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Regional Trade in South Asia - Towards Stronger Linkages and Growth

Recommendations for Action through the South Asia Free Trade Agreement

A policy paper from the South Asia Trade and Investment Network (SATIN)

July 2008

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The SAARC Chamber of Commerce and Industry (SCCI) is recognised by all the governments of SAARC member countries as the apex trade organisation of the region with its permanent headquarters based in Islamabad, Pakistan. The constitution of SCCI was given official recognition by SAARC in 1993. The SCCI acts as an institutional framework for promoting economic cooperation in South Asia. It was created with the objective to build and develop global linkages. SAARC countries are Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. Since 2007 the following have observer status at SAARC: the USA, EU, China, Japan, South Korea and Iran.

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SCCI-CBC Partnership: South Asia Trade and Investment Network (SATIN)

The SCCI-CBC partnership was created under the banner of SATIN (South Asian Trade and Investment Network). Recognising the importance of growing business linkages with South Asia, the CBC extended its involvement with the establishment of SATIN to increase investment and trade flows in the region. SATIN aims to mobilise an international private sector base with interest in the region to broaden and extend existing business relationships. Key objectives include encouraging intra-regional trade, business-government dialogue on strengthening the investment climate, sharing best practices in corporate governance, private sector development and productivity, facilitating networks and expanding opportunities for diasporas and business entrepreneurs outside South Asia to participate in international trade and investment in the region. The support of the UK Department for International Development (DFID) for the SATIN project is gratefully acknowledged.

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EXECUTIVE SUMMARY

South Asia's economies are amongst the fastest growing in the world. Despite well-documented obstacles including conflict and high fiscal deficits in some countries, less readily acknowledged is that South Asia has achieved impressive economic growth and poverty reduction in the past decade. The South Asia Free Trade Agreement (SAFTA), which became operational in July 2006, has immense potential to increase intra-regional trade which is currently constrained to less than 2% of GDP. With the implementation of SAFTA, it is estimated that the current level of intra-regional trade could rise from $6 billion to $14 billion.

Concurrent streams of multilateralism, regionalism and bilateralism are ongoing in South Asia. South Asian countries are involved in 22 multilateral and 21 bilateral arrangements besides SAFTA. Bilateral negotiations are not limited to initiatives outside the region, with India and Bangladesh, Bangladesh and Sri Lanka, Pakistan–Sri Lanka FTAs recently agreed or in advanced stages of discussions. These bilateral agreements that are prevailing / emerging in South Asia, unlike SAFTA, are not part of the SAARC process but are more liberal in nature and have been implemented much faster as compared to SAFTA. However if the main message from the experiences of regional trade arrangements (RTAs) in other parts of the world is that RTAs can spur growth and poverty reduction, the results are by no means automatic.

Compared to the initial optimism, recent analysis in fact indicates that SAFTA may have a rather limited impact on liberalising trade in the region. This is because of the fairly restrictive "sensitive lists" that member countries have put up, rather strict rules of origin, and a slower time frame and scope of trade liberalisation compared to the recent bilateral and regional trade arrangements that SAARC members have signed or are considering. Tariff reductions alone will not necessarily lead to immediate economic gains for the economies of South Asia. The benefits from 'deep integration' of South Asian markets are likely to be more significant.

Recent evidence from ADB suggests that contrary to popular intuition, India and Pakistan are not the most important markets vis-à-vis each other. More than 60% of the increase in exports to the region for both India and Pakistan are directed towards Bangladesh. This seems to indicate the relative lack of complementarities between India and Pakistan, but the existence of complementarities of between India and Bangladesh, and Pakistan and Bangladesh. More than 50% of Pakistan's gains from SAFTA, are from increased exports to Bangladesh in textiles alone.

SAFTA faces many challenges. Some characteristics of the South Asia region (for example, small regional market relative to the world both in terms of GDP and trade flows, high level of protection among SAARC countries) increase the probability that SAFTA is likely to be largely trade diverting. 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. The third challenge is that SAFTA overlooks the role of the services sector. The welfare effects of trade preferences for services are likely to be more positive compared to trade preference for goods, as preferential liberalisation in services leads to trade creation with little or no trade diversion.

Barriers and constraints impeding trade in the region are many and varied and require awareness, attention and action. Freedom of movement should also be allowed for more people to people contacts across borders and the visa regime in South Asia needs to be more open. The SAARC region lacks adequate communication infrastructure and some countries follow a restrictive policy when it comes to developing regional communication links. In particular an 'open sky' policy should be adopted in South Asia to fly unhindered within the region and telecommunications links should be uninterrupted and penetrable in the region (all eight SAARC countries have been experiencing booming mobile markets, the fastest of any region in the world). To enhance business and trade, there needs to be adequate infrastructure for transportation of goods. Regional banking facilities should exist to expedite business transactions for increased business activity. To enhance trade and ensure smooth business, mutual certification and standards must be accepted throughout the region. Non-Tariff Barriers are restrictive to trade and not only add to costs and increase time for delivery.

Two specific opportunities where there has been growing momentum and which address real needs are in the areas of services and energy. Firstly South Asia is the fastest growing region in the export of services and including services and investment in SAFTA as soon as possible will drive innovation across the region and signal that the region is serious in its desire to integrate with the global economy. South Asia needs to take advantage of its geographical proximity and build new partnerships in various sectors including the capital markets, banking, IT and telecommunications, aviation and medical services. Secondly South Asian growth is becoming constrained by significant shortages in energy supply and unless corrective steps are urgently initiated and implemented it may be difficult to sustain the achieved and aspired growth rates. Fostering of cross border energy investments and promotion of regional energy trade in order to take full advantage of the energy resources available within the region and its neighbourhood are important elements of the solution to this problem.

A four-track policy can help navigate the way forward. The first is on Indo–Pakistan trade, building on several key developments in 2008 such as improved air links. Agreement between India and Pakistan to renew direct cross-border trade would advance regional integration, strengthen trust and lay the foundation for progress in SAFTA. A second track is collaborative movements to improve trade facilitation customs, and ports. Bilateral and plurilateral trade agreements with countries outside South Asia provide another track. India and Pakistan have embarked on a series of bilateral initiatives with other countries. While these cannot substitute for multilateral initiatives, they may offer some new market-widening opportunities. The fourth track relates to SAFTA itself. Beginning the SAFTA discussions with a clear objective of increasing cross-border trade and new import competition in national markets is paramount. Moreover focussing on services and energy trade is not only possible, but recognises latent opportunities and needs and could have a dramatic impact within a shorter timeframe while signalling to the international community that South Asia really is a region on an emerging cusp.

The role of the private sector is vital for success through the positive intervention of SCCI and in Public-Private partnerships. There need to be effective forums for dialogue: Government should engage in dialogue with the private sector on a wide range of investment climate reform matters such as trade policy – trade agreements between countries of the region, and at WTO level; regulatory frameworks (including tax and competition policy); and strengthening public administration. Business needs to encourage governments to accelerate and deepen SAFTA. SCCI has also emphasised its commitment to creating regional economic cooperation and focusing on poverty alleviation and employment generation in the region.

The recommendations for action by South Asian governments to address significant barriers and constraints impeding trade in the region are:-

1. **Improve Mobility of People** In order to facilitate business development and access to necessary skills, knowledge and relationships, the visa regime in South Asia needs to be more open in letter and spirit. SAARC should allow freedom of mobility for more people-to-people movement across borders. Opportunities should also facilitate access by business communities in the West including from the diaspora.

2. **Strengthen Communications and Transport Links** The SAARC region lacks adequate communication infrastructure and some countries follow a restrictive policy when it

comes to developing regional communication links. In particular an 'open sky' policy should be adopted in South Asia to fly unhindered within the region (for passengers and cargo) and telecommunications links should be uninterrupted and penetrable in the region with deregulation and foreign investment encouraged.

3. **Finalise an Agreement on the Services Sector** At their SAARC Summit in New Delhi in April 2007, SAARC Heads of Government called for early finalisation of an Agreement in the services sector and the SAFTA Ministerial Council in Delhi in March 2008 directed the drafting of the SAARC Agreement on Trade in Services (SAFAS) under the SAFTA Agreement. Extending South Asia Free Trade Agreement (SAFTA) to include services would considerably broaden its scope and impact and boost competitiveness in key emerging sectors such as banking, communications and aviation.

4. **Foster Cross Border Energy Investments and Regional Energy Trade** SAARC needs to take full advantage of the energy resources available within the region and its neighbourhood to meet shortages in energy supply.

5. **Implement Measures for Trade Facilitation** To enhance business and trade, there needs to be adequate infrastructure for transportation of goods. Collaborative measures are required to improve trade facilitation by improving customs management (for example through enhanced risk management and the introduction of an Authorised Trader Regime) and movement of goods through ports and airports. SAARC Governments are urged to make faster progress on the roadmap and then implementation of a South Asian Customs Union emphasised at the 2007 SAARC Summit. Regional banking facilities should exist to expedite business transactions for increased business activity. Mutual certification and standards must be accepted throughout the region. Non-Tariff Barriers are restrictive to trade and not only add to costs and increase time for delivery.

6. **Enable Direct Cross-Border Trade between India and Pakistan** Building on several key developments in 2008 such as improved air links, an agreement between India and Pakistan to renew direct cross-border trade would advance regional integration, strengthen trust and lay the foundation for progress in SAFTA with tangible spillover effects for other countries.

CONTENTS

APPENDICES

Introduction

South Asia's economies are amongst the fastest growing in the world and South Asia is amongst the fastest growing regions with Despite obstacles such as conflict, corruption and high fiscal deficits in some countries, South Asia has achieved impressive and unprecedented poverty reduction and economic growth (averaging close to 6% p.a. since the 1990s) thanks mainly to economic reforms in the last decade. GDP in South Asia is estimated to have expanded at 8.2% in 2006 and 7% for 2006 and 2007. It is expected to moderate but be among the strongest in Asia in 2008 due primarily to sustained expansion of the Indian economy and acceleration in Pakistan. Annual income growth in South Asia has averaged 7.7% since 2002, outpacing Southeast Asia by about 2 percentage points and almost matching that of East Asia. A high growth rate has created the interest and allowed political space for greater regional integration. South Asian countries have experienced high growth in traded volumes during the past decade which is part of the backdrop for trade regimes to be important for promoting intra-regional trade.

While South Asia has made significant progress in integrating with the global economy, integration within the region remained limited. Restrictive policies within the region have neutralised the beneficial effects of common cultural affinity, common geography and the 'gravitational' pull of proximity on movement of goods and people within the region. South Asia is the least integrated region in the world where integration is measured by intraregional trade in goods, capital and ideas. South Asia is marked by the lowest level of intraregional trade as a share of total trade and little cross-border investment. The flow of ideas as the number of phone calls[1] or the purchase of technology and royalty payments is all low for South Asia where only 7% of international phone calls are regional against 71% for East Asia.

However the demographic dividend in South Asia remains compelling and underlines the region's trade potential from both domestic and international commerce. In South Asia one fifth of the population is aged between 15 and 24 (the largest number of young people ever to transition into adulthood in the world). With reduced birth rates and consequent demographic changes, the dependency ratio by the year 2020 is projected to come down to about 49 in South Asia and to about 47 in India. Such a low dependency ratio would imply that the economically active population in the South Asia region will increase from about 800 million in 1999 to about 1.2 billion by 2020 and bring in its wake associated advantages of demographic transition. What this means is that over the next few decades, South Asia will have the world's largest economically active population.[2]

South Asia is also home to the largest concentration of a growing middle class in any three bordering countries (estimated at around 350 million) and by 2015 to five of the world's ten largest cities. Recent research on mega-regions[3] underscore the importance and potential of South Asia. Mega-regions are natural economic units arising as metropolitan regions become

[1] although the region has the fastest growing mobile phone markets in the world and amongst the lowest in cost

[2] it has been estimated by the US Government (Strategic Studies Institute of the US Army War College, 2002) that with all the major countries in the South Asia pursuing reforms at the same pace, if not faster than India, an increasingly open and more integrated South Asian economy would be able to increase the region's GDP from US$593 billion in 2002 to as much as US$4 trillion by 2020

[3] The world's 40 largest mega-regions are responsible for 66% of global economic activity and about 85% of technological and scientific innovation. It makes little sense to think of the growth of India as a national phenomenon but rather as mega-regional one. Research suggests that geography and location matter significantly to economic development. While it has become commonplace to argue that advances in transport and communication technology have allowed the world to become 'flat' the reality is that both economic activity and innovation remain greatly concentrated. Thus the paradox that at the same moment that technology enables the geographic spread of economic activity, economic activity continues to cluster and concentrate around this mega-regional unit.

increasingly integrated with one another and emerging as a considerable economic force globally. South Asia is home to one mega-region among the world's 40 largest mega-regions, according to criteria for contiguity and economic output: Delhi-Lahore. The Goldman Sachs N-11 report (2004) identified Pakistan and Bangladesh together (in its earlier BRICs report, 2003) with India as rapidly rising economies which would have on average 7-8% growth until 2020. This is part of the backdrop for more linkage, a leverage of common strengths and mitigation of common risks through a region with a free market area including goods, services, investment and economic cooperation.

Growth rates in South Asia generally have been lagging in agriculture (in the rural areas), behind those in manufacturing and industry and the services sector. In the case of India, this has been reflected in a steady increase in the ratio of urban to rural real consumption levels. As growth in South Asia has also been driven by export growth and trade liberalisation in the manufacturing and services sectors, it will be important in the future to consider how the agriculture and rural sectors can be included in export driven growth.

