ready but it had to be passed by the Parliament. He also said that if everything is okay, the demutualization proposal will also come into play in 2015. See Sri Lanka Business News. <http://slbiznews.blogspot.com/2014/12/csedomutualization-next-year-regulator.html>

### Issuer Regulation

Indicator	Description
Ownership and location restrictions	There are no obstacles, except in banking, to foreign ownership of listed companies. Sri Lankan incorporated subsidiaries of foreign companies can be listed. All listed companies, including foreign subsidiaries, must have a minimum public float of 25%.
Information and disclosure	The CSE listing agreement specifies the requirements for prospectuses and quarterly reporting. The CSE is the regulator of corporate disclosures. Listed companies are also required to immediately notify the stock exchange of price-sensitive information including directors' dealing. Participants consider standards quite good and above average for the region.
Corporate governance	Since 2008, it has been a requirement that listed companies should comply with the corporate governance rules which are part of the CSE listing rules. Companies are required to publish their compliance or reasons for noncompliance in their annual report. The rules are based on the United Kingdom Corporate Governance Code.
Accounting standards	Accounting standards are regulated by the Sri Lanka Accounting and Auditing Standards Monitoring Board. The standards are partially compliant with IFRS. Some significant IFRS have not been adopted. Practitioners are regulated by the Institute of Chartered Accountants of Sri Lanka.

### Macroeconomic Regulations

Indicator	Description
Currency flows	During 2010, the Central Bank of Sri Lanka announced some relaxation of exchange controls. In particular, Sri Lankan individuals and companies now have general permission to acquire, hold, and transfer shares of companies outside Sri Lanka. This is to be accomplished through special outward investment accounts held at commercial banks. Each person has an annual allowance of \$100,000 for investment in foreign equities.
Taxation	The Sri Lankan taxation system is complex, although successful steps have been taken to simplify it. The issue of taxation of foreign companies or foreign-owned investments was not raised as a barrier in any of the fieldwork meetings.

### Mutual Funds in South Asia

Mutual funds are not well developed in any of the capital markets of SAARC countries. India has a substantial industry, but it is largely used as a tax-efficient deposit substitute. Bangladesh, Pakistan, and Sri Lanka have long-standing but relatively small mutual fund industries. Nepal is at the earliest stages of setting up a mutual fund industry, having recently introduced regulations and having two asset management companies licensed. Bhutan and the Maldives have no mutual fund industry. The development of mutual funds has been slow, with approximately three-quarters of funds being invested in fixed-income assets. The Indian market, while nearly 40 times the size of the next largest, is particularly skewed with nearly 80% of assets under management in money market and other interest-bearing assets and nearly all of new investment in short-term money market assets.

Table 15.2 summarizes the situation.

**Table 15.2: South Asian Mutual Funds**

Country	Start Date	Fund Management Companies (number)	Assets under Management (\$ million)	Equity Assets under Management (\$ million)	Share of Domestic Equity Market Value (%)
Bangladesh	1980	26	1,100	300	1.0
India	1964	47	133,000	30,000	2.6
Nepal	2010	2	16	-	0.0
Pakistan	1962	23	3,500	1,060	2.0
Sri Lanka	1991	13	240	69	0.4

Source: Fieldwork discussions with market participants.

## Cross-Regional Analysis of Regulations

### Market Regulation

#### *Regulatory Structure and Independence*

The International Organization of Securities Commissions (IOSCO) principles place considerable importance on the independence of the regulator. Several of the core principles address the independence and hence effectiveness of the regulator; those principles form the basis of the analysis in this section. Six of the seven SAARC countries have a single regulator for the capital market, with banking and insurance subject to different regulators. In all but two SAARC markets, regulators are protected from arbitrary dismissal, which thus strengthens their independence (Table 15.3). Funding of the regulator is difficult in several countries, partly because of the small size of the markets. Self-funding, whereby the regulator is funded by revenue derived from users of the market rather than from the government, is seen by IOSCO as an important support for regulatory independence. Legal immunity for regulatory staff when carrying out their normal duties—another feature recognized by IOSCO—is the norm among the SAARC countries except Bangladesh.

#### *Intermediary Regulation*

Questions during the fieldwork on intermediary regulation covered the qualifications of brokers, the ability of foreigners to enter the market, and the permitted range of activities of brokerage businesses (Table 15.4). In most countries, formal professional qualifications, such as examinations, are not required for the licensing of brokers. In all countries, except Bhutan, foreign brokers can operate but must set up a separate subsidiary, which can be wholly owned. Broking activities are restricted in four of the seven markets—in the smaller ones they are usually restricted to the execution of orders and cannot offer advice. Some

**Table 15.3: Regulatory Structure and Independence**

Country	Structure	Dismissal of Senior Officials other than for Misconduct	Funding of Regulator	Legal Immunity of Staff
Bangladesh	Single regulator for capital market	No	Mixed, mainly government	No
Bhutan	Combined regulator for finance sector	Yes	Mixed, part of overall regulator	Yes
India	Single regulator for capital market	No	Industry	Yes
Maldives	Single regulator for capital market and pensions	Yes	Mixed, largely government	Yes
Nepal	Single regulator for capital market	No	Industry	Yes
Pakistan	Single regulator for capital market	No	Industry	Yes
Sri Lanka	Single regulator for capital market	No	Mixed, largely government	Yes

Source: Fieldwork discussions with market participants.

**Table 15.4: Qualifications of Brokers**

Country	Professional Qualifications Required for License as a Broker	Foreign Brokers	Role of Brokers
Bangladesh	No	As subsidiaries, up to 100%	Limited to research and advice
Bhutan	No	No foreign brokers allowed	Limited in practice to execution
India	No	As subsidiaries, up to 100%	Brokers offer all investment services
Maldives	Yes—examinations	As subsidiaries, up to 100%	Limited in practice to execution
Nepal	No	As subsidiaries, up to 100%	Limited to execution
Pakistan	No	As subsidiaries, up to 100%	Full service
Sri Lanka	Yes	As subsidiaries, up to 100%	Full service

Source: Fieldwork discussions with market participants.

are prevented from soliciting business, and most are prohibited from proprietary trading, although margin lending through brokers is common.

#### *Market Abuse and Investor Protection*

Fieldwork questions under this subtitle addressed prohibition of market abuse and over-the-counter (unregulated) trading, and surveillance responsibility (Table 15.5). All SAARC markets have prohibitions on a normal range of market abuses. In most cases, trading in an unregulated venue is prohibited. The usual configuration for monitoring and surveillance is for the stock exchange to have responsibility for real-time detection of potential abuse and the regulator to have facilities for off-line examination as well as wider powers over investors and other persons not regulated by the stock exchange.

**Table 15.5: Market Abuse and Investor Protection**

Country	Prohibition on Market Abuse	Unregulated Off-Exchange Equity Trading Allowed	Surveillance
Bangladesh	Yes	Yes	The two stock exchanges with limited coordination Regulator currently procuring an online system
Bhutan	Yes	No	Joint—regulator and stock exchange
India	Yes	No	Joint—regulator and stock exchanges
Maldives	Yes	No	Regulator
Nepal	Yes	No	Joint—regulator and stock exchanges
Pakistan	Yes	No	Joint—regulator and stock exchanges
Sri Lanka	Yes	No	Joint—regulator and stock exchanges

Source: Fieldwork discussions with market participants.

### Issuer Regulation

**Ownership and location restrictions.** Fieldwork questions under this subtitle addressed the extent to which foreign issuers could access the domestic market, the limitations on foreign ownership, barriers to foreign takeovers, and the free float requirement (Table 15.6). The regulations in five SAARC countries only permit listing of the locally operating subsidiaries of foreign companies. India allows listing of foreign company subsidiaries and has an additional provision for Indian depository receipts (IDRs), which allows the listing of an entire foreign company (i.e., the domestic and foreign operations). However, the IDR provision requires a set amount to be issued in IDRs, which means the IDR holdings are not fungible with the normal shares of the company. Six countries have only light or no restrictions on foreign ownership of domestic companies outside the banking sector. India has sector limits that set maximum foreign-owned percentages in companies in certain industries, but these are probably more of a problem for foreign direct investment (FDI) than for portfolio investors. It is common to have free float requirements for listed companies, including foreign subsidiaries. Companies that fail to maintain the minimum free float can be delisted, but this is rare in practice.

**Information and disclosure.** Fieldwork questions under this subtitle addressed disclosures and the extent to which minority investors were protected against misbehavior by dominant shareholders (Table 15.7). All countries require and regulate prospectuses, and all but one requires quarterly financial updates. Treatment and definitions of price-sensitive information vary considerably from strict requirements for immediate reporting of any information likely to affect the price to slower disclosure or disclosures limited to board decisions. Complex voting structures where investors have differing voting rights are permitted in all countries. Protection of minorities is generally weak and/or partial, except in India. It is commonly believed that dominant shareholders and sponsors are able to take

**Table 15.6: Ownership and Location Restrictions**

Country	Listing of Foreign Companies	Limits on Foreign Ownership	Barriers to Foreign Takeovers	Minimum Public Float at Initial Public Offering
Bangladesh	Local subsidiaries only	None	None	40% (or 10% for larger issues)
Bhutan	No	Total prohibition	Not allowed	25%
India	Local subsidiaries and IDRs of foreign companies	Sector limitations	None subject to sector limitations	25%
Maldives	Local subsidiaries only	None except for land	Tax barrier of royalties in foreign companies	Must offer minimum of 250,000 shares to public
Nepal	Local subsidiaries only	Only in banking	None	No requirement
Pakistan	Local subsidiaries only	None	None	50% or 25% for larger issues
Sri Lanka	Local subsidiaries only	Only in banking	None	25%

IDRs = Indian depository receipts.

Source: Fieldwork discussions with market participants.

**Table 15.7: Disclosures and Protection of Minorities**

Country	Regulation of Prospectus Content	Regular Updates	Price-Sensitive Information Disclosure	Complex Voting Structures Allowed	Protection of Minorities in Rules
Bangladesh	Yes	Quarterly	Board decisions made public within 30 minutes	Yes	Weak
Bhutan	Yes	Semiannual	Within 24 hours	Yes	None
India	Yes	Quarterly	Immediately	Yes	Regulations give protection
Maldives	Yes	Quarterly	Immediately	Yes	None
Nepal	Yes	Quarterly	Within a week of board decision	Yes	Limited
Pakistan	Yes	Quarterly	Publish on stock exchange before anywhere else	Yes	Protection against being excluded from advantageous price
Sri Lanka	Yes	Quarterly	Immediately	Yes	Anyone acquiring more than 30% of a company must make an offer for the remainder

Source: Fieldwork discussions with market participants.

advantage of their position.<sup>19</sup> The responses to questions on corporate bond issues showed that all but two countries have a requirement for a rating. The exceptions are Bhutan, which does not have a rating agency, and Nepal, which has only recently licensed an agency. Only the Maldives and Nepal require listing of corporate bonds.

**Corporate governance.** This section reports on corporate governance standards, including whether there is a code and whether it is based on an international standard. In principle, noncompliant companies can be delisted, although this sanction is seldom applied. The main discipline in most markets is a requirement to publish levels of compliance (Table 15.8). All SAARC countries have some form of corporate governance regulation except for Nepal, which only has the minimal requirements of its Companies Act. In general, the codes are based on or approach the Organisation for Economic Co-operation and Development (OECD) standard, except for Bangladesh, which is at an early stage of governance regulation.

**Accounting standards.** This section examines compliance with or convergence toward international accounting standards (IAS) and openness to foreign accountancy firms (Table 15.9). Most countries comply with or are moving rapidly toward conformity with international standards. The exception is India, which has “adopted a direction” but not yet published a time schedule. Foreign accountancy firms can operate in only four countries and can operate only as joint ventures in all but one country.

<sup>19</sup> Sponsors are individuals who are involved in launching the company but are not necessarily founders.

**Table 15.8: Corporate Governance**

Country	Rules or Codes on Governance	Companies Must Publish Compliance	Code Based on International Standard
Bangladesh	Yes, stock exchanges regulate	Yes, in annual report	No, local
Bhutan	Yes, by regulator	No	Modeled on OECD principles
India	Yes, stock exchanges regulate	Yes, in annual report	Compliant with OECD principles
Maldives	Yes, by regulator	Yes, in annual report	Modeled on OECD principles
Nepal	General provisions in Companies Act No code	No	No
Pakistan	Yes, stock exchanges regulate	Yes, audited statement of compliance required	Modeled on OECD principles
Sri Lanka	Yes, stock exchanges regulate	Yes, in annual report	Modeled on United Kingdom code, OECD compliant

OECD = Organisation for Economic Co-operation and Development.

Source: Fieldwork discussions with market participants.

**Table 15.9: Accounting Standards**

Country	Follow International Standard	Regulator of Standards	Foreign Accountancy Firms Permitted
Bangladesh	IFRS/IAS	Professional institute	No
Bhutan	Currently Indian standards but moving toward IFRS/IAS	National board	No
India	Local standards but moving toward IFRS	Professional institute	In partnerships with local firms
Maldives	IFRS/IAS	Auditor General	Yes
Nepal	IFRS adopted and implementation expected to be complete by July 2016	National board	No
Pakistan	IFRS/IAS	Professional institute	In partnerships with local firms
Sri Lanka	Partially compliant with IFRS	Professional institute	In partnerships with local firms

Note: IAS = international accounting standards, IFRS = international financial reporting standards.

Source: Fieldwork discussions with market participants.

## Macroeconomic Regulations

### Currency Flows

Exchange control is a major barrier to greater integration in the SAARC region. Fieldwork questions covered restrictions on inflows, outflows, and fund investments (Table 15.10). Exchange control is a prevailing feature of the SAARC region. All countries, except Bhutan, accept portfolio inflows subject to other restrictions on foreign ownership. In practice, all countries have strict controls on portfolio outflows, but India has gradually relaxed its controls and Sri Lanka has begun a similar process.

### Taxation

This section looks at differences in tax treatment between foreign and domestic holders of domestic investments, and treatment between of foreign and domestic investments (Table 15.11). Apart from Bhutan, SAARC members treat foreign and domestic companies and foreign and domestic intermediaries in broadly the same manner. However, the Maldives has an additional royalty tax on foreign companies. India has a generally complex taxation structure, this complexity extends to differential treatment of foreign and domestic investors. Most of the other SAARC countries have little experience of foreign investment, so the taxation issue has probably not arisen.

**Table 15.10: Currency Flows**

Country	Restrictions				
	Interest and Dividend Payments to Foreign Investors	Portfolio Investment Inflows	Outflows from Domestic Investors	Inflows to Domestic Investors	Foreign Investment by Domestic Investment Institutions
Bangladesh	No	No	Yes, not permitted	No	Yes
Bhutan	Yes, not permitted	Yes, not permitted	Yes, not permitted	Yes, not permitted	Yes, except through national scheme
India	No, through special account	No	Yes, annual limit \$200,000	No, through special account	Aggregate limits on mutual funds Other funds generally prohibited by investment mandate rules
Maldives	No, but may not always be possible to exchange	No	Began a process of relaxation in February 2010.	No	National pension fund can invest in foreign assets
Nepal	Yes	No	Yes, but rules are imprecise	Yes, but rules are imprecise	Yes, but rules are imprecise
Pakistan	No, through special account	No	Yes, requires case-by-case permission	No, through special account	Yes, mutual funds subject to caps
Sri Lanka	No	No	Yes, annual limit	No	Case-by-case approval required

Source: Fieldwork discussions with market participants.

**Table 15.11: Taxation**

Country	Differences in Treatment		
	Foreign and Domestic Investors	Foreign and Domestic Listed Companies	Foreign and Domestic Intermediaries
Bangladesh	No	Only local subsidiaries allowed to list so treatment same	Only local subsidiaries allowed so treatment same
Bhutan	Not allowed, so not applicable.		
India	Yes		
Maldives	No		
Nepal	No	Only local subsidiaries allowed to list so treatment same	Only local subsidiaries allowed so treatment same
Pakistan	No		
Sri Lanka	No		

Source: Fieldwork discussions with market participants.

## Analysis of Findings

### *Diversity of Size and Development*

SAARC members show wide divergences in their capital market development. This is most apparent in their market size, with India at one end of the scale, representing 93% of the total market value of listed equity in the SAARC region, and very small markets at the other end of the scale, such as the Maldives with four listed companies and a total market value of \$115 million (end of 2012) and very few transactions. In addition to the difference in size, innovation in exchange-traded products is low, except in India. Almost no markets trade any product other than basic equity shares. There are few exchange-traded funds; almost no derivatives except in India, which has a large market, and Pakistan, which has a modest market; no real estate investment trusts; and almost no corporate bonds.

The markets also show considerable instability—again with the exception of India. Most are undergoing or have undergone extreme volatility. They do not have the resilience to withstand volatility, and regulatory reactions may have exacerbated already difficult situations.

### *Similarity of Standards, Diversity of Compliance and Enforcement*

In terms of basic structures and regulations, the markets show considerable harmonization. All have regulators tasked with supervising the market, and requirements for prospectuses and continuing disclosure. Most have some form of corporate governance standards, and most have adopted or are adopting a recognized IAS. In addition, the codes, disclosure requirements, and regulations are largely based on international practice.

However, discussions with practitioners suggested that enforcement standards in most SAARC member countries are low. Some consistent themes were that markets were manipulated but the regulators had not been able to act, governance standards fell well short of any code, and corporate disclosures were not honest. Participants also suggested that those involved in abuse were powerful and influential, and that regulators sometimes lacked the confidence to act decisively against powerful interests. Generally, the larger and more developed markets, especially those where foreign intermediaries played a

significant role, had fewer problems with abuse and better standards of compliance and enforcement. In most cases, the participants agreed that standards were improving, but further improvement was needed.

This is a common observation among developing markets in other regions, and it does not preclude progress on harmonization and integration. Even in regions where integration has progressed further, there are wide variations in the effectiveness of regulators. The Association of Southeast Asian Nations (ASEAN) may opt to integrate in two streams to reflect the differences in development among its members. However, weak enforcement of regulations is likely to be a barrier to further development of SAARC markets.

There have been some regional and local initiatives to increase cooperation between regulators in the SAARC region. For example, at the South Asian Federation of Exchanges (SAFE) annual general meeting in 2005, the South Asian Securities Regulators' Forum was established and a memorandum of understanding (MOU) was signed between the regulators of Bangladesh, Bhutan, Mauritius, Nepal, and Pakistan.<sup>20</sup> Efforts continue on bilateral MOUs: India and Pakistan signed an MOU in January 2008, and the Maldives is in discussions with the Securities and Exchange Board of India (SEBI) about an MOU. In addition, several SAARC members—Bangladesh, India, the Maldives, and Pakistan—are also members of Organization of Securities Commissions (IOSCO). India, the Maldives, and Pakistan are signatories to the IOSCO multilateral MOU. However, contacts between the regulators are still limited, largely because there is little cross-border business hence little practical need for regulator cooperation.

#### *Markets Closed to Foreign Companies*

No SAARC markets provide for listing of foreign companies, whether from within SAARC or from outside. All except Bhutan allow listing of subsidiaries of foreign companies. With one exception, it is only possible to list the subsidiary that operates in the country concerned, not the entire foreign company.<sup>21</sup> The IDR facility allows the entirety of a foreign company—Indian and non-Indian parts—to raise money and be traded on the Indian market. However, as already noted, the facility has been limited by the Central Bank and has so far only attracted one company.

The advantages of cross-listing have been reduced in developed markets. In the past, cross-listing allowed investors in one country to invest in foreign companies; but now it is relatively easy, and usually preferable, to invest directly through the foreign market. Listing in another market only brings significant benefits when the home market is too small or otherwise inadequate to support an issue. However, many less developed markets cannot support large issues, so the benefit to their companies of being able to issue into other markets may be substantial. Cross-listing gives companies in smaller markets an opportunity to raise capital without swamping their home market or moving their listing to one of the global financial centers.

<sup>20</sup> Mauritius is an affiliate member of SAFE.

<sup>21</sup> This is not uncommon, but it tends to mean either (i) the subsidiaries do not list because they do not wish to raise capital locally, or (ii) they list with almost all the shares being held by the parent company and practically no free float.

The case of Druk Green, a state-owned hydroelectric company in Bhutan, illustrates the need for cross-listing. While privatization is not being considered, the company wishes to fund some of its new projects privately through an initial public offering (IPO). However, the IPO would be larger than the Bhutanese capital market can absorb. The national pension fund is keen for assets and could possibly buy the issue, or a large part of it, but Druk Green would prefer an IPO that would give them a more diverse and broad shareholder base. The company would like to do an IPO in SAARC—ideally in India, because this limits the currency risk. However, none of the SAARC stock exchanges can list a foreign company operating outside their country; they can only list a subsidiary part that operates within their country. The only option for meeting Druk Green's needs is the IDR facility, but a condition for issuing an IDR is that the company must have a track-record of listing compliance over several years on another stock exchange. This precludes Druk Green from doing an IPO in the SAARC region. It could, however, do an IPO in Hong Kong, China; London; New York; or Singapore. The company has yet to decide on a course of action.

#### *Markets Open to Foreign Brokers*

The entry of foreign brokers into a market often leads to a general improvement of standards, greater compliance, and increased innovation. All SAARC countries, except Bhutan, permit foreign brokers to operate through a local subsidiary. This restriction is reasonable because the regulator needs to have some entity that it can license and de-license, and this must be located and legally incorporated within the country. The alternative is mutual recognition which, because it requires some form of intergovernment treaty, is seen by most participants as impractical. In most cases, there are no limits on the degree of foreign ownership of brokerages in SAARC countries.

The necessity of operating through a local subsidiary has not been a barrier so far. Several SAARC countries host subsidiaries of foreign brokers. However, it presents a difficulty for the smaller markets. If operating through a local subsidiary continues to be a requirement, then foreign brokers may be deterred by costs that may not be justified by the low volume of business. Foreign brokers can access a market through correspondent relationships with local brokers, but this route would deny smaller markets the improvements that foreign brokers often bring.

#### *Viability of Smaller Markets*

The SAARC region contains some very small markets. These markets are well organized and have competent regulators. However, their long-term viability is questionable. In the Druk Green case, the market was not large enough to absorb an IPO that was intended to fund an important development project. Several markets have been unable to generate sufficient revenues to fund the longer-term development of the intermediaries, regulators, and stock exchange. Finances are especially difficult in the current circumstances, but the problem is long-standing. Several markets were acquiring new systems with donor assistance, which suggests that they could not fund them from their business and that the new systems may not be well-suited to their needs.

To some extent, these markets are protected by artificial barriers such as exchange controls. Historically, small markets have tended to be subsumed into larger ones as the barriers that

supported them have been reduced. For example, regional markets within a country have tended to be absorbed into the national market as communications have improved, such as in India, where trading has migrated to the national markets. In some cases, smaller regional markets have developed niches for themselves. For example, Vancouver developed a niche in trading mining companies, Osaka specialized in trading derivatives, and the Indian regional exchanges are developing businesses as portals for listing.<sup>22</sup> Some of the small SAARC markets have aspirations to develop their markets into regional financial centers. Taking a practical view, these aspirations are unlikely to be met.

It is important for national development that capital markets are adequate to support the funding and investment needs of the country. Therefore, markets in small economies need to take a strategic view of how they perform that development role. It may be that they would be better able to serve that role by becoming integrated with larger markets in the region. Integration may involve the migration of some functions from a small national market, for example, the provision of trading services. Consolidation of stock exchanges has been going on apace in developed markets. Equally, other capital market functions are best performed locally, for example, the provision of investment and corporate finance advice and accountancy services. As markets integrate and become more efficient, the local functions tend to expand as the total volume of activity increases.

#### *Exchange Control Remains a Challenge*

All SAARC members have exchange controls. Only India and, more recently, Sri Lanka have relaxed their controls to any significant extent. Most countries are concerned about possible outflows of reserves if they relax their controls. At the same time, all countries, except Bhutan, are keen to attract portfolio investment inflows. However, foreign investors are wary of exchange controls, seeing them as a significant risk. Even where controls are benign toward portfolio investors, the risk remains.<sup>23</sup> Malaysia in 1998 and Thailand in 2007 are examples of countries where events caused them to radically change their treatment of portfolio investments at short notice. Both faced a serious loss of credibility among international investors as a consequence.

#### *Limited Interest in SAARC as an Investment Destination*

There is only limited interest in the SAARC region as an investment target among regional investors. There is a desire to invest abroad, but this is mainly directed at traditional financial centers and India. There seems to be relatively little interest in cross-border investment among SAARC countries. Many see investment overseas as impossible because of exchange controls, so if an opportunity arises they want to get funds out of the region. This may change, but it is clear that there is no pent-up demand for intra-SAARC investments.

<sup>22</sup> Vancouver, which acquired a reputation for lax regulation of listed companies, was taken over by the Toronto Stock Exchange at the behest of the national securities regulator. On 15 July 2013, the Osaka and Tokyo exchanges agreed on a merger.

<sup>23</sup> Even if the controls are tightened in areas that do not directly affect foreign investors, they can still spark a capital exodus. In August 2013, India tightened controls of foreign investment by Indian residents, which is said to have caused an exit of foreign investment even though inward investment was not affected by the new regulations.

For global investors, the main interest in SAARC countries is India, where they are already active; the other countries are perceived as being “like India” but more risky. There may be excellent opportunities in the SAARC region outside India, but investors tend to see only the risks in settlement, risks of poor disclosure, risks of being disadvantaged by better-informed local traders, and the political risks in some SAARC countries. From a global investor’s viewpoint, the pragmatic strategy for the SAARC region would be to adopt in large measure India’s capital markets policy, regulatory, and institutional framework. Harmonization of standards and more effective enforcement are a key part, but far from the only part, of that process.

#### *Limited Contact and Interaction within SAARC*

There is little contact and interaction among SAARC capital markets. A few interviewees said that they had interaction with the Indian market through Indian programs of assistance. Some interaction is also arranged through SAFE and SAARC, although interaction through SAARC is mainly among the ministries of finance. The overall picture is one of considerable lack of knowledge of other SAARC markets. Improving regional knowledge was seen as a key part of the process of harmonization and integration within SAARC.

Lack of knowledge is often combined with a lack of interest in developments in other SAARC markets. This is surprising, because most of the SAARC markets are facing similar issues, such as low volumes, excessive volatility, and difficulties in enforcement. They are also often looking at similar solutions, such as demutualization. At the same time, greater integration within SAARC is viewed as unlikely in the near term, so market participants feel there is little to be gained by expending resources in learning about other SAARC markets. Most do not see the SAARC region as their source of growth. To the extent that they look outside, they see global investors as the main external driver of growth.

#### *Demutualization*

Apart from the Indian exchanges, all the larger stock exchanges in the region are run as mutual associations. Globally, the trend is toward demutualization of stock exchanges, which tend to be more efficient, better focused on business, less driven by sectional interests, and more innovative especially in terms of product development—all areas where SAARC stock exchanges are not strong. Even among small developing markets, the experience has been that commercially oriented stock exchanges, which in practice means demutualized stock exchanges, have been more willing and able to develop their markets. Such exchanges have been less constrained by vested interests, more likely to innovate with products, and better able to manage costs than mutually run exchanges. Based on the experiences of other markets, it is likely that development of the SAARC capital markets would be enhanced if more of the stock exchanges were demutualized.