Regional inequality is a threat to the region's continuing growth and stability. Several lagging regions in South Asia are border economies. They are land-locked or geographically isolated. Examples are northern Bangladesh, Bhutan, northeast India, northwest Pakistan, and parts of Nepal and Afghanistan. These sub-regions have poor connectivity, difficult access to information and markets within the country, with the neighbours, and the rest of the world.

Most South Asian countries resorted to comprehensive economic reforms during the 1990s. A number of bilateral and regional agreements were also signed and implemented on a priority basis. The switching of the policy regime in these countries significantly contributed to the outward orientation of these economies as well as to intra-regional trade under the regional process. The South Asian Free Trade Agreement (SAFTA), which started its first phase of implementation on 1 July 2006, supports trade liberalisation between the South Asian countries through the elimination of trade barriers. SAFTA has immense potential to increase intra-regional trade, which is currently extremely limited and constrained to less than 2% of GDP as compared to 20% for East Asia. SAFTA is no doubt an enabler of South Asian regional integration, but it presents some challenges which the region has to work together to overcome for it to be a complete success and promote sustained economic development in the region. At the 14th SAARC Summit in Delhi in April 2007, Heads of Government agreed that 'SAFTA should be implemented in letter and spirit.' Moreover there was a recognition that 'successful implementation of SAFTA will catalyse other areas of regional economic cooperation.' Regional integration can go a long way towards developing market synergies, improving business linkages, contributing to sustainable economic growth, eradicating poverty and balancing the regional demand and supply in various sectors of South Asia. If the challenges facing SAFTA are proactively addressed, South Asia can become a highly advanced, developed, secure, sustained and economically integrated regional bloc in the world.

Contemporary challenges including food, fuel and financial turbulence underline the importance of SAFTA and the realisation of regional trade and investment synergies to help address them. South Asia is growing, generally at high rates and steadily, which has helped to reduce the percentage of people living on less than $1 per day from 41% to 32%. Thus the region is on track to halve income poverty by 2015 – although that still means about 273 million people living on less than $1 per day in 2015. There are also a number of threats to this positive outlook. Growth has often not benefited the poorest. Social exclusion, buttressed by gender, caste, class, ethnicity and religious divides, has been a very persistent problem in South Asia. Insecurity has increased throughout the region. As Pakistan's Foreign Minister reminded a London audience the week before the 2008 SAARC Summit, there are common concerns for South Asians which include 'poverty, food and energy security, rampant inflation, rise in oil prices, environmental degradation, illiteracy, unemployment, terrorism and extremism, regional rivalries and conflicts and nuclear non-proliferation' and 'across South Asia poverty and social fragmentation impact on overall security.' Climate change is also increasingly affecting the region, and impacting on huge numbers of people.

The World Bank and the IMF in their latest review of progress towards the Millennium Development Goals in May 2008 highlighted that 'shortfalls in the human development areas are especially serious in South Asia.' Moreover 'population growth will cause per capita water resources to fall below critical levels in the very near future in South Asia.' According to a WHO report (2008), South Asia is not on track to meet the MDG sanitation goals. South Asia has the highest rate of open defecation in the world at 48% and 63% (750 million people) of all open defecation takes place in South Asia. It also has the lowest rural coverage in the world at 23% and the largest urban-rural disparity in the world (57% to 23%). There are once more than a billion people (1,031,400) without access to improved sanitation which represents an increase in 200 million people from 2004. Against this the prognosis is that while 'South Asia lags on most human development MDGs, it will likely meet the poverty reduction MDG [and] ...South Asia would contribute the most to global poverty reduction in the next decade.'

It is important to recognise that achieving the first MDG (to eradicate extreme poverty and hunger) would still leave millions of people in South Asia living in absolute poverty and deprivation (estimates vary between 126 and 176 million people) – many of whom will be chronically poor.[4] While inroads on chronic poverty have started and/or are well advanced elsewhere such as in East Asia, South East Asia and the Middle East, this has not yet been matched by progress in South Asia, where Bangladesh, India, Nepal, Pakistan and Sri Lanka are all defined as 'partially chronically deprived.' growth is a crucial part of poverty reduction and the improvement of people's lives. As the Commission on Growth and Development concluded (2008), it is impossible for poor countries to lift large populations out of poverty without growth. International trade - and SAFTA - has immense potential to transform economies and lift people out of poverty. As the Commonwealth Secretary-General Kamalesh Sharma said on the occasion of the July 2008 setback in the Doha Round Talks,[5] 'trade is the acknowledged route out of poverty.' However, benefits from trade can exclude chronically poor people, such as those who live in regions where possibilities for export-crop farming are limited (as many do).

South Asia's rice-wheat systems,[6] the bedrocks of food security, are already under threat with long-term experiments showing that crop yields are stagnating and that soil and water quality

4 The distinguishing feature of chronic poverty is extended duration in absolute poverty. Therefore, chronically poor people always, or usually, live below a poverty line, which is normally defined in terms of a money indicator (eg. consumption, income, etc.), but could also be defined in terms of wider or subjective aspects of deprivation. This is different from the transitorily poor, who move in and out of poverty, or only occasionally fall below the poverty line.

5 It has been suggested recently (CUTS, 2007) that a common South Asian position on Special Products and Special Safeguard Mechanisms in agriculture needs to be developed, which can help South Asian countries to play their legitimate part at the Doha Round of negotiation in order to face the problem of cyclical food shortages in the region; provide protection to farmers and others to ensure better food security, livelihood security and rural development; have price control of agricultural commodities - domestically as well as internationally; and develop potential for the export of agriculture and value added agricultural products providing policy space to become export competitive over time.

6 No other agricultural commodity is subject to such widespread policy interventions as pervasive as in the case of rice. Both developed and developing countries use such policy instruments as high import tariffs, tariff rate quotas, and state trading in order to influence and regulate domestic production and imports of rice. Despite the stalled WTO Doha Round of multilateral trade negotiations, as rice has been one of the most protected commodities in world trade, significant liberalisation will have likely huge welfare implications for Sooth Asian countries dependent on its production and trade. Rice lies at

are in decline. South Asia's poor are now at risk from the escalation in world food prices. World food prices have been increasing rapidly since 2006, and the rate of increase during 2007 has been much higher than average. Most countries in South Asia are net importers of food and have suffered severe terms of trade shocks of 1% of GDP. The foreign exchange earnings and international purchasing power for these countries have also decreased. The World Bank has pointed to the likelihood of food prices continuing to increase in the near future due to raising standards of living in countries like China and India; increased use of food crops for bio-fuels and animal feeds; and increased oil and fertiliser prices. In South Asia, which has the largest concentration of poor people in the world, the increase in food prices is particularly damaging since food accounts for a substantial share of poor people's income. South Asian countries, however, have very few options available to deal with the challenge.[7]

The issue of food shortages is exacerbated in South Asia where Afghanistan has already appealed for foreign help to combat a wheat shortage while Bangladesh recently warned that it faced a crisis over rice supplies. The UN reported in June 2008 that Nepal, which imports much of its rice, has 2.5 million people in immediate need of assistance and 3.9 million more whose welfare may be compromised by rising prices. The paradox is that most of the economies of South Asia are agro-based economies, which have been suffering because of a shift away from agriculture.

Asia will not be immune from the economic weakness spreading through the world's leading economies and can be expected to grow but it will be with less momentum than in the recent past because of rising inflation in the face of commodity price pressures. There is not likely to be any let up in the near term and it is unlikely that we have the full impact of deteriorating credit card and other consumer debt in the US and Europe and there will clearly be more financial institutions that fail both in the US and elsewhere. The nature of the credit crisis has gradually evolved over the past year from a pure liquidity logjam, into a broader deleveraging trend, as solvency doubts rose, and then, finally, into a broad real economy crisis, not just in the US but across the global economy.

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the heart of South Asian livelihood with its cultivation the single most important economic activity in a region where the majority of the world's poor reside and the purchase of rice constitutes a large proportion of food expenditures of the poor. More than 60% of the daily calorie intake of the population in Bangladesh comes from rice, whereas for both India and Sri Lanka the comparable figure is about 50%. In the case of Pakistan, while the dependence on it as the basic food is lower, nevertheless it is the second staple food. For India and Pakistan, rice is also a major export item. A recent study from the Commonwealth (2008) found that the liberalisation of trade in rice and agriculture is to generate global welfare gains in South Asia however the distribution of the gains is likely to be highly skewed. There will both be losers and winners depending on respective country situations, including whether they are net exporters or net importers of rice and agricultural products.

[7] Bangladesh, which imports a substantial portion of major grains consumed by its people, has been particularly badly affected by the continued increase in world food prices. Natural disasters in the past year – two major floods in July and August 2007 and a cyclone in November 2007 - destroyed about 2 million metric tons of rice crops. Bangladesh is currently importing rice from its immediate neighbours, India and Myanmar, to meet the shortage. This has already created a problem because, several times in past few months, India has imposed a ban on rice exports or has increased the minimum export price, and each time the price of rice in Dhaka spiked. In Pakistan most families consume the same kind of wheat, making it difficult to target poor people and any subsidy on wheat will thus be an untargeted subsidy. The Indian government buys wheat from farmers at a Minimum Support Price which is highly distortionary and contributes to high costs for its budget. Sri Lanka is also a net importer of food products, and food price inflation is estimated at 34% however it is already facing high inflation with an average of 20%, independent of food prices. Nepal also depends on food imports from India and other countries to manage its needs and has a limited social assistance program to protect the urban poor.

Growth in emerging markets has weakened, partially in response to the weakness in the G3, but also partly because of the tightening of monetary conditions in response to inflationary pressures. Emerging markets face a cyclical slowdown but from very high levels of growth. The longer-term outlook is still very positive, though. The secular shift of economic power from West to East will continue and the eventual end of the credit crisis will almost certainly leave Asia and much of the rest of the emerging markets in a much stronger relative position. The subprime mortgage crisis in the United States is not likely to seriously impact South Asian countries because of the structure of the region's trade and financial flows and partly because of compensating effects. Given the impact in the US and Europe this can be seen as an opportunity for South Asia. The World Bank cites three factors that work well for the region - lack of exposure to US mortgage securities; availability of liquidity in domestic markets; and the possibility that lower capital inflows could help countries such as India with macroeconomic management. The share of South Asia's trade with the United States has been declining and China, not the US, is now India's leading supplier. Sri Lanka, which used to rely on the United States for its garment exports, has now increased them to Europe and other regions substantially.

On the other hand, a slowdown of economic growth in the US will moderate the increase in prices of oil and other commodity prices, which will have a favourable impact on South Asia. Since all South Asian countries are net importers of these commodities, such a slowdown will provide some relief in their balance-of-payments. Inflation remains the predominant issue for emerging markets, mostly because of commodity prices. Inflation has hit many of these markets hard as their exposure to commodities, given their investment-intensive growth, is high and oil/energy-use efficiency is often low. South Asian countries are facing more serious problems associated with global external shocks such as increasing oil and food prices, as well as country-specific "shocks" such as escalating conflicts or political turmoil. While the countries in the region may be only slightly affected by the subprime crisis, these critical issues need to be addressed if South Asia is to protect the gains in growth and poverty reduction of the last decade.

It is significant that recent months have also seen a wind of change blowing through the region with dramatic developments whose collective impact outside South Asia has scarcely been noticed let alone understood. These include democratic transition accelerating in Pakistan (acknowledged by its return to the Commonwealth), elections in Nepal leading to its declaration as a democratic republic, the election of representatives in Bhutan, a new constitution in the Maldives and key upcoming elections in Bangladesh and India. When SAARC Heads of Government meet in Kandy in August 2008 they will have the opportunity for viewing regional relationships, stability and growth - and the crucial role of trade and investment within that - with fresh eyes, commitment and urgency. Perhaps more than ever before more people in South Asia can participate in that process.

The growth of regional trading arrangements (RTAs)

There has been a significant increase in the number of regional trade agreements in recent years with presently more than one third of the world's trade taking place within the framework of such agreements. The average South Asian country belongs to four different regional trade agreements. South Asian countries are actively engaged in entering into bilateral FTAs among themselves. Apart from SAFTA, these South Asian countries are now making accelerated efforts to form or become members of several preferential trading agreements (PTAs) / RTAs. The three bigger countries (India, Pakistan and Sri Lanka) are engaged in forming bilateral/ plurilateral FTAs. While India is engaged in signing FTAs with countries in Asia, Africa, Europe as well as Latin America, smaller South Asian countries such as Bangladesh, Bhutan, the Maldives, Nepal, and, the newest member of SAARC, Afghanistan have an FTA with India only.

The urgency for SAFTA to assert its relevance is particularly pressing due to the proliferation of FTAs in the region. The India-Sri Lanka Free Trade Agreement (ISFTA) will be fully in place by 2008 and the Pakistan-Sri Lanka Free Trade Agreement (PSFTA) by 2010. Moreover, the BIMSTEC FTA Framework Agreement is running parallel to SAFTA, with five SAFTA Members also part of the trans-regional FTA, which goes beyond SAFTA to include investment and trade in services, and also contains a provision for fast-track liberalisation.

Bilateral market access to India for the smaller South Asian economies is evolving at a much more rapid pace than under the SAFTA framework. A multiplicity of alternative bilateral and regional arrangements amongst SAFTA members would not pose a major constraint if the SAFTA process was keeping pace with such developments. Unfortunately, the current experience is that SAFTA is, in fact, lagging behind.

As regional arrangements have assumed a more prominent place on the international development agenda, it is important to recognise why such regional trading arrangements / agreements (RTAs) are formed and what is the economic rationale behind them. There are in general four motivating factors for forging regional alliances. These are to promote economic cooperation among the members of the group by increasing economic efficiency and exploiting economies of scale; to achieve international competitiveness during globalisation; to build a sense of security and to facilitate political harmony within a region; and to forge a collective bargaining position in global negotiations.

Recent work by the World Bank (2007) in examining India-Pakistan trade drew lessons for SAFTA from the experiences of RTAs in other parts of the world. The main message is that RTAs can spur growth and poverty reduction but the results are by no means automatic. In reviewing the effects of RTAs on growth, trade, technological diffusion, and foreign investment, six key lessons have been identified:-

1. *signing a regional trade agreement does not automatically produce positive results in increased trade and growth.* Two types of initial errors are painfully evident. History is littered with cases in which RTAs, once signed, have produced little because countries did not translate their good intentions into actual reductions in their border barriers, but instead allowed interest groups to exempt large segments of their economies from the accord. The early attempts to foster Latin American integration in the 1960s produced little. Indeed, South Asia's first experience with SAPTA was disappointing for this reason. Moreover, agreements that kept in place high external border barriers— or in some cases raised them—often protected inefficient activities and undermined the competitiveness of all countries.

2. *successful agreements were often preceded - or accompanied - by unilateral efforts among members to reduce external protection.* Reducing trade barriers vis-à-vis the rest of the world creates an incentive for all members to export, augments competition that drives domestic productivity, and spurs all firms to look for new markets abroad. Moreover, low tariffs allow exporting firms to import necessary inputs at international prices, and permit them to be competitive in foreign markets. This is critical for several reasons. When external protection is generally low, trade creation usually dominates trade diversion, and so the risks that regional agreements will be a drag on growth is substantially reduced. Indeed, regional agreements where members have had low external protection have enjoyed greatest success. Trade creation has dominated diversion in East Asia, in NAFTA and, though perhaps less conclusively, in Latin America. Chile reduced its external tariff from a peak of 30% in 1983 to 11% in the 1990s, and to 6% in 2004. This enabled it to sign more than a dozen trade agreements without concern that trade diversion would undermine growth.

3. *North-South agreements have shown more consistent success because of the opportunities to exploit different comparative wage rates, capital availability, and technological levels that give rise to differing factor proportions in production—and more faithful implementation*. This explains part of NAFTA's success. For SAFTA, it may well be that opening up India could offer substantial complementarities to the other smaller economies of the region that would, for many products, offer some of these same advantages compared to some South-South agreements in Africa.

4. *regional integration can only be successful if trade actually unleashes new competition that lowers domestic prices and provides new technology.* As with all trade, this involves economic change, the process of creative destruction necessary to drive productivity. It is impossible to have the benefits of a regional agreement without exposing the member economies to new competition.

5. *successful integration has usually been associated with new competition in services.* Because member countries usually will not have the full range of service providers, especially in the South-South agreements, opening up a particular service sector to competition from member countries may foreclose competition that would otherwise propel growth. Much of the FDI going to East Asia and Latin America has been in the service sectors, and competition in telecommunications, finance, business services, and retail and wholesale commerce can be a driving force of productivity gains. Because of the forward linkages these sectors have in the economy, it may be that this will have a positive productivity-increasing effect across the entire economy.

6. *integration is likely to be most successful when partners streamline border transactions by facilitating trade.* Here, as in service efforts to increase efficiency within the region, the efforts often spill over to trade outside the region as well, because improving customs or improving efficiency of ports necessarily applies as much to extraregional trade as it does to intraregional trade, but the RTAs need to be spurred toward facilitating trade.

It is worth emphasising that formal regional cooperation and effective integration interact with each other: formal cooperation can pave the way for the creation of cross-border input-output linkages, while pressure from producers within the region to lower or remove the various barriers to intraregional trade grows as such external linkages intensify. These various demands are likely to be accompanied by the creation of institutions for closer cooperation.

Regional cooperation in South Asia has the potential to support national development strategies but in order to do so it has to extend beyond trade liberalisation to include policy areas that strengthen the potential for growth and structural change in developing countries. These include macroeconomic and financial management, as well as trade support and industrial policies.[8]

"New regionalism" denotes a departure from multilateralism, and has grown out of a sense of frustration of some governments at the slow progress in multilateral trade negotiations. The presence of voluntary export restraints, antidumping mechanisms *inter alia* make the negotiating space in WTO vastly more complicated than it was in the past. Under these circumstances, with multilateral trade negotiations under the WTO proving so difficult, nations, including those in South Asia, keen to liberalise trade are turning to RTAs as an alternative way to achieve this goal. Also since it involves fewer participants it is much easier

[8] As UNCTAD pointed out (2007), a distinction is frequently made between policy induced integration, which is also called regionalism and involves formal economic cooperation arrangements, and market-driven integration, also termed regionalisation, which is spurred by regional growth dynamics, the emergence of international production networks and related FDI flows.

under an RTA to establish rules for new issues that are not yet under discussion in the WTO. This has contributed to the fact that the number of trade agreements notified to the GATT/WTO increased from 20 in 1990 to 86 in 2000 and to 159 in 2007. Moreover recent concrete progress in ASEAN (which now aims have a free flow of goods, services and investment in 2015, an agreement already in place with China and ASEAN to create no-tariff zone by 2010 and one with India coming into place) and SADC, the Southern African Development Community (which became a Free Trade Area in 2008) underline the need for South Asia to avoid complacency in its implementation of SAFTA.[9]

With India looking increasingly to strengthen economic relations with the wider Asian region through initiatives such as ASEAN+3+India, the strategic interests of the smaller South Asian economies are likely to become inextricably linked to successful integration with the Indian economy. The evidence to date suggests that economic integration of the South Asian region is gathering pace, but that SAFTA remains fairly marginal in that process.

There are strong links between internal market integration, intra-industry trade and the formation of regional blocs. Direct investment which usually follows (and is complementary) to these trade flows adds to these links, whereby industries in different countries of the bloc either collaborate in the creation of a single product or specialise in the production of different finished goods for export to the entire bloc or beyond. As a result of these cross-border vertical production relations, trade becomes increasingly intra-firm, intra-industry and intraregional.

A comparison between the composition of intraregional and extra-regional trade suggests that the former in many cases offers a considerably greater potential for export upgrading than the latter. Regional blocs of developing countries such as South Asia typically represent important, and in many cases dynamic, markets for the manufactured exports of their members, including those of higher skill and technology content. Regional markets generally provide a supportive economic context for local industries in the initial stages of development and are more likely to attract manufacturing FDI than smaller national markets. Indeed regional cooperation is more important for coordinating policies for attracting FDI to the manufacturing or service sectors, where there is a greater likelihood for competing interests among countries in the same region to lead to a race to the bottom in offering incentives to potential foreign investors.

Thus, increasing trade within the same geographical region such as South Asia can be more conducive to diversification, structural change and industrial upgrading than overall trade. Geographical proximity matters as much as the initial economic structure of each country, but regional trade agreements, as well as other arrangements at the regional level that foster trade integration and greater product diversity, especially in the manufacturing sector, can enhance the positive impact of intraregional trade. For a developing country seeking to upgrade its production structure and the technology content of its domestic industry, an orientation towards the regional market can be an important factor for enhancing the competitiveness of domestic producers and an initial step for integrating into the wider international market.

There are three reasons why South Asia will need to further lower external trade barriers: to generate classical gains from trade, to lessen the chances that trade diversion will occur, and to reduce income transfers between member countries resulting from regional integration and

[9] Within Asia two primary modes of integration have been taking place: the expansion of existing FTAs (namely, SAFTA, the ASEAN Plus-Three APT grouping - China, Japan and Korea - and the revamped Bangkok Agreement, a preferential trading agreement (PTA) that aims at promoting subregional economic ties between six economies of South Asia with those of East Asia) and ASEAN's initiatives as a bridge between the regional groups of Asian economies.

the tensions that can arise from such transfers. History shows that a successful regional integration is often preceded by global integration.

However regional integration also provides opportunities to make progress in areas that otherwise would not take place in the absence of regional cooperation. Some of these opportunities include addressing the problems of energy shortage, relaxing the mobility constraints for lagging and landlocked regions, overcoming high transaction cost due to poor trade facilitation across regions, and reaping the positive benefits emerging from reputation effects/political risk premium/peace dividend through regional cooperation. The gains from these opportunities can contribute to higher sustained growth. Importantly, better economic cooperation can lead to better political relations thereby reducing conflicts and associated social and economic costs.

Regional cooperation, along with national initiatives, could play a useful role in ensuring that no region/country in South Asia is left behind. Rising inequality across regions and within countries is becoming a concern to the policymakers as rising inequality is a threat to the region's growth and stability. Several lagging regions in South Asia are border economies. They suffer from the disabilities typically associated with landlocked countries or geographical isolation. Examples include north-east India, north-west Pakistan, northern Bangladesh, and parts of Nepal and Afghanistan. Typically, these sub-regions have poor connectivity with the markets within the country and with the neighbouring countries. Regional cooperation on transport and trade facilitation can transform these landlocked regions into land-linked regions. There are other areas where the region can benefit through cooperation. These include tourism, education, health, and professional services, where the risk of trade diversion is low.

At present, South Asia combines a low level of regional integration - especially among its largest members - and the presence of relatively high trade barriers. The proportion of trade originating in the region has increased in the last decade but still lags behind ASEAN levels. While Bangladesh, India and Pakistan sustain 5% of their exports and 2.5% of their imports with regional partners, the smallest members (Bhutan, Nepal, Maldives, and Sri Lanka) exhibit a higher reliance on local trade relations averaging 20% and 9% for imports and exports, respectively.[10]

As SCCI have pointed out, 'when SAARC was created in 1985, intra-regional trade was only 3.4%, which even after 23 years remains less than 5%, showing an insignificant increase of mere 0.05% per annum which is incomparable with trade growth with contemporary regional trade blocs.' Regional trade in South Asia is clearly below potential. In 2006 intra-regional trade stood at US$10.48bn. with a potential estimated by RIS in Delhi of US$40bn. with 74% of trade potential remaining to be realised. The very limited intraregional trade in South Asia which in aggregate terms does not exceed 5% of the region's total trade is mainly because trade relations of the largest economies in the region, India and Pakistan, with the other members, and particularly with each other, are of minor importance compared to their extra regional trade. Factors including the lack of trade complementarities among member countries and homogenous nature of composition of exports of member countries still stand as constraints to intra-SAARC trade. The causes of high underutilisation of intra-regional trade potential are mostly economic in nature and include a lack of supply capabilities of LDCs; high trade barriers - both visible and invisible; inadequate trade facilitation measures; and poor transportation links. Nevertheless, SAARC countries, especially India, are important trading partners for the smaller members of the bloc. In 2005/2006 SAARC members accounted for 57% of Nepal's exports and for 48% of its imports. The respective figures for

[10] Due to limited availability of trade statistics for smaller members, the variability should be interpreted with caution. The last observation year for these four members (exports and imports) is 1999.

Sri Lanka are 10% and 21%, for the Maldives 15% and 17%, and for Bangladesh 2 and 14%. These asymmetries explain the gap between the two measures of intraregional trade shown in Figure 1, with very low total intraregional trade but a significant average indicator for the countries.

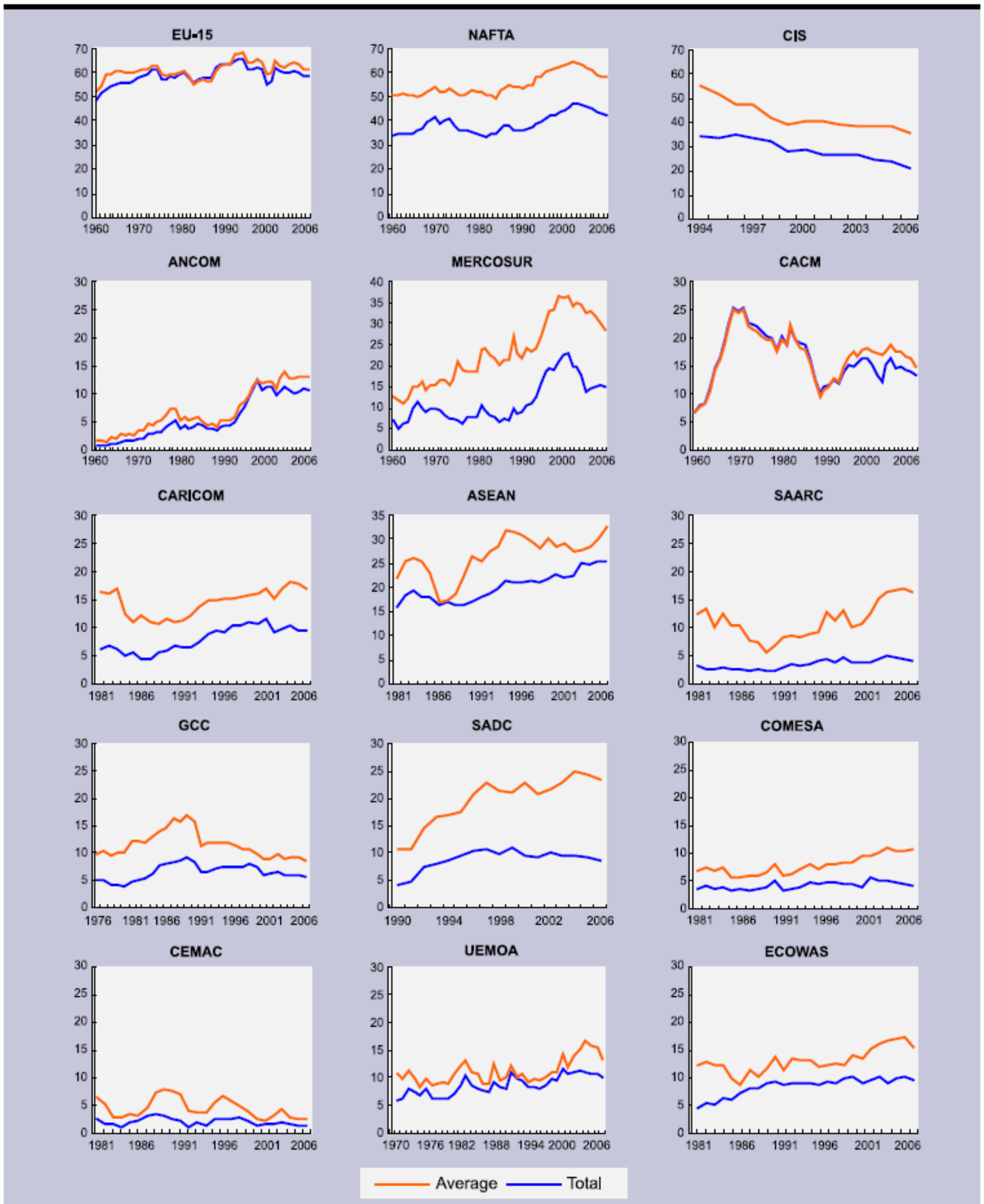
Figure 1 shows the evolution of intraregional trade in selected regional agreements, using two indicators: the *total share* of intraregional trade, which is obtained by comparing the aggregate intraregional trade to the aggregate total trade of the group of countries; and the *average share* of intraregional trade, which is the simple average of each country's share of intraregional trade. The combination of the two measures is indicative of the degree of heterogeneity of each bloc. In regional agreements involving partners of very different economic size, the first indicator is strongly influenced by the geographical trade patterns of the larger member States; however, the relative importance of the members of a regional agreement as markets and as suppliers of goods may vary considerably among participants, and tends to be greater for smaller economies. In such cases, the second indicator (simple average) will show a higher level of intraregional trade than the first (aggregate share). This is clearly the case in SAARC (as well in MERCOSUR and SADC, the Southern African Development Community).