The theoretical benefits of demutualization are widely accepted. However, timing demutualization to a period of strong market turnover is seen as likely to ensure success, and past experience of other exchanges supports this. The contrary view is that it is impossible to judge the right time, and the gains from demutualization are so great that the timing should not be a barrier. Furthermore, the situation in some of the markets is partly a consequence of the stock exchanges’ failure to address issues that a demutualized stock exchange would be best placed to resolve.

This section has drawn out some key factors affecting a market's readiness for greater harmonization and integration. It should be stressed at this point that, if the goal is wider economic integration and greater development of capital markets, harmonization is best seen as a step toward integration and not as a goal in its own right. Harmonization, meaning a high level of similarity of regulatory structures and standards, is undoubtedly a valuable step. This is because it usually has meant harmonization toward higher standards (e.g., IOSCO principles). Equally importantly, harmonization makes smaller markets more attractive to global investors because they will encounter familiar regulations and processes, which reduce the cost of accessing a market and so make accessing smaller markets viable.

But regional harmonization without regional integration tends to mean that investors from outside the region have easier access to the markets but that investors within the region have no cross-border access. Consequently, the regional markets tend to become dominated by investors from outside the region, as is arguably the case with some ASEAN markets, but the cause of greater economic integration and capital market development is not much advanced. A further point is that integration is the true test of harmonization. It is relatively easy to announce the adoption of common standards and best practice, but it is much more difficult to implement them. Harmonization means standards look the same; integration means there is mutual recognition and trust, which can only happen if standards are the same—both in form and implementation.

Table 15.12 summarizes the barriers to integration, areas of progress, and readiness for integration of the SAARC countries. In many cases, there are similarities in the standards and processes, giving an appearance of harmonization. However, during the interviews it became clear that the apparent similarities masked considerable differences in practice. Such differences will inevitably reduce the level of trust and mutual confidence that are essential for increasing integration.

**Table 15.12: Summary of Main Barriers to and Positive Factors for Integration**

Country	Main Barriers to Integration	Main Positive Factors	Readiness
Bangladesh	<ul style="list-style-type: none"> <li>- Strict exchange control</li> <li>- Weak enforcement of market abuse rules</li> <li>- Poor enforcement of issuer disclosure rules</li> <li>- Lack of independence of regulator</li> </ul>	<ul style="list-style-type: none"> <li>- Regulation improving but many challenges remain</li> <li>- Some quality participants</li> </ul>	Medium
Bhutan	<ul style="list-style-type: none"> <li>- Strict exchange control</li> <li>- Complete barriers to foreign issuers and investors</li> <li>- Potentially nonviable national market</li> <li>- High level of government involvement in economy</li> </ul>	<ul style="list-style-type: none"> <li>- Effective regulator</li> </ul>	Low
India	<ul style="list-style-type: none"> <li>- Already a large market</li> <li>- Barriers to foreign listings remain</li> <li>- Complex and rigid tax structure</li> <li>- Fragmented settlement system</li> </ul>	<ul style="list-style-type: none"> <li>- Effective, well-developed regulator</li> <li>- Progress in reducing exchange control</li> <li>- Foreign institutional investor structure permits foreign investors</li> </ul>	Medium
Maldives	<ul style="list-style-type: none"> <li>- Weak disclosure enforcement</li> <li>- Potentially nonviable national market</li> </ul>	<ul style="list-style-type: none"> <li>- Effective regulator</li> </ul>	Low

*continued on next page*

Table 15.12 continued

Country	Main Barriers to Integration	Main Positive Factors	Readiness
Nepal	<ul style="list-style-type: none"> <li>- Strict exchange control</li> <li>- Patchy regulatory structure</li> <li>- Potentially nonviable national market</li> <li>- Weak disclosure by listed companies</li> </ul>	<ul style="list-style-type: none"> <li>- Relatively low barriers to inward investment</li> </ul>	Low
Pakistan	<ul style="list-style-type: none"> <li>- Weak enforcement of market abuse rules</li> <li>- Lack of independence of regulator</li> </ul>	<ul style="list-style-type: none"> <li>- Some relaxation of exchange control</li> </ul>	Medium
Sri Lanka	<ul style="list-style-type: none"> <li>- Weak enforcement of market abuse rules</li> <li>- Obsolete settlement system</li> <li>- Potentially nonviable national market</li> </ul>	<ul style="list-style-type: none"> <li>- Some relaxation of exchange control</li> <li>- Effective regulator</li> <li>- Disclosure fairly good</li> </ul>	Medium

Source: Authors.

## Suggested Model of Capital Market Integration in South Asia

Two features of SAARC capital markets are important in determining the steps toward integration. First, while the SAARC capital markets display structural and regulatory similarities, they are at very different stages of development and their progress toward integration varies. Second, while capital market industry participants are generally keen to move toward greater integration, they each face different challenges that will affect the speed at which they can progress.

Therefore, it is not feasible to adopt a strategy for integration that commits all the markets to move toward integration in lockstep or to a fixed timetable; the EU approach is not suitable for SAARC. The ASEAN approach, which is pragmatically moving toward two streams of integration, is more relevant. But it is not clear that even a two-stream approach will suit the diversity within SAARC because

- some markets are relatively less developed but are able to move toward integration more rapidly,
- some markets are relatively less developed but face internal constraints that will prevent them from moving rapidly toward integration,
- some markets are relatively more developed and are able to move toward integration more rapidly, and
- some markets are relatively more developed but face internal constraints that will prevent them from moving rapidly toward integration.

SAARC capital markets should each move toward integration at a pace that suits their individual levels of development and the obstacles they face, progressing from different start points, at different speeds, but with a common goal. It is not practical to draw up a rigid plan for capital market integration within SAARC in which all member countries

arrive at the same point at the same time. However, much can be done to mitigate the barriers, increase awareness, harmonize standards, and assist the less developed markets. The recommendations of this chapter are designed to allow the SAARC countries to move toward the integration goal in a way that recognizes the different starting points and differing speeds with which they can progress.

Capital market integration in SAARC should follow its own appropriate model with the following features:

- **Bottom-up Approach.** Rather than a top-down approach, as used in the ASEAN and the EU, it should be a bottom-up process. The top-down approach requires a high-level agreement among member government to, for example, impose common standards on national markets. For various reasons, this seems less likely to be achieved in the SAARC region than elsewhere. Therefore, the expectation is that integration should take place through a process of harmonization driven from the grass roots by industry participants. The recommendations of this chapter are couched in terms of a gradual coming together around common standards rather than in terms of intergovernmental agreements.
- **Goods and Services Market Integration.** It should run alongside or indeed possibly ahead of integration of the goods and services market. It is sometimes argued that capital market integration is a follow-on from goods and services market integration, but there is no reason why one sequence is better than another. Indeed, in the EU example, capital market integration began in the 1980s and is now complete, while integration of the real markets still has some way to go, for example, in professional services. The same is true in ASEAN. The situation in the SAARC region is particularly favorable to this sequence given that physical infrastructure is often weak throughout the region, whereas communication infrastructure (which is the foundation of capital market integration) is relatively strong. Integration of capital markets in SAARC could become a driver for goods and services market integration as more efficient allocation of capital pushes financial resources to areas of comparative advantage, possibly spurring similar movements in goods and services.

SAARC members are at a much earlier stage of capital market integration, and a model based on an EU-style regime of commonly agreed directives may not be the right approach. Such a structure is generally regarded by market participants as an unlikely prospect, mainly because of the high-level intergovernment treaties or agreements that would be required. However, there is a considerable degree of regulatory similarity among the SAARC members, at least in terms of structure.

The general model for SAARC countries includes

- rules requiring prospectuses and similar requirements on the contents of prospectuses,
- corporate governance codes based to a considerable extent on international best practice,
- prohibitions on most of the normal types of market abuse,
- requirements for brokers to know your customer and act in their best interests,
- rules on trading transparency,
- standards for clearing and settlement,
- accounting standards that are approaching international standards,
- rules on capital adequacy of broking firms, and
- rules on fit and proper persons for companies and for brokers.

There will be significant variations in standards of monitoring and enforcement among SAARC members as there are in Europe. Typically, markets that have sought to attract international investors have standards that are closer to global best practice than those that have not sought foreign involvement in their markets.

Accepting such differences, which also exist in Africa, ASEAN, Europe, and every other region where there are moves toward market integration, SAARC members have a sound foundation for establishing common standards. The approach would be different from that in other regions because of the unique characteristics and history of the SAARC countries. In particular, there could be a valuable role for one or more of the regional agencies, such as SAARC and SAFE to

- gather detailed data on existing structures, regulations, and codes from existing studies and by making further enquiries;
- analyze the results to determine what could become minimum common standards;
- encourage awareness of the common standards so that the regional standards become well-known;
- conduct or facilitate detailed assessments of implementation standards; and
- support efforts to improve implementation of standards, especially in the less developed markets.

Capital markets in the SAARC region would benefit from greater interaction, and this should be fostered by the organizations already involved. The participants in such groups should be those involved directly in the capital markets rather than high-level government officials who have little direct market involvement. The groups should focus on specific issues rather than generalities, ensure accountability by having proper agendas and action points to follow up, and possibly be facilitated with outside assistance.

The topics that could be addressed in such groups include managing volatility, demutualization, pension fund investments, common standards, new products, capital-raising at the regional level, and bond markets.

## Policy Suggestions

**Initiate a program for information exchange and development, and to form a capital markets lobby**

The recommendation is to institute an information exchange program leading to a “SAARC capital market viewpoint.” The program would consist of a series of regular contacts among the SAARC capital markets. An effective and straight-forward way of starting such a program would be to initiate regular forum for regulators, which should be extended to include a wide range of stakeholders. The program should be used to produce evidence-based material and clearly thought-through policies that can be used in each SAARC market to influence policies and champion capital markets as a valuable part of economic development.

**Formulate a common policy on exchange control relaxation**

Although exchange control is gradually being relaxed in India and Sri Lanka, it remains a significant barrier to market integration. Exchange rate policy is closely linked to macroeconomic conditions and policies. Smaller markets are concerned about capital flight related to capital market flows. However, there should be a two-way interaction, with capital market integration policies being drawn up in a way that is mindful of the requirements of monetary and exchange rate policy, and exchange control policy being drawn up in a way that is mindful of its impact on capital markets. Central banks are responsible for exchange rate controls, which they use to achieve their specific policy objectives, in particular, protection against capital flight and protection of domestic industry.

The capital market will only be one of many interest groups wishing to change exchange control policy. This makes it incumbent upon capital markets to work with the central banks to relax controls where possible and to mitigate the negative effects on controls when relaxation is not possible. The forum should take a leading role in managing these discussions and supporting the capital markets case. This should draw upon the experiences of other SAARC countries as well as other regions to help central banks pursue their goals in ways that minimize negative impacts on capital markets.

**Make harmonization a policy aim and set basic SAARC standards**

There is already harmonization in terms of structure, rules, and standards. However, the appearance to an investor who does not investigate the situation in detail is of an uncoordinated set of disparate rules. The European approach of writing and legislating minimum standards through directives is not appropriate for SAARC because it would require intergovernment cooperation leading to international treaties. An alternative approach is to use the proposed regulators’ forum to write baseline SAARC standards in key areas of capital market regulation—prospectuses, disclosures, market transparency, market abuse, and corporate governance. Initially, these would be based on what is already in place—a lowest common denominator approach, but gradually the standards could be raised. The existence of common standards would encourage national regulators, who should include a harmonization objective in their regulatory actions, to strive to ensure that new regulations conform to the harmonization objective.

**Assist improvements in regulator capacity**

Two activities are recommended. First, provide further capacity-building assistance. India, in particular, has supported regional markets with capacity building and other assistance.

This has been provided through the Securities and Exchange Board of India (SEBI) and the major Indian exchanges, and has focused on strengthening regulatory skills and developing market systems. Second, assess the effectiveness of enforcement performance of each of the SAARC markets through statistical measures. In the initial stages, the results should not be published. The results, including anonymous comparisons would, however, form a valuable benchmark for regulators wishing to raise performance.

A further area where capacity needs to be greatly enhanced is financial literacy. If the population of the SAARC region is to make use of the opportunities that capital markets provide for better investment of their long-term savings, it is important that they understand what they are entering into. Most SAARC regulators are at a relatively early stage in developing financial literacy, and there is considerable scope for assistance through capacity-building regional workshops.

### **Assist small markets to develop sustainable business strategies**

SAARC has some very small markets, and it is unlikely that these will become large. Smaller markets face particular risks in moving to integrate with regional markets, such as migration of investment business to larger markets. But, equally, integration offers opportunities for smaller markets, such as the ability to broaden their offerings through links with larger markets. There are no examples of national markets being abolished or failing to survive as a consequence of regional integration. However, the ongoing challenge for smaller markets, which is independent of the degree of regional integration, is that they may be unable to generate adequate revenue to cover the costs of essential regulation, trading facilities, settlement, and other infrastructure. If stock exchanges fail to develop adequately because of lack of revenue, then they may be unable to meet the investment or fund-raising needs of their countries, which will lead to slower development.

There are some functions in capital markets where there are benefits of scale. In addition to the cost savings, larger markets have higher liquidity. Small markets will only have low trading volumes, so transaction costs will be higher. There is an argument that those functions where there are economies of scale gains and/or liquidity gains should be provided in a way that allows those economies to be captured. This might mean outsourcing or sharing a trading or settlement function.

A clear and realistic examination is needed to establish whether there are the opportunities for outsourcing some activities of smaller markets without compromising their independence. There should be assessments of the potential for smaller markets to combine some of their activities with those of larger markets while still retaining operational, commercial, and regulatory independence. There should also be an examination of the problem of large issuers and investors in countries with smaller markets which allows them to access the regional capital market while also ensuring that there is a sustainable business model for the local market. There should be an investigation of alternative business opportunities to increase the sustainability of stock exchanges in smaller markets, such as developing niche positions or diversifying their product range. There are many viable small exchange models outside the region, and a study of these would provide indications of development paths. Finally, plans should be drawn up detailing the assistance that can be given within the region to sustain smaller markets and maintain diversity while being consistent with the commercial needs of larger regional markets.

### **Be aware of and support private sector initiatives**

Much of the development of capital markets is driven by private sector initiatives.

This is as true of integration as it is of other developments. Regulators must attempt to understand the needs of the private sector and should be open to exploring various ideas with the latter that could work for the market. This is one of the reasons why it is so critical to have market participants involved in the proposed regulators' forum. Greater understanding will support a flexible approach to novel proposals that may benefit the market.

### **Improve commercial imperatives and skills in stock exchanges**

Commercial imperatives and skills in stock exchanges need to be improved through privatization or, if that is not feasible, by imposing commercial discipline. The track record of stock exchanges has demonstrated that the more commercially driven a stock exchange is, the more likely it is to serve its users well by innovating, regulating firmly, and controlling costs. Demutualization or privatization can achieve this, but some of the SAARC exchanges may not be large enough to support themselves at this stage in their development.

In some of the exchanges there is a shortage of fundamental commercial skills and knowledge of the stock exchange business in the wider world. This is undoubtedly slowing the process of demutualization and, unless remedied, is likely to lead to problems in the longer term.

### **Set up a regional body to support capital market harmonization and development**

If the harmonization and integration goals are to be achieved, then an independent capital market body, tentatively called the SAARC Capital Market Integration Group (CMIG), is required to champion and support this. The ASEAN Secretariat might be a model for this entity. The remit of the CMIG would be to support actions leading to capital market integration across the SAARC region, and it would be accountable for the work streams. It is unlikely that the resources to support such a body could be generated within the region. Therefore, support from an external development assistance agency could be required.

The CMIG's activities would center on the following work streams based on the recommendations of this chapter:

- Initiate and maintain a program to exchange information between market participants in the SAARC region. The main feature would be a series of regular contacts involving a wide range of market participants, including those from the private sector, to discuss issues of common interest. The discussions would be managed and structured in a way that ensures that actions are agreed upon and followed up. The regional body would act as a lobbyist to promote agreed-upon policies.
- Work with central banks and other authorities in the SAARC region to draw up a strategy to reduce the damaging effects of exchange controls on the regional capital market. Such a strategy would address the needs of the authorities to protect their currencies and reserves. Part of the task would involve championing the cause of relaxation and building support.

- Encourage regulators to adopt objectives that recognize the benefits of harmonization. The task would involve drawing up common standards and codes of practice to be adopted by SAARC regulators. These would be a voluntary version of the sort of directives adopted in the European Union (EU).
- Develop capacity-building programs for regulators involving exchanges of staff and the provision of specific assistance. The programs should cover the basic regulatory activities such as market surveillance; the more general skills, such as consultation with users; and the setting up of financial literacy programs.
- Assist the smaller exchanges in drawing up viable and sustainable business models involving, where appropriate, outsourcing and sharing of facilities but not compromising their independence.
- Develop links to private sector participants in the capital market through involving them in the information exchange programs with the aim of involving them in the decisions affecting the regional markets and in gaining knowledge of current thinking among practitioners.
- Set up an information exchange on privatization or demutualization of stock exchanges and assist stock exchanges in developing sound business practices and business models.

Under the purview of the SAARC Secretariat, the CMIG would work to produce a road map with milestones appropriate to each country's capital market development aspirations.

The CMIG would require staff resources to achieve the tasks. It would draw upon resources from other entities in the region including SAFE—the regional trade association whose objectives of harmonization and regionalization are congruent with the objectives of the CMIG—as well as stock exchanges and regulators. Some such assistance already takes place within the region, and it is proposed to continue such assistance toward the goal of integration.

The staff of the CMIG would be mainly engaged in project management, management of working groups, and public relations activities to drive forward the integration agenda, in particular, promoting the agreed programs and policies. Organizations such as the World Federation of Exchanges fulfill these activities with small permanent staff. The World Federation of Exchanges has a staff of 9 and a membership of 70. The capital market integration staff of the SAARC Secretariat should be of a similar size.

## CHAPTER XVI

# Cross-Border Energy Cooperation in South Asia

*P. N. Fernando*

South Asian countries vary widely in their endowments of commercial energy resources. Bangladesh, India, and Pakistan account for the major natural gas and coal resources, and Bhutan and Nepal have large exploitable hydropower resources. Efficient integration and sharing of these energy resources would lead to optimal supply solutions and greater energy security for the region. South Asian countries need to more closely cooperate in promoting and facilitating cross-border trade in energy. Energy sector cooperation toward this end is centered on (i) increased energy supply availability; (ii) expanded energy trade infrastructure; (iii) a regional power market; and (iv) harmonized legal and regulatory frameworks, together with an improved investment environment. This chapter focuses on the developments, issues, and challenges associated with regional cooperation in the energy sector.

Key challenges in the region include serious energy deficits, lack of balance in the energy supply mix, increasing dependence on oil imports, and inadequate energy sector infrastructure. The regional demand for energy is projected to increase sharply, underscoring the urgency of dealing effectively with these challenges. The current pace of energy development in the region and the current bilateral energy trade arrangements are far short of what is needed to meet demand. It is evident that South Asian countries need to greatly improve the means for intra- and interregional energy trade, which would spur resource development and facilitate the best use of resources.

Intraregional electricity trade will be largely based on the expansion of hydropower and transmission links between Bhutan and India, India and Nepal, and Bangladesh and India, and on the establishment of new power transfer links between India and Sri Lanka and between India and Pakistan to the extent feasible. Apart from imports of petroleum products, coal, liquefied natural gas (LNG), and limited electricity imports, there is relatively little energy trade between South Asia and other regions. However, feasibility studies have been undertaken for three high-capacity interregional power and natural gas transmission systems: the Central Asia–South Asia (CASA-1000) power link, the Iran–Pakistan–India (IPI) natural gas pipeline, and the Turkmenistan–Afghanistan–Pakistan–India (TAPI) natural gas pipeline. The key features of these projects are addressed in this chapter.

## Energy Demand and Supply Scenario in South Asia

During 2010–2020, fossil-based commercial energy supplies in the region are expected to increase by a compound annual rate of 5.3%, based on development of the region's resources of petroleum, coal, and natural gas. If this expectation is realized, energy supply from these sources would increase from 603 million tons of oil equivalent (mtoe) to 1,006 mtoe. Table 16.1 shows the projected fossil-based commercial energy supplies. Hydropower-based energy supplies are projected to increase from 36 mtoe to 79 mtoe, and nuclear energy from 7 mtoe to 43 mtoe.<sup>1</sup>

**Table 16.1: Projected Fossil-Based Commercial Energy Supply (mtoe)**

Country	Petroleum			Coal			Natural Gas		
	2010	2020	CAGR (%)	2010	2020	CAGR (%)	2010	2020	CAGR (%)
Afghanistan	0.3	0.8	10	0	0	0	0	0.8	
Bangladesh	4.9	8.0	5	0.7	6.5	25	16.0	29.0	6
Bhutan	0.2	0.5	10	0	0	0	0	0	0
India	175	300	5.5	290	450	4.5	55	90	5
Maldives	0.3	0.6	7	0	0	0	0	0	0
Nepal	1.0	2.0	7	0.3	0.4	3	0	0	0
Pakistan	22	37.5	5	4.5	19.9	16	27.5	49.3	6
Sri Lanka	4.3	7.8	5	0	2.9		0	0	0
<b>Total</b>	<b>208</b>	<b>357</b>	<b>5.5</b>	<b>296</b>	<b>480</b>	<b>5</b>	<b>99</b>	<b>169</b>	<b>5.5</b>

CAGR = compound annual growth rate, mtoe = million tons of oil equivalent.

Source: Wijayatunga, P, and P. N. Fernando. 2013. *An Overview of Energy Cooperation in South Asia*. South Asia Working Paper Series No 19, Manila: Asian Development Bank.

Table 16.2 shows the projected demand for electricity in South Asia up to 2020, and the growth in demand in each country from the base year 2010. For the region as a whole, electricity demand is expected to increase at a compound annual growth rate of about 7%. Hydropower and nuclear power will continue to make modest contributions to meeting this demand, but most will be supplied by electricity generation from coal, oil, and natural gas. A substantial portion of these resources will have to be imported to the region.

<sup>1</sup> The energy supply projections draw from the following references: India Energy Handbook (2011), Bangladesh Power System Master Plan (2010), Sri Lanka Generation Expansion Plan (2011), and the SEC Integrated Energy Potential of South Asia: Vision 2020 (2011). The Pakistan projections are from ADB. ADB. 2010a. *Pakistan Integrated Energy Model*. Manila: Asian Development Bank.

**Table 16.2: Projected Electricity Demand  
(GWh)**

Country	Demand		CAGR (%)
	2010	2020	
Afghanistan	2,600	6,750	10
Bangladesh	28,470	67,400	9
Bhutan	1,749	3,430	7
India	938,000	1,845,000	7
Maldives	800	1,300	5
Nepal	3,200	6,910	8
Pakistan	95,000	246,000	10
Sri Lanka	10,718	21,040	7
<b>Total (mtoe)</b>	<b>1,080,537 (267)</b>	<b>2,197,830 (544)</b>	<b>7.4</b>

CAGR = compound annual growth rate, GWh = gigawatt-hours, mtoe = million tons of oil equivalent.

Source: Wijayatunga, P, and P. N. Fernando. 2013. *An Overview of Energy Cooperation in South Asia*. South Asia Working Paper Series No 19, Manila: Asian Development Bank.

The hydroelectricity contribution in India is estimated to increase from 128 billion kilowatt-hour (kWh) (29.0 mtoe) to 255 billion kWh (58 mtoe) during 2010–2020, while the nuclear electricity contribution is estimated to increase from 29 billion kWh (7 mtoe) to 158 billion kWh (38 mtoe) during the same period. In Pakistan, the contribution from hydroelectricity is estimated to increase from 33 billion kWh (7.5 mtoe) to 97 billion kWh (22 mtoe) over the same period, while the corresponding contribution from nuclear electricity would be from 3.3 billion kWh (0.8 mtoe) to 10.0 billion kWh (2.4 mtoe). Sri Lanka is also a significant hydropower producer but its best resources have already been harnessed, and the hydroelectricity contribution is estimated to increase by less than 40%, from 4.7 billion kWh (1.1 mtoe) to 6.5 billion kWh (1.5 mtoe) by 2020. In contrast, Bhutan, which has an ambitious hydropower development plan, is expected to increase its supply of hydroelectricity from 7.1 billion kWh (1.6 mtoe) to 58 billion kWh (13 mtoe). Nepal, which has the most substantial hydropower potential in South Asia, is in the process of firming up its hydropower development plans.

As shown in Table 16.3, the region's combined fossil-based and hydropower-based energy resources in 2020 are projected to total 76,310 mtoe: coal would account for 73,004 mtoe, crude oil for 803 mtoe, natural gas for 2,280 mtoe, and hydropower for only 223 mtoe. Clearly, coal is projected to be the dominant source of energy for the region. India is the overwhelming source, with its coal resources accounting for 60,357 mtoe. However, India is importing coal to supplement its domestic production, mainly because of quality and logistical issues. It imported 67 million tons (45 mtoe) of coal in 2010, and this is projected to more than double to about 150 million tons (100 mtoe) by 2020.

**Table 16.3: Commercial Energy Resources of South Asian Countries**

Countries	Coal	Crude Oil	Natural Gas	Hydropower
	million tons (mtoe)	million barrels (mtoe)	TCF (mtoe)	MW (mtoe)
Afghanistan	440 (295)	...	15 (360)	25,000 (19)
Bhutan	2 (2)	0	0	30,000 (23)
Bangladesh	884 (592)	12 (2)	8 (192)	330 (0)
India	90,085 (60,357)	5,700 (775)	39 (936)	150,000 (114)
Maldives	0	0	0	0
Nepal	...	0	0	42,000 (32)
Pakistan	17,550 (11,758)	324 (44)	33 (792)	45,000 (34)
Sri Lanka	...	150 (20)	0	2,000 (2)
<b>Total</b>	<b>108,961 (73,004)</b>	<b>5,906 (803)</b>	<b>95 (2,280)</b>	<b>294,330 (223)</b>

... = no data, mtoe = million tons of oil equivalent, MW = megawatts, TCF = trillion cubic feet.

Note: Numbers in parentheses are Mtoe of annual energy. In the case of hydropower, a 50% annual plant factor and 38% efficiency in thermal equivalence are assumed.

Source: SAARC. 2010. *SAARC Regional Energy Trade Study*. Kathmandu: South Asian Association for Regional Cooperation.

Table 16.3 indicates that the region's crude oil and natural gas resources are relatively scarce. The natural gas resources are mainly in Bangladesh, India, and Pakistan. India is already importing natural gas (as LNG) to supplement domestic natural gas production; it imported 9 million tons of LNG (10.2 mtoe) in 2010. Pakistan is planning to import LNG; and Bangladesh, with limited local gas production, is also moving toward importing LNG. Imports of LNG to the region are projected to increase to about 45 million tons (50 mtoe) by 2020. In addition, it is estimated that about 30% of India's coal and natural gas requirements by 2020 will be met by imports. Likewise, oil imports to India are expected to increase by 60%, from 125 mtoe in 2010 to about 200 mtoe by 2020.

These projections highlight the importance of harnessing unutilized regional hydropower potential and accessing large-scale electricity and natural gas sources from outside the region. Further, the projections underscore the urgency of developing low-carbon alternatives (wind and solar) and of conservation and energy efficiency initiatives. Having coal account for 95% of the region's energy resources in 2020, as indicated in Table 16.3, would seriously undermine global efforts to contain climate change. Intra- and interregional trade is needed to help diversify energy sources in favor of cleaner alternatives. Given the focus of this chapter on cross-border energy trade, the next section discusses the elements of a broad road map for energy trade.