It is important to note, as recent research by the Exim Bank of India (2008) has pointed out, that while the dominance of Free Trade Agreements implies a growing tendency between member countries to establish bilateral preferential agreements, a growing number of Economic Integration Agreements indicate the increasing preference among countries to deepen bilateral economic integration beyond trade in services.

Intra-SAARC trade, quite small until about 1999, has grown significantly since then, largely on account of increased exports from India. An examination of the intra-regional trade shows that India has the largest share in total intra-SAARC exports at 74.4%. There has been an increase of 39.4% in India's total trade to South Asia in 2007-08 compared to the previous year with the provisional figure of India's total trade with South Asia being US$11.1bn. However the percentage share of South Asia's trade with India's total trade is only 2.8% and there exists an opportunity to increase it further. On the other hand, Maldives' share in exports of the region is paltry at 0.3%. The share of other countries too is very low with Sri Lanka's and Pakistan's share being at 8.6% each. Further, while SAARC export share to Nepal is an exception with the share being 59.28%, SAARC countries collectively do not export much to countries within the region as compared to the rest of the world. Total intra-regional exports comprise only 5.3% of total SAARC countries exports to the world. This indicates that there exists a large potential for intra-regional exports.

In terms of imports, Sri Lanka and Bangladesh have the highest share in imports within the region at 28 and 26.9% respectively. This is followed by India at 17.3% and Nepal at 14.9%. Further, with the exception of Bhutan and Nepal, SAARC country imports from other member countries is very low as compared to the imports from the rest of the world.

Figure 1 Share of intraregional trade in total trade: selected regional blocs



Source: UNCTAD secretariat calculations, based on IMF, Direction of Trade Statistics database, UNCTAD (2007)
Note: The periods differ, depending on availability of comparable data.

South Asian countries share some basic similarities (low income, relatively abundant labour, comparative advantage in similar commodities such as tea and garments) reduces the potential for comparative advantage driven trade. There is a lack of complimentarity of regional economies and South Asian countries enjoy comparative advantage on a relatively narrow range of products. This has led to competition among the endowment-based industries in South Asia for the same market and products.

Bangladesh has comparative advantage in fish, vegetables, jute, tea, leather, textile yarn, made-up articles of textile material, clothing, and woven cotton fabrics. India has comparative advantage in food, beverages and tobacco products including meat, fish, crustaceans, rice, fruits and nuts, tea and coffee, spices, feeding stuff for animals, a wide range of 'crude materials' including oilseeds, cotton, stone, sand and gravel, iron ore, ores and concentrates of basic metals, and crude animal, vegetable materials, petroleum, oils and preparations, fixed vegetable oils; in chemicals and related products including nitrogen-function compounds, other organic chemicals, synthetic organic colouring material, medicinal and pharmaceutical products, perfumery, cosmetic and soaps, and insecticides and herbicides; leather; articles of textile and clothing; machine tools, household equipment, and steel products; and motor vehicles, motor cycles, and bicycles.

Nepal has comparative advantage in men and women's clothing, knitted or crocheted, floor coverings, textile clothing accessories, and essential oils and perfumes etc. Pakistan's revealed comparative advantage is in fish and crustaceans, rice, fresh and dried fruits, sugar, molasses, honey, spices, vegetables, roots and tubers; crude materials including cotton, besides oilseeds and oleaginous fruits, warm clothing, stone, sand, gravel, crude animal and vegetable materials; textile and clothing; leather; floor coverings; medical instruments; baby carriages; and toys and cutlery.

Sri Lanka has comparative advantage in fish, crustaceans, other cereal meals, flour, fruits and nuts, tea and spices; crude materials such as synthetic rubber, fuel wood, oilseeds, oleaginous fruits, paper, paperboard, vegetable, textile fibres, and crude vegetable materials; rubber tyres and articles; wood manufactures; made-up articles of textile materials; pottery, pearls and precious stones; materials of rubber; textile yarn, and woven fabrics of textile materials; and electric power machinery. The profile of revealed comparative advantage suggests that the pattern of revealed comparative advantage is quite similar across the South Asian countries.

With the exception of India and Sri Lanka, the South Asian countries enjoy comparative advantage in a relatively narrow range of products. Out of 71 commodity groups, Bangladesh, Nepal and Pakistan have revealed comparative advantage in only 7, 5 and 12 commodity groups while India and Sri Lanka have comparative advantage in 26 and 21 product categories; and no country has comparative advantage in capital intensive and high value-added products. Despite the similar comparative advantage, there is still some scope for increasing intra-regional trade. South Asian countries could import veneers, plywood, particle boards and other textile fabrics from Bangladesh; 43 products ranging from various food items to machinery and transport equipment from India; oilseeds and oleaginous fruits from Nepal; molasses, honey, cotton, clothing, crude animal and vegetable materials, fabrics, cutlery, live animals, and surgical instruments from Pakistan; and synthetic rubber, fuel wood, raw or processed textile fibres, residual petroleum products, tobacco, rubber articles, and electric power machinery and parts from Sri Lanka.

A major ADB study on SAFTA (2008) analysed the competitiveness and complementarities in the SAFTA region. It found that there has been a distinct change in the trade patterns of major trading partners in the region with respect to intra-regional trade with the competitive basket changing over time. Countries within the region have become competitive vis-à-vis other countries in the region in different products. Compared to 1991 in 2004 there has been a drastic increase of all four major trading partners with SAFTA region. The export potential of countries matches more to the import profile of the region in 2004 as compared to 1991. These increase the possibility of higher intra-regional trade. Intra-industry trade is also found to have increased drastically in sectors like agriculture raw materials, chemicals and textiles. Within textiles, ADB found that the intra-industry trade has increased over time. This indicates that in many sectors including textiles, countries can specialise in products at different stage of production or in differentiated products. This strongly suggests that there exists potential for intra-regional trade even in sectors where all the major trading countries are competitive. At the same time the challenge remains of developing new industries in which countries can identify their area of competitive advantage considering the option of non-traditional sectors beyond goods.

While a lack of complimentarities will not result in significant changes in trade, policymakers are of the view that the dismantling of tariffs in South Asia could result in substantial trade-related adjustments. India can potentially supply all types of commodities produced in Bangladesh and perhaps in all other countries. As long as supplies from India are less expensive than those of Bangladesh, there will be welfare gains for the latter, unless there is trade diversion from the rest of the world. Therefore, the lack of trade complementarities may not be the issue that prevents trade from taking place.

Three critical issues face business people and policymakers in relation to FTAs in South Asia. First, as trade between countries in some sectors is very small or insignificant, it is problematic and sometimes not possible to predict future trends and gains. Second, most research shows a significant proportion of increased intra-regional trade in South Asia is the result of trade deflection. Thirdly all South Asian economies contain large informal trade about which very little information exists.

While an FTA would ideally strike a balance between the two conflicting objectives of rapid liberalisation and mitigating adjustment costs, the problem faced by SAFTA is that it is joining the race too late. Nonetheless, SAFTA could potentially strike a balance by identifying certain products of particular trade interest within the region (items that are heavily traded or those identified to have trade potential), and fast-tracking the liberalisation of these key products. Similar measures have been adopted by ASEAN and BIMSTEC. Furthermore, SAARC countries could explore other methods of mitigating adjustment costs, without resorting to delaying liberalisation. These include improving the fluidity of labour markets to make it easier for workers to switch between industries; ensuring that temporary safety nets are provided for workers in industries that are likely to suffer due to trade liberalisation; and providing specific training to workers to prevent long-term unemployment in these industries.

One reason that South Asia is among the least integrated of all regions is that tariffs, though lower now, remain high relative to other regions meaning that South Asian exporters are at a disadvantage. Developing countries impose higher tariffs on imports from other developing countries than industrial countries do on their imports. South Asian tariffs on developing imports are frequently five times as high as the rates imposed by industrial countries.

The “Trade centrality index” (cited in Asian Development Bank, 2008) reflects an economy’s number of trading partners, and the influence of countries on product supply and value chains which connect the inputs to products and services (supply) via vertically integrated trade networks across many countries to the customer who demands the finally assembled product and service. A high relative value of centrality (on a scale from 0 to 100) reflects a central position of influence within key global supply and value chains. For South Asia, this measure provides important insights into global trade positioning: South Asia is still relatively marginal to global supply and value chain (outsourcing and integration) in comparison to the key players US, Japan, Europe, and increasingly China. Of all major economies in South Asia, India is the most centrally connected trade economy, Nepal the least.

Moreover the South Asian LDCs (eg. Bangladesh, Nepal) are vulnerable to vagaries and costs of getting a few (quality, standards, and time-sensitive) products via supply chains into a few competitive markets. Significantly adding to trade cost, LDCs do not have in place the know-how, institutional capacity, and infrastructure that combine into a product standards and conformity assessment system which invites international recognition. Especially in agro-based industries and trade, South Asian exporter SMEs fail to conform to sanitary and phytosanitary measures imposed by central export markets. South Asian firms report standards, technical regulations and conformity assessment as very important to export success, and at a higher percentage than countries in other regions.

Critical challenges facing the regional trading cooperation schemes in South Asia included the prospect of trade diversion, concerns regarding the interests of LDCs and smaller developing countries in the region like Bangladesh, Nepal and Sri Lanka, the potential consequences of South Asian countries' involvement in other regional arrangements and the implications of unilateral MFN liberalisation for regional preferences. There is a need to understand the nature of dynamic gains and their potential materialisation while pursuing a policy towards regional integration.

Table 1: South Asian trade - issues overview

ISSUES	EFFECT	UNDERLYING CONSTRAINTS
Uneven sector and geography distribution of trade benefits	Urban areas experience higher real living standards than rural areas; some regions left behind (for instance northern Bangladesh, Bhutan, northeast India, northwest Pakistan, parts of Nepal)	• Limited entrepreneurial pool and supply capacity • Low connectivity
Limited integration with world markets and comparatively low South Asia trade integration	Some South Asian countries increase export share as percent of GDP and others are experiencing stagnating or falling shares	• Regulatory burden and negative business environment • non-tariff barriers and high cross-border trade costs
Divergent capacity among countries and regions to avail of growth opportunities emerging from trade	Relative marginalisation some countries or regions in global supply and value chains	• Insufficient trade-related infrastructure • difficult access to knowledge networks which are part of value chains
South Asia LDCs vulnerable to few low value added export products and markets	Uncertain income and growth perspectives	Constrained SME access to finance for trade capacity and technology upgrading

Source: Asian Development Bank (2007)

Major features of the SAFTA Agreement, trends and impact

The SAFTA agreement has its origin in the South Asian Preferential Trading Arrangement (SAPTA) that was signed by Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka and came into force in 1995 as part of their plan to move toward forming an Economic Union. The SAFTA agreement aims at turning the SAPTA into an FTA. For that purpose, it covers tariff reductions, rules of origin, safeguards, institutional structures, and dispute settlement. It is a more sophisticated and comprehensive agreement than SAPTA to the extent that it also provides a framework to include measures regarding trade facilitation, harmonisation of customs classification, investment, macroeconomic consultations, and development of communication systems and transportation infrastructure (Article 8 - Additional Measures). With the implementation of SAFTA, it is estimated that the current level of intra-regional trade could rise from \$6 billion to \$14 billion.

This agreement came into force on January 1, 2006, and is scheduled to be fully implemented by the end of 2015. SAFTA's tariff reduction program calls for India, Pakistan, and Sri Lanka to reduce tariffs to 20% from existing (actual) levels by 2008. SAFTA's least-developed country members - Nepal, Bhutan, Bangladesh, and Maldives - receive preferential treatment and are required to reduce their actual tariffs to 30% in the same period. During the following five years (eight for LDC members and six for Sri Lanka), all members are committed to reduce their tariffs to a 0-5% level. India, Pakistan, and Sri Lanka, however, will reduce their tariffs on imports from the LDC members to this low level by 1 January 2009.

Table 2 Tariff Reductions Proposed Under SAFTA

Countries	Tariff Rates	Proposed SAFTA Reduction	Timeline
First Phase			
India, Pakistan, Sri Lanka[a]	> 20%	Reduce to 20%	2 years
	< 20%	Further annual reductions	2 years
Bangladesh, Bhutan, Maldives, Nepal[b]	> 30%	Reduce to 30%	2 years
	< 30%	Further annual reductions	2 years
Second Phase			
India, Pakistan, Sri Lanka[a]	<= 20%	Reduce to 0-5%	2 years
Bangladesh, Bhutan, Maldives, Nepal[b]	<= 30%	Reduce to 0-5%	3 years (primary products); 5 (other products)

Notes: a. non-least-developed countries; b. least-developed countries.

The agreement calls for elimination of all quantitative restrictions for products on the tariff liberalisation list. Furthermore, the number of products on the sensitive list (list of products excluded from the preferential tariff) is to be reviewed at four-year intervals with the aim of reducing this list and expanding the free trade coverage of the agreement. Another major feature of the SAFTA agreement is the establishment of a compensatory mechanism for LDCs. The aim of this mechanism is to compensate LDCs for the initial loss in their tariff revenue as a result of liberalisation. The agreement establishes the SAFTA Ministerial Council, the regional body's highest decision-making authority, and the SAFTA Committee of Experts, which is responsible for monitoring implementation and resolving disputes. The committee is required to update the ministerial council every six months on the progress of the agreement.

Before coming into force, the Committee of Experts reached agreement on key pending issues regarding the implementation of SAFTA.

- An agreement was reached on rules of origin. According to these, the products from non-LDCs will qualify for preferences in the twin criteria of change in tariff heading and 40% domestic value-added (30% for LDCs). Furthermore, regional accumulation will be accepted (50% of regional value in addition to 20% of domestic value added at the last stage of the processing). Product-specific rules for 191 tariff lines were agreed to accommodate the interests of LDCs because of their limited natural resource bases and small and undiversified industrial structures.

- Regarding the mechanism for compensation of revenue loss, it was established that compensation will be paid in US dollars by the non-LDC countries to the LDCs in the region. The mechanism would be enforced one year after the implementation of the Trade Liberalisation Program (starting in July 2007). It would be subject to a cap of 1%, 1%, 5%, and 3% of customs revenue collected in the first four years, respectively, on non-sensitive items under bilateral trade in the base year (ie., the average of 2004 and 2005).

- Areas for technical assistance to the LDCs was agreed to in September 2005, which include capacity building in standards, product certification, product development and marketing, trade analysis and computerisation, trade-related institutions, and trade negotiation skills; improvement in tax policy and instruments, customs, and related procedures; legislative and policy measures such as sanitary and phyto-sanitary measures and technical barriers to trade; legislation on antidumping and safeguard measures; WTO agreements; export promotion; and market development.

- Each country finalised a list of “sensitive” products. The total number of tariff lines submitted for exclusion under the Trade Liberalisation Policy by each country is the following: Bangladesh, 1,254 items for non-LDCs and 1,249 items for LDCs; Bhutan, single list of 157 items; India, 884 items for non-LDCs and 763 items for LDCs; Maldives, single list of 671 items; Nepal, 1,310 items for non-LDCs and 1,301 items for LDCs; Pakistan, single list of 1,183 items; and Sri Lanka, single list of 1,065 items.

Key recent developments related to SAFTA include:-

- During the SAFTA Ministerial Council meeting in Delhi in March 2008, India announced the pruning of negative lists from 744 items to around 500 items for the least developed country members of SAARC. The meeting also directed the drafting of the SAARC Agreement on Trade in Services (SAFAS) under the SAFTA Agreement.

- A sub-group on Non-Tariff Measures (NTMs) has been appointed to address the restrictive effect of Non-Tariff Measures (NTMs) on intra-SAARC trade.

- Arrangements are underway to establish the SAARC Regional Standards Body by 2008.

- A Group on Customs Co-operation has been engaged in the harmonisation of Customs rules and Procedures and Customs documentation. The Sub-Group is currently engaged in harmonisation of tariff lines at 8 digit level and also capacity building.

- Discussions are progressing on elimination of Quantitative Restrictions (QRs) which are not permitted by GATT 1994.

- Discussions are also continuing on the modus operandi of reduction / elimination of tariff lines on products attracting specific or composite tariff.

- The SAFTA Ministerial Council meeting held in February 2007 decided to constitute a Sub-Group on Working Procedures for Dispute Settlement among the member countries.

From January 2008 India reduced import duties on 4,800 goods from SAFTA members. The duty reductions will be applied at varying rates. For imports of meat, fish, milk and dairy products from Bangladesh, Nepal and the Maldives, which are classed as LDC, import duties have been reduced to zero from the previous band of 16-40%. In the case of Pakistan and Sri Lanka, duties on such products have been reduced to 12-20%. Tariffs on biomedical and pharmaceutical products from LDCs in SAFTA were cut from 12.5% to 10%, while fertiliser, lime and cement duties have been reduced to 10.0%. No adjustments were made in import duties on these products from Pakistan and Sri Lanka. For cars and motorcycles, duties have been cut from 40-50% to 0-20% on imports from the region, while alcoholic products will be subject to a 0-20% tariff, down from 66.7%-80%. The realignment of the tariffs came into effect from January 1, according to India's Central Board of Excise and Customs. However India has not set a timeline to phase out its negative list. Moreover while bilateral FTAs with India are increasing, state governments can and do in many cases apply trade restrictions thereby affecting the relative competitiveness of supplying countries in India’s domestic market.

In its 2008-09 Trade Policy, Pakistan increased the number of items it can import from India and took further steps in promoting bilateral trade with India by adding 136 more tariff lines to its list of importable goods from India. The list now includes the addition of 136 tariff lines (including machinery for mining, cement bulkers and academic and reference books) with the list increasing from 1802 to 1938 tariff lines. SCCI expects the volume of trade between India and Pakistan to double as a consequence. The policy specifically asks investors to set up manufacturing units in Pakistan and for the first time Pakistan has invited direct investment from India in the manufacture of CNG buses and allowed the test import of ten year old CNG buses from Indian companies who had committed to opening a manufacturing facility in Pakistan.

The current growth of intra-SAARC trade shows the benefits of SAFTA have started coming through and SCCI expects that by end of 2016, when the tariffs would be zero-rated, the intra-regional trade would become almost double ie. to $20 billion. However the analysis to date - interpreted through its most protectionist lens - does not give rise to optimism about the amount of new trade that will be created. Table 2 presents a summary of the number of total tariff lines under the "sensitive list' by each country, these as share of the total tariff lines and estimation of what share of value of imports and exports would be affected by being included in the sensitive lists. Although most countries have adhered to keeping the sensitive lists close to the 20% target they had agreed to, the estimated value of imports from the SAARC region protected under SAFTA is quite excessive. For instance, Bangladesh has protected 65% of its imports from the SAARC region through its 'sensitive list," while 22% of its exports to the region would be affected by the sensitive lists of other countries. Paradoxically, Pakistan, which has the largest number of tariff lines among non-LDCs in its sensitive list, would only be protecting an estimated 17% of its imports from the region, while 34% of its exports (largely textile products) would not get concessional tariffs under SAFTA by other SAARC countries. Although SAFTA has a provision for reviewing the sensitive lists every four years with the aim of reducing them, since there is no well-defined time frame for reducing the list, it is feared that pruning of the sensitive list would not be binding on member states. Hence, there are concerns that the practice of exempting such a large number of "sensitive products" risks replicating the unfortunate history of SAPTA.

Table 3 Trade Restricted Under SAFTA

Country	Tariff Lines in Sensitive List[1]	As % of Total Tariff Lines[2/]	% of Trade Restricted Under SAFTA Sensitive List[3/]	
			Value of Imports	Value of Exports
Bangladesh	1,254	24%	65%	22%
Bhutan	157	3%	n.a.	n.a.
India	884	17%	38%	56%
Maldives	671	13%	75%	57%
Nepal	1,310	25%	64%	46%
Pakistan	1,183	23%	17%	34%
Sri Lanka	1,065	20%	52%	47%

* For non-LDCs only.
Sources: Ministry of Commerce, Pakistan

The size of the sensitive lists in SAFTA is, in general, greater than those of bilateral FTAs in the region. Under India-Sri Lanka FTA, for example, only 13% of Sri Lankan exports to India fall in the sensitive list, while under SAFTA, nearly 42% of Sri Lankan exports to India are exempt from the tariff liberalisation programme. All in all, almost 53% of total imports in South Asia are subject to sensitive lists. The LDCs have placed between 64% and 74% of the total value of their imports from South Asia under sensitive lists. Likewise, 47% of Sri Lankan exports and 57% of Indian and Maldivian exports are restricted by the sensitive lists of fellow SAARC Members, allowing little scope for improved market access through SAFTA.

SAFTA should incorporate a mechanism that stipulates a binding commitment to pruning the same. As things stand now, the SAFTA Agreement only mandates a review of sensitive lists every four years without any binding commitments on the reduction of the extent of protection. Given the size of sensitive lists in SAFTA, the four-year period of review is too long, and since there is no binding commitment involved, the 'review clause' lacks teeth. Until there is a mechanism to downsize the sensitive lists, the impact of SAFTA will be limited and it will lose its relevance in a region where other less restrictive trade agreements are prevalent. Given that SAFTA has left the issue of negative lists fairly open ended – where even four years is also a fairly long time horizon to wait to see any improvement in the agreement – there is always the danger that the agreement will fall short of free trade even in the long term. By comparison to SAFTA, the negative lists of existing bilateral FTAs in the region are much more limited.

The perceived need for supporting domestic industries, along with the urgency of protecting tariff revenues, has resulted in sensitive lists that shield products from tariff liberalisation. Along with LDC members, developing members too have put a large number of items on their sensitive lists. Around 25% of the Harmonised Tariff Schedule (HTS) of Bangladesh and Nepal are on their sensitive lists, while the corresponding figures for India and Pakistan are 14% and 23% respectively. The presence of such large proportions of products on the sensitive list somewhat undermines the regional cooperation initiative in South Asia. As the export baskets of LDCs lack diversity, even a small number of goods on the sensitive list will reduce their gains from regional trade. Besides, the issues of non-tariff and para-tariff barriers are also prominent in South Asia.

Mapping the sensitive list of each country to their imports from the rest of South Asia reveals that nearly 53% of total import trade amongst South Asian countries by value (at the time negotiations were initiated in 2004) is excluded from the liberalisation of tariffs proposed under the SAFTA treaty. The LDC member countries such as the Maldives, Bangladesh and Nepal have sought to 'protect' 65-75% of their imports from South Asia by excluding them from being subject to tariff liberalisation. Sri Lanka (51.7%) and India (38.4%) have also restricted a fairly high share of imports from being subject to tariff cuts. At first glance, it appears that Pakistan has been fairly generous in restricting only around 17% of its current imports to the sensitive list despite the fact that it has the largest number of items in the sensitive list of non-LDC members. However, it should also be remembered that Pakistan maintains a positive list of items vis-à-vis its trade with India which can in theory limit the potential trade volumes to a great extent.

A closer look at the sensitive lists of the member countries suggests that there is no similarity in their sensitive lists. A section wise distribution of the sensitive lists reveals that Bangladesh is not willing to open up the sectors like textiles and clothing, base metal, electrical appliances and miscellaneous industrial products, while Bhutan tries to protect prepared foodstuff, vegetable products, mineral products and wood products. On the other hand the most sensitive products for India are vegetable products, apparel and plastic and rubbers, while Nepal gives importance to animal products, vegetable products, prepared foodstuff, plastic and rubber and textiles and clothing. Pakistan has given importance to plastic and rubber products, textiles and clothing, machinery and electrical appliances, base metal and articles. The major items included in the sensitive list of Sri Lanka are vegetable products, prepared foodstuff, plastic and rubber products, animal and animal products and Base metal and products. Maldives basically gives importance to plastic and rubber products and base metal. It appears that agriculture is considered less sensitive by Bangladesh and Pakistan while it is considered to be sensitive by other countries.

Table 4 Distribution of products under sensitive lists between agriculture and non-agriculture products

Category of products	HS codes	Bangladesh	Bhutan	India	Nepal	Pakistan	Sri Lanka	Maldives
WTO Agriculture	12.16%	11.32%	65.38%	37.48%	24.25%	11.59%	45.65%	19.13%
Non-Agriculture	87.84%	88.68%	34.62%	62.52%	75.75%	88.41%	54.35%	80.87%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Taking into account the experience of the FTA between India and Sri Lanka, it could be possible that even under restrictive scenarios of liberalisation, intraregional trade flows could increase in products that are currently not traded. Since, however, one of the important lessons learned from studies analysing the impact of RTAs on growth is that the higher the MFN tariffs, the greater the risk that trade diversion will occur, and given that, in the case of SAFTA, the region remains highly protected (by far above the protection levels observed in other regions), the potential risk that this new trade comes from trade diversion is increased. Are trade diversion costs too high? The World Bank (2007) has estimated that South Asia regional trade is $5 billion whilst trade with the rest of the world is $232 billion.

One important factor for a potentially large trade diversion is the relatively high most-favoured-nation (MFN) tariffs in Bangladesh and Nepal. The higher the MFN tariffs the more competitive advantage it provides to members to cause trade diversions. A recent simulation exercise shows that a SAFTA scenario of 100% tariff cuts by members lead to a net-welfare loss of US$184 million for Bangladesh. However, when Bangladesh cuts its MFN tariffs by 50% along with the full tariff liberalisation for SAFTA members, it stands to gain US$84 million.