## Road Map for Cross-Border Energy Trade

### Export-Oriented Hydropower Development

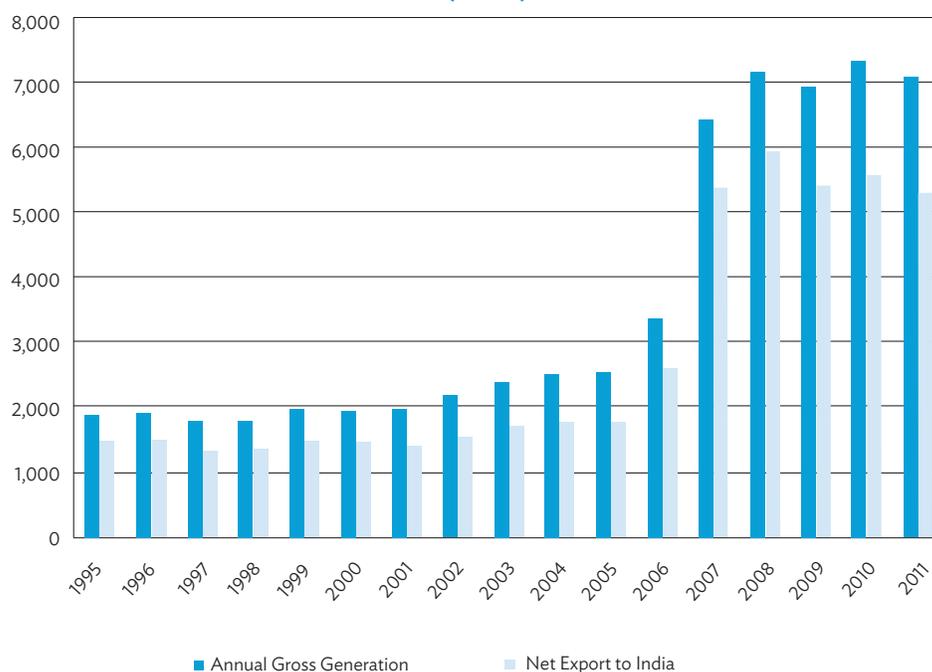
The large-scale, export-oriented hydropower development opportunities in Bhutan and Nepal are the most promising in the region and are being pursued by the public and private sectors. Figure 16.1 and Table 16.4 show the scope for such development in Bhutan.

**Table 16.4: Hydropower Development Potential in Bhutan**

River Basins	Area (km <sup>2</sup> )	Schemes	Potential (MW)	Energy (GWh)
Amochhu (Basin I)	2,400	6	2,060	9,656
Wangchhu (Basin I)	4,689	10	2,740	11,139
Punatsangchhu (Basin II)	10,355	19	8,099	25,495
Mangdechhu/Manas-West (Basin III)	7,392	17	3,889	18,322
Drangmechhu/Manas-East (Basin III)	9,207	20	6,692	33,422
Jaldhaka, Mau, Nyeraamari, Dhansiri	2,750	4	280	1,213
Others	1,601			
<b>Total</b>	<b>38,394</b>	<b>76</b>	<b>23,760</b>	<b>99,247</b>

GWh = gigawatt-hour, km<sup>2</sup> = square kilometer, MW = megawatt.

Source: Bhutan Presentation at South Asia Subregional Economic Cooperation Transmission Utility Forum 2012, Kandy, Sri Lanka.

**Figure 16.1: Bhutan's Electricity Export to India (GWh)**

GWh = gigawatt-hour.

Source: Bhutan Presentation at South Asia Subregional Economic Cooperation Transmission Utility Forum 2012, Kandy, Sri Lanka.

Bhutan has a small power system with about 300 megawatts (MW) of local peak demand in 2011. However, it is endowed with 23,760 MW of technically feasible hydropower resources at strategic locations that could partially meet India's growing need for electricity. The net annual electricity transfers from Bhutan to India since 1995 constitute about 75% of Bhutan's electricity generation (Figure 16.1).

Bhutan's hydropower potential has been developed with Indian assistance, centered on three major hydro projects—Chukha (336 MW), Kurichu (60 MW), and Tala (1,020 MW)—totaling nearly 1,500 MW in long-term power purchase agreements between the governments of Bhutan and India. India, however, provides electricity to Bhutan during the winter season when hydropower availability in Bhutan is inadequate to supply its own needs. India's Power Trading Corporation oversees the commercial power transfer arrangements. The transmission infrastructure for Bhutan's hydropower projects has also been developed with assistance from India. This includes two 220-kilovolt (kV) lines for the Chukha Hydropower Project and double-circuit 400 kV lines for the Tala Hydroelectricity Project connecting Bhutan with West Bengal; the combined power transfer capacity is about 2,500 MW.

About 3,000 MW of additional hydropower development is underway, and is expected to be completed by 2016, including the Punatsangchu (Stage 1 of 1,200 MW and Stage 2 of 990 MW) and Mangdechhu (720 MW) projects. Most of this additional power will be exported to India. By 2020, a further 4,000 MW of hydropower development on the Sankosh River is expected to be completed. Other hydropower scheduled for commission by 2020 includes the Kuri–Gongri (1,800 MW), Chamkarchhu (672 MW), and Amochhu (620 MW) projects. By 2020, Bhutan's total installed power generating capacity is expected to be more than 11,000 MW (Table 16.5). It should be noted, however, that about 10% of the nearly 2,700 glacial lakes in Bhutan have a high risk of bursting. Risk assessments have been carried out and preemptive measures are being undertaken, such as lowering the water levels of high-risk lakes and undertaking special construction measures.

**Table 16.5: Hydropower Projects for Commissioning by 2020 in Bhutan**

Name of Project	Capacity (MW)
Sunkosh Reservoir	4,000
Kuri Gangri <sup>a</sup>	1,800
Chamkharchu	1,670
Punatsangchu 1 <sup>a</sup>	1,200
Punatsangchu 2 <sup>a</sup>	1,000
Wangchu Reservoir	900
Mangdechhu <sup>a</sup>	720
Amochu Reservoir	620
Kolong Chu <sup>a</sup>	486
Bunakha Reservoir	180
<b>Total</b>	<b>11,576</b>

<sup>a</sup> Already started.

Source: Bhutan Presentation at South Asia Subregional Economic Cooperation Transmission Utility Forum 2012, Kandy, Sri Lanka.

Nepal's installed electric power generating capacity in 2011 totaled 879 MW. Hydropower accounted for 826 MW (94%) of this capacity (652 MW state-owned and 174 MW independent power producers [IPPs]). Thermal power in the form of small diesel-based power plants accounted for 53 MW. The geographical structure of Nepal, with its great variations in altitude combined with abundant snowmelt and monsoon water flows, offers tremendous hydropower generation potential, particularly in the major river basins of Koshi, Gandaki, Karnali, and Mahakal. The theoretical hydropower potential of Nepal's rivers, based on average flows, has been estimated at 83,000 MW (Table 16.6). The commercially exploitable potential is estimated to be at least 43,000 MW. However, only a very small percentage of this potential has been realized to date, leaving the country seriously deficient in meeting its supply needs.

**Table 16.6: Theoretical Hydropower Development Potential in Nepal**  
(megawatts)

River Basin	Major River Courses with Catchment Area Greater than 1,000 km <sup>2</sup>	Small River Courses with Small Catchment Area	Total
Kosi	18,750	3,600	22,350
Gandaki	17,950	2,700	20,650
Karnali and Mahakali	32,680	3,500	36,180
Southern Rivers	3,070	1,040	4,110
<b>Total</b>	<b>72,450</b>	<b>10,840</b>	<b>83,290</b>

Source: Nepal Presentation at South Asia Subregional Economic Cooperation Transmission Utility Forum 2012, Kandy, Sri Lanka.

Table 16.7 shows the hydropower projects planned by the Nepal Electricity Authority and IPPs. Development of these projects, principally for the export of electricity to India with some to supply local demand, is a major area for cooperation. In this regard, the Government of Nepal is trying to secure IPP agreements for the West Seti (750 MW), Budhi Gandaki (600 MW), Upper Karnali (400 MW), Kali Gandaki (660 MW), Arun III (800 MW), and Tamakoshi (880 MW) projects. However, the necessary project development framework and offtake market assurances have not reached the level of maturity evident in the Bhutan–India case. It is difficult, therefore, to establish electricity export targets for Nepal.

While Bhutan and Nepal have substantial hydropower potential, their development involves critical riparian issues. South Asia has four major rivers basins: the Brahmaputra, Ganges, Indus, and Meghna. These river basins provide irrigation for millions of hectares of fields and sustain the livelihoods of millions of people in the region. Water management interventions in these river systems, including hydropower projects, impact on the upper and lower riparian countries in a wide variety of economic, environmental, and social ways. Inevitably, disagreements have arisen, despite established agreements and treaties. More effective cooperation is needed among South Asian countries to resolve water utilization and environmental degradation problems, as well as social issues arising from glacier retreat and climate change. Hydropower development is of great importance, but a careful balance will have to be found between run-of-the-river hydropower developments and

large storage-based barrier developments, even if it is at the expense of export value. The environmental and social costs of hydropower development must be taken into account.

**Table 16.7: Planned Hydropower Development in Nepal**  
(Hydropower projects planned under Nepal Electricity Authority initiative)

Projects	Capacity (MW)	GWh	Cost (\$ million)	Earliest Commissioning Year
Upper Modi A	42	282.73	85	2017
Upper Seti	127	476	328	2017
Budhi Gandaki	600	2,495	774	2018
Nalsyagugad	400	1,151	539	2019
Andhikhola	180	693	374	2019
Dudh Kosi 1	300	1,806	690	2020
Kankai	90	247	142.7	2020
Kali Gandaki	650	3,470	772	2020
<b>Total</b>	<b>2,389</b>			

Source: Nepal Presentation at South Asia Subregional Economic Cooperation Transmission Utility Forum 2012, Kandy, Sri Lanka.

There is an urgent need to increase the power transfer capacity between India and Nepal, primarily to address the severe electricity supply crisis in Nepal and, secondarily, to enable transmission of any summer hydropower generation surplus in Nepal to India. In view of this, work has begun on a 1,000 MW, 400 kV, 126-kilometer (km) transmission link between Dhalkebar in Nepal and Muzaffarpur in India, for completion in 2015.<sup>2</sup> The Cross Border Power Transmission Company, a joint venture company, will construct the Indian section while the Power Transmission Company Nepal, another joint venture company, will construct the Nepali section. However, significant power transmission upgrades in Nepal are required to support the 400 kV link. Once completed, the link is expected to provide a major boost to power trade between India and Nepal. This cross-border transmission link is scheduled to be followed by other similar links, such as the West Seti–Bareli, Hetauda–Gorakhpur, and Duhabi–Purnea links, designed to support export-oriented hydropower development in Nepal.

## Intraregional Electricity and Natural Gas Access

### *Central Asia–South Asia 1000 Project*

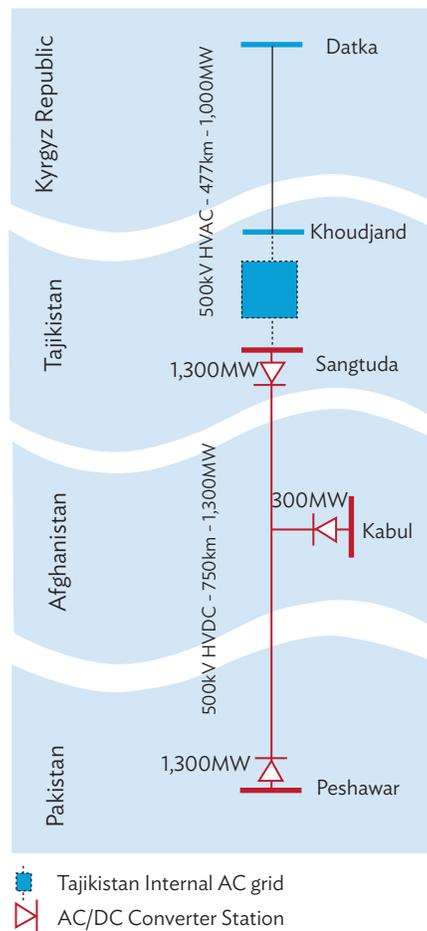
The Central Asia–South Asia (CASA-1000) project is a comprehensive initiative to interconnect Afghanistan, the Kyrgyz Republic, Pakistan, and Tajikistan to form a CASA regional electricity market. The core elements of the project include a 500 kV, 750 km high-voltage direct current (HVDC) power interconnection with alternating current/direct current conversion capacities of 1,300 MW at Sangtuda (Tajikistan), 300 MW at Kabul (Afghanistan) and 1,300 MW at Peshawar (Pakistan); and a 500 kV, 477 km high-voltage alternating current (HVAC) power interconnection between the Kyrgyz Republic (Datka substation) and Tajikistan (Khoujand substation) (Figure 16.2). The HVDC converter capacity in Pakistan (Peshawar) is equal to that in Tajikistan (Sangtuda). This provides

<sup>2</sup> About 40 km of the transmission line will be in Nepal and 86 km will be in India.

flexibility for Pakistan to absorb up to 1,300 MW should Afghanistan not need to import its entire share. The project cost estimate is \$873 million (SNC-Lavalin 2011).

The project was motivated by the surplus hydropower available in the Kyrgyz Republic and Tajikistan that could be usefully exported to provide electricity to Afghanistan and Pakistan, both of which face severe power shortages. The Kyrgyz Republic and Tajikistan have about 6,000 GWh of surplus electricity during summer months, which would prove very beneficial in helping to meet Afghanistan’s and Pakistan’s requirements. Hydroelectricity costs in Tajikistan are estimated at \$15 per megawatt-hour (MWh), compared to thermal IPP costs of \$132 per MWh in Pakistan and equivalent electricity costs in Afghanistan. Clearly, the power exchange is attractive as long as there is surplus hydroelectricity for transmission from Tajikistan. The CASA 1000 Project is supported by the Asian

**Figure 16.2: Central Asia–South Asia 1000 Power Transmission Arrangement**



AC= alternating current, AC/DC = alternating current/direct current.

Source: Wijayatunga, P, and P. N. Fernando. 2013. *An Overview of Energy Cooperation in South Asia*. South Asia Working Paper Series No 19, Manila: Asian Development Bank.

Development Bank (ADB) and the World Bank. However, ADB is considering modifying the project design to better integrate the still isolated and not interconnected Afghanistan power systems. ADB is also considering avoiding the less-proven three-terminal HVDC system (with terminals at Kabul, Peshawar, and Sangtuda) by having two HVDC links and an alternating current system in between for Afghanistan.

#### *Iran–Pakistan–India Gas Pipeline Project*

The Iran–Pakistan–India (IPI) Project was originally designed to supply 55 billion cubic meters per year (BCM/year) of natural gas for use by India and Pakistan. This would be equivalent to 47 mtoe/year and 5.2 billion cubic feet of natural gas per day (BCF/day). In 2005, the estimated project cost was about \$7 billion. However, the gas volume to be supplied has been revised down to 21 BCM/year (2.0 BCF/day), equivalent to about 18 mtoe/year, to be shared equally between India and Pakistan in the first phase of the project. Iran has constructed the required natural gas transmission facilities from Asalouveh to the Iran–Pakistan border, including a 1,172 km pipeline. Pakistan is planning to lay a 42-inch diameter, 700 km long pipeline to transport up to 1.0 BCF/day from the Iranian border to Nawabshah in Pakistan. Another section of the same size can be added later as and when India decides to join the project.

In 2010, Iran signed a contract to export 1.0 BCF/day of natural gas to Pakistan on the basis that Pakistan would have its section of the pipeline commissioned by 2014. The model for funding the pipeline section in Pakistan was based on an integrated project structure, with the government or a strategic investor taking a lead role in implementing the project. The natural gas transit charge was expected to be paid by the major gas purchasers, such as Pakistan State Oil, Oil and Gas Development Company, Pakistan Petroleum, Sui Northern Gas Pipelines, and Sui Southern Gas Company. However, in 2012, Pakistan announced that private investors were showing diminished interest, and that the government might have to impose a tax on consumers or seek arrangements with Iran and other countries to build the pipeline.

#### *Turkmenistan–Afghanistan–Pakistan–India Gas Pipeline Project*

The Turkmenistan–Afghanistan–Pakistan–India (TAPI) Gas Pipeline Project, has been proposed for exporting natural gas from the Dauletabad and adjacent gas fields in Turkmenistan to Afghanistan, India, and Pakistan. An ADB-funded feasibility study envisaged a 56-inch diameter, 1,735 km long pipeline from Turkmenistan through Afghanistan and Pakistan to the Indian border, capable of transporting 3.2 BCF/day (29 mtoe/year). The capital cost of the project was estimated in 2008 at \$7.6 billion. The project would take 4 to 5 years to complete after signing of all contracts. The TAPI parties have agreed in principle to initially share 2.2 BCF/day of natural gas, equivalent to about 20 mtoe/year, equally between Pakistan and India (about 1.0 BCF/day each), with Afghanistan taking about 0.2 BCF/day.

A gas pipeline framework agreement was initialed in April 2008 by the ministers, and an intergovernmental agreement on the pipeline was signed in December 2010. In April 2012, Afghanistan and India failed to agree on a transit fee for gas passing through Afghanistan. In addition, India and Pakistan could not agree on the transit fee for the segment of the pipeline passing through Pakistan. However, in May 2012, Afghanistan approved the agreement, and subsequently the state-run Gas Authority of India signed a gas sale and purchase agreement

with TurkmenGaz, Turkmenistan's national oil company. Afghanistan is expected to earn about \$350 million annually in natural gas transit fees when the TAPI project becomes operational.

The TAPI route passes through extremely challenging terrain, including the 830 km in Afghanistan. Consequently, the financing risk is higher than in the case of the IPI pipeline. Continued commitment by Turkmenistan to supply gas could also be an issue, given the existence of other lucrative markets, particularly in Europe.

#### *Scope for Natural Gas Import from Myanmar*

Myanmar has about 22 trillion cubic feet of recoverable natural gas resources. It has been interested in exporting to South Asian countries, particularly India. Transit through Bangladesh, however, is an issue. Myanmar exports natural gas to the People's Republic of China (PRC) and Thailand. Current natural gas production in Myanmar is about 1,865 million cubic feet per day (MMCF/day), primarily from three offshore gas fields: Yadana (900 MMCF/day, of which 700 MMCF/day is exported to Thailand), Yetagun (400 MMCF/day, all of which is exported to Thailand), and Shwe (500 MMCF/day, of which 400 MMCF/day is exported to the PRC). Nearly 80%, or 1,500 MMCF/day, of Myanmar's natural gas production is exported, leaving only 365 MMCF/day for domestic use. In 2013, however, domestic demand for natural gas was about 700 MMCF/day. Myanmar is now focusing on meeting growing domestic demand while honoring its export commitments. Currently, therefore, there is little scope for exporting natural gas from Myanmar to South Asian countries.

#### **Regional Energy Trade Prospects**

Given the limited domestic demand for electricity in Bhutan and Nepal, large-scale hydropower developments in these countries must be targeted at the regional electricity market. The power transmission arrangements under way between Bhutan and India and between India and Nepal toward that end were discussed earlier. Feasibility studies are also in progress to examine the scope to further interconnect Bangladesh and India, which were first interconnected by a 500 MW HVDC link between Bheramara in Bangladesh and Baharampur in India in 2013. Further studies concern interconnecting India with Sri Lanka through a 500 MW undersea HVDC link and India with Pakistan through a 500 MW overland HVAC link.

The Maldives is a special case, both because of its isolated location (in the Indian Ocean about 700 km from Sri Lanka) and its low level of electricity demand (well below 100 MW in 2013) scattered across hundreds of islands with no transmission system. Male, the capital, has less than 50 MW of installed power generating capacity. Construction of a submarine cable to connect the Maldives to either the Sri Lankan or Indian power system would be a prohibitively expensive undertaking for the Maldives. The cost of delivered power to Male, including the cost of the submarine cable, would be well in excess of \$1,000 per MWh. Forming a national grid connecting the islands would in itself be a major task. Consequently, the Maldives will need to continue its dependence on oil-based power generation supplemented by wind and solar photovoltaic-based power generation.

India leads South Asia in non-conventional renewable energy (NCRE) development. At the end of 2013, India had a total of nearly 30,000 MW of NCRE-based electricity generating capacity, mainly from wind (6,270 MW) and solar photovoltaic (2,180 MW) sources. The key NCRE-related issues in India are representative of those faced by other South Asian countries. High capital costs coupled with low plant load factors are a common issue with NCRE

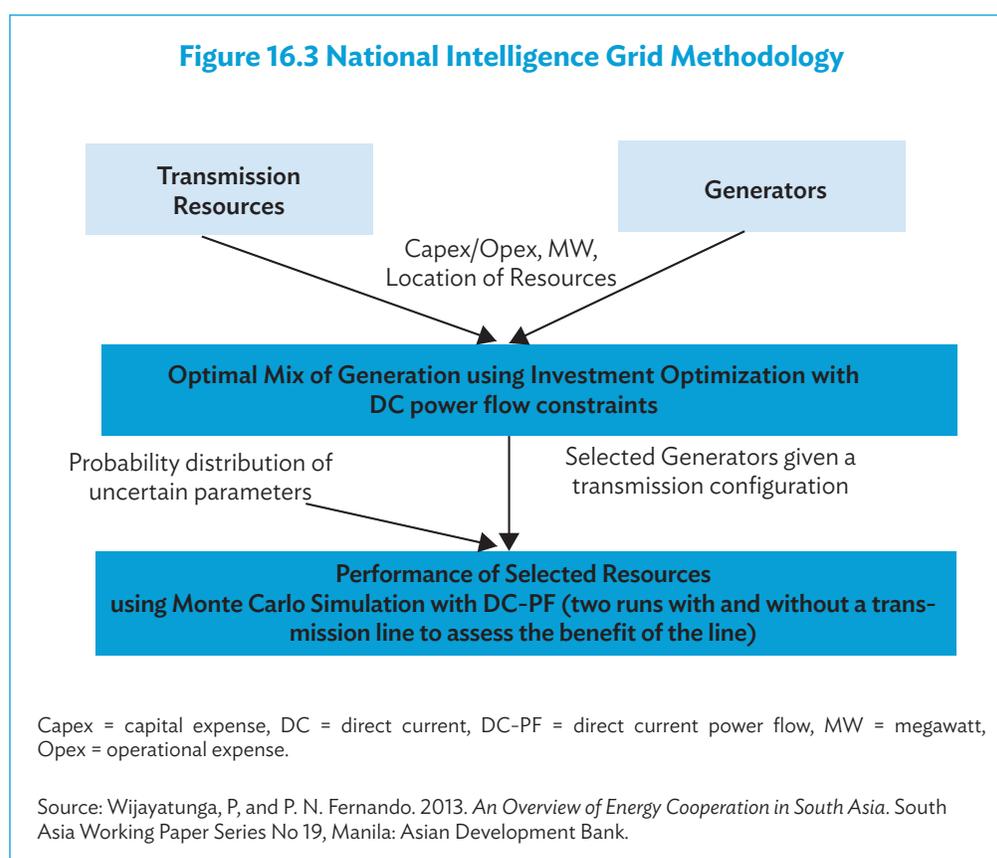
projects, which makes the electricity expensive and uncompetitive with grid-based electricity generation. This is particularly the case when grid feed-in tariffs are based on avoided costs, and subsidies support fossil fuel-fired electricity generation. This issue needs to be addressed through the provision of low-cost capital for NCRE projects and cost-based grid feed-in tariffs. Another common issue is the capacity and robustness of the local grid transmission systems, which determines the ability to absorb wind-based electrical power and the need for backup due to changing wind speeds. Various electromechanical design solutions are being developed and implemented to deal with this problem. Solar photovoltaic technology is proven but still expensive compared with wind and mini-hydro-based electricity generation. Solar photovoltaic energy costs, however, are declining, especially through economies of scale from bulk module production and other components designed for large-scale installations.

## Economic Viability of Interconnections

If costs are carefully controlled, the interconnections outlined are economically viable and would open up very substantial opportunities for regional electricity trade. Greater regional energy trade would benefit countries in the region by (i) helping overcome the mismatch between energy demand and energy resource endowments, especially among neighboring countries; (ii) enhancing energy security through diversifying the forms and sources of energy, while lowering the average cost of supply; (iii) enabling small countries with large energy resources, such as hydropower, to develop these resources while exploiting economies of scale; (iv) helping countries, especially small ones, to postpone, reduce, or avoid large and lumpy capital investments in new production facilities; (v) helping promote public-private partnership arrangements and private sector participation in the energy sector; and (vi) creating environmental benefits by enabling the substitution of high-pollution-emission projects by lower-pollution-emission projects.

The technical and economic viability of cross-border power interconnections are typically analyzed on the basis of planning studies with and without integration of the country power systems considered for integration. Figure 16.3 illustrates this methodology, as carried out under an ADB technical assistance project Study on a South Asia Regional Power Exchange (2013d), for evaluating the power interconnections discussed earlier. The methodology employed the National Intelligence Grid (NATGRID) system, a short-term planning software platform that optimizes the power generation dispatch process while capturing power transmission constraints. The NATGRID analysis considers power demand projections, existing systems and operating details, and possible power supply expansion options together with their capital costs, in-country and cross-border power transfer options, and power system operating procedures.

Two cases were run for a particular power system or a combination of power systems, with and without a particular transmission asset. The NATGRID methodology gives the impact of the transmission asset on the total system in terms of the following benefits: (i) the reliability benefit, in terms of avoided (expected) unserved energy demand and costs to the extent the new transmission asset lowers unserved peak demand and energy demand; (ii) operating cost benefits, in terms of avoided costs of expensive fuel and other savings attributable to power available from the new transmission asset; and (iii) capacity benefits, in terms of any avoided cost of new generation capacity that the transmission asset makes unnecessary.



Based on the interregional and intraregional power interconnections discussed in sections E and F, Table 16.8 identifies the power transmission projects that were considered for economic assessment together with their key features. Given the limited time horizon for which power system planning data was available, the NATGRID analysis focused on 2017.

**Table 16.8: Interconnection Projects Selected for Case Studies**

Case Study	Description	Capacity (MW)	Total Cost (\$ million)
India–Bhutan grid reinforcing	Hydropower evacuation to India	2,100	140–160
Nepal–India 400 kV link	Hydropower evacuation to India	500	186
India–Sri Lanka HVDC link	HVDC including undersea cable	500–1,000	650
India–Bangladesh HVDC link	HVDC line	500	192–250
India–Pakistan 220/400 kV Link	Short 220/400 kV AC links	250–500	50–150
CASA 1000 and India–Pakistan 400 kV link	Portfolio of transmission projects	1,000	~ 1,000

AC = alternating current, CASA = Central Asia–South Asia, HVDC = high-voltage direct current, kV = kilovolt, MW = megawatt.

Source: ADB. 2013d. *Study on a South Asia Regional Power Exchange*. Manila: Asian Development Bank.