In addition, the rules of origin negotiated so far, although allowing regional accumulation, have been set at very restrictive levels (40% value content for non-LDCs, 30% value content for LDCs and tariff change at HS four-digit). A simpler and more transparent set of rules of origin that minimises the restrictive character of these measures would be required to guarantee a more successful outcome from the implementation of this agreement. For example, in the case of textiles and clothing, a rule of origin of 10% value-added (with the alternative of satisfying either the value-added rule or a tariff change at the HS four-digit requirement) would widen the access of exports from LDCs to the European market.

Good progress has been made in finalising the four SAFTA components, ie., on the list of sensitive items, the rules of origin, and the technical assistance and revenue compensation for the least developed countries; however, compared to the initial optimism, recent analysis indicates that SAFTA may have a rather limited impact on liberalising trade in the region. This is because of the fairly restrictive "sensitive lists" that member countries have put up, rather strict rules of origin, and a slower time frame and scope of trade liberalisation compared to the recent bilateral and regional trade arrangements that SAARC members have signed or are considering. Moreover, there have been a few recent setbacks because of disputes between the two largest economies - Pakistan and India.

Pakistan has offered tariff concessions to India only on its "positive" list of importable goods from India. India has termed this move as a non tariff barrier by Pakistan and it has hinted that it may review and, in the worse case, even possibly revoke the tariff concessions given to Pakistan. There is a fear that if these issues are not resolved quickly, the potential benefits from elimination of tariffs under SAFTA that hoped to boost intraregional trade and enhance trade flows, especially of the smaller countries in South Asia, would be rather limited. Any setback on SAFTA would also imply that promoting trade through developing trade-related infrastructure and promoting regional investments, which was intended to follow trade liberalisation by SAARC member states, may also be jeopardised.

At the same time though there is an awareness in Pakistan that increased trade with India can bring consumer welfare and help local industry in many ways, by making available raw materials and intermediate goods at more competitive terms, there is a feeling that in the absence of a shared vision for South Asia coming from India, Pakistan's growing trade deficit with India would become a tool of undue dominance in the relationship through trade. The strengthening and shaping of SAARC's institutional architecture and forward strategy during India's Chairing of SAARC between April 2007 and August 2008 goes some way towards addressing this concern but anxieties remain.

It is important to emphasise however that tariff reductions alone will not necessarily lead to immediate economic gains for the economies of South Asia. The benefits from 'deep integration' of South Asian markets are likely to be more significant. Moreover facilitating trade through ports, customs and transport can be as important as cutting tariffs - and are central to deep integration. It is worth adding that many of the countries in South Asia are involved in several other RTAs (e.g. BIMSTEC, ISFTA, Pakistan-Sri Lanka FTA) each of which has its own regulations on Rules of Origin, preferential tariffs and other allowances.

Concurrent streams of multilateralism, regionalism and bilateralism are ongoing in South Asia. South Asian countries are involved in 22 multilateral and 21 bilateral arrangements besides SAFTA. In order to ensure that other regional and bilateral agreements do not overshadow SAFTA, the region needs to give priority to SAFTA by other agreements acting as building blocks to SAFTA. The recent proliferation of bilateral and other RTAs by the SAARC region countries may imply that SAFTA by itself may have a fairly limited impact on expanding regional trade. For instance, Sri Lanka signed bilateral agreements with both India and Pakistan that gives it access to two of the largest economies in South Asia well before SAFTA came into force. All the LDCs in SAFTA - Nepal, Bhutan, Maldives, and Bangladesh - already have access to their largest trading partner - India - and the biggest regional economy through the bilateral process. Moreover, India seems to be entering a number of bilateral and regional arrangements in recent years. It has negotiated a treaty with ASEAN, and trade agreements with China, Japan, South Korea, Malaysia, Indonesia, Israel, GCC, Mauritius, South Africa Customs Union amongst others are in varying stages of process. India also has a comprehensive economic cooperation agreement with Singapore and an FTA with Thailand.

All but two of the countries of SAFTA are part of the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) and also includes fast-track liberalisation and well as inclusion of FTA, including services and investment negotiations from July 2007. Pakistan has already entered into an FTA with China (negotiations are underway to extend this to services) and is considering FTAs with a number of Middle Eastern, African, and East Asian countries. Bilateral trade deals with countries outside SAARC can have an impact on economic relations between different SAARC states with Bangladesh, the EU and GSP a case in point. However all these developments do not bode well for SAFTA, which comparatively has a longer time frame for implementation, highly restrictive sensitive lists, and relatively stringent rules of origin.

Bilateral negotiations are not limited to initiatives outside the region, however. In fact, discussions between India and Bangladesh, and between Bangladesh and Sri Lanka, are ongoing. In the case of Pakistan–Sri Lanka, the FTA entered into force since June 2005. In terms of the tariff concessions granted, 206 products from Sri Lanka to Pakistan will enjoy duty-free market access, whereas in the case of exports from Pakistan to Sri Lanka, 102 products from Pakistan to Sri Lanka will enjoy duty-free access. Both countries, however, have "negative" lists of 540 items (in the case of Pakistan) and 697 items (in the case of Sri

Lanka) at the six-digit level. In addition to that, two main export products for both countries (rice, which represented 15% of the exports from Pakistan in 2004, and black tea, which represented 15% of the exports from Sri Lanka in 2004) are subject to quotas. Finally, rules of origin have been set at 35% value-added content plus a tariff heading at the six-digit level. All these elements seem to indicate that the liberalisation arising from this agreement might prove to be limited.

There are numerous bilateral agreements that are prevailing in South Asia that unlike SAFTA, are not part of the SAARC process. The Indo-Sri Lanka FTA will be fully in place by 2008, the Sri Lanka-Pakistan FTA will be fully in place by 2010 and the BIMSTEC FTA will begin implementation in 2007. These bilateral agreements are more liberal in nature and have been implemented much faster as compared to SAFTA. For example, under the Indo-Lanka BFTA between India and Sri Lanka, Sri Lankan exports have increased drastically which has narrowed the trade gap between the two countries. Under this BFTA, only 13% of Sri Lanka exports subject to Indian negative list, whereas, under SAFTA, the figure is 42%. Moreover, Sri Lanka gained duty free access to Indian market in 2003, whereas under SAFTA, full implementation will be achieved by 201. The same is the case with the Pakistan-Sri Lanka BFTA where 15% of Pakistan's exports are subject to Sri Lanka's negative list and under SAFTA the comparable figure is 28%. Hence, SAFTA has not been able to generate much interest in particularly the Sri Lankan business community because of the success of the BFTAs.

Table 5 SAFTA vs. Bilateral FTA Negative Lists

	SAFTA	Indo-Lanka FTA	Pak-Lanka FTA
India	884	419	
Pakistan	1183		540
Sri Lanka	1065	1180	697

Mapping the negative list of each country to their imports from the rest of South Asia reveals that nearly 53% of total import trade amongst South Asian countries in 2004 by value is excluded from the liberalisation of tariffs proposed under the SAFTA treaty. Paradoxically, Pakistan, which has maintained the highest number of tariff lines in its sensitive list amongst the non-LDC member countries - a total of 1,183 as against a list of 884 by India and 1,065 by Sri Lanka - has the lowest application of goods on the negative list by value of imports from the rest of the region. Just over 17% of Pakistan's total imports from SAFTA member countries is excluded from the tariff liberalisation process. By contrast, India and Sri Lanka have restricted up to 38% and 52% respectively of their total imports from the SAARC region under the negative list category. The LDC member countries by and large have protected up to 65-75% of their imports from South Asia from the SAFTA tariff liberalisation process.

The degree of restrictiveness of the negative lists looked at from an export perspective confirms the nature of imbalances. Although Pakistan has restricted only 17% of total imports from SAARC under its negative list, more than 34% of Pakistan's exports to the SAFTA member countries fall within the respective negative lists of its trading partners. While India has excluded 38% of its imports from SAARC countries, a slightly higher proportion of total Indian exports of around 57% are excluded under the negative lists of its trading partners in SAFTA. Sri Lanka has, on the other hand, restricted around 52% of imports from SAARC countries, and in turn a comparable 47% of its exports to the rest of the region is subject to the negative lists of member countries where no tariff reductions will be enjoyed.

India and Pakistan are rigorously pursuing bilateral trade agreements, with 12 agreements overlapping; however, the missing link is between the two countries themselves. The problem with India is that it imposes non-tariff barriers whereas the problem with Pakistan is that it only allows a limited number of items to be imported from India. An attempt needs to be made to identify genuine barriers that affect bilateral trade between Pakistan and India.

This reorientation in the trade policy strategy of the South Asian countries toward bilateral or regional agreements is a response to the proliferation of trade agreements around the globe but also to the slow pace at which the multilateral negotiations are progressing. In any case, given the past experience of integration in South Asia (SAPTA and also the FTAs between India and Sri Lanka - see Appendix 1 on The India–Sri Lanka Free Trade Area - and Pakistan and Sri Lanka), the agreements have fallen well short of their potential because of product exemptions, special arrangements for selected products and restrictive rules of origin. At the same time, is it important to take account of the distributional impacts of trade liberalisation in South Asia. Whilst FDI and trade liberalisation will be beneficial in the long run, initial 'deals' may benefit one country much more than another and the gains or losses may impact different parts of the population in very different ways.

A recent landmark study by the ADB (2008), in which SCCI convened a consultation meeting with the business community, provides an in-depth assessment of the likely changes induced by SAFTA on South Asian countries and on the region as a whole. The emphasis of the analysis was based on three criteria:-

- Whether the trade affected areas are already under stress or boom
- Whether significant economic impacts are likely to be linked to trade measures
- Whether there are likely to be cumulative impacts that could be significant

The impact of various SAFTA scenarios was simulated on variables such as prices, income and welfare at the regional level as well as at the country level. Further, the study examined the impact of deepening of SAFTA by including investment cooperation and trade in services. This was done by analysing impact of SAFTA on inward FDI flows into the region and the possibility of a rise in intra-regional FDI flows. The study included an analysis of the benefits that would accrue from transport and trade facilitation under four identified infrastructure projects (road, air, rail, and port enhancement) for the region. An in-depth analysis was undertaken for identifying restriction on trade in services like health services, higher education, tourism, telecommunication services and construction services.

Comparative advantage was calculated for two time periods (1991 and 2004) for the four major trading member countries of SAARC, ie. Bangladesh, India, Pakistan and Sri Lanka at the SITC five digit level. The results showed that the competitive basket has changed substantially overtime. The number of products that each country has a competitive edge in the region has increased over time. This indicates the possibility of increased intra-regional trade. The shift of these economies from agriculture to manufacturing and from manufacturing to services in some has led to higher trade potential.

An argument which has often been put forward against SAFTA being economically viable to its member-countries is that there exists low complementarity between the member countries. In other words what is exported by one country may not be imported by the other country. However, using three year averages for the period 1991-1993 and 2003-2005, complementarity indices has been estimated for the four major trading partners (Bangladesh, India, Pakistan and Sri Lanka) with respect to the region as a whole. The results show that the complementarity index has improved considerably over time for Bangladesh, India and Sri Lanka. This implies that for these countries, the products that they export are to a greater extent now being imported by the region as a whole. The only country where the complementarity index has declined in Pakistan. The improved complementarity indices indicate strong possibilities of higher intra-regional trade with SAFTA.

ADB found that intra-industry trade increased drastically in sectors like agriculture raw materials, chemicals and textiles. Within textiles, it found that the intra-industry trade has increased in some of the sub sectors of textiles between the four major trading partners of the region, ie. Bangladesh, India, Pakistan and Sri Lanka. This indicates that even within textiles, countries specialise in products at different stages of production or in differentiated products.

The results of ADB's economic analysis therefore strongly suggest that there exists a huge potential for intra-regional trade between the SAARC member countries. The study further estimates the extent to which an additional market access that each country will gain due to SAFTA and total intra-regional trade that may results from SAFTA.

Results with respect to the trade potential due to SAFTA revealed that the estimated trade is much higher than the actual trade indicating huge potential for intra-regional trade. Even if tariffs are not removed the gap between potential and actual intra-regional trade exists. Increase in trade which can be directly attributed to removal of tariffs under SAFTA is 80% of the actual intra-regional trade from the predicted intra-regional trade of 120%. This implies that apart from tariffs there exist other barriers to trade. Intra-regional trade may rise by further 40% if other factors affecting trade are addressed like non-tariff barriers, political constraints, etc. In addition while there will be revenue losses to all member countries of SAFTA, in most of the countries trade creation appears to compensate for the revenue loss, except for Bangladesh and Nepal. Welfare and trade effects are found to be positive in all member countries.

ADB concluded that SAFTA is likely to lead to stronger economic growth, notwithstanding the controversies pertaining to trade and development policies, and the mixed results of specific impacts from various studies. Moreover since India is a large and rapidly growing member country of SAFTA it has the potential to serve as a 'growth-pole' for the region. It has growth enhancing effects for the region which is also due to the fact that India's MFN tariffs are among the highest in the region.

Key issues and challenges for SAFTA

In order to have a positive impact, SAFTA needs to yield trade opportunities in new areas, rather than just reducing barriers to existing traded items. The efficacy of SAFTA is also undermined by factors within, such as the slow pace and ineffective tariff liberalisation programme, the huge size of sensitive and negative lists, the prevalence and slow elimination of non-tariff barriers (NTBs),[11] stringent rules of origin, lack of agreement and the exclusion of services and investment, high transaction costs, and the ever present uncertainty resulting from India-Pakistan trade relations, particularly the non-application of most-favoured nation (MFN) status for Indian products by Pakistan.

In a recent examination of the effects of SAFTA's tariff liberalisation programme (TLP), the IMF (2007) found the initial tariff reduction imposed by the TLP would be mild, to achieve the medium term goals of the agreement would require significant reductions especially by Bhutan and Maldives. In aggregate terms, the initial requirement of having tariffs lower than 30% by 2008 (LDCs) and 20% for non-LDCs would have minor effects. The required initial tariff liberalisation – eg. to achieve a threshold of 20% – is quite minimal given that most South Asian economies have been unilaterally lowering MFN tariffs quite substantially over time. For instance, if the liberalisation formula is applied to the Sri Lankan context, leaving aside those items in Sri Lanka's SAFTA sensitive list, it is clear that the only commitment

[11] In identifying NTBs, a distinction can be made between those which have to be eliminated and those which have to be harmonised, such as measures relating to technical standards, plant and animal health, environmental protection and safety. If any quantitative restrictions exist, these can more easily be converted to tariffs and subsequently reduced.

required is to reduce tariffs from 28 to 20% on approximately 300 tariff lines (at HS 6-digit) in 3 instalments over a 2 year period. However the final goal of having a tariff level of at most 5% will represent reductions in the average tariff rate ranging from 2 to 3 percentage points for Sri Lanka and Pakistan to 16 to 18 percentage points for Bhutan and Maldives.

Taking current intra-regional trade values, over 50% of intra-regional trade in aggregate amongst SAFTA member countries are restricted through the application of extensive negative lists. In the absence of a formal mechanism within the framework agreement to reduce and phase out negative lists over time, there is no binding requirement on the part of member countries to move from their current position. All this places a serious question mark over the degree of commitment of these countries to the concept of creating a regional free trade area through the SAARC framework.

There are concerns that the SAFTA accord has not paid sufficient attention to important details such as the clarification of the rules of origin of exports. A key goal of SAFTA is to reduce tariffs to the range of 0%–5%, but this was to be realised over a long-term period (by 2013–16); by that time these targets may have become irrelevant as a result of multilateral negotiations (under WTO) and/or bilateral trade agreements. SAFTA has also avoided making commitments to lower NTBs to promote intra-regional trade and lacks any special provision that would allow for the adoption of measures of deeper integration, such as granting of transit facilities, cooperation for development of transport and other forms of infrastructure, liberalisation of investment and trade in services, cooperation in the financial and monetary fields, and coordination, if not harmonisation, of macroeconomic policies. Moreover there is no mechanism to reduce NTBs with recent discussions focussing on notification. Though the SAFTA Agreement requires Members notify the Committee of Experts (CoE) of any NTBs and para-tariff measures, the CoE can only recommend their removal and this recommendation does not entail a binding commitment. NTBs include government aid, anti-dumping duties, valuation, customs (classification, documentation, consular formalities) and administrative entry procedures (rules of origin), and technical barriers (technical regulations and standards, testing and certification) all of which pose a threat to the success of SAFTA.

At the 14th SAARC Summit in Delhi in April 2007, 'Heads of Government underlined the importance of implementing trade facilitation measures, especially standardisation of basic customs nomenclature, documentation and clearing procedures. They directed that a comprehensive agreement on harmonising customs procedures be finalised. They also noted that harmonisation of technical and phyto-sanitary standards and their implementation in a trade-friendly manner is important in boosting intra-regional trade. They appreciated the establishment of the SAARC Standards Coordination Board that would function as a precursor to the SAARC Regional Standards Body.' They also 'emphasised the need to develop, at an early date, a roadmap for a South Asian Customs Union.'

In a recent study, the IMF (2007) found that SAFTA would affect customs revenue in a number of ways. Small countries could find their tariff collection decrease by up to 2½ of GDP (for Bhutan), while India and Pakistan may experience no significant change. It is important to note that these estimates ignore possible gains from trade facilitation such as homogenisation and simplification of customs administration and incentives to promote formal trading. Recent tax reforms in the region as well as in other developing countries illustrate that difficulties in adjusting the tax system to compensate for tariffs losses can be significantly eased if technical changes are matched by strong political commitment. Thus, India which has progressively dismantled trade barriers since 1991−92, has recouped a significant portion of the tariff loses via improvements in overall tax productivity.

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

Pakistan has low NTBs, but it does apply technical and safety regulations under WTO rules on goods trade. In Bangladesh, there is a significant application of para-tariffs (eg. industrial development surcharges and supplementary duties), to the extent that 38% of the average protection is due to paratariffs.

Bangladesh continues to maintain quantitative restrictions on eggs, poultry and salt, for which the government has obtained waivers from the WTO. Sri Lanka bans the import of tea and spices on the grounds that low quality imports, if mixed with Sri Lankan products, reduce the quality of exports and thus affect their marketability. Some of these NTBs, such as certain items of security, health and cultural interest, are genuine. However, a majority of them are simply protectionist measures. If SAFTA fails to phase out NTBs within a stipulated timeframe, tariff liberalisation will have little positive impact.

NTBs become increasingly important as tariffs fall. As trade becomes increasingly liberalised, protection shifts from at the border tariffs to behind the border NTBs. If SAARC is serious about trade liberalisation, these behind the border measures need to take on a new significance. The lessons of other RTAs make it clear that the hoped-for benefits from the agreement itself will not be realised unless trade facilitation[12] measures are vigorously implemented. While the SAFTA framework agreement has provisions to deal with para-tariffs and NTBs, there is no explicit commitment required of countries. In particular, there is no commitment in the SAFTA framework agreement to eliminate NTBs on items where tariff reductions are to be made.

SAFTA has some important provisions for ensuring trade facilitation in the region. Article 3 in the accord states members' commitments to trade facilitation reform. This includes plans to integrate more closely transport systems and harmonise standards in the region, among other steps. India has specifically indicated interest in providing the main technical support and other trade facilitation steps in the field of harmonisation of customs procedures and standards for products of trade interest to the region. However at the same time many vital provisions are absent. It calls for prompt publication of rules and regulations and identification of enquiry points for exchange of information on mandatory requirements. There are also provisions related to consultation on rules of origin with emphasis on simplification of formalities connected with exportation and importation. The SAFTA agreement also suggests paperless trading, electronic means of reporting and identification of low risk, high risk goods. There are also provisions related to harmonisation of standards, technical assistance for LDCs and customs cooperation at the SAARC level. SAARC's Group on Customs Cooperation, set up in 1996, is entrusted with the mandate to harmonise customs rules and regulations and to simplify documentation, procedural requirements and improve infrastructure facilities and provide training for human resource development. A Customs Action Plan has been agreed upon.

Customs is one of the most important links in the trade facilitation chain between producers in

[12] The definition of trade facilitation varies depending on the extent of measures to be included. In a narrow sense, trade facilitation simply addresses the logistics of moving goods through ports or at customs checkpoints at national borders. A broader framework for understanding trade facilitation and its impact on international commerce includes a number of interrelated factors. These include port reform and modernisation and streamlining regulatory requirements and harmonising standards, as well as customs regimes. Common to all these areas is expanding the use of information technology to lower trade transactions costs.

one country and consumers in another. Apart from transport logistics it could be the most significant nontariff barrier. Successive survey results from the World Economic Forum's Global Competitiveness Reports make clear that although South Asian countries' rankings vary, all the countries have considerable scope for improving customs efficiency.

Recent analysis from the World Bank (2007) found that when considering intraregional trade, if countries in South Asia raise capacity halfway to East Asia's average, trade is estimated to rise by USD 2.6 billion. This is approximately 60% of the total intraregional trade in South Asia. Countries in the region also have a stake in the success of efforts to promote capacity building outside its borders. If South Asia and the rest of the world were to raise their levels of trade facilitation halfway to the East Asian average, the gains to the region would be estimated at USD 36 billion. Out of those gains, about 87% of the total would be generated from South Asia's own efforts (leaving the rest of the world unchanged). The World Bank found that the South Asian region's expansion of trade can be substantially advanced with programs of concrete action to address barriers to trade facilitation to advance regional goals.

Free movement of people between the countries is not on the agenda though there has been some progress in facilitating cross-border business visas with the support of SCCI. Moreover good intentions may be becoming lost in the system and political commitments to help further co-operation are held up by poor implementation - examples include the Sri-Lanka India RTA, recent changes to border policies at the Indian Pakistan border and FDI rules in banking in the region. Another area that needs immediate attention is making trade policies gender sensitive. The case of women garment workers in Nepal shows that women are extremely vulnerable to shocks resulting from trade liberalisation or changes in international trade policies.

There is an insufficient focus on opportunities for and the development of SMEs, which contribute about 60% in the overall economies of South Asian countries. SCCI has argued strongly that there is need to identify some potential areas, where cluster development could be established. This would not only help strengthen SMEs sector within the region but also enhance productivity and competitiveness of the products produced and manufactured in South Asia.

In the context of SAFTA, environmentally sensitive goods (ESGs) assume significance as the region is significantly dependent on these products for trade. Research by RIS (2005) suggests that South Asia has a large market for these products, and nearly one quarter of the regional trade is falling under the medium and high technology product groups.

South Asia is critically dependent on ESGs for both exports and imports. The contribution of ESGs in the total exports of the region was 21.1% and the similar figure for imports was 17.3% in 2002. The dependence on such trade varies significantly across the region. Certain countries in the region like, Maldives, Nepal, Pakistan, and Sri Lanka are significantly dependent on ESGs trade both for exports and imports. Moreover India's exports are also largely dependent on ESGs exports. About 61.5% of Maldives' export is dominated by ESGs. Countries like Bangladesh and Bhutan have shown less dependence on these products in their export baskets. Import dependence of the region on such products has been relatively lower than that of exports at the regional level. At the individual country level, the picture is something different. Unlike exports, most of the South Asian countries rely more on ESGs imports, with the sole exception of India. The region's intra-regional trade in ESGs is almost double that of all trade. The intra-regional export in ESGs was 9.1% and figure for import was 10.8% in 2002.

South Asia is largely dependent on both exports and imports of ESGs both with the region and also the rest of the world. The South Asian region is sourcing nearly 9.1% of its import requirements from within the region and importing the rest from the rest of the world. This trend brings underlines the point that there is large scope within the region to have intra-regional trade in ESGs. Furthermore trade liberalisation in ESG trade is not complete in the region. There is large amount of ESGs trade, falling within the ambit of intra-regional trade, which is not yet fully liberalised under SAFTA.

With the growing focus on trade-related environmental issues at regional and the multilateral forums, South Asia needs to be prepared to meet the challenges. Restricting of the flow of ESGs trade from South Asia may be detrimental to the interest of the region while augmenting trade in ESGs with cleaned up products is an increasingly viable, attractive and necessary option. There is tremendous scope for trade within the region in ESGs. Nearly 78% of trade in ESGs is not liberalised under SAFTA. If three important sectors namely animal products, minerals and vehicles (including vessels) could be liberalised under SAFTA, nearly 70% of the ESGs sector could be liberalised.

However it needs to be acknowledged that in South Asian there is growing concern about the rapid degradation of major ecosystems and their biological components. Developing and establishing adequate conservation measures and mechanisms for sustainable utilisation of bioresources pose multidimensional challenges. Thus the environmental management of regulatory aspects of biotechnology needs urgent attention in the region. The biosafety regulations in some countries in the region are not in place while others have to work further on the gaps between the Cartagena Biosafety Protocol and their national legislation for effective management of biosafety.

Another issue that needs to be addressed is the weakness of the dispute settlement mechanism (DSM) which under SAFTA is fairly ad hoc. Under SAFTA forms the basis of enforcement of the agreed rules of the Agreement. A dispute arises when one contracting state feels that another contracting state is violating the SAFTA agreement. If such a situation arises the two parties will engage in mutual consultations to resolve the dispute failing which the matter will be put to the dispute settlement body to give recommendations. The current DSM within the SAFTA agreement follows many international practices in terms of being time bound, beginning with joint consultations, offering appeal and recommending appropriate trade sanctions. However, there are certain clauses that vary from international best practices and a few other areas of concern. Failure to address some of these could lead to protracted dispute settlement cases and the failure to effectively implement the rules of the agreement, which form the foundations of SAFTA. The entire process of DSM under SAFTA can take up to 330 days. In comparison ASEAN DSM can take up to 290 days, NAFTA 310 and MERCOSUR 265 days. The time length for the SAFTA DSM can be reduced in the first stage where the accused country can delay entering consultations by up to a month; this is not seen in most international DSMs (except ASEAN). Furthermore, the length of time allowed for compliance is 90 days in SAFTA whereas in ASEAN, NAFTA and MERCOSUR the time allowed is 30 days. The time period of 330 days is too long if the case is an urgent one (for instance involving perishable goods). For such situations the DSM needs to be flexible, which enables an accelerated process.

The SAFTA framework for dispute settlement existing as of now does not indicate the trappings of a formalistic legal mechanism. It is not even clear within how much time a dispute should be settled and the guiding principles that should be followed by Committee of Experts (COE) in settling disputes. An interesting aspect of the SAFTA dispute settlement process is the availability of the appeal process. Article 20 of the Agreement states that all the decisions of COE can be appealed to the SAFTA Ministerial Council (SMC), the apex decision-making body. SMC will have to hear appeals even on the decisions of COE. The very fact the SMC is supposed to meet only once in a year weakens the role of such an appeal mechanism. It cannot be expected of the SMC to meet at short notice for settling a relatively inconsequential dispute. For instance, if a dispute relating to the imposition of a safeguard measure is brought before the SMC under the appeal process, it is highly unlikely that the SMC will have either the time and/ or expertise to deal with such matters. Moreover as of now, the dispute settlement provisions of SAFTA are quite skeletal with the detailed procedures yet to be drawn up. In the absence of an overriding compulsion to comply with the recommendations of COE, SAFTA members are still ‘free’ to take recourse to unilateral measures in response to certain stands taken by other member countries. There is a need to institute an arbitration mechanism to prevent widespread misuse of tariff-rate quotas, anti dumping duties and other non-tariff barriers.