Table 16.9 presents a summary of the key assumptions and benefit–cost estimates. All six interconnection or grid reinforcement projects have significant benefits in fiscal year 2017, compared to the (annualized) cost of the projects. The India–Bhutan grid reinforcement stands out as the most beneficial of the six projects, mainly because it helps make available as much as 2,100 MW of hydropower for a modest annualized cost of \$20 million. The project has the potential to achieve \$336 million per year in operating cost savings alone; the substantial savings resulting from a reduction in unserved energy would be even more significant. The possibility of interconnecting Afghanistan and Pakistan with Central Asian countries via the CASA 1000 Project would complement South Asian interconnected grid development. Pakistan could benefit from economically viable electricity import options from Afghanistan, Tajikistan, and Kyrgyz Republic, as well as India. The remaining three projects connecting India with Bangladesh, Nepal, and Sri Lanka also have high benefit–cost ratios.

**Table 16.9: Summary of the Six Case Studies**

Case Study	Key Assumption	Total and Annualized Cost of Transmission (\$ million)	Annual Benefit in 2016–2017 (\$ million)	Benefit–Cost Ratio
India–Bhutan grid reinforcement	Three major hydropower projects totaling 3,066 MW will be developed in Bhutan	Total cost \$140 million–\$160 million Annualized cost \$18 million–\$20 million	Up to \$1,840 million per year including \$336 million in opex benefit and \$1,504 million in unserved energy reduction benefit	92–102
Nepal–India 400 kV link	Two scenarios: (a) Nepal builds all planned projects (2,000 MW) to reach surplus state; and (b) 650 MW of planned capacity addition is delayed i.e., deficit state	Total cost \$186 million including internal transmission upgrade costs Annualized cost \$20 million	Surplus state benefit of \$105 million per year (\$71 million in unserved energy reduction and \$34 million in opex benefits)  Deficit state benefit of \$215 million (\$173 million in unserved energy reduction and \$42 million in opex benefits)	(a) Surplus state: 5.2 (b) deficit state: 10.7
India–Sri Lanka HVDC link	630 MW of new coal and 400 MW of new hydropower added	Total cost \$339 million (2006 estimate) Annualized cost \$50 million (2010 estimate).	\$186 million pa comprising \$96 million in unserved energy reduction and \$90 million in fuel/capacity benefits	3.7
India–Bangladesh HVDC link	Three scenarios around demand growth in Bangladesh that range between 9,000 MW and 12,000 MW in 2016–2017	Total cost range \$192 million–\$250 million Annualized cost of \$25 million assumed for cost–benefit analysis	Annual benefits range between \$145 million and \$389 million, depending upon demand–supply assumptions	5.8–15.6

*continued on next page*

Table 16.9 continued

Case Study	Key Assumption	Total and Annualized Cost of Transmission (\$ million)	Annual Benefit in 2016–2017 (\$ million)	Benefit–Cost Ratio
India–Pakistan 220/400 kV Link	Two scenarios: (a) short-term 250 MW transfer at 220 kV, and (b) medium- to long-term 400 kV transfer of 500 MW	Total cost of option (a) maximum \$50 million for 220 kV option (45 km); and (b) maximum \$150 million for 400 kV option (similar to Bangladesh line) Annualized cost of (a) \$6 million for 220 kV (b) \$18 million for 400 kV	Annual benefit for 220 kV transfer is \$335 million including \$122 million in fuel cost savings Higher transfer via 400 kV increases benefits to \$491 million including \$163 million in fuel cost savings	(a): 55.8 (b): 27.2
CASA 1000 and India–Pakistan 400 kV link	Limited hydro (460 MW) development in Afghanistan. Surplus hydro from Kyrgyz Republic and Tajikistan can be exported to South Asia.	Cost of CASA project is \$893 million and for India–Pakistan link maximum \$195 million Annualized cost of two projects \$110 million	Annual combined benefit of two projects is \$1,250 million for Base Case including \$906 million in unserved energy cost reduction and \$306 million in fuel cost savings	11.4

HVDC = high-voltage direct current, kV = kilovolt, km = kilometer, MW = megawatt, opex = operating expense.

Note: Annualized cost includes capital cost of transmission projects calculated using a weighted average cost of capital of 7.5% and life of 30 years, and operation and maintenance costs.

Source: ADB. 2013d. *Study on a South Asia Regional Power Exchange*. Manila: Asian Development Bank.

If unserved energy benefits are not considered as part of the overall benefits, overall benefits would be largely limited to fuel (or “dispatch”) related cost savings. In this case, a high-cost link would need to be fully utilized to yield a decent return on the investment. Similarly, about two-thirds of the benefit of the integrated CASA 1000 and India–Pakistan project rests on the ability to reduce unserved energy in Pakistan and other countries. Given that the investment would be in excess of \$1 billion, ignoring the unserved energy benefits would diminish the strength of the economic argument. However, it must be recognized that the extent to which unserved energy benefits are factored in is a policy decision.

## Energy Trade Issues and Policy Recommendations

The key issues regarding regional energy trade center on the need to develop enhanced energy supply availability, energy trade infrastructure, a regional power market, and harmonized legal and regulatory frameworks.

### Enhanced Energy Supply Availability

The energy trade initiatives discussed in sections E and F would not be sufficient to meet the medium-term supplementary energy requirements of South Asian countries.

Therefore, the Regional Energy Trade Study by the South Asian Association for Regional Cooperation (SAARC) recommended pursuing further energy trade options including (i) a regional power market, (ii) regional liquefied natural gas (LNG) terminals for bulk LNG imports, (iii) large-scale regional power plants based on LNG or imported coal, and (iv) regional bulk crude oil refining (ADB 2013d).

Expanding regional electricity trade would require further development of the major hydropower resources in Bhutan and in Nepal, together with bulk, regionally competitive coal and/or LNG-based power generation. It would also require power transfer infrastructure to connect India to Pakistan and Sri Lanka and the expansion of existing power transfer infrastructure between Bhutan and India, Bangladesh and India, and India and Nepal.

Bhutan, with an economically viable hydropower generation capability of about 24,000 MW, has an installed capacity of nearly 1,500 MW, primarily for electricity export to India, and a firm agreement for the export of 10,000 MW to India by 2020. Nepal, with 43,000 MW of economically viable generation capability, still has no firm agreement with India for time-bound electricity exports from large-scale hydropower projects. This is primarily because of the lack of a strong enabling framework, including power purchase arrangements for external participation in the development of hydropower and associated transmission projects. Nepal is negotiating project development on a public-private financing basis with support from multilateral bank lending and guarantees. Nepal needs to draw from Bhutan's key success factors, including (i) close attention to detailed project feasibility; (ii) availability of an umbrella agreement with India for both public and private sector cooperation in hydropower development, and power export and trading valid for 60 years (extendable with mutual consent); and (iii) energy-based escalating project tariffs.

With an installed power generating capacity of 229 gigawatts at the end of September 2013, India accounts for a very large share of the region's total installed power generating capacity. However, India itself experiences peak power supply deficits of around 15%, mainly due to the need to derate the power generating capacity for various reasons, including fuel supply shortages. India has taken steps to rapidly expand its power generating capacity to about 300 gigawatts by 2017 through imported LNG- and coal-based mega power generating plants, in addition to power plants using domestic natural gas and coal. As noted in section C, it is estimated that by 2020 India would need to fulfill about 30% of its coal and natural gas requirements through imports.

Imported coal-based mega power plants generating up to 4,000 MW are being developed in India on the basis of best practices. These plants yield operational as well as coal procurement economies of scale. One or more of such plants could be considered for overall regional benefit. Importing electricity from a regional power plant would, however, need to be dictated by its competitiveness when compared to the cost of in-country electricity generation. An LNG-based power plant may not be as financially competitive as a coal-based power plant; but if the environmental costs, especially those related to emissions of carbon dioxide are internalized, the LNG option becomes competitive.

In light of the need to minimize carbon emissions, India is emphasizing LNG-based mega power plants. India is seeking to import 40 million tons a year of LNG by 2017 to provide an

incremental supply of 5,100 MMCF/day of natural gas. A regional LNG plant based in India could result in significant benefits for neighboring countries. Given that India is already an LNG importing country, and that Bangladesh and Pakistan are also considering importing LNG, the region would benefit from a bulk LNG terminal project to capture the benefits of economies of scale. Ownership and financing of the LNG terminal could be structured as a joint venture of the participating countries. Development of the natural gas distribution infrastructure would be a parallel requirement. An alternative would be onsite power generation and transfer of the natural gas energy in the form of electricity. A regional LNG terminal would provide wider and more flexible opportunities for sourcing natural gas and could be pursued in parallel with the IPI and TAPI projects.

The IPI and TAPI natural gas supply pipelines have been viewed by India and Pakistan for many years as possible sources of additional bulk natural gas supplies. Bangladesh has also shown interest in the TAPI project. However, the success of these projects would depend on (i) ensuring the availability of adequate natural gas reserves for 15–20 years; (ii) firming up the construction costs and schedule, and ensuring the pipeline operator can keep the pipeline functioning for 15–20 years (construction and operation risk); (iii) a commitment by the buyers to take all the natural gas over this period and pay for it in currencies matching the gas supply costs (market and payment risk); and (iv) the ability to obtain timely financial closure for the project (financing risk). Apart from the need to minimize these commercial risks, political risks in pipeline transit countries would have to be addressed. Similar commercial and political risks are associated with the Central Asia–South Asia (CASA-1000) power transmission project, which may require some design modifications for the project to be more useful for Afghanistan.

### *Policy Recommendations*

The following policy initiatives are recommended to strengthen access to energy supplies in South Asia:

- (i) Expand the scope in Bhutan for further private sector participation in hydropower development and associated power transmission.
- (ii) Provide targeted assistance to Nepal to strengthen its hydropower development framework, including detailed feasibility studies, financing mechanisms, and formulation of public–private project implementation arrangements.
- (iii) Carry out further quantitative analysis to determine the attractiveness for South Asian countries of power purchases from large-scale, high-efficiency centralized regional power plants, based on imported coal and natural gas.
- (iv) Review the commercial risks associated with TAPI and IPI—particularly related to project cost, implementation, and payment mechanisms for delivered natural gas—and develop a risk mitigation strategy.

### **Energy Trade Infrastructure**

Cross-border energy trade in South Asia has been hampered by inadequate export-oriented energy development and unrealistic energy price expectations on the part of prospective importing countries. Energy tariffs are often subsidized and held below

economic costs. Delays in negotiating energy transit agreements have also impeded cross-border energy trade. However, investment in cross-border energy transfer infrastructure is now growing as efforts to expand energy supplies increase, expectations of energy cost become more realistic, analytical techniques for assessing interconnection viability improve, and legal and regulatory frameworks become more coherent.

The technical and economic viability of cross-border power interconnections are typically analyzed on the basis of generation and transmission planning studies. A reliable database is required to carry out these studies, including detailed information on power demand projections, existing systems and operating details, possible power supply expansion and transfer options, and integrated and non-integrated power system operating procedures. It is important to recognize that HVAC interconnection of two or more power systems calls for synchronizing all the connected grids, with common criteria for system operation and control. These aspects would have to be factored into the cross-border power transfer option selection process.

Strong stakeholder commitment and political backing are important factors that help in carrying out the necessary analysis and moving toward implementation. Technical and financial support from external stakeholders, such as multilateral financial institutions, can be crucial in getting initial project development underway and forming legally enforceable agreements. Private sector participation can speed up the financing process and improve the confidence of commercial lenders. The creditworthiness of the main buyer of energy imports is very important for completing the project financing arrangements.

Two ADB-financed dedicated power transfer projects illustrate the process. The first is the double-circuit 220 kV power interconnection in 2006 and 2010 (supplementary) for the transmission of 300 MW of power from Tajikistan to Afghanistan. The total project cost was \$121.9 million (\$67.9 million of investment in Afghanistan and \$54.0 million in Tajikistan), of which ADB provided financing of \$47.0 million for Afghanistan and \$21.5 million for Tajikistan. Other major external financiers included the Afghanistan Reconstruction Trust Fund, the Islamic Development Bank, and the Organization of the Petroleum Exporting Countries (OPEC) Fund for International Development.

The second project is the power transfer link constructed by Powerlinks Transmission, a public-private partnership joint venture between Tata Power (51%) and Power Grid Corporation of India (49%), to provide about 3,000 MW of power transmission capacity between Siliguri in West Bengal and Manduala in Uttar Pradesh. The project, designed mainly to transmit power generated in Bhutan, was commissioned in September 2006 at a cost of \$265 million. Financing was by ADB (\$66.3 million), the International Finance Corporation (\$75.0 million), and domestic financial institutions (\$44.2 million). The entire power transmission capacity has been assigned to Power Grid Corporation of India under a transmission service agreement for a regulated transmission fee.

### *Policy Recommendations*

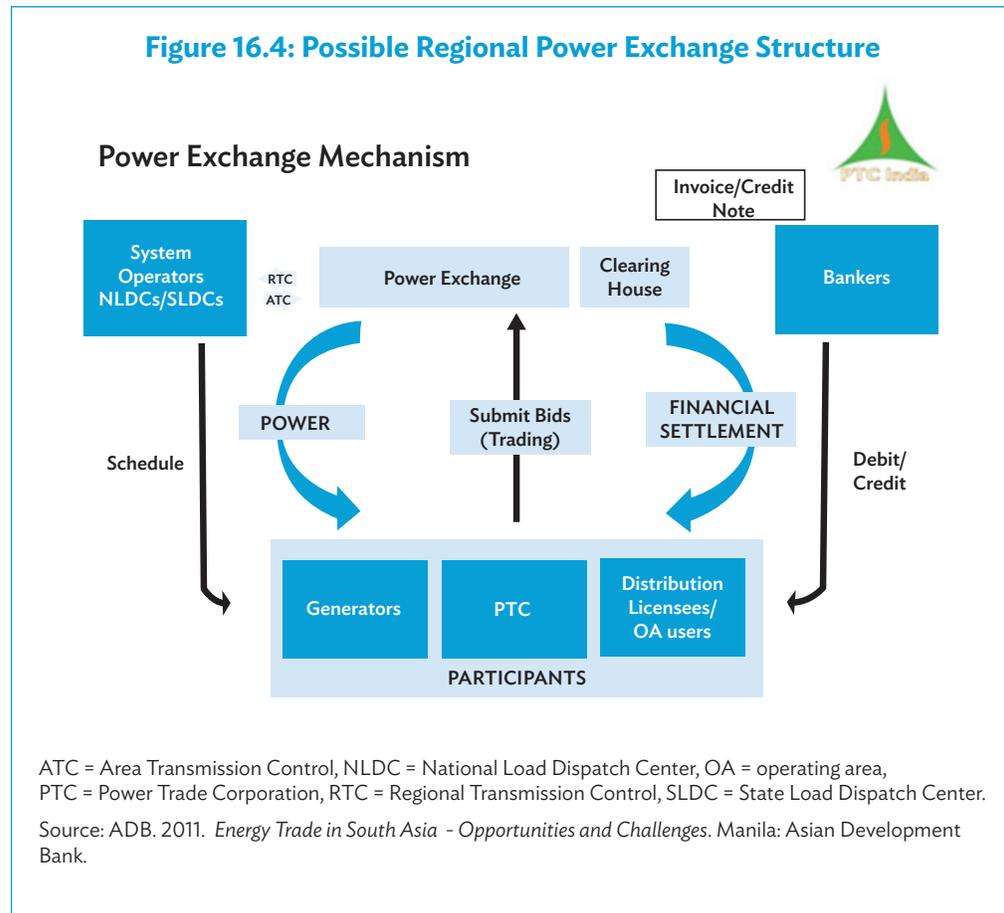
The following policy initiatives are recommended for developing the cross-border electricity trade infrastructure in South Asia:

- (i) Identify possible cross-border power transmission interconnection scenarios for the South Asia region and develop a regional database to carry out power system studies.
- (ii) Examine in detail the interconnection modality, whether HVAC or HVDC, its size, timing, and operational feasibility.
- (iii) Assess the technical and economic viability of candidate interconnections, and the power system performance from a with and without interconnection perspective.
- (iv) Develop financing options, including the extent to which public sector financing can be mobilized and the level and modality of multilateral financing required to catalyze private sector investment.

### **Regional Power Market**

Given the high opportunity cost of electricity shortages in the region, any effort to reduce those shortages would result in significant economic benefits. Enhanced electricity trade in the region, including surpluses that South Asian countries may have, would help reduce shortages in deficit countries. As noted in section D, there has been some progress in this regard. Bhutan has agreed to export about 10,000 MW of hydropower to India by 2020. Sri Lanka is in the process of implementing nearly 2,000 MW of coal-fired power plants and is considering a 500 MW HVDC power transmission link with India. India is progressing with implementation of coal- or LNG-based 2,000 MW–4,000 MW power plants. Bangladesh completed a 500 MW HVDC interconnection with India in October 2013. Nepal anticipates early completion of a 1,000 MW HVAC power interconnection with India to ease its power shortages. Pakistan is also seeking power trade opportunities with India to ease its power shortages. Current bilateral energy trade between India and Bhutan, Nepal, and Bangladesh, could be enhanced to involve much larger power volumes.

These bilateral initiatives could be enhanced by a regional power exchange. Bilateral trade arrangements could graduate to multilateral trade arrangements within a regional framework. India already has two working national electricity exchanges, the India Energy Exchange and the Power Exchange India, through which bilateral as well as competitive electricity trade is taking place. Interested power producers and buyers in South Asia could consider participating in enhanced regional electricity trade through a regional power exchange linked to India's exchanges. As a first step, South Asian countries could participate in the Indian power market through bilateral contracts facilitated by this regional power exchange, and then proceed to transfer power to third parties where feasible (Figure 16.4).



Because of its size and its central location, India has an important role to play in building a regional electricity market. All trade, except that between Afghanistan and Pakistan, would involve India as the conduit for electricity transmission. India’s experience in linking regional grids to a national grid could serve as the basis for building the proposed regional power market. India has five regional transmission grids: the northern, western, southern, eastern, and northeastern. At present, the four regions (northern, western, eastern, and northeastern) are synchronously interconnected through high-capacity 400 kV alternating current (AC) lines. HVDC interconnections are also available between the eastern and northern regions and between the western and northern regions. These supplement the AC synchronous links. The southern region is now connected with the remaining all-India power grid through HVDC and AC links.

India’s national electricity exchanges are day-ahead markets. In their market operations, they first make an estimate of the marginal clearing price and the marginal clearing volume for power, based on the bids from sellers and buyers for each hour over the next day. The exchanges then check the required transmission capacity with the National Load Dispatch Center (NLDC) and regional load dispatch centers, and recalculate the marginal clearing price and marginal clearing volume. After this, the exchanges issue day-ahead power generation and dispatch schedules. They issue financial statements for the settlement of payments after the actual power transactions take place.

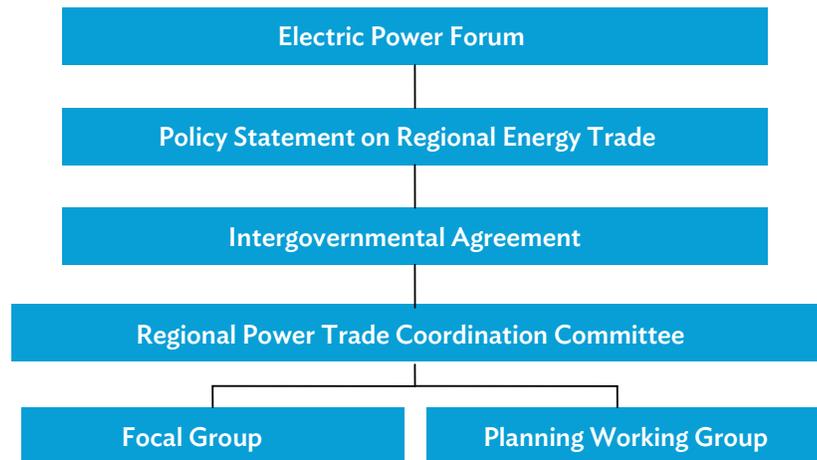
At this stage, two power exchanges facilitate bilaterally traded power between generators and major consumers. However, given the continuing power shortages, there is strong interest in further development of power plants in India. These typically tie up about 70% of their generating capacity through long-term bilateral contracts with major consumers, trading only the balance on a competitive basis. Given this background, there is scope for expanding cross-border bilateral electricity trade by a regional power exchange.

In the case of contract-based bilateral power exchanges between South Asian countries, a country NLDC could evaluate the net feasible power exchange (based on data from generators, traders, or aggregators) along with the points of power export or import for each scheduling period. In the case of market-based power transactions, the power available for export in excess of bilateral commitments could also be marketed through the regional power exchange. Harmonized regulatory provisions, including grid codes to ensure reliable interconnected operation and control and communication mechanisms among the NLDCs to coordinate the regional power exchange, are a prerequisite for both modes of power exchange.

International experience demonstrates that a regional power market can be established by adopting a building block approach. Regional electricity markets need to evolve over time for technical, regulatory, and policy-related reasons. The evolutionary path for this market would depend on the pace at which the regional resource potential is exploited, the demand–supply balance in the foreseeable future, the structure of the power supply industry (including the legal and regulatory framework), government policies, and the surpluses (seasonally and during the time of day) that the countries involved identify. The first and foremost requirement for moving toward a regional power market would be broad agreement among the participating member states to facilitate bilateral power exchanges, followed by multilateral power exchanges. This has been the initiating point for some power pools operating in various parts of the world.

Under the program of the Greater Mekong Subregion (GMS), comprising Cambodia, the People’s Republic of China (PRC, specifically Yunnan Province and Guangxi Zhuang Autonomous Region), Lao People’s Democratic Republic (Lao PDR), Myanmar, Thailand, and Viet Nam, power interconnections among the countries have been emphasized to provide more reliable supply, improve consumer access to electricity, reduce operational costs, and promote investment in energy resource developments. The institutional framework adopted by the GMS for power trade in the region could be instructive for the SAARC region (Figure 16.5).

**Figure 16.5: Institutional Framework for Greater Mekong Subregion Power Trade**



Source: SAARC. 2010. *SAARC Regional Energy Trade Study*. Kathmandu: South Asian Association for Regional Cooperation.

The Electric Power Forum was established to serve as an advisory body to ministers on GMS power projects and issues. Its objectives are to

- serve as a cooperative link among government agencies and institutions that are directly involved in power supply and power system development;
- serve as a promotional and advisory organization for the development of efficient electric power systems;
- identify and promote opportunities for mutually beneficial power projects;
- promote financing of such projects by governments, power utilities, development partners, and the private sector;
- provide and disseminate information to participating countries, and communicate and cooperate with regional and international organizations involved in the energy sector; and
- facilitate training and other human resource development initiatives.

The Electric Power Forum prepared a Policy Statement for Regional Cooperation in Power Trade, which was signed by member countries in 1999. The key objectives of the policy were to

- promote the efficient development of the power sector in the GMS;
- promote opportunities for energy economic cooperation between members;
- facilitate implementation of priority power projects;

- address technical, economic, financial, and institutional issues relevant to GMS power development; and
- protect and improve the environment through the adoption of appropriate technologies and plans.

The policy statement also required GMS governments to sign an intergovernmental agreement, setting out the following principles and framework for electricity trade among member countries:

- coordinate and cooperate in the planning and operation of their systems to minimize costs while maintaining satisfactory reliability;
- fully recover their costs and share equitably in the resulting benefits, including reductions in required generation and transmission capacity, reduction in fuel costs, and improved use of low-cost electricity sources; and
- provide reliable economic power services to the customers of each party.

Under the intergovernment agreement, a Regional Power Trade Coordination Committee was formed to coordinate implementation of the regional trade. Its mandate is to

- prepare a regional power trade operating agreement specifying the rules of regional power trade;
- recommend policies for the overall and day-to-day management of regional power trade;
- establish short-, medium-, and long-term initiatives to achieve the objectives of regional power trade within a specified timetable; and
- identify the necessary steps for implementation of regional trade, including the means of financing.

A memorandum of understanding (MOU) was signed for implementation of the Regional Power Trade Operating Agreement, and two subgroups were formed—the Focal Group and the Planning Working Group—for implementing the agreement. The Focal Group has a mid-level official from each country acting as the focal point. The Planning Working Group has senior representation from each country, with responsibility for national transmission planning. It prepares plans for augmenting the capacity of cross-border transmission infrastructure and facilitating cross-border power trading. This group also developed performance standards regarding safety, security, reliability, and quality of services, and created and maintained the regional database on power trading. As a result, power trade in the GMS has been developed according to a Regional Indicative Master Plan on Power Interconnection that identifies priority power grid projects.

The Nordic power exchange, or Nord Pool, is another example of regional energy trade. Established in 1996 for the exchange of electricity among the four Scandinavian countries (Denmark, Finland, Norway, and Sweden), it provides useful lessons for the SAARC region. A key motivation for the power pool was the significantly different power generation mix of each country. Norway had completely hydro-based power generation, whereas Denmark had all thermal-based power generation. Sweden and Finland had a mix of hydro, nuclear,

and thermal-based power generation. The countries decided to cooperate to realize benefits from the differences in their energy sources and to improve the security of energy supply.

The transmission system operator (TSO) in each Nordic country plays an important role in managing the Nord Pool. The core duty of the TSOs is system responsibility, which includes:

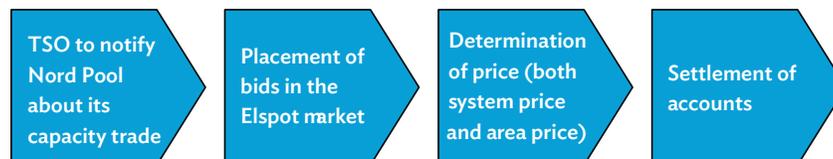
- ensuring the operational security of the power system so that the power reaches the end consumers,
- maintaining the balance between supply and demand,
- ensuring the stability of the transmission system by keeping frequency at 50 hertz, and
- being responsible for the efficient functioning of the electricity market.

The Nord Pool operates a spot market called Elspot, which is a day-ahead market, where power contracts of a minimum of one hour's duration are traded for physical delivery the following day. Figure 16.6 illustrates the steps involved in the Nord Pool spot market. To maintain grid discipline across the region, one TSO operates in each country—Energinet in Denmark, Fingrid in Finland, Statnett SF in Norway, and SvenskaKraftnä for Sweden.

To begin operations, the TSO in each country notifies the Nord Pool spot market (also called the Nord Pool Spot AS) of the capacities allocated by them under Elspot contracts for the following day's trade. The entire Nordic Exchange area is geographically divided into bidding areas, which are consistent with the geographical area of each of the TSOs. Power flows between the bidding areas are determined according to the bids submitted by the participants. Bids made by participants fall in the bidding area where their production or consumption lies.

A bid is a sequence of price–volume pairs for each specified hour, with volumes stated in megawatt-hours (MWh). Participants submit their bids (to make or take delivery) on bidding forms covering all 24 delivery hours through an internet application or by fax. All bids received from the market participants are summed to form a curve for purchase

**Figure 16.6: Operation of Nord Pool**



TSO = transmission system operator.

Source: SAARC. 2010. *SAARC Regional Energy Trade Study*. Kathmandu: South Asian Association for Regional Cooperation.

(demand) and a curve for sale (supply). The intersection point of the two curves determines the system price for that hour. In all, 24 price calculations are made, one for each delivery hour of the following day. If the contracted power flow between the bidding areas is the same as the capacity allocated to the areas by the TSOs, then a single system price prevails in the entire market, otherwise separate area prices are determined. This market-splitting mechanism is a congestion management tool that ensures that all available capacity will be utilized from sales surplus areas (lower price) to sales deficit areas (higher price).

If the contractual power flow demand across bidding areas exceeds the capacity allocated, then the price of power is increased in the power deficit area to stimulate higher generation (supply) and lower consumption (demand), and the price is reduced in the power surplus area to stimulate lower generation (supply) and higher consumption (demand). Area prices, in effect, introduce an extra charge on those causing an imbalance in the system. For settlement of accounts between participants, net amounts to be debited/credited to each participant are calculated at the end of the day. Invoices or credit notes are issued and sent to the participants. Nord Pool receives payment from buyers the following day, and it subsequently makes payment to the sellers.

In the case of both the GMS and Nord Pool, the countries involved have harmonized their legal and policy regimes. The Nord Pool countries adopted similar market structures by unbundling the power sector and appointing TSOs in each country. In both the GMS and Nord Pool, there is clear demarcation of the roles and responsibilities of each of the stakeholders involved. This provides clarity in the functioning of the regional trade arrangement, an important consideration for a possible SAARC power exchange option.

SAARC has taken a significant step toward creating a SAARC market for electricity by endorsing in 2011 of the Draft Intergovernmental Framework Agreement. The agreement provides for unrestricted cross-border trade, commercial negotiation of power purchase agreements, nondiscriminatory open access, private sector trading, and participation in power exchanges. The SAARC Framework for Energy Cooperation (Electricity), as finalized by the Member States, was signed during the Eighteenth SAARC Summit in Kathmandu in November 2014. In 2013, the South Asia Subregional Economic Cooperation (SASEC) Electricity Transmission Utility Forum was established to facilitate planning and regional power trade.

### *Policy Recommendations*

The following actions are recommended to enhance the regional power market in South Asia, including a regional power exchange linked to India's power exchanges:

- (i) Undertake a study of the power systems in South Asian countries, including the legal and regulatory aspects, the power transmission systems, and the security and stability standards in the participating countries.
- (ii) Review power generation scheduling and dispatch procedures, energy accounting systems, and financial settlement systems for electricity transactions in South Asian countries, detailing their degree of suitability for cross-border power trade. Analyze the institutional, regulatory, and commercial requirements for cross-border power trade.

- (iii) Develop a structure for a regional power exchange linked with India's power exchanges, and centrally facilitate the Indian power market to cater to regional power trade.

### Harmonized Legal and Regulatory Frameworks

Energy markets in South Asia are governed by individual legal, regulatory, and policy frameworks. Having multiple legal and regulatory frameworks for the energy sector would greatly hamper cross-border energy trade. Therefore, as a first step, South Asian countries need to harmonize the legal and regulatory frameworks relevant to regional electricity trade.

Most South Asian countries have energy sector regulators. While Pakistan and India have separate energy subsector regulators, Bangladesh has one regulator for the whole energy sector. Sri Lanka has a public utilities commission, which is not restricted to the energy sector. Such divergence in the mandates of regulators across the region could complicate coordination.

The following are key aspects for consideration:

- (i) **Licensing for trading of electricity to enable development of a cross-border market.** The generation licensees, bulk suppliers, and distribution licensees could be recognized as deemed trading licensees. A participating member country could initially limit the right to cross-border trade to one of the recognized government entities, but this should be subsequently relaxed to permit greater market participation and competition.
- (ii) **Open access of transmission network.** There should be nondiscriminatory open access to the transmission network to encourage a competitive regional power market. The rules and regulations for open access should be coordinated by the country nodal agencies.
- (iii) **Coordinated system operation and treatment of system imbalances.** There must be coherence in the grid code followed by the system operator in each participating country. A mechanism for treatment of system imbalances at the regional level needs to be established.
- (iv) **Transmission planning.** Power transmission planning should be coordinated across transmission licensees in the region to develop cross-border links.
- (v) **Policy for regional electricity trade.** Promotion of regional electricity trade and development of a regional power market should be part of the national energy/ electricity policy in the respective countries.
- (vi) **Export taxes and import duties.** Electricity traded through power exchanges should be exempted from any export tax or import duties. Any uncertainty with respect to the liability for export tax and/or import duties on electricity sales would impede country participation in power exchanges.
- (vii) **Dispute resolution.** Establish a regional mechanism for joint resolution of disputes related to cross-border power trade. A coordination committee of the participating countries could be empowered to adjudicate between the parties involved in cross-border electricity trade.

Private sector financing of large hydropower projects involves complex hydrological, environmental, and social issues. Given proper attention to these issues, multilateral financial institutions, such as ADB, can facilitate the financing of hydropower projects in tandem with the private sector. For this purpose, it is important to have in place the enabling framework for private sector participation. The same concerns apply for thermal power projects. Financing for dedicated cross-border power transmission can normally be secured from ADB or the World Bank, provided the technical, economic, financial, environmental, and social issues are satisfactorily addressed.

Harmonization of the legal and regulatory frameworks for regional electricity trade would be a strong factor for public and private sector investment in cross-border power transmission facilities and in hydro and thermal power generating facilities. The promotion of regional energy trade would also benefit from the countries being members of the Energy Charter Treaty (ECT), as this would provide greater security for investments related to cross-border energy transfer.

The objective of the ECT is to create a set of rules for participating governments to minimize risks associated with energy-related regional investments (Box). It would be helpful for South Asian countries to develop a regional energy trade cooperation agreement that includes the provisions in the ECT.

### The Energy Charter Treaty

The provisions of the Energy Charter Treaty (ECT) focus on five broad areas:

- (i) protection and promotion of foreign investments based on the extension of national treatment or the most favored nation treatment, whichever is more beneficial;
- (ii) free trading in energy-related materials and products and energy-related equipment based on World Trade Organization (WTO) rules;
- (iii) freedom of energy transit through pipelines and grids;
- (iv) reduction of negative environmental impact of the energy cycle by improving energy efficiency; and
- (v) mechanisms for resolution of state-to-state or investor-to-state disputes.

The ECT promotes long-term energy cooperation through stable and predictable rules. Developed in line with the WTO rules for the energy sector, the ECT guarantees security of supply through reliable and well-defined transit rules. Through its various provisions, it creates an investor-friendly environment favorable to the flow of investments and technologies. The ECT acts as a forum for experience sharing and encourages cooperative efforts aimed at promoting market-oriented reforms in the energy sector.

The ECT is structured so that it benefits all parties in a cross-border trade arrangement—the supplier of energy or producer, the transit entity or country, and the consumer:

- (i) The producer member countries benefit from the treaty through investor confidence, encouraging foreign direct investment in the countries.
- (ii) For the transit country, the treaty creates a secure transit framework, which benefits the purchasers and consumer countries. The treaty also tries to secure a certain income for the transit countries so that they can cover risks associated with transit.
- (iii) For the consumer country, the treaty provides greater security of supply.

Source: SAARC. 2010. *SAARC Regional Energy Trade Study*. Kathmandu: South Asian Association for Regional Cooperation.

#### Policy Recommendations

The following policy initiatives are recommended for harmonizing the legal and regulatory framework for cross-border electricity trade in the South Asia:

- (i) Harmonize the legal and regulatory frameworks. This should primarily address electricity trading licensing, open-access power transmission, coordinated power system operation, transmission planning across interconnected power systems, inclusion of regional electricity trading in country energy policies, exemption of electricity trade from taxes and duties, and regionally supported mechanisms for dispute resolution.
- (ii) Encourage South Asian countries to become members of the ECT, which would provide greater security for cross-border investments related to energy transfer, as well as security of supply.

- (iii) Include internationally accepted measures in the enabling framework to promote private sector participation in cross-border power transmission and in the development of hydro and thermal power generation.



## CHAPTER XVII

# Institutional Capacity Building for South Asian Integration

*Cuong Minh Nguyen*

The vision of South Asian Association for Regional Cooperation (SAARC) leaders for a broad-based South Asian Economic Union (SAEU) calls for accelerated regional cooperation and integration (RCI). In turn, this calls for a strong supporting institutional framework. But the institutional framework must be more than simply state-centric. In addition to a market-led dimension, South Asia's integration also has a community-driven dimension, reflecting the deep historical, cultural, and linguistic links among the peoples of the region. Also, there are similarities of administrative systems. As a result, South Asia's regionalism is a combination of state-centric and community-based regionalism. The institutional framework is, therefore, multidimensional and includes both state-driven institutions and informal institutional structures led by nonstate community representatives.

Reinforcing this multidimensional framework is market-led regionalism. The global geoeconomic environment is continuously evolving, with East Asia gradually losing its attractiveness as a manufacturing center because of rising labor costs. In contrast, South Asia has become one of the preferred regions for multinational corporations seeking new manufacturing locations, reflecting the region's increasing trade openness, relatively stable political environment, low labor costs, and reasonably well-educated labor force. Market-led integration in South Asia is expected to intensify and must be integrated with state-centric and community-led regionalism. The need for an effective institutional architecture is increasingly imperative for South Asia.

This chapter reviews South Asia's institutional readiness for these developments. The chapter summarizes the literature concerning institutions for RCI and examines the historical development of regional institutions in South Asia. Of particular focus is the relative effectiveness of the state-led and community-based institutional arrangements in South Asia. Based on this review, broad recommendations are made for improving the overall institutional architecture for a South Asia economic union.

## Defining Regional Institutions

Regional institutions vary widely reflecting, among other factors, the intended degree and scope of RCI. While conventionally regionalism is described as a process of state-led trade liberalization and eventual economic union, new regionalism broadens the concept

to include the emergence of multilevel patterns of governance (Hettne and Soderbaum 2000). New regionalism encompasses (i) emergence of north and south regionalism, (ii) wide variations in the level of institutionalization, (iii) their multidimensional character, and (iv) a marked increase in regional awareness and consciousness (Sudo 2002). Acharya (1999) expands on the concept of new regionalism by drawing attention to the informal and multidimensional nature of newly emerging regional interactions and processes. Hossain (2010) describes new regionalism as a process encompassing a wide range of issues, actors, and institutions with a view to building a regional community or a supranational authority. Hettne (1996) defines new regionalism as

...a multidimensional form of integration which includes economic, political, social and cultural aspects and thus goes far beyond the goal of creating region-based free trade regimes or security alliances. Rather, the political ambition of establishing regional coherence and identity seems to be of primary importance.

In this chapter, regionalism is defined as the process of state-led, top-down regional cooperation. In contrast, regionalization is defined as the process of bottom-up regional integration in two forms: market-driven and community-based. Regionalism results in formal, interstate agreements, while regionalization leads to increasing interconnectedness among business interests and community groups. Hence, regionalism and regionalization are mutually reinforcing. Increasing interconnectedness among business interests, as advanced through regional and global value chains, as well as increasing people-to-people contacts across borders, as facilitated by social and cultural links, may compel states to forge more formal regional policies.

South Asian integration is considerably influenced and to some extent led by its social and cultural cohesiveness. This special characteristic is often overlooked by analysts who emphasize state- and market-led regionalism in evaluating South Asian regionalism.

An Asian Development Bank (ADB) study, *Institutions for Regional Integration*, defines such institutions as ranging from ad hoc and informal forums lacking an organizational core to formal organizations serving a well-defined purpose. The principals or contracting parties of these formal institutions are national governments, although nongovernment organizations (NGOs) and other nonstate actors may also participate in their work (ADB 2010b). The study classifies regional institutions in Asia as follows:

- **Overarching institutions.** These are umbrella organizations with comprehensive terms of reference, possibly based on a vision of an integrated regional economy and community. Less formally, overarching institutions may be a network of dialogue-based arrangements to coordinate the implementation of regional agreements and facilitate regional policy dialogue. Many of these institution-based groupings have their own secretariats with full-time staff and assigned budgets—e.g., the Association of Southeast Asian Nations (ASEAN) Secretariat in Jakarta, the (SAARC) Secretariat in Kathmandu, the Asia-Pacific Economic Cooperation (APEC) Secretariat in Singapore, the Shanghai Cooperation Organization (SCO) Secretariat in Beijing, and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) Secretariat in Dhaka.

- **Functional institutions.** These are specialized institutions with a narrow, often technical or project- and/or program-driven agenda. With some exceptions, such as South Asia Subregional Economic Cooperation (SASEC) and the Greater Mekong Subregion (GMS), functional institutions tend not to have formal secretariats with full-time staff and independent budgets.
- **Facilitating institutions.** These are service providers that bolster regional integration by providing advisory, administrative, technical, and financial support.

Table 17.1 summarizes membership in 18 regional organizations in Asia that are categorized as either overarching or functional.

While the classification is useful, the subtle difference between binding overarching institutions --the European Union (EU) type --and nonbinding regional institutions defined as the “Asian way” needs to be analyzed. Most importantly, the classification would be more useful in describing institutional developments in South Asia, if it could further examine the role of nonstate actors that have contributed significantly to widening and deepening the social fabrication for regional integration in South Asia. In this chapter, regional institutions are classified as follows:

- **Formal institutions based on binding agreements and majority voting.** The EU’s institutions are intergovernmental arrangements supported by legally binding agreements based on majority voting principles. The EU model worked well until 2008 when the global economic crisis erupted and exposed its flaws.
- **Formal institutions based on open regionalism, consensus, and voluntary principles.** APEC, ASEAN, BIMSTEC, SAARC, and other regional groupings in Asia follow this intergovernmental open-regionalism structure, based on consensus principles. While this arrangement gives the participating members flexibility, the voluntary nature of the regional grouping may limit progress in advancing RCI.
- **Program- and/or project-based institutions.** Another RCI model is based on the development of programs and/or projects. Subregional cooperation programs of this form have gained prominence in Asia because of their ability to generate tangible and quick outcomes for the participating countries. These subregional programs often start with the development of transport corridors and other forms of trade and investment facilitation. The combination of cross-border transport corridors linking industrial zones facilitates cross-border trade and hence greater regional economic integration and cooperation. Current institutional arrangements of this type include SASEC, Central Asia Regional Economic Cooperation (CAREC), and the GMS. Despite their subregional approach, these institutions are still formal and intergovernmental arrangements.
- **Informal institutions.** The increasing participation of nonstate actors has transformed the state-centric nature of regionalism, making it a multidimensional process. Depending on the composition of the region or subregion, different types of informal institutions and nonstate actors tend to prevail. For example, transnational and multinational corporations in East Asia have spearheaded market-driven integration by locating their manufacturing and assembly units in the most cost- and time-effective

locations. By contrast, small and medium-sized firms, specialized institutions (research institutes and think tanks), social networks, and NGOs play an important catalytic role in promoting RCI in South Asia. In other words, if regional integration can be categorized as market-led in East Asia, it is largely a community-based process in South Asia. It would be a misjudgment if one views South Asia's community-based regional integration through the lenses of market-led integration of East Asia.

**Table 17.1: Typology and Membership of Selected Asian Regional Arrangements**

Groupings Countries	Project/Program-Based Groupings (Functional Institutions)						Network/Institution-Based Groupings (Overarching Institutions)											
	GMS <sup>a</sup>	IMT-GT	CAREC <sup>b</sup>	BIMP-EAGA	SASEC	MRC	ASEAN	ASEAN + 3	East Asia Summit	APEC	SAARC	ACD	ACMECS	SECSCA	SAGQ	ECO	BIMSTEC	SCO
<b>Central and West Asia</b>																		
Armenia																		
Azerbaijan			○													○		
Kazakhstan			○								○					○		○
Kyrgyz Republic			○													○		○
Tajikistan			○										○			○		○
Turkmenistan			○										○			○		
Uzbekistan			○										○			○		○
<b>Northeast Asia</b>																		
People's Republic of China	○		○			○		○	○	○		○						○
Mongolia			○									○						
Hong Kong, China									○									
Japan								○	○	○		○						
Republic of Korea								○	○	○		○						
Taipei,China									○									

continued on next page

Table 17.1 continued

Groupings Countries	Project/Program-Based Groupings (Functional Institutions)						Network/Institution-Based Groupings (Overarching Institutions)											
	GMS <sup>a</sup>	IMT-GT	CAREC <sup>b</sup>	BIMP-EAGA	SASEC	MRC	ASEAN	ASEAN + 3	East Asia Summit	APEC	SAARC	ACD	ACMECS	SECSCA	SAGQ	ECO	BIMSTEC	SCO
<b>Southeast Asia</b>																		
Brunei Darussalam				○			○	○	○	○		○						
Cambodia	○					○	○	○	○			○	○					
Indonesia		○		○			○	○	○	○		○						
Lao People's Democratic Republic	○					○	○	○	○			○	○					
Malaysia		○		○			○	○	○	○		○						
Myanmar	○					○	○	○	○			○	○				○	
Philippines				○			○	○	○	○		○						
Singapore							○	○	○	○		○						
Thailand	○	○				○	○	○	○	○		○	○				○	
Viet Nam	○					○	○	○	○	○		○	○					
<b>South Asia</b>																		
Afghanistan			○									○		○		○		
Bangladesh					○							○	○		○		○	
Bhutan					○							○	○		○		○	
India					○			○				○	○		○		○	
Maldives												○						
Nepal					○							○			○		○	
Pakistan			○									○	○		○			
Sri Lanka												○	○				○	

ACD = Asia Cooperation Dialogue, ACMECS = Ayeyawady–Chao Phraya–Mekong Economic Cooperation Strategy, APEC = Asia-Pacific Economic Cooperation, ASEAN = Association of Southeast Asian Nations, ASEAN+3 = Association of Southeast Asian Nations Plus Three (the People's Republic of China [PRC], Japan, and the Republic of Korea), BIMP-EAGA = Brunei Darussalam–Indonesia–Malaysia–Philippines East ASEAN Growth Area, BIMSTEC = Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation, CAREC = Central Asian Regional Economic Cooperation Program, ECO = Economic Cooperation Organization, GMS = Greater Mekong Subregion Program, IMT-GT = Indonesia–Malaysia–Thailand Growth Triangle, MRC = Mekong River Commission. SAARC = South Asian Association for Regional Cooperation, SAGQ = South Asia Growth Quadrangle, SASEC = South Asia Subregional Economic Cooperation, SCO = Shanghai Cooperation Organization, SECSCA = Subregional Economic Cooperation in South and Central Asia.

Note: Boao Forum is not included in the table as it is a “track-2” process involving academia, the private sector, and government officials. Some regional groupings have ADB regional member countries as observers: SAARC (the PRC and Japan) and SCO (India, Mongolia, and Pakistan).

<sup>a</sup> The PRC participates in the GMS program in the interests of Yunnan Province and the Guangxi Zhuang Autonomous Region and western PRC more generally.

<sup>b</sup> The PRC participates in CAREC representing the interests of the Xinjiang Uygur Autonomous Region and western PRC more generally.

Source: Author's compilation from different sources.

## Historical Perspective of South Asia's Regional Institutions

Regionalism in South Asia evolved in four distinctive stages. The first stage was the Quadrangle period, marked by interstate and intrastate conflicts. Despite the political difficulties, the post-colonial time gave rise to South Asia as a region. Although regional institutions were not developed at this time, there were references to a South Asian Federation of Afghanistan, India, Iran, Iraq, and Myanmar (Narain and Upreti 1991). In the following decades, South Asian countries attempted to create institutional links with East Asian countries through the Asian Relations Conference in New Delhi in March 1947, the Baguio Conference in the Philippines in May 1950, the Colombo Plan in July 1951, and the Colombo Powers Conference in April 1954. India, Pakistan, and Sri Lanka were cosponsors of the historic Bandung Conference in 1955, along with Indonesia and Myanmar (Hossain 2010).

The second stage of South Asian regionalism was ushered in by the signing of the SAARC Charter by seven heads of state in December 1985 (Afghanistan joined in 2007). SAARC is essentially a state-led institutional arrangement and the first formal regional institution of South Asia. Its state-centric character was enhanced by the import-substitution development strategy adopted by SAARC countries in this early period. As a result, there was a well-aligned institutional structure for state-planned economies at the country level and state-led institutional arrangements at the regional level. This synergy helped give prominence to the establishment of SAARC. The SAARC Charter provides the fundamental legal basis for the institutional structure, which includes the summit, ministerial meetings, standing committees, technical committees, a regional secretariat, and financing.

The second stage of regionalism in South Asia coincided with the evolution of ASEAN, which was initially motivated by security concerns and economic development interests. ASEAN was established by a ministerial declaration, referred to as the Bangkok Declaration, signed in 1967 by the five original members—Indonesia, Malaysia, the Philippines, Singapore, and Thailand. The declaration set out a schedule for regular ministerial meetings but made no provision for ASEAN summits or a regional secretariat. ASEAN's first summit was not held until 1976, in Bali, Indonesia. The ASEAN Secretariat was first established at the time of the summit, also in Bali. ASEAN's institutional structure was not formalized until endorsement of the ASEAN Charter in 2007. Table 17.2 provides information on the memberships and observers of ASEAN and SAARC.

The third stage of South Asian regionalism and institution building started in the mid-1990s. The end of the cold war boosted regionalism in East and Southeast Asia. ASEAN's institutional structure matured rapidly, and market-led integration accelerated with the landmark ASEAN Free Trade Area signed in 1992. The rapid rise of ASEAN regionalism in this stage resulted in a widespread frustration with the slow progress of SAARC intergovernmental cooperation. This fermented the development of subregional organizations or arrangements as means to break the stalemate: the South Asia Growth Quadrangle (SAGQ) in 1997, the Bangladesh–India–Sri Lanka–Thailand Economic Cooperation in 1994, and the Bangladesh–People's Republic of China–India–Myanmar in 1999.

Table 17.2: Membership and Observers of ASEAN and SAARC

Item	ASEAN	SAARC
Membership	<b>Founding Members:</b> Indonesia, Malaysia, Philippines, Singapore, and Thailand 1984: Brunei Darussalam 1995: Viet Nam 1997: the Lao People's Democratic Republic 1999: Cambodia and Myanmar	<b>Founding Members:</b> Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka 2007: Afghanistan
Observer Countries	Papua New Guinea and Timor-Leste	Australia, the People's Republic of China, European Union, Iran, Japan, the Republic of Korea, Mauritius, Myanmar, and the United States
Country Dialogue Partnership	Australia, Canada, the People's Republic of China, European Union, India, Japan, the Republic of Korea, New Zealand, Pakistan, Russian Federation, United Nations Development Programme, and the United States,	None
Development Dialogue Partnership	United Nations Development Programme  The Asian Development Bank was considered in 2007.	None
Modality	ASEAN+1, ASEAN+3, East Asia (ASEAN + 8), and Asia Regional Forum (East Asia + six other countries)	Limited

ASEAN = Association of Southeast Asian Nations, ASEAN+1 = Association of Southeast Asian Nations Plus One (the People's Republic of China [PRC]); ASEAN+3 = ASEAN Plus Three (PRC, Japan, the Republic of Korea); ASEAN+8 = ASEAN Plus Eight (Australia, PRC, India, Japan, the Republic of Korea, New Zealand, Russia, the United States), SAARC = South Asian Association for Regional Cooperation.

Sources: Author's compilation from ADB. 2010b. *Institutions for Regional Integration Toward an Asian Economic Community*. Manila: Asian Development Bank; ASEAN Secretariat. <http://www.asean.org/>; and SAARC Secretariat. <http://www.saarc-sec.org/>

The most important development during this third stage was the emergence of multidimensional regionalism, which is a combination of state-led and community-based regionalism. While interstate and intrastate political instabilities remain the constraints to South Asian regionalism, nonstate community and business leaders have continued to build cross-border social links. Common languages, history, culture, and political and administrative institutions enable the nonstate actors to continue to shape a dynamic regional identity and cohesiveness. Regionalism entails commitments and trust, both of which are supported when the participants share common cultural and social characteristics that define them as a community (Keohane and Ostrom 1995, and Snidal 1995). Distinct from the agreements and charters of ASEAN, Mercosur, and the Pacific Islands Forum, the SAARC Charter acknowledges that "Member States are bound by

ties of history and culture.” Widespread poverty in South Asia has also underscored the importance of community-based regionalism.

South Asia’s dynamic social regionalism results in a strong sense of “South Asian identity,” which is a more socially accepted concept in South Asia than elsewhere in Asia. At the “people” level, state boundaries become less important because people share common cultural and linguistic links across South Asia. This South Asian identity is growing despite interstate politics; and it continues to make the people-to-people interconnectedness stronger in South Asia, which in turn can eventually strengthen interstate relations.

In this context, South Asia has two distinctive institutional frameworks. One is composed of the SAARC-centric institutions, which include the summits, ministerial meetings, technical committees, and SAARC-led centers. The other is driven by nonstate interests, particularly domestic firms, national and regional think tanks, social movements, and civil society networks and alliances. Non-state-driven collaboration in South Asia has had a significant impact on state-led cooperation. The rapid growth of civil society in South Asia has important implications for South Asian regionalism. Increasingly, civil society has been pressing for common political space, as evidenced by regional dialogue, people summits, and movements expressing the interests of peoples of the region rather than just individual country interests. They bring regional outlooks to bear upon individual issues (Hossain 2010), with the result that community regionalism has created a strong feedback mechanism for SAARC-centric regionalism. Most importantly, community regionalism helps to circumvent interstate complexities and hence helps to enforce and oversee policy implementation (Hix 2009).

The fourth stage of South Asian regionalism coincided with events leading up to and following the global financial and economic crisis in 2008. Two developments were particularly influential. First, the ASEAN leaders in 2007 endorsed the formation of the ASEAN Economic Community (AEC) by 2015. This encouraged South Asia to strengthen its regional economic integration, urging SAARC leaders to adopt the vision of a South Asian Economic Union (SAEU). Second, the global financial and economic crisis revealed inherent problems in the EU model, which put regional economic integration initiatives on hold in many places. Nonetheless, regionalism resumed quickly on the bicycle principle—if the bicycle stops moving, it falls. In all summits from 2007 to 2011, South Asian leaders have continued to press on for the establishment of an SAEU.

## SAARC Institutions: Assessment and Comparative Analysis

In light of the importance of community-based regionalism for SAARC, this section of the current chapter discusses the institutional framework. It provides a detailed comparative analysis of SAARC institutions. The comparative analysis of their state-led regional institutions addresses the (i) institutional structure, (ii) decision-making process, (iii) SAARC Secretariat, (iv) dispute settlement mechanism, and (v) financing mechanisms.

### State-Led Institutional Structure

South Asia is active in fostering state-led regional cooperation. The countries of South Asia are members to at least 9 major regional arrangements, while the countries in Southeast Asia are members to 11 regional arrangements. Countries in Northeast Asia are members to

seven regional arrangements, while five for Central and West Asia (Table 17.1). Southeast Asia has nine regional arrangements, while South Asia has three regional arrangements. Central Asia has two regional arrangements, and Northeast Asia has one (Table 17.1).

ASEAN's state-led institutional structure evolved in two stages: pre-Charter and post-Charter. The pre-Charter structure was first set by the ASEAN Declaration in August 1967, which stated that the objective of regional cooperation was to facilitate economic growth, social progress, and cultural development.

The limited activities and purpose did not justify ASEAN developing a full-fledged institutional structure. Therefore, ASEAN did not have meetings of heads of state during its first decade of activity, and the highest level of decision was at the ministerial level. The first summit in 1976 marked a historic step in ASEAN's institutional development. In addition to the establishment of the ASEAN Secretariat and the formalization of economic cooperation, ASEAN agreed to hold annual meetings of heads of state. The ASEAN Summit was supported by two ministerial meetings—ASEAN Foreign Ministers and ASEAN Economic Ministers. In turn, both were supported by ASEAN senior officials meetings and ASEAN senior economic officials meetings. The ASEAN Standing Committee served as the executive body, responsible for managing and coordinating routine work; it included representatives from the director general level of ASEAN foreign ministries.

Following the first summit, the institutional structure of ASEAN evolved rapidly. The number of meetings proliferated to 800–1,000 per year. This put a huge load on ASEAN's institutional capacity, calling for streamlining and rationalizing the institutional structure. Approval of the ASEAN Charter in 2007 marked a historic milestone in the institutional structure. Under the Charter, the ASEAN institutional structure consisted of four layers: ASEAN summits; the ASEAN Coordinating Council of ASEAN Foreign Ministers; the ASEAN Political Security, Economic Community, and Socio-Cultural community councils); and the ASEAN Sectoral Ministerial Bodies and Committee of Permanent Representatives (Table 17.3).

**Table 17.3: Comparison of Institutional Structures of ASEAN and SAARC**

ASEAN Structure	SAARC Structure
Heads of state or government (summit)	Heads of state or government (summit)
ASEAN Coordinating Council (foreign ministers)	Council of Ministers (foreign ministers)
ASEAN community councils (3)	
Sectoral ministerial meetings (21)	
Committee of Permanent Representatives	Standing Committee
Senior officials meetings (21)	Programming Committee (senior officials)
Technical Committee (6)	Technical Committee (6)
Working groups (as required)	Working groups (4)
Regional centers (7)	Regional centers (11)
Business organizations (19)	Specialized bodies (4)
No equivalent body of SAARC's apex and recognized bodies	Apex bodies (5) and recognized bodies (13)
No equivalent body of South Asia Forum	South Asia Forum
800–1,000 meetings per year	

ASEAN = Association of Southeast Asian Nations, SAARC = South Asian Association for Regional Cooperation.

Source: Author based on information from the websites of the ASEAN and SAARC secretariats.

While SAARC's institutional structure evolved in a somewhat similar manner to that of ASEAN, there are important differences. SAARC was established by a charter and not simply by a declaration, as was the case with ASEAN. The SAARC Charter established five institutional decision making, and advisory and administrative layers:

- **SAARC summits** are meetings of heads of state to be held once a year or more often as and when considered necessary by the member states.
- The **Council of Ministers** is composed of the SAARC ministers of foreign affairs who meet twice a year to formulate SAARC policies, review cooperation progress, and identify new cooperation areas and additional institutional mechanisms as deemed necessary.
- The **Standing Committee** is composed of the SAARC foreign secretaries who meet regularly to monitor and coordinate cooperation initiatives, review and approve projects and programs, identify new areas of cooperation for approval of the Council of Ministers, and mobilize resources.
- **Technical committees** include representatives of SAARC countries responsible for coordinating and implementing various programs in their respective areas of cooperation. The technical committees enable closer interaction between professionals and institutions in member countries, spanning a wide range of subjects including infrastructure, science and technology, biotechnology, tourism, energy, human development, and agriculture and rural development. The activities of these committees are approved by the Programming Committee and SAARC summits, while the implementation responsibility rests with the host country government.
- The **SAARC Secretariat** is responsible for reporting to the summits on the overall activities of these institutions. A review of the SAARC Secretariat is provided in subsequent sections.

Comparing the Bangkok Declaration that prevailed during the pre-Charter period of ASEAN with the SAARC Charter, it is clear that SAARC had a more developed institutional structure at the outset. Although the functions of its institutional layers were not well defined, SAARC started its regional cooperation activities with a more complete institutional hierarchy than ASEAN. However, ASEAN's structure evolved more rapidly in the subsequent period.

To assess the effectiveness of SAARC institutions, two criteria are used: the ability of the institutional structure to (i) enforce implementation of regional agreements, and (ii) build mutual understanding and trust.

#### *Enforcement*

Despite ASEAN's more complex institutional structure, there appears to be an "uncanny resemblance" (Khatri et al. 2010) between ASEAN and SAARC regarding implementing regional agreements. SAARC institutions resemble a diluted version of the ASEAN structure. Their hierarchical structures are led by summits of the heads of state, followed by ministerial meetings and standing committees (or permanent representatives in the case of ASEAN) serving as executive bodies (Table 17.3).

It should be noted that the similarity of institutional structures is shared by most regional institutions in Asia and the Pacific (e.g., Asia-Pacific Economic Cooperation [APEC], the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation [BIMSTEC], and the Shanghai Cooperation Organization), reflecting the state-centric format and resistance to a supranational institutional organization. This structure is also applicable to program- and project-based organizations, including the GMS, the Brunei Darussalam–Indonesia–Malaysia–Philippines East ASEAN Growth Area (BIMP-EAGA), the Indonesia–Malaysia–Thailand Growth Triangle (IMT-GT), and SASEC. In a region of relatively new sovereign states following the colonial period, this hierarchical institutional structure places priority on national sovereignty, territorial integrity, and noninterference in countries' internal affairs. In this context, ASEAN and SAARC have only weak enforcement powers for the implementation of summit and ministerial agreements.

### *Confidence Building*

While the institutional structure of SAARC (and ASEAN) is not ideal for enforcement, it provides an enabling environment for confidence building and promoting mutual understanding. The frequency and intensity of regional meetings at all levels help to raise awareness and create partnerships among officials with powers to decide on matters related to regional cooperation.

However, there is a delicate balance between partnership building through frequent regional meetings and becoming “talk shops.” Factors that can undermine confidence building and turn meetings into talk shops include the tendency to become more ceremonial, resource intensive, and logistically detailed, and less businesslike. This tendency is largely caused by the complexity of state protocols when the heads of state, ministers, and other senior officials are involved in the summits and regional meetings. Unfortunately, the bulk of time and resources of most SAARC meetings are spent on protocol and logistics arrangements rather than on the substance of the policy dialogue.

Measures to improve the institutional structure of SAARC have to strike a balance between enforcement and confidence building. It would be counterproductive to try to strengthen the current institutional hierarchy by empowering certain institutional layers with supranational authority. In the absence of transformation geopolitical developments in the region, the option of some form of supranational authority is a nonstarter.

It is therefore more useful to focus on confidence building rather than enforcement. Confidence building could be advanced by addressing “low-hanging fruits,” such as reducing and streamlining the required protocols, logistics, and resources for the summits and ministerial meetings, and creating more informal retreats for the leaders, ministers, and officials with the aim of strengthening policy dialogue.

## **Decision Making**

### *Decision-Making Rule*

Rules for decision making can be by consensus, unanimity, or voting. Consensus is the most popular decision-making rule of intergovernmental institutions. Attachment to national sovereignty largely explains the resistance of member countries to majority voting systems and their resemblance to a form of supranationalism (Severino 2009).

ASEAN and APEC are based on political consensus. While the possibility of majority voting was considered by ASEAN for inclusion in the 1996 Protocol on Dispute Settlement Mechanism concerning economic agreements, the proposal was never implemented. In 2004, a protocol reaffirmed decision making by consensus, and again reaffirmed in the ASEAN Charter of 2007 (Severino 2009, Chesterman 2008). However, to facilitate regional cooperation initiatives, ASEAN has devised several ways to allow flexible application of the consensus rule. These include the “minus x” and “two plus x” formulas in which not all countries are required to move forward at the same speed in regional cooperation. Some countries can choose to implement the regional cooperation measure, while the others can join when ready. Nonetheless, consensus-building remains the fundamental principle for ASEAN’s decision-making process.

The consensus principle is also the dominant decision-making process in the EU, despite significant delegation of power to supranational institutions. The delegation of power itself has to be taken unanimously, with the result that intergovernmental decision making continues to play an important role in the EU. Intergovernmental consensus is the dominant mode of decision making concerning foreign affairs and security, economic and monetary union, and policy and judicial cooperation. Supranational decision making applies to a limited set of issues primarily related to the creation and regulation of Europe’s continental-scale market. Even within these cases, the heads of state and governments are involved in all major issues and reach decisions through a consensus-building process (Hix 2009).

SAARC’s Charter stipulates that decisions at all levels are to be on the basis of unanimity. The difference between consensus and unanimity needs to be acknowledged. Consensus is a process that emphasizes consultation to secure consent from all or at least most countries. Members may disagree, but they can still give consent for the group to go ahead if there is no explicit objection. Unanimity connotes explicit agreement of all countries. In short, while consensus is a collective process of reaching agreement but allowing room for objections, unanimity connotes a voting procedure in which all countries must agree without objection (Table 17.4).

**Table 17.4: Decision Making of ASEAN, APEC, the PIF, and SAARC**

Criteria	APEC	ASEAN	PIF	SAARC
Decision-making principle	Consensus	Flexible Consensus		
(Minus x)	Consensus	Unanimity		
Rules	Voluntary basis	Nonbinding	Nonbinding	Nonbinding
Delegation	Minimal	Limited	Minimal	Limited
Legal form	Declaration	Declaration (1967) Charter (2007)	Treaty	Charter (1985)

APEC = Asia-Pacific Economic Cooperation, ASEAN = Association of Southeast Asian Nations, PIF = Pacific Islands Forum, SAARC = South Asian Association for Regional Cooperation.

Sources: SAARC. SAARC Charter 1985. <http://saarc-sdmc.nic.in/pdf/charter.pdf>

SAARC's slow RCI process is often seen as resulting from its adherence to the unanimous decision making principle. SAARC could improve its decision-making process by shifting from the unanimous to the consensus principle. Because there is only a subtle distinction between unanimity and consensus, the shift to consensus would entail nominal significance. Still, the change would require the amendment of SAARC's Charter.

Various ways could be considered for making the decision-making process more flexible while retaining intergovernmental control. A dual form of decision making could be adopted in which consensus would apply to policy, strategy, and sensitive issues (political and economic), and majority voting would apply at the project level and for technical issues. ASEAN has actually applied this dual decision-making processes. Some ASEAN agreements, such as the Treaty on the Southeast Asia Nuclear Weapon-Free Zone and the Agreement on Transboundary Haze Pollution, have entered into force with fewer than 10 ratifications. ASEAN has occasionally resorted to informal voting, the results of which could be presented as having been unanimously arrived at (Severino 2009).

Similarly, SAARC's Charter provides flexible application of the unanimity principle by allowing action committees, established by the Standing Committee, to implement projects involving more than two but not necessarily all member states (Article VII, SAARC Charter). In this manner, the plus two formula has been formally accepted under the SAARC Charter for project approval and implementation.

#### *Delegation of Decision-Making Authority*

In accordance with the ASEAN Charter, the ASEAN Summit is the supreme policy-making body of ASEAN. The summit deliberates, provides policy guidance, takes decisions, and instructs ministers. The main responsibility of ASEAN's Coordinating Council is to organize ministerial meetings to prepare for the summit. ASEAN community councils and sector ministerial bodies are tasked with reporting on progress in implementing policies, programs, or projects in their respective sectors.

SAARC's institutional structure delegates more decision-making authority to the Council of Ministers, which is tasked with formulating policies, reviewing progress, and identifying and deciding on new cooperation areas and institutional mechanisms. Because the Charter does not specify the roles and functions of the SAARC Summit, it could be concluded that it is largely ceremonial while actual decision-making authority is delegated to the Council of Ministers.

Despite this difference, ASEAN and SAARC are similar in that neither organization delegates decision-making authority to supranational institutions. Despite its rapid expansion, the ASEAN Secretariat is not vested with independent agenda-setting authority. The SAARC Secretariat coordinates and supports regional meetings.

#### *Legal Instruments*

Legally binding instruments are the building blocks for rules-based regional integration. The main forms of legal instruments for ASEAN and SAARC are regional charters, agreements, and treaties. ASEAN did not conclude a legally binding agreement until the first ASEAN Summit in Bali in 1976 (the Treaty of Amity and Cooperation in Southeast Asia). The 9-year lag between ASEAN's founding and its first summit attests to the "ASEAN way," which

is characterized by insistence of sovereignty, territorial integrity, and noninterference. It was another 10 years before ASEAN held a second summit and endorsed another legally binding agreement—the 1977 Preferential Trading Arrangements. Yet another 10 years were to pass before ASEAN held a third summit in 1987, during which two agreements were endorsed: the Agreement for the Promotion and Protection of Investments and the Agreement on the Standstill and Rollback of Non-Tariff Barriers, both of which conferred legal rights and obligations on their signatories. ASEAN agreements started to proliferate after the financial crisis and the promulgation of the ASEAN Charter. To date, ASEAN has concluded 88 legally binding agreements.

There are 28 legally binding SAARC Agreements/Conventions/Charter. For example, the Agreement for Establishment of the SAARC Arbitration Council, the Final Agreement on Avoidance of Double Taxation, the Final Agreement on Customs Matters, the Charter of South Asia Development Fund, the Agreement on Establishing the SAARC Food Bank, the Agreement on South Asian Free Trade Area (SAFTA), and the Agreement on the Establishment of South Asian Regional Standards Organisation.

Legal agreements are prerequisites for the development of rules-based regional cooperation. However, a proliferation of regional agreements requires enforcement at the regional level and capacity of each member state to enact national legislation to implement regional agreements. It is important, therefore, for SAARC to maintain a balance between expanding the legal infrastructure for regional cooperation and ensuring enforcement at the regional level and implementation at the country level.

#### *Legal Personality*

An entity such as a regional institution may be endowed with legal personality and therefore subject it to either domestic or internal law, or both. An international organization, as a subject of international law, has a legal personality derived from its constitution, in the form of a treaty agreed by states establishing the organization. The constitution will provide a provision conferring the organization with legal status (Juwana and Aziz 2010).

Agreements establishing many regional institutions confer legal personality. Article 3 of the ASEAN Charter confers legal personality on ASEAN. In the Additional Protocol to the Treaty of Asunción on the Institutional Structure of Mercosur, Chapter II recognizes the legal personality of Mercosur. The Agreement Establishing the Pacific Islands Forum (PIF) states that the PIF is a legal entity. The Charter establishing the Shanghai Cooperation Organization (SCO) accords legal personality to the SCO.

In contrast to the current status of ASEAN, there are no documents, including the SAARC Charter, that recognize the legal personality of SAARC. Rather, SAARC is regarded as an association rather than a regional institution with legal personality, in a way similar to APEC. However, the implications for SAARC's decision-making process—compared to ASEAN—are debatable. By providing legal personality, it does not mean that the regional institution is granted supranational authority to conclude legal agreements with third parties. Legal personality has not significantly strengthened or influenced the decision-making process of ASEAN, SCO, and the PIF. This being the case, assignment of legal personality may be of marginal value. Still, legal personality designation may have implications in international forums, where SAARC may wish to formally present views and positions on certain

issues. Legal personality designation would need to be further studied before proposing amendment of its inclusion in the SAARC Charter.

### Regional Secretariat

ASEAN and SAARC have their secretariats strategically located in Jakarta and Kathmandu, with full-time staff. Both secretariats support the functions of various committees and regional meetings. A comparison of the two secretariats includes the Secretary-General's role, staff complements, and organizational structure.

#### Secretary-General

A permanent ASEAN secretariat was established during the first ASEAN Summit in February 1976, 10 years after the Bangkok Declaration. Initially, the ASEAN Secretariat was limited in scope, financing, and staff (Severino 2009). With the signing of the ASEAN Charter in 2007, the role and status of the ASEAN Secretariat was considerably strengthened. The ASEAN Secretary-General is empowered with more functions than are accorded the SAARC Secretary-General. The ASEAN Secretary-General can initiate and implement regional cooperation initiatives, although in practice this role has rarely been exercised. Despite the ministerial rank, in practice the ASEAN Secretary-General is not able to perform as much as the ASEAN Charter mandates. Except for the Secretary-General and two deputy secretaries-general, who are politically appointed, the secretariat staff are openly recruited from the member countries. The ASEAN Secretariat uses a scorecard system to monitor implementation and concurrence with ASEAN cooperation initiatives. However, it appears to have limited effect in helping to strengthen enforcement of ASEAN initiatives.

The SAARC Charter does not outline the role of the SAARC Secretary-General or that of the SAARC Secretariat. However, according to the memorandum of understanding (MOU) establishing the SAARC Secretariat, the Secretary-General is at the level of ambassador and is to initiate and coordinate SAARC cooperation (Table 17.5). In short, the

**Table 17.5: Comparison of Secretaries-General of ASEAN and SAARC**

Item	ASEAN Secretary-General	SAARC Secretary-General
Rank	Ministerial level	Ambassador
Term	Nonrenewable term of 5 years	Nonrenewable term of 3 years
Selection	Alphabetical rotation	Alphabetical rotation
Roles	<ul style="list-style-type: none"> <li>Facilitate and monitor cooperation initiatives</li> <li>Monitor compliance</li> <li>Assist and participate in ASEAN meetings</li> <li>Present views of ASEAN to international organizations</li> <li>Recommend deputy secretaries-general</li> <li>Perform as chief administrative officer of ASEAN</li> </ul>	<ul style="list-style-type: none"> <li>Identify regional and subregional projects and fund for it</li> <li>Coordinate and monitor</li> <li>Submit staff rules and financial regulations</li> <li>Act as a channel of communications with international organizations</li> <li>Assist in organization and preparation of SAARC meetings</li> <li>Act as a custodian of SAARC documents</li> <li>Report to the Standing Committee</li> </ul>

ASEAN = Association of Southeast Asian Nations, SAARC = South Asian Association for Regional Cooperation.

Source: Author's compilation from the ASEAN Charter at <http://www.asean.org/archive/publications/ASEAN-Charter.pdf> and the SAARC Memorandum of Understanding on the Establishment of the Secretariat.

secretaries-general of both organizations largely perform the role of secretary, with their primary responsibility being to support the committees and meetings of their respective organizations. While ASEAN's Secretary-General is given more responsibilities, much depends on personality rather than on institutional mandates. The longer tenure of the ASEAN Secretary-General (5 years versus 3 years in the case of SAARC) is a major advantage because it allows more time for the Secretary-General to put in place and follow through institutional reforms and other initiatives.

### Staffing

Initially, staff of the ASEAN Secretariat were nominated by the member countries. The Agreement on the Establishment of the ASEAN Secretariat, 1976 specifies the engagement for 3 years of three bureau directors to take charge of economic matters, science and technology, and social and cultural affairs. In January 1983, with the secretariat's staff regarded as inadequate to manage the association's growing activities, the agreement was amended to add to its complement "such other officers as the Standing Committee may deem necessary" (Severino 2009). Subsequently, in July 1989, another agreement added one deputy secretary-general, who would be nominated by member states, in alphabetical rotation for a term of 3 years. However, due to the rising number of meetings during the 1990s and hence the need to increase the number of staff substantially, staff of the ASEAN Secretariat are now selected on a competitive, region-wide basis. Currently, the ASEAN Secretariat has four deputy secretaries-general, two of which are selected on a competitive basis and two are politically nominated (Table 17.6).

SAARC Secretariat's responsibilities have increased as the areas of cooperation have expanded and complexities have grown. Therefore, the staff are now being augmented with technical expertise and recruited on a competitive, region-wide basis. The Secretary-General is assisted by eight directors seconded from the member states.

**Table 17.6: Staff of the ASEAN and SAARC Secretariats**

Staff	ASEAN Secretariat	SAARC Secretariat
Deputy Secretary-General	Two deputy secretaries-general are political nominees for nonrenewable term of 3 years.	No
Professional staff	Nationals of member states Open recruitment Renewable term of 1 to 3 years	Nationals of member states Appointed by Secretary-General on nomination by member states Nonrenewable term of 3 years
Local staff	Local Staff are from Indonesia, the host of the ASEAN Secretariat. Open completion Renewable term	Nationals of member states Open competition Renewable term

ASEAN = Association of Southeast Asian Nations, SAARC = South Asian Association for Regional Cooperation.

Source: Author's compilation from the Memorandum of Understanding on the Establishment of the SAARC Secretariat and the ASEAN Charter.

The SAARC Secretariat is supported by the following regional centers established in member states to promote regional cooperation:

- (i) SAARC Agricultural Information Centre;
- (ii) SAARC Energy Centre;
- (iii) SAARC Tuberculosis and HIV/Aids Centre;
- (iv) SAARC Cultural Centre;
- (v) SAARC Environment and Disaster Management Centre (SEDMC) - the location for which is yet to be decided.

These centers are managed by governing boards comprising representatives from all the member states, the SAARC Secretary-General, and the Ministry of Foreign Affairs or Ministry of External Affairs of the host government. The director of the center acts as member secretary to the governing board, which reports to the Programming Committee.

There are, however, concerns about the capacity of the staff at the SAARC Secretariat, as noted by Kelegama (2013):

[SAARC] has many technical, standing, and working committees...a heavy bureaucratic set-up with several layers of decision-making characterizes the SAARC institutional structure.

This situation is further complicated by three other factors: (1) the SAARC Secretariat lacks necessary resources to implement projects and monitor the progress of activities being implemented; (2) the Directors of the SAARC Secretariat are not appointed according to subject specialization (e.g., trade, investment, transport, energy, etc.) but on usual Foreign Ministry appointment basis...; and (3) the SAARC Secretary-General has limited powers to drive the SAARC process between SAARC Summits.

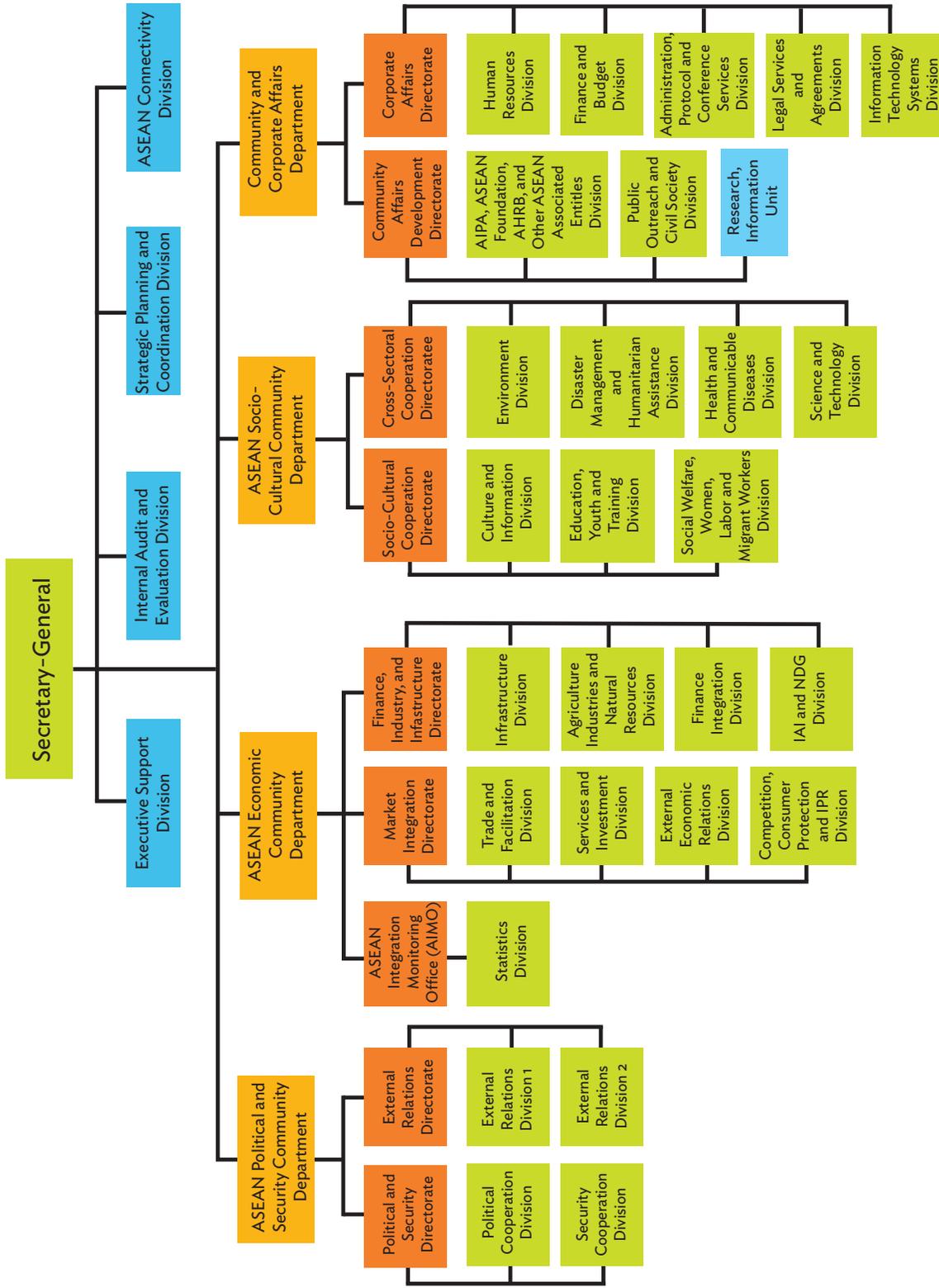
### *Organizational Structure*

The structure of the ASEAN Secretariat reflects the three main pillars of the ASEAN Community: economic community, political and security community, and culture community (Figure 17.1).

Similarly, the SAARC Secretariat is based on cooperation sectors (Figure 17.2).

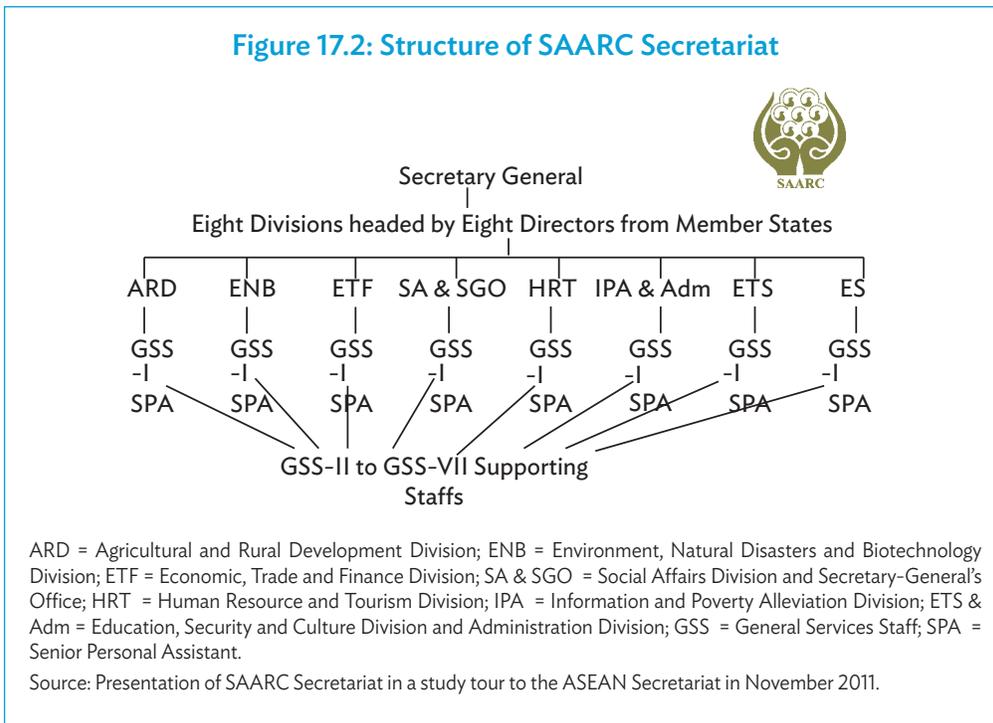
The organizational structures of the two secretariats suggest that their main role is administrative, especially servicing meetings, rather than advising on strategic directions. It should be noted that the SAARC Secretariat does not have a research unit, while the ASEAN Secretariat has a small but understaffed unit. Consequently, both secretariats rely extensively on outsourcing policy research to external institutions. While it is economical and efficient to outsource research activities, problems arise when the secretariats are tasked to undertake policy research that is highly politically sensitive.

Figure 17.1: Structure of the ASEAN Secretariat



ASEAN = Association of Southeast Asian Nations.  
 Source: ASEAN Secretariat. <http://www.asean.org/asean-secretariat/organisational-structure>.

Figure 17.2: Structure of SAARC Secretariat



## Dispute Settlement

Dispute settlement is an important factor in determining the effectiveness of a regional or global organization. Table 17.7 provides a comparison of the dispute settlement provisions of ASEAN and SAARC.

Table 17.7: ASEAN and SAARC Dispute Settlement Mechanism

Item	ASEAN	SAARC
Mechanism for economic dispute	ASEAN Protocol on Enhanced Dispute Settlement	SAFTA dispute settlement Arbitration Council
Mechanism for other disputes	Treaty of Amity and Cooperation	Limited
Conciliation and mediation	ASEAN Chair and ASEAN Secretary-General to act in an ex officio capacity	Limited

ASEAN = Association of Southeast Asian Nations, SAARC = South Asian Association for Regional Cooperation, SAFTA = South Asian Free Trade Area.

Source: Author's compilation.

To date, ASEAN member countries have not applied the provisions of the ASEAN Protocol on Enhanced Dispute Settlement Mechanism, signed in 2004. Further, ASEAN countries never used the provisions in the protocol's predecessor, the ASEAN Protocol on Dispute Settlement Mechanism, signed in 1996. Nonuse of the ASEAN dispute settlement system, despite multiple disputes and instances of alleged inconsistency with obligations under ASEAN, can be attributed to a preference for negotiated solutions.

The less confrontational nature of Asian culture leads governments to choose negotiations and diplomatic means rather than resort to legal and institutional mechanisms for the resolution of disputes. The ASEAN way favors cooperation and compromise rather than enforcement and compliance, and informal understanding, consultation, and consensus-building rather than “across-the-table negotiations involving bargaining and give-and-take that result in deals enforceable in a court of law” (Severino 2001). The application of these principles applies to the resolution of disputes. The systematic pursuit of agreement and harmony, attention to sensitivity, politeness, nonconfrontation and agreeability, quiet diplomacy, and the preference for being non-legalistic appear to have shaped the way in which conflicts (including trade conflicts) have been managed (Rodolfo 2001). Consultations and consensus among parties are preferred over court or quasi-judicial procedures and legally binding rulings.

A similar approach prevails in South Asia, although SAARC is trying to build an effective regional economic dispute settlement mechanism. Despite some binding agreements, such as under SAFTA, when disputes arise, the SAARC member countries prefer to resort to the multilateral dispute settlement provisions of the WTO or the UN.

## Financing Mechanisms for Regional Cooperation

The financing mechanisms in support of regional cooperation initiatives are clearly vital. Comparison of the financing mechanisms of ASEAN and SAARC include (i) the extent that the organizations can progress beyond equal contribution principle, and (ii) the sustainability of the financial facility and its financing modality (Table 17.8).

**Table 17.8: ASEAN and SAARC Financing Mechanisms**

Item	ASEAN	SAARC
Contribution (budget for secretariat)	Equal contribution (\$1.4 million per country annually)	India 30.32% Pakistan 22.52% Bangladesh, Nepal, and Sri Lanka 10.72% each Afghanistan, Bhutan, and the Maldives 5% each
Funding contributed by member states	ASEAN Development Fund	SAARC Development Fund
Joint funding sources	ASEAN Cultural Fund ASEAN Foundation ASEAN Infrastructure Fund  Various trust funds from Australia, the People's Republic of China, the European Union, India, Japan, the Republic of Korea, the United States, the Asian Development Bank, the United Nations Development Programme, and the World Bank	SAARC Japan Special Fund

ASEAN = Association of Southeast Asian Nations, SAARC = South Asian Association for Regional Cooperation.  
Source: Author's compilation.

### *Equal Contribution*

ASEAN is financed through equal contributions by the member countries, set in accordance with the ability of the least well-secured member. To date, ASEAN has not been able to progress beyond this principle. This has resulted in ASEAN having limited financial capability and lacking a sizable and independent budget for the implementation of numerous development cooperation initiatives. ASEAN regional cooperation is largely financed by the ASEAN Development Fund, the ASEAN Science and Technology Fund, the ASEAN Foundation, and various other donors such as Australian Aid, the EU, the United Nations Development Programme, and the United States Agency for International Development. The ASEAN Infrastructure Fund, set up in 2011 with ADB support, is a sizable financing mechanism for infrastructure projects.

SAARC has managed to progress beyond the equal-contribution formula, enabling it to establish the SAARC Development Fund (SDF). The total paid-in capital of the SDF is \$300 million, of which India has contributed \$100 million.

### *Sustainability*

ASEAN's financial resources in support of its cooperation initiatives are not, for the most part, sustainable as they rely heavily on external assistance. Project financing is provided through grants, which result in little ownership and responsibility by participating countries in monitoring and implementation. In contrast, the SDF is expected to become a development bank for South Asian countries, providing loans and technical assistance for projects focused on poverty reduction, development cooperation, and infrastructure. However, the financial structure of the SDF needs to be further strengthened to make it more sustainable.

## Community-Led Institutional Structure

Community-led regionalism is defined as a process in which nonstate actors, such as specialized institutions (research institutes and think tanks), social networks, nongovernment organizations (NGOs), including SMEs, could influence and impact decisions by the states. To a large degree, community-based regionalism sustains South Asian regionalism and makes it unique. First, civil society in South Asia can support the regionalization process. Because of their statehood nature, state-centric institutions are bound by sovereignty concerns, and thus they are constrained in implementing many of collective actions which may be considered to have implications on national sovereignty. In contrast, community-led regional cooperation is not constrained by sovereignty issues, and as a result, they can create an unbiased environment, which is critical for facilitating a common political space at the regional level. Due to the slow pace of state-led regionalism, community-based interests in South Asian countries are trying to open new platforms for regional cooperation (Hossain 2010). These platforms provide important feedback mechanisms for the intergovernmental cooperation process in South Asia.

Second, community-led interests in South Asia have contributed significantly to advancing the development dimension of state-led regional cooperation. Poverty reduction, environmental concerns, the plight of refugees, human rights, women and child trafficking, and global trade are examples of issues considerably influenced by the views and actions

of civil society. For example, community leaders were instrumental in conceptualizing the SAARC Social Charter. They were also active in pushing for the adoption of the SAARC Convention on Preventing and Combating Trafficking in Women and Children for Prostitution. The framework agreement on SAFTA draws upon the work of the South Asia Center for Policy Studies. Summit declarations on the need for cooperation in energy and investment, and in international forums such as the WTO, reflected the recommendations of the center's task forces (Sobhan 2004).

## Recommendations

It is assumed that SAARC's existing institutions and programs will be progressively strengthened to support an SAEU. Once the strategic framework for this union or economic community is clarified, the path for institutional building and new components will also be clearer.

SAARC's policy of economic integration will continue to focus primarily on the creation of a common market. Trade liberalization, through the reduction of tariff and nontariff barriers, is the main thrust of economic integration. The agenda, though, is moving beyond trade in goods to cover trade in services, trade facilitation, and integration of financial services. State-led institutions are no longer the principal agents in this process. Private sector business interests, civil society, and think tanks have indispensable roles in promoting regional cooperation and integration (RCI).

Based on the preceding institutional analysis, this chapter makes the following recommendations for strengthening South Asia's institutional framework for RCI. Table 17.9 provides a summary.

### Institutional Structure

#### *Frequency of Summits*

SAARC's Charter calls for the heads of state to meet once a year or more often as and when considered necessary by the members. However, the regularity of SAARC summits has been sometimes interrupted by interstate conflict or domestic problems in the host country. The irregularity of these high-level gatherings has slowed the cooperation process, and the absence of media headlines has weakened public interest. Some have proposed that SAARC heads of state should meet only once every 2 years. This would help reduce the risk of interruption, as well as rationalize agreements that tend to proliferate after each summit.

However, the frequency of summits depends greatly on their intended role. Given that the SAARC Summit involves decision making at the highest level, annual meetings are recommended to maintain the momentum of RCI.

SAARC summits should be conducted more informally, in a closed-door retreat during which topics and initiatives of common interest can be discussed in a businesslike and open exchange. Protocol and logistics requirements should be reduced as much as

possible. Such steps would substantially improve the quality of regional policy dialogue and contribute to building confidence and mutual understanding among the member states.

#### *Ministerial Meetings*

The Council of Ministers, composed of foreign ministers, is the lead body for policy and strategy formulation on RCI. Participation in the council should be widened to include other ministries, especially finance, commerce, and planning. A joint ministerial forum would better ensure the inclusion of financial and macroeconomic issues in the decision-making process. Importantly, the participation of planning ministries would enhance inclusion of SAARC agreements in the national development plans. Resources could then be allocated for implementation at the country level.

#### *Mechanism for Informal Consultation*

SAARC summits and ministerial meetings offer ideal platforms not only for formal policy dialogue but also for informal consultations. Although SAARC's Charter excludes bilateral and contentious issues from being discussed during SAARC deliberations, it would be appropriate to consider a mechanism for informal consultations on the sidelines of SAARC summits.

#### *Membership Expansion*

**Guidelines for membership expansion.** An issue that SAARC may need to address in the near future is expansion of membership. While membership expansion would increase SAARC's market size, it is likely to lead to more complex decision-making processes because of the more divergent interests. South Asia acts as a bridge with East and Central Asia, suggesting possible membership expansion eastward and westward. Countries geographically contiguous to South Asia, such as Myanmar, may be interested in becoming a SAARC member. In addition, strategic considerations may suggest inclusion of emerging or established powers. Guidelines for possible membership expansion should be drawn up.

**SAARC Plus mechanism.** Given the increasing interest of non-SAARC countries in SAARC cooperation, SAARC should consider a SAARC+1 mechanism, similar to the ASEAN+1 mechanism, to allow greater participation by nonmembers. A SAARC+1 mechanism could significantly strengthen the SAARC institutional framework and act as a further catalyst for cooperation. It would also be very useful if SAARC could encourage greater contributions from international organizations, such as ADB and UN agencies, by according them the status of development dialogue partnership.

#### *National Focal Points*

National focal points are central to the SAARC institutional structure. They are expected to coordinate and monitor the implementation of SAARC initiatives at the national level, and incorporate binding commitments under SAARC into national legislation and national development planning. However, the focal points are foreign ministries whose mandate concerning domestic matters is relatively limited. Consideration could be given to establishing permanent interagency institutions in the member countries, led by the foreign ministries, to coordinate SAARC-related action. Alternatively, ad hoc committees could

be formed for interagency coordination, convened on an intermittent basis to prepare for ministerial or summit meetings. These interagency arrangements could be gradually institutionalized, depending on the frequency of the summit and ministerial meetings. Annual summits would necessitate regular interagency meetings and thus significantly boost the momentum for in-country coordination.

#### *Facilitating and Formalizing People-to-People Summits*

Given the dynamic degree of social regionalism in South Asia and its substantial contribution to state-centric regionalism, consideration should be given to measures to facilitate and formalize people-to-people summits. Shared cultural and other attributes and similar democratic structures support the concept of people-to-people summits. Social regionalism is the driving force leading to the South Asian identity and people-to-people interconnectedness. If encouraged, it would be an effective feedback mechanism for the formal, state-led institutional structure. There is some resistance, however, to providing regional platforms for civil society to become part of the formal decision-making process. Nonetheless, even without any endorsement from the governments, cross-border civil society movements will increasingly become a formidable driving force of social regionalism. Instead of trying to limit their role, constructive ways must be found for mainstreaming these nonstate actors in the decision-making process. A task force should explore ways to facilitate greater participation of nonstate actors in the formal decision-making process.

### Decision Making

#### *Shifting from Unanimity to Consensus*

SAARC should consider adopting a consensus principle for decision-making in place of the unanimity principle established in the Charter. Although the difference between consensus and unanimity is subtle, the shift to political consensus would allow more flexibility for SAARC decision making. SAARC could also consider a dual system for decision making in which important issues at the policy level are agreed on by consensus, while technical issues at the project level can be implemented by more than two countries but not necessarily all member states. This would not require major changes of the Charter because it already stipulates that the action committees of the SAARC Standing Committee can implement projects on a partial consensus basis as long as more than two members support the project.

#### *Strengthen capacity for enforcement and implementation*

SAARC's legally binding agreements will increase over time, putting pressure on the least developed countries (LDCs) in implementing and enforcing these agreements at the national level. Thus, it is important for SAARC to help LDCs mobilize sufficient resources to improve their capacity for implementation and enforcement. Measures to assist in the implementation and enforcement of regional agreements at the subregional level should also be explored.

#### *Legal personality of SAARC*

The benefits of having a legal personality are limited. However, it may be useful for SAARC to have a legal personality when voicing its views in global policy forums. Amendment to the Charter may be required to accord legal personality to SAARC.

### SAARC Secretariat

An important first step must be strengthening the manpower and staffing, infrastructure, finance, and institutional responsibilities of the SAARC Secretariat. In the future, SAARC countries could consider the possibility of according the SAARC Secretary-General with ministerial rank.<sup>1</sup> The term of the Secretary-General should also be extended to 5 years, as in the case of the ASEAN Secretary-General. To ensure rotation of management representation in the SAARC Secretariat, two deputy secretary-general positions should be considered for appointment on an alphabetical rotation basis.

The SAARC Secretariat should have more staff on an open recruitment basis to supplement the staff seconded by SAARC member states. The increasing number of meetings and the ambition to form a SAEU justifies adding to the staff of the SAARC Secretariat. In addition, the SAARC Secretariat should seek development partnership assistance in advancing the secretariat as a resource center or sponsor for applied research in regional cooperation.

SAARC countries should consider increasing their financial contributions for the SAARC Secretariat. Voluntary financial contributions should be encouraged for the construction of meeting facilities and provision of equipment for the secretariat. Annual financial contributions to the secretariat should be increased to ensure its effective operation.

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<sup>1</sup> This view is based on extensive interviews with diplomats and analysts in the region and with officials at the SAARC Secretariat.

Table 17.9: Suggested Road Map for SAARC Institutional Building and Strengthening

Item	Recommendations	Required Legal Instruments and/or Actions	Time Frame
<b>Institutional Structure</b>			
Frequency of formal SAARC summit	Define role of the summit, hold it once every 2 years if the summit plays ceremonial role or once a year if the summit is the highest decision-making body.	Amend the SAARC Charter.	2016–2018
Joint ministerial meeting	Define the role of the joint ministerial meeting.	Amend the SAARC Charter.	2016–2018
Informal consultation	Consider measures to encourage and enable information consultations on the sidelines of SAARC summit and ministerial meetings.	Amend the SAARC Charter allowing informal consultation of bilateral and contentious issues.	2016–2018
Guidelines for membership expansion	Define criteria for becoming an SAARC member state.	Commission a study on implications of membership expansion.	Study can be prepared as requested by SAARC countries. Membership expansion is not foreseen in short to medium term.
SAARC+1 arrangement	Assess possibility of SAARC+1 arrangement.	Undertake study to examine costs and benefits of SAARC+1 arrangement.	2016 onward
National focal points	Ad hoc interagency coordination should be led by foreign ministries for pre-Summit preparation and post-Summit follow-up.	Establish ad hoc interagency coordination. Gradually institutionalize the interagency coordination.	2016–2018
People-to-people summit	Define measures and mechanisms to facilitate and formalize the participation of nonstate actors in the formal processes of SAARC.	Establish a task force to study the issue and make recommendations.	2016–2018
<b>Decision Making</b>			
Improve decision-making rule	Adopt a consensus rule.	Amend the SAARC Charter to allow the consensus principle in decision making.	2016–2018
	Adopt a protocol to specify project areas that can be implemented by more than two but not all member states.	Amend the SAARC Charter and an additional protocol for project implementation.	
Improve national capacity for enforcement and implementation of regional agreements	Provide technical assistance to build LDC capacity.	Obtain technical assistance from international organizations to build capacity of LDCs.	2015 onward
Explore opportunities for implementation of regional agreements at the subregional level	Identify projects that can be implemented at the subregional level, such as railway and motor vehicle agreements to be implemented by SASEC countries.	Build capacity of LDCs with technical assistance from international organizations.	2015 onward

continued on next page

Table 17.9 *continued*

Item	Recommendations	Required Legal Instruments and/or Actions	Time Frame
<b>SAARC Secretariat</b>			
SAARC Secretary-General	Extend the term to 5 years Provide ministerial rank to the SAARC Secretary-General.	Amend the SAARC Charter.	2016–2018
Improve staff capacity	Introduce competitive selection of staff.	Amend the MOU establishing SAARC Secretariat.	2016–2018
Improve program formulation and coordination	Establish a program coordination unit in the SAARC Secretariat.	Amend the MOU establishing SAARC Secretariat.  Seek technical assistance from international organizations.	2015 onward
Improve research capacity of SAARC Secretariat	Establish a research team.	Amend the MOU establishing SAARC Secretariat.  Seek technical assistance from international organizations.	2015 onward

LDC = least developed country, MOU = memorandum of understanding, SAARC = South Asian Association for Regional Cooperation.  
Source: Author.

## Annex

# Regional Institutions and Arrangements in South Asia

### Regional, Subregional, and Interregional Cooperation Arrangements

1. **South Asia Association for Regional Cooperation (SAARC)** is a regional cooperation arrangement among Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka. SAARC aims to promote regional cooperation in South Asia. <http://www.saarc-sec.org/>
2. **South Asia Growth Quadrangle and South Asia Subregional Economic Cooperation.** In 1996, four of the seven SAARC member countries—Bangladesh, Bhutan, India, and Nepal—formed the South Asia Growth Quadrangle (SAGQ), with the primary objective of accelerating sustainable economic development among the four countries. This subregional initiative was endorsed at the SAARC Summit held in Malé in 1997. The SAGQ was a project-based institutional arrangement and did not aim to establish a common market as SAARC does. Subsequently, these four countries requested the assistance of the Asian Development Bank (ADB) in facilitating their economic cooperation initiative. This request led to the implementation of the South Asia Subregional Economic Cooperation (SASEC) program to facilitate cooperation among the four countries. <http://sasec.asia/>
3. **Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)** is an interregional arrangement involving five countries from South Asia (Bangladesh, Bhutan, India, Nepal, and Sri Lanka) and two countries from Southeast Asia (Myanmar and Thailand). <http://www.bimstec.org/>
4. **Bangladesh–People’s Republic of China–India–Myanmar (BCIM)** is a subregional arrangement that aims to facilitate regional connectivity, trade, and investment among the four countries.

### SAARC Regional Centres

1. SAARC Agriculture Centre
2. SAARC Energy Centre
3. SAARC Tuberculosis and HIV/AIDS Centre
4. SAARC Cultural Centre
5. SAARC Environment and Disaster Management Centre (SEDMC) - the location for which is yet to be decided

### **SAARC Apex Bodies**

1. SAARC Chamber of Commerce and Industry
2. SAARCLAW
3. South Asian Federation of Accountants
4. South Asia Foundation
5. South Asia Initiative to End Violence Against Children
6. Foundation of SAARC Writers and Literature

### **SAARC Recognized Bodies**

1. SAARC Federation of University Women
2. Association of Management Development Institutions in South Asia
3. South Asian Association for Regional Cooperation of Architects
4. Federation of State Insurance Organizations of SAARC Countries
5. SAARC Diploma Engineers Forum
6. Radiological Society of SAARC Countries
7. SAARC Teachers Federation
8. SAARC Surgical Care Society
9. South Asian Regional Association of Dermatologists, Venereologists and Leprologists
10. South Asian Free Media Association
11. SAARC Women's Association in Sri Lanka
12. Hindukush Himalayan Grassroots Women's Natural Resources Management
13. Federation of Association of Pediatric Surgeons of SAARC Countries
14. South Asian Federation of Exchanges
15. SAARC Federation of Oncologists
16. South Asia Association of National Scout Organization
17. South Asian Network of Economic Research Institutes (SANEI)

### **Selected Nongovernment Institutions with Regional Focus**

1. South Asia Watch on Trade, Economics and Environment
2. South Asia Alliance for Poverty Eradication
3. South Asia Forum for Human Rights
4. South Asia Consortium for Interdisciplinary Water Resources Studies
5. South Asia Network of Economic Research Initiatives
6. Coalition for Action on South Asian Cooperation
7. South Asia Centre for Policy Studies
8. South Asian Network of Economic Research Institutes
9. Regional Centre for Strategic Studies
10. South Asian Policy Analysis
11. South Asian Civil Society Network on International Trade Issues
12. South Asian Network for Food, Ecology and Culture

13. South Asian Network against Torture and Impunity
14. Climate Action Network – South Asia
15. Independent Scholars of South Asia
16. South Asia Foundation
17. South Asian Free Media Association
18. South Asian Media Net
19. South Asian Health Project
20. South Asia Partnership International
21. South Asia Terrorism Portal
22. South Asian Fund Raising Group
23. South Asian Journalists Association
24. South Asian Marrow Association of Recruiters
25. South Asian News Agency
26. South Asian Public Health Association
27. South Asian Regional Cooperation Academic Network
28. South Asian Research Centre for Advertisement, Journalism and Cartoons
29. South Asian Social Researchers' Forum
30. South Asian Strategic Stability Institute
31. South Asian Women's Empowerment and Resource Alliance
32. South Asian Women's Network

## CHAPTER XVIII

# Toward a South Asian Economic Union: Policy Suggestions and Conclusions

*Selim Raihan*

## Elements of South Asian Economic Union

Advancement of South Asian Economic Union (SAEU) should entail four pillars of initiative:

- Pillar 1: Market liberalization (trade liberalization under the South Asian Free Trade Area [SAFTA] and South Asian Association for Regional Cooperation [SAARC] Agreement on Trade in Services [SATIS]; reduction of sensitive list, rules of origin (RoO) and nontariff barriers; and investment liberalization)
- Pillar 2: Sector liberalization (priority sectors identified for fast-track liberalization)
- Pillar 3: Economic corridors (promoting integration with global and regional value chains)
- Pillar 4: Cross-border connectivity (especially transport and energy)

Cross-cutting issues should include institutional strengthening, capacity building, and financing.<sup>1</sup>

The main features of SAEU are summarized as follows, highlighting its free trade agreement (FTA), common market, and growth focus, supported by efficient regional institutions and funding mechanisms:

- Freer flow of goods (FTA): Yes (SAFTA)
- Freer flow of services, labor, and capital: Yes (agreements on services liberalization under SATIS; and the Draft Agreement on Investment, to be finalized)
- Efficient cross-border infrastructure (subregional growth areas): Yes (transit and energy agreements)
- Integration of regional production networks (subregional growth areas): Yes (regional industrial policies)

<sup>1</sup> This chapter draws from ADB. 2014c. Next Steps To South Asian Economic Union: A Study on Regional Economic Integration (Phase II). Executive Summary. Commissioned by the SAARC Secretariat. Manila: Asian Development Bank

- Efficient regional institutions: Yes (SAARC Secretariat, South Asian Regional Standards Organization; SAARC Arbitration Council, etc.)
- Sufficient financial resources for regional cooperation: Yes (SAARC Development Fund)
- Common external tariffs (customs union): No
- Common currency (monetary union): No
- Harmonization of economic policies: Yes (through an incremental approach)

## Trade Potential of South Asian Economic Union

Intraregional trade in South Asia accounts for only 5% of the total trade of SAARC countries, underscoring their stronger trade ties, in most cases, with other countries. Only 4% of India's total exports are to SAARC members and only 2% in the case of Bangladesh. Afghanistan, Bhutan, and Nepal, however, are heavily dependent on exporting to SAARC members. These same countries are also heavily dependent on imports from SAARC members. The FTA between India and Sri Lanka prompted a surge in trade between the two countries, illustrating the trade potential through trade liberalization. Reflecting their size and economic development, India and Pakistan account for more than 86% of total intra-SAFTA export trade, but a significantly smaller share of total intra-SAFTA import trade. Only 1% of India's imports are from the region, and only 5% in the case of Pakistan.

Sector intra-industry trade indexes show considerable degrees of complementarity among the imports and exports of SAARC members. However, there is a great deal of variation in the degree of complementarity, underscoring the need to carefully tailor facilitation of intraregional trade. Chapter 2 of this volume provides country-by-country complementary values for exports and imports. For Bangladesh, Bhutan, India, Nepal, and Sri Lanka the intra-industry trade indexes are relatively higher for manufactured goods, while for Afghanistan, the Maldives, and Pakistan, intraregional trade appears to be more oriented toward the primary sector.

Economic analysis in Chapter 13 of this volume indicates that full implementation of SAFTA would generate significant increases in intraregional trade and income gains for all SAARC members. In volume terms, the largest trade gain would accrue to India; in terms of boosts to gross domestic product (GDP), Nepal would benefit most. All SAARC countries would experience measurable increases in their total exports, with Nepal experiencing the largest increase (32%), followed by Bangladesh (5%), Pakistan (5%), Sri Lanka (3%), and India (1.3%). Intraregional trade could triple over current levels, providing a boost of more than \$30 billion to the region annually.

## Full Implementation of SAFTA

SAARC members should agree on clear targets and specific timelines for a common agenda to transform the region into a much more highly integrated market and production base.

Full implementation of SAFTA should be accelerated, notably through tariff liberalization. More progress should be made in reducing the number of tariff lines in sensitive lists and the number of sectors protected under the sensitive lists. While Article 7.3 (b) of SAFTA stipulates revision after 4 years or earlier, the stipulation is not mandatory. The first 20% reduction in the sensitive lists took nearly 4 years to complete, and discussions for the next round of reduction have just begun. SAARC members have agreed to reduce their sensitive lists, and agreement must now be reached as to the degree and in which sectors.

Two measures should be adopted:

- **Reduction based on priority sectors.** Based on the trade potential, 29 priority sectors have been identified. The highest number of tariff lines protected under the sensitive lists relate to textiles, electronic equipment, iron and steel, and plastic and rubber products. Following further analysis, it is recommended that members agree on an annual reduction in their tariff lines in priority sectors, by 20% for non-least developed countries (non-LDCs) and by 10% for least developed countries (LDCs) by 2016. It is also, it is recommended that non-LDCs agree to having no more than 100 tariff lines in the sensitive list by 2020, and that LDCs agree to achieve the same by 2025.
- **Reduction based on tariff structure.** Tariffs for the priority sectors range from 5% to 50%. Following further analysis, it is recommended that member countries adopt tariff liberalization programs for sensitive lists, whereby the peak tariff will be reduced to 30% by 2016 and to 20% by 2020, with some flexibility for highly sensitive products.

A high-level task force should review the legal, technical, institutional, and administrative features of SAFTA, identifying changes needed to accelerate its full implementation. The review should include not only the sensitive lists and nontariff barriers, but also the RoO, compensation mechanism, and dispute resolution mechanism. The RoO should be liberalized to take account of the changing business environment and bilateral agreements in the region. Combined value-addition requirements and the issuance of certificates of origin should be facilitated through better use of technology. The scope and jurisdiction of the dispute resolution mechanism should be strengthened, thereby providing greater confidence that SAFTA is being implemented as intended.

## Reducing Nontariff Barriers

SAARC's capacity to address core nontariff barriers—e.g., sanitary and phytosanitary (SPS) standards, technical barriers to trade, port entry restrictions, and para-tariffs—should be strengthened. The SAARC Secretariat must be able to respond effectively to the reports and complaints received by the SAARC Chamber of Commerce and Industry and apex trade bodies. Greater harmonization is required concerning technical barriers to trade and SPS standards, particularly with regard to animal and plant products. Harmonization of nontariff barriers will enable importing countries to accept certificates issued by the exporting country, thereby reducing the need for inspections at border points.

Mutual recognition agreements for specific products or sectors would greatly expedite intraregional trade. Adequate funds should support the human and financial resources needed to make the South Asian Regional Standards Organization effective. The process of accreditation and certification should be advanced by ensuring the more ready acceptance of certificates issued by competent laboratories in SAARC countries. National treatment should be accorded to all products in respect to registration, labeling, and testing, together with charges and fees thereof. SAARC countries should expedite automation of their customs clearance procedures under the Automated System for Customs Data (ASYCUDA).

## Integrating South Asian Free Trade Area and Bilateral Trade Agreements

SAFTA should match the tariff reduction and other provisions of bilateral FTAs (notably of the India–Sri Lanka and Pakistan–Sri Lanka FTAs), harmonizing the commitments and eventually eliminating any differences.

SAFTA's RoO provisions, notably the 30% value-addition provision, should be adjusted to better facilitate intraregional export trade expansion in South Asia. The value addition of most LDC export products is limited; hence the current 30% value-added provision acts as a barrier to export trade. SAFTA's RoO should also better align with the Pakistan–Sri Lanka and other bilateral FTAs regarding tariff headings and shifts in headings following processing (e.g., final product classification at the first four-digit level compared with non-originating materials). Trade diversion in South Asia should be minimized by reducing the absolute level of external tariffs of SAARC members and narrowing intercountry differences in their external tariff rates.

Harmonizing SAFTA preferences with those of bilateral FTAs should be addressed through easing the RoO by introducing a “de minimis” rule, where a specified maximum percentage of non-originating materials is allowed without affecting the determination of origin; and by easing the regional cumulative rule concerning domestic value added.

## Integrating Formal and Informal Trade

Informal trade among SAARC members is substantial, in part because of the extensive sensitive lists under SAFTA and the relatively tight RoO. Export restrictions (e.g., on food exports) and nontariff factors (e.g., trade-restrictive product standards) are additional impediments to formal trade.

Further, the lack of proper transport and transit facilities, cumbersome customs procedures, excessive paperwork, and poor infrastructure at border areas prompt traders to rely on informal rather than formal channels. While SAARC members have made important progress in facilitating cross-border trade and reducing the associated transaction costs, including time, further improvements are urgently needed. Customs procedures and paperwork need to be simplified and connectively improved through upgraded

cross-border infrastructure and streamlined transport protocols. Easier visa processes, cellular services, and courier facilities are other measures for spurring formal trade.

The trade information base should be strengthened, including through increased communication among export and import traders in SAARC countries. Greater dialogue among traders would contribute to a more active and amenable business environment, along with filling gaps in information concerning trade regulations and procedures. SAARC online networks, trade fairs, and exhibitions are further means for promoting intraregional trade.

Streamlined border security is another step toward SAEU. Security checks, payment of bribes, and harassment by border officials discourage formal trade. Border officials must be better able to differentiate between legitimate trade and informal or illegal trade. Information concerning legitimately traded goods, routes, correct standards, and genuine trading partners should be improved.

The payment process for formal trade transactions should be streamlined. Establishment of cross-border banking facilities will help traders throughout the region. Easier access to credit and banking systems will encourage informal traders to gradually switch to formal trade, although ethnic trading networks are expected to continue.

## Facilitating Trade in Services

The SATIS should be advanced through some initiatives, including the following:

- Investment regulations should be streamlined through fast-track procedures for regional investors and selected commercial services. Information should be improved on the investment regulatory framework in SAARC countries and on the bidding processes for service contracts. A regional investment treaty addressing investment-related SATIS concerns should be formulated, harmonized with the India–Pakistan bilateral investment treaty under discussion. A SAARC investment treaty should address investment facilitation, investor protection, dispute settlement, and contract enforcement. Double-taxation treaties should also be developed.
- Institutional and regulatory cooperation should be expanded, notably through harmonization of financial services regulations and standards, thereby facilitating remittances and investment flows through formal banking and capital market channels. Additional steps should include the reduction of exchange restrictions, adoption of common standards, and strengthening regulatory enforcement of the finance sector.
- The business environment should be improved, including through improved transport connectivity and transit trade agreements. In addition, standards and regulatory principles for the service sector should be established.
- The approach to liberalization of trade in services should be phased and incremental, focusing first on the least contentious services, such as tourism and information technology (IT). Negotiations concerning service trade liberalization

should proceed on issues, sectors, and subsectors where there is a minimum core group of three or more interested members, following the open approach taken by the Association of Southeast Asian Nations (ASEAN). Bilateral and multilateral agreements—e.g., the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)—should also serve to advance trade in services. SAARC members should consider a request-and-offer approach to liberalizing the movement of natural persons for selected categories of service providers. SATIS discussions should be linked with those on trade facilitation.

Implementation of SATIS should involve four critical steps: (i) improving information on the service sector to better understand its importance and on the barriers to trade in services; (ii) focusing regional discussions on regulatory and institutional issues critical to trade in services; (iii) developing regional transport and trade facilitation infrastructure; and (iv) building capacity, including in selected services such health care, environment, education, renewable energy, and tourism.

## Labor Mobility

SAARC members should take the following short- and long-term measures to facilitate the movement of skilled and highly skilled labor in the region:

- Member countries should work together to design an agreement that facilitates the movement of certain categories of professionals and specialized skills under a common framework.
- A special visa category should be issued for business travel, including an easier entry process.
- Barriers to Mode 4 trade under SATIS should be phased out.<sup>2</sup>
- Standards and qualifications should be harmonized by universities, professional bodies, and research institutes.
- Members should set timelines for entering into mutual recognition agreements for selected groups of professions.
- Members should provide the supporting technology and infrastructure (e.g., visa counters) to facilitate labor mobility.
- Members should reduce the cost of remittances, following 5 percentage point reduction in 5 years being implemented by the G8 and G20 countries.<sup>3</sup>

<sup>2</sup> Under the General Agreement on Trade in Services, services can be traded internationally in four different ways—known as the four modes. Mode 4 refers to the presence of persons of one World Trade Organization (WTO) member in the territory of another for the purpose of providing a service.

<sup>3</sup> G8 refers to the group of the largest industrialized countries: Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States. G20 is an international forum for the governments and central bank governors from 20 major economies. The members include 19 individual countries—Argentina, Australia, Brazil, Canada, the People's Republic of China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, the Republic of Korea, Turkey, the United Kingdom, and the United States—along with the European Union, which is represented by the European Commission and the European Central Bank.

In recognition of the sensitivity of labor mobility issues, SAARC members should focus on noncontroversial and achievable measures. SAARC members recognize that they must work together to create a skilled, mobile workforce.

## Investment Cooperation

SAARC members should advance investment cooperation under the framework of open regionalism, appropriate home and host country measures, progress toward a common market, harmonized regulatory provisions, and country-specific priorities for building regional supply chains. Accordingly, SAARC members should undertake the following measures:

- draw from the ASEAN model for investment cooperation, adjusting for conditions in South Asia;
- simplify and harmonize procedures for investment application and approval;
- widely disseminate investment-related rules and regulations;
- harmonize guidelines for investment in specific sectors;
- strengthen institutional capacity for regulating investment, including foreign direct investment (FDI);
- facilitate investment transactions through improved financial and banking networks;
- coordinate investment and trade liberalization; and
- simplify cross-border customs regulations.

SAARC members should take measures to facilitate public-private investment partnerships for the development of regional or subregional energy and infrastructure projects, and regional value chains in the apparel, other industries, and service sector. Small and medium-sized enterprises (SMEs) should be given special support. Member countries could consider reducing corporate and personal income taxes to incentivize foreign investment in high-priority sectors, subject to limits to avoid counterproductive regional competition.

## Economic Corridors

SAARC members should develop economic corridors to more closely integrate the region (including with ASEAN) and facilitate participation in global value chains. Steps should include

- preparation of a master plan of South Asian economic corridors, together with timelines for their completion;
- effective coordination among key stakeholders, both public and private, in formulating the master plan;
- identification of the infrastructure (e.g., physical infrastructure, logistics networks, and maintenance) necessary to develop the economic corridors;

- mobilization of the necessary financial resources, including through partnerships with multilateral financial institutions and the private sector;
- identification of industries and sectors for the designated economic corridors;
- identification of policy and regulatory (software) measures needed in support of the industries and sectors intended as the focus of investment in the economic corridors;
- clarification and harmonization of the rights of passage for goods, people, and vehicles, and of the associated permits, licenses, and other measures;
- accession to the seven international transport conventions, especially the Customs Convention on the International Transport of Goods under Cover of Transit International Routier Carnets and the International Convention on the Harmonization of Frontier Controls of Goods; and
- identification of the logistics requirements for effective economic corridors and coordinated action in response.

## Trade Facilitation

Supplementary to trade liberalization, the reduction of nontariff barriers and other measures outlined, SAARC members should undertake the following trade facilitation measures:

- establish national trade facilitation committees;
- adopt the World Trade Organization (WTO) Trade Facilitation Agreement, with the support of the Asian Development Bank (ADB), the United Nations Economic and Social Commission for Asia and the Pacific, the World Bank, and other organizations;
- introduce targeted measures, including by the private sector, to reduce the time and transactions costs of cross-border trade;
- involve chambers of commerce and industry associations in simplifying and automating documentation, certificates of origin, and other steps in the import-export process;
- make progress on aligning national procedures and documents with international standards and conventions;
- tailor trade facilitation measures to support cross-border production networks, especially those involving SMEs;
- identify back end production opportunities in South Asia and the steps needed to realize these links, possibly led by a project development facility in support of planning and implementation of cross-border projects;
- establish single-window border facilities for processing of trade-related information and documents, modeled after successful single-window border facilities (e.g., in the Republic of Korea);
- increase the use of information and communications technology (ICT) and development of paperless trade (e.g., acceptance of electronic cross-border bills of lading) and increased use of e-filing of documents;

- streamline and harmonize inspection and testing procedures and improved risk management systems;
- harmonize hours of operation of customs facilities;
- improve multimodal connectivity; and
- introduce trade facilitation performance monitoring systems.

## Poverty Eradication

SAARC members should demonstrate that regional integration addresses the interests of the poor. Accordingly, SAARC members should

- document and widely communicate how regional integration has spurred economic growth in their countries, generating new and better-paying jobs for low-income workers, including in remote and slow-growth areas;
- document and widely communicate how regional integration has spurred increased trade, foreign direct investment (FDI), regional infrastructure investments, migration, and other benefits;
- ensure labor adjustment programs and other forms of support (e.g., social safety nets) for low-income workers and others who would be adversely impacted by trade liberalization;
- strengthen infrastructure, health, education, and other services in poor areas to strengthen the ability of workers in these areas to respond to new employment opportunities arising from trade liberalization and other economic integration steps;
- improve access to credit and other financial services to help the poor take advantage of new investment and job opportunities; and
- ensure that the legal and regulatory system (e.g., contract enforcement) is accessible to the poor and exercised in a fair manner.

## Regional and Global Value Chains

SAARC members should collaborate in promoting and facilitating regional value chains (RVCs) and global value chains (GVCs) in South Asia—a fundamental building block for strengthening business competitiveness in key sectors. RVCs in the textile, clothing, leather, food processing, and other sectors provide opportunities for businesses in the region to gain higher value for their exports and participate in GVCs. To promote and facilitate RVCs and GVCs, SAARC members should collaborate in

- identifying strategic policy interventions needed at the regional and national levels (e.g., preferential trade agreements and cluster formations);
- forming regional industry associations;
- establishing regional design centers;

- conducting joint research and development in support of target industries;
- accelerating trade facilitation;
- improving transport and other critical infrastructure, and telecommunication services;
- harmonizing industrial support policies;
- building capacity of relevant institutions and their ability to formulate and enforce regulations; and
- building capacity in technical innovation and skills development.

## Integration of Capital Markets

SAARC members should integrate their capital markets at a pace that reflects each country's level of development and challenges. Integration should be guided by pragmatism, recognizing the different starting points and different speeds, but moving toward a common goal. Integration of capital markets should be a bottom-up process and should accompany integration of the goods and services markets. Integration should be achieved incrementally through step-by-step harmonization of standards, led by industry participants and building on the considerable degree of regulatory similarity. A SAARC agreement on capital markets is viewed as the logical result of the bottom-up process of harmonizing standards toward a common goal.

Integration of capital markets in SAEU requires

- regular meetings of the SAARC Experts Group on Development of Capital Markets to guide the integration and harmonization process;
- in-depth analysis of capital markets in SAARC members as a foundation for establishing common standards, including analysis of market volatility, demutualization, pension fund management, new products, bond markets, and other capital market issues;
- wide consultation with stakeholders concerning integration of capital markets;
- broad dissemination of baseline common standards and support for their implementation;
- rules requiring prospectuses and specifying their contents;
- rules on capital adequacy and staff training of brokerage firms;
- corporate governance codes based on international best practices;
- rules for trading transparency and standards for clearing and settlement;
- accounting standards based on international standards;
- strengthening of regulatory skills and statistical measures of enforcement;
- building capacity on financial literacy and the stock exchange business;
- support for small capital markets, including possible outsourcing of settlement and other functions subject to economies of scale; and
- guidance from central bankers concerning exchange rate policy and management of capital markets.

## Energy Cooperation

In recognition of their extensive energy potential and requirements, SAARC members should intensify their cooperation in developing and sharing the region's energy potential, including renewable energy.

Policy initiatives for the development and sharing of the hydropower potential in Bhutan, Nepal, and other areas of the region should include

- encouraging and facilitating expanded participation by the private sector;
- assistance for detailed feasibility studies, financing mechanisms, and public-private partnership (PPP) investments;
- developing a regional database on possible cross-border power transmission connections; and
- determining interconnection modalities (high-voltage alternating current or high-voltage direct current), their operational feasibility and economic viability.

Policy initiatives concerning development of a regional power market should include

- analysis of the power structures in the member countries and their legal and regulatory frameworks, security and stability standards, and compatibility;
- analysis of the power generation scheduling and dispatch procedures, energy accounting systems, financial settlement systems, and institutional, regulatory, and commercial requirements for cross-border power trade; and
- development of a framework for regional power exchanges linking with the power systems of SAARC countries.

Policy initiatives concerning large-scale power stations should include

- analysis of their competitiveness if based on imported coal and natural gas;
- analysis of the infrastructure and policy initiatives needed to facilitate establishment of large-scale power stations; and
- formulation of commercial risk mitigation strategies for the proposed Turkmenistan-Afghanistan-Pakistan-India and Iran-Pakistan-India pipelines.

Policy initiatives concerning renewable energy should include

- assessment of each country's renewable energy potential (wind, solar, biogas, and biofuel) and development to date;
- sharing of experience in promoting and facilitating renewable energy investments; and
- collaborative research in adapting the technologies to local conditions.

## Conclusion

The commitment to SAEU should be made by key stakeholders throughout the region, including governments, the private sector, civil society, academe, and think tanks. The action plan presented below is neither exhaustive nor conditional on all the elements being agreed to. While pursuing the action plan, the following four broad areas need to be kept in mind:

- (i) Why is there a need for deeper regional economic integration in South Asia?

The region must become more integrated so that it can be more competitive and participate more effectively in GVCs. Success in reducing poverty and opening up new and better job opportunities for workers in SAARC countries will greatly depend on reducing the barriers to trade and investment, and promoting other forms of integration.

- (ii) How can deeper regional integration in South Asia be achieved?

In short, deeper integration will be achieved by building on success. While implementation of SAFTA has been slow, it nonetheless represents a landmark. In many respects, private sector cooperation and business initiatives are leading the way, providing a course for further steps during SAARC summits.

- (iii) What needs to be done?

The list is extensive. Full implementation of SAFTA is perhaps the first order of business but other major steps, such as effective and faster implementation of SATIS and progress in forming an investment agreement, should also be priorities.

- (iv) Who will do what?

SAARC summits should catalyze the process. SAARC's full institutional structure must be mobilized in making SAEU a reality. In turn, SAARC's vast population needs to be mobilized to support this vital challenge.

### Action Plan Recommended by the Study

Strategic Action	2014–2016	2017–2020	2021–2025
<b>Tariff liberalization</b>	<p>Reduce tariff on all products, except those in sensitive lists, to 0%–5% by least developed countries (LDCs).</p> <p>Reduce tariff on all products, except those in sensitive lists, to 0% by non-LDCs.</p> <p>Harmonize the South Asian Free Trade Area (SAFTA) tariff reduction scheme with bilateral free trade agreement (FTA) tariff reduction schemes by introducing regular review and monitoring process to keep track of rapid modifications in the bilateral FTAs.</p>	<p>Reduce tariffs on all products, except those in sensitive lists, to 0% by LDCs.</p>	
<b>Reduction in sensitive lists</b>	<p>Non-LDCs reduce tariff lines by 20% annually in priority sectors.</p> <p>LDCs reduce tariff lines by 10% annually in priority sectors.</p> <p>Reduce peak tariff to 30%.</p> <p>Harmonize the sensitive lists of SAFTA and bilateral FTAs by introducing regular review and monitoring process to keep track of faster amendments in the bilateral FTAs.</p>	<p>Non-LDCs have no more than 100 tariff lines.</p> <p>LDCs reduce tariff lines in other sectors by 10% annually.</p> <p>Reduce peak tariff to 20% with some flexibility for highly sensitive products.</p>	<p>LDCs have no more than 100 tariff lines.</p>
<b>Elimination of nontariff barriers</b>	<p>Set up reporting, evaluation, and monitoring mechanism.</p> <p>Enhance transparency by abiding by notification requirement.</p> <p>Non-LDCs reduce nontariff barriers by 50% in priority sectors.</p>	<p>LDCs reduce nontariff barriers by 50% in priority sectors.</p>	<p>LDCs and non-LDCs achieve full elimination of nontariff barriers with flexibility for some products.</p>
<b>Rules of origin (RoO)</b>	<p>Review all bilateral RoO in the region and explore possible accumulation mechanism.</p> <p>Reform RoO to respond to changes in global production process to develop value chains in the region.</p> <p>Simplify procedure for certification through electronic data interchange.</p>		

*continued on next page*

Table continued

Strategic Action	2014–2016	2017–2020	2021–2025
<b>Consultation and dispute settlement</b>	Identify the bottlenecks and downsides of the existing dysfunctional settlement mechanism.	Make dispute settlement more effective by significantly adjusting the current system.  Promote mutually agreed rules for enhanced implementation of the facilities.	
<b>Investment facilitation</b>	Set up a task force to discuss speedier clearances and approvals and fast-tracking of investments in the region, and for regular updating of information on the regulatory framework governing investment in different services.  Initiate discussions for including an investment chapter in the South Asian Association for Regional Cooperation (SAARC) Agreement on Trade in Services (SATIS).	Implement fast-track procedures for selected investors and selected services.  Start discussions on a regional investment treaty and double taxation treaties among the countries.  Continue discussions on an investment chapter in SATIS.	Design a regional investment framework that addresses issues on investment facilitation, investor protection, dispute settlement, and contract enforcement.  Add an investment chapter in SATIS.
<b>Financial integration</b>	Set up a committee to discuss financial integration through harmonization of financial services regulations and standards to ease the flow of remittances, payments, and investment flows through formal banking and capital market channels.  Ensure regular dialogue between finance sector regulators in the SAARC region under the SAARC finance network.	Take steps to ease the cross-border establishment of banks within the region.  Take steps to remove exchange restrictions.	Arrive at harmonized financial services regulations and standards.
<b>Capital market</b>	Set up a regional information exchange group, define goals and membership, and set up inaugural meeting to agree to processes.  Set up secretariat support for the group, define role, arrange funding, and establish resources.  Identify scope of work streams.  Exchange control.  Codify current exchange controls in SAARC and the rest of the world.  Make harmonization a policy goal.  Identify key areas for harmonization.	Identify policy constraints on relaxation by country.  Draft and agree upon common minimum standards.	Propose viable program to relax and reduce impact of controls.  Members move toward common standards.

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Strategic Action	2014–2016	2017–2020	2021–2025
	<p>Enhance regulatory capacity.</p> <p>Agree to common approach to pooling resources and measuring success.</p> <p>Assist smaller exchanges.</p> <p>Identify key business constraints on smaller exchanges and propose solutions.</p> <p>Support private sector initiatives.</p> <p>Share information on new private sector products.</p> <p>Improve commercial imperatives at stock exchanges.</p> <p>Publicize information on new products and other business development opportunities.</p>	<p>Implement capacity-building program and initiate assessment measures.</p> <p>Assess possibilities for pooling and/or sharing resources and outsourcing functions.</p> <p>Identify other revenue streams.</p>	<p>Publish assessment measures.</p> <p>Develop and implement specific solutions.</p>
<b>People mobility</b>	<p>Set up a task force to identify categories of movement for which visa procedures and requirements can be eased.</p>	<p>Implement recommendations of the task force by streamlining visa procedures and requirements for selected categories of persons within the region.</p> <p>Initiate discussions for mutual recognition of qualifications.</p>	<p>Develop a regional template for recognition of qualifications and for immigration requirements for a selected set of professions and categories of movement.</p> <p>Implement mutual recognition of qualifications for selected professions among the member countries.</p>
<b>Connectivity</b>	<p>Set up a committee to identify bilateral and subregional projects to develop road, rail, and air transport links and joint investments.</p> <p>Provide transit facilities for the landlocked nations (Afghanistan, Bhutan, and Nepal).</p>	<p>Implement these projects.</p> <p>Sign open skies agreements between countries in the region.</p>	<p>Integrate the regional transport network.</p> <p>Create land corridors through member countries.</p> <p>Develop transit hubs in the region.</p>
<b>Data and information exchange on services trade</b>	<p>Set up mechanisms to regularly exchange and update information among governments, regulatory bodies, professional associations, industry associations, research institutions, and civil society in the region.</p> <p>Set up a task force to examine data on regional and bilateral trade in services.</p>	<p>Work toward a regional database on services trade, investment, and regulations.</p>	

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Strategic Action	2014–2016	2017–2020	2021–2025
<b>Regulatory harmonization for services trade liberalization</b>	<p>Set up a group on regulatory harmonization.</p> <p>Discuss a set of regulatory principles for the service sector under SATIS.</p>	<p>Develop a cross-cutting “Services Reference Paper” that specifies pro-competitive principles applicable across all services.</p>	
<b>Fast-track sectors for services trade liberalization</b>	<p>Identify services where fast-track liberalization is possible.</p> <p>Examine scope for pilot projects in these services and take up existing initiatives on priority basis.</p>	<p>Implement the pilot initiatives and deepen commitments in these sectors under SATIS.</p>	
<b>Subregional platforms for services trade liberalization</b>	<p>Create subregional task forces on issues where a core of three or more countries are interested in liberalization.</p> <p>Identify existing bilateral agreements and other plurilateral agreements among countries in the region and build on these platforms.</p>	<p>Implement subregional projects and initiatives.</p>	<p>Expand the subregional groups to a larger number of member countries.</p>
<b>Synchronizing deficits and surpluses in agriculture production and ensuring food security</b>	<p>Identify priority food and agriculture products where there is export surplus and potential to trade.</p> <p>Allocate sufficient resources for agricultural research and development (R&amp;D).</p> <p>Effectively utilize the Regional Food Reserve.</p> <p>Increase the pledges made by member countries to have a sufficient reserve amount in the SAARC Food Bank to effectively address a large-scale food shortage.</p> <p>Build capacity within SAARC to produce uniform and useable data to ensure the effective functioning of the SAARC Food Bank, i.e., a food security information system.</p>	<p>Further reduce tariffs and nontariff barriers applied to these products.</p> <p>Synchronize the identified deficits and surpluses in agriculture production.</p> <p>Conduct joint agricultural research to develop high-yielding crops.</p> <p>Share experiences and best practices in agriculture R&amp;D.</p> <p>Improve coordination among member countries to effectively manage the SAARC Food Bank.</p> <p>Manage stockpiles and monitor stock releases.</p>	

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Strategic Action	2014–2016	2017–2020	2021–2025
<b>Enhancing intra-industry trade and promoting intraregional investment</b>	<p>Identify areas where regional supply capacities can be improved given the clear division of labor in terms of the region's sector composition and specialization in exports, e.g., in the textile and clothing sector.</p> <p>Consult and involve the private sector in developing a regional strategy.</p> <p>Identify specific instruments to promote regional investment.</p> <p>Improve the investment climate.</p> <p>Relax restrictions related to outward foreign direct investment (FDI) at the country level.</p>	<p>Develop regional supply capacities to enhance vertical specialization and economies of scale.</p> <p>Develop sourcing relations through regular meetings of stakeholders, e.g., through the SAARC Chamber of Commerce and Industry.</p> <p>Undertake measures to reduce bureaucratic red tape, and energy and transport costs.</p> <p>Establish working groups at the regional level to focus on key areas of trade and investment, i.e., RoO, customs, agricultural trade and subsidies, standards, investment and services, cross-border movement of businesspeople, and dispute settlement.</p>	Harmonize regulations in identified key sectors.
<b>Regional migration strategy</b>	<p>Embark on a clearly defined migration management policy at the country level.</p> <p>Identify impediments to ratifying International Labour Organization conventions and provide adequate information on the implications of ratifying; assist countries to develop and make necessary changes to national laws that are in line with the provisions of the conventions.</p> <p>Develop effective support systems in the region to reduce irregular migration, e.g., financial assistance, insurance, etc.</p> <p>Improve access to and information on banking and financial services, and improve financial literacy.</p>	<p>Have a system at the regional level that can provide legal assistance and coordinate enforcement on cases related to fraud and exploitation of workers.</p> <p>Develop multilateral mobility agreements within the region.</p> <p>Adopt and implement best practices of member states.</p> <p>Design better financial and investment products for migrants.</p>	

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Strategic Action	2014–2016	2017–2020	2021–2025
<b>Promoting energy cooperation and development of a regional power market</b>	Identify energy endowments and surpluses in the region for potential energy trade.	Commit to a common agreement to promote energy trade.	Harmonize legal and regulatory framework in the energy sector of each SAARC member state.
	Identify areas of energy infrastructure that need to be developed.	Develop crucial energy infrastructure at the regional level.	
	Identify energy-related projects at the subregional level.	Promote FDI and private sector participation in the power sector.	
<b>Trade facilitation measures</b>	Facilitate cross-border by vehicles.	Agree on mutual recognition of standards.	
	Simplify visa requirements.	Improve infrastructure at borders.	
	Lower the fees for formal trade and make payment more transparent.	Strengthen cross-border banking facilities.	
	Automate the system for handling clearances.	Simplify or reduce documentation requirements.	
	Disseminate trade-related information through enquiry points.	Use a single window for lodging of all trade-related documents.	
		Harmonize documentation requirements and formalities for import clearances.	
		Introduce a single form for customs clearance .	

Source: Author's compilation from different chapters of this volume.

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