SAFTA faces many challenges. First, a critical factor in determining whether SAFTA would raise or lower the real incomes of the South Asian countries depends on whether it will be predominantly trade creating or trade diverting. Thus, for example, when Bangladesh allows Indian cement to be imported duty-free and this leads the more efficient Indian cement industry to outcompete the less efficient Bangladesh cement industry, there is trade creation: increased imports into Bangladesh represent a shift from high-cost Bangladeshi producers to low-cost Indian producers. On the other hand, if duty-free access to Indian computers into Bangladesh allows the less efficient Indian computer manufacturers to displace more efficient Korean suppliers who remain subject to the duty, there is trade diversion: increased imports from India in this case represent a switch from low-cost outside sources to the high-cost within-union sources of supply. Some characteristics of the South Asia region (for example, small regional market relative to the world both in terms of GDP and trade flows, high level of protection among SAARC countries) increase the probability that SAFTA is likely to be largely trade diverting.

The second challenge is the political economy of the selection of excluded sectors and rules of origin. When countries are allowed to choose sectors that can be excluded from tariff preference of free trade, domestic lobbies make sure that the sectors in which they may not withstand competition from the union partner are the ones that get excluded. On the other hand, lobbies go along with free trade in the sectors in which they are competitive and the preference will threaten the imports from outside countries. In the same vein, lobbies tend to go for tight rules of origin or outright quantitative restrictions in precisely those sectors in which they fear the competition from the partner most. On the other hand, when the threat is mainly to the imports from outside countries, they are willing to accept greater liberalisation. The rules of origin can also be subject to abuse by the bureaucrat 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.

The third challenge is that SAFTA overlooks the role of the services sector. The welfare effects of trade preferences for services are likely to be more positive compared to trade preference for goods, as preferential liberalisation in services leads to trade creation with little or no trade diversion. Loss of tariff revenue from services is less of an issue and it allows countries to take advantage of increasing returns to scale. Regulatory cooperation, of particular importance in services, may be more practical at a regional level rather than global level, as there is less of a free rider problem at the regional level. However purely on efficiency grounds, most-favoured national liberalisation is to be preferred, as it offers access to most competitive service providers and avoids complexity of negotiations, and other gains from trade (more intense competition, knowledge spillovers) are likely to be bigger if liberalisation is non-discriminatory. Nevertheless, certain forms of regulatory cooperation (air service agreements, recognition of educational qualifications, and mutual recognition of standards) are more feasible and desirable within a smaller group of countries. If regional agreements create large markets and do not impose stringent ownership related rules of origin, they may assist in attracting FDI when economies of scale matter.

Barriers and constraints impeding trade in the region

According to a recent World Bank report, on an average it takes 34 days and 8 documents to export and 42 days and 13 documents to import, making South Asia the second least trade-friendly region in the world. Furthermore, the cargo traded is inspected more in South Asia than other region, leading to significant delays. Customs paperwork and other red tape cause the most delays. Only a third of the delays are caused by problems with ‘hard infrastructure’ such as poor port facilities and roads, Consequently, the cost to trade in South Asia remains relatively higher as compared with the other major regions in the world, which is due mainly to inadequate provisions of trade facilitation in the region.

SCCI has identified key barriers and constraints impeding trading relationships in the region. These have been gathered by consultations with the private sector from all the SAARC countries. Although this list is not exhaustive, it has tried to cover the major constraints that have been brought forward to it. Some of the constraints are general whereas others are specific. The constraints highlighted are:-

1. Visa regime

Any regional bloc including SAARC should allow freedom of mobility for more people to people movement across borders. This will also ease cross border movement of business people and lead to increased business activity. Hence, the visa regime in South Asia needs to be more open. This applies particularly to India and Pakistan for which obtaining a visa is not only tedious but extremely restrictive.

- Restrictions for Pakistani and Indian visas such as city specifications, police reporting, single entry and short term visas hamper business development and thus should be eradicated.

- Business travel to India or Pakistan for SAARC Visa Exemption Sticker holders should not be confined to a limited number of cities per visit. It has been observed that the Indian Immigration Authority has recently evoked restrictions to limit the number of cities on the SAARC Visa Exemption Sticker. Any such limitation will denounce the purpose of such regional facilities.

- The number of SAARC Visa Exemption stickers for the category of leading business people in the region should be enhanced from 100 to 300 for all SAARC countries on the recommendation of SCCI and allowing multiple visas for 300 Pakistani and Indian business people each.

- Similar to Maldives, Sri Lanka and Nepal, all SAARC countries including India, Pakistan, Bhutan and Bangladesh should adopt “on-arrival” visas, especially to facilitate businessmen and also introduce a dedicated SAARC Immigration Desk at airport arrival lounges.

2. Communication links

In this era of globalisation where the world is becoming a global village, effective communication links are essential. However, the SAARC region lacks in communication infrastructure and some countries in the region follow a restrictive policy when it comes to developing regional communication links. The region needs to improve its infrastructure and discard its restrictive policy to allow open communication at the regional and bilateral level.

- An ‘open sky’ policy should be adopted in South Asia to fly unhindered within the region. This will improve air connectivity between the SAARC countries by ensuring direct linkages available to and from all major cities of all SAARC countries, especially between the SAARC country capitals. Moreover, private airlines should be given access to operation in all countries of the region.

- Telecommunications links (including mobile and Internet) should be uninterrupted and penetrable in the region. International roaming facilities of local carriers should be allowed especially in Pakistan and India.

- Cross border free flow of information, free movement of journalists and media products continue to suffer from various restrictions in SAARC. Member countries of SAARC continue to ignore the urgency to overcome information deficit in the region. To overcome this, broadcasting of TV channels (government and privately owned) of all SAARC countries should be allowed. Printed material including national newspapers and magazines of every country should be easily available throughout the SAARC countries. This will promote sharing and availability of information in the entire region.

3. Transportation of goods and infrastructure

To enhance business and trade, there needs to be adequate infrastructure for transportation of goods. Inadequate land, sea and/or air links will lead to increased costs and delays in delivery. According to research conducted at Purdue University, it has been found that a one-day delay in delivering goods from the exporter to the final market on average increased the cost of those landed goods by 0.8%. Hence, such links need to be improved as well as expanded to increase and facilitate trade in the region.

- Finalise and implement a Regional Motor Vehicle Transport Agreement which will allow countries in the region move freely across land borders. This will save cost and time and there will be minimum hassle at border check posts for smooth regional transport movement.

- Road links in the region need to be made effective to save time for delivery and freight costs, particularly during harsh seasons. For example, when transporting goods between Bhutan and Bangladesh, the road conditions particularly during the monsoon season are dilapidated. Moreover, in winters, trucks take over 6-7 hours instead of 3 hours to reach bordering areas. It takes a minimum of seven days and a maximum of a month for goods to be transported through Bhutan and India. Furthermore, to improve land connectivity, movement of all goods should be allowed through all land routes eg. the land routes including Wagha, Khokhrapar, Azad Kashmir (Pakistan), Amirtsar (India) and all other cities region.

- Additional trade routes should be created in the region to expand infrastructure for trade facilitation eg. trade routes from Assam (India), Srinagar (India), Muzaffarabad (Pakistan) or Mealaya (India) should be established to increase trade particularly with Bhutan. This is especially important for highly perishable goods which must reach the market within a specific time frame but cannot do so due to inadequate infrastructure.

- Promote and facilitate the shipping vehicles owned by the SAARC countries for priority berthing at each others ports. Special facilities should also be established for land-locked countries. A regional shipping protocol should be initiated in the region, such as the shipping protocol between India and Pakistan which was signed in December 2006 that allows vessels from the two countries to lift the cargoes of a third country from each other's ports.

- Sea routes in the region need to be expanded to facilitate trade through sea ports. In Chittagong, Bangladesh, there is only one major berth port which causes heavy congestion.

- Rail links in the region should also be improved and enhanced to increase transportation of goods through rail. The rail protocol in the region should be implemented so that restrictions on wagon balancing are removed and wagon availability is improved. Moreover, the Munabao–Khokrapar rail link should be made available to allow transport of goods. The proposed opening of the Karachi-Mona-Bao border also will greatly help in trade promotion.

- Facilities at Land Border Stations should be provided of the same quality as is available to air transport and marine transport. These facilities include infrastructure at ports including warehousing, cargo handling equipments, parking, and telephone facilities are not available at some of the road and railed based land ports.

- Container Corporation of India must be asked to organise movement of goods from\to India by containers from the manufacturer's factory to the buyer's factory.

- There is no dry port or inland container terminal (ICT) in Bhutan. Hence, importers have to pay duties on the cost insurance freight rates.

- Transhipment facilities, which are common practice giving logistic benefits, should be available throughout the region. India and Bangladesh do not have such facilities.

4. Banking facilities and Insurance

Banking facilities are crucial to the smooth handling of business transactions and insurance is vital for risk management. Regional banking facilities should exist to expedite business transactions for increased business activity. However, the SAARC region has inadequate regional banking infrastructure and in many cases the existing banks do not facilitate regional business transactions. The region needs to realise that in order to ease doing business among the South Asian countries and to facilitate trade, adequate banking facilities and efficient insurance services must be offered.

- The Governments of respective countries in SAARC must facilitate and promote opening of branches of banks of other SAARC countries in their respective countries. In late 2004, Pakistan and India agreed to open bank branches of two banks from each country on a reciprocal basis. To date, both India and Pakistan have identified the banks and are reviewing the applications and regulatory measures for opening branches. The implementation of this agreement has to be expedited. Furthermore, in Bangladesh, there are a number of private banks with no credit worthiness. Payments get delayed and Indian banks are not ready to add confirmation of letters of credit of Bangladeshi banks.

- Business transactions especially between India and Pakistan are routed through foreign banks rather than using the infrastructure of local national banks - eg. the services of foreign banks like Royal Bank of Scotland (ABN Amro) and Standard Chartered Bank are utilised. The rate of transactions becomes higher with the involvement of foreign banks.

- Letter of Credits (L/Cs) are honoured in the SAARC countries, however unnecessary payment delays still occur. In Pakistan, India and Bangladesh, it can on the average take up to a month to confirm L/Cs. At times, payments are delayed as the banks point out discrepancies in the L/Cs. Because of the problems related to accepting and confirming L/Cs, trade transactions are sometimes carried out through a contract offered by the bank that states the details of the trader and of the transaction; however, such contracts do not offer any guarantees, but trade is carried out on the basis of trust. There needs to be greater transparency to address problems related to confirmation of L/Cs and to payments.

- Most of the Indian companies have raised the issue that Bangladesh insurance companies should own the responsibility of insurance coverage after goods have crossed into Bangladesh territory.

- A number of firms in India and Pakistan are settling their payments through the Asian Clearing Union (ACU). While payments through the ACU are ensured, there is often a delay as ACU has weekly clearing tranches.

5. Customs and Harmonisation of Standards

Harmonisation of standards seen as the key to competitiveness in international markets and can boost intra-regional trade. As products are traded across country borders and boundaries, compliance with international standards has become a paramount issue to compete in the global marketplace. International harmonisation and standardisation is a defining problem as regional markets open up and the economy grows increasingly interdependent. Hence, to enhance trade and ensure smooth business, keeping in consideration time and costs involved, mutual certification and standards must be accepted throughout the region. Doing so will encourage business activity and ease doing business in the region.

- The custom and border officials should be more effective (eg. through enhanced risk management) and trained so that they have the knowledge of agreements between countries to facilitate trade. This should also reduce the harassment faced by business people by the custom officials.

- In most cases, unilateral decisions related to customs are taken by a respective country's government and the affected country is not timely informed. The decisions made should be communicated at least a minimum of three months in advance before the decision is implemented to ensure smooth trading of goods.

- Electronic Data Interchange facilities should be introduced at the land borders to computerise systems and issue documents immediately to save time and costs. For example, the Indian customs at Benapole should automate their system as is done at the Inland Container Depot (ICD) in New Delhi.

- Testing procedures must also be simplified to save costs, time and facilitate trade. For example, all the consignments of imported food products have compulsorily to be referred to the Port Health Officer (PHO) in India for testing. At the customs clearance points where PHOs are not available, the Customs are required to draw the samples and get them tested from the nearest Central Food Laboratory or a Laboratory authorised by the Directorate General of Health Services. Clearance is allowed only after receipt of the test report. The lengthy procedures and tests in many cases create problems as food items are perishable and can deteriorate during this wait in customs warehouses where temperatures are not controlled. Simplified standards can help eliminate the problems that arise in this case.

- Full knowledge of the terms and conditions of trade agreements must be known to custom officials and traders so that they are properly implemented. Training and clarity of customs regulations is needed. It has been a general complaint that customs officials at the New Delhi and Dhaka airport are not giving preference to Bhutanese exports or imports as per the trade agreements signed between the respective countries.

Some groundwork is in place due to the existence of the SAARC Standing Group on Standards, Quality Control and Measurements. A useful first step would be to identify the main items of intra-regional trade within SAARC that are adversely affected by the lack of a common standard. Harmonisation could begin with the standards of these products and then move on in a progressive manner until complete harmonisation is achieved.

6. Non-Tariff Barriers on Goods

Non-Tariffs Barriers (NTBs) are restrictive to trade and not only add to costs and increase time for delivery. These NTBs may be financial (eg. internal taxes and customs fees) or non-financial (eg. quantitative restrictions and excessive documentation requirements). It has long been argued that trade is impeded in South Asia due to excess of NTBs.

- The positive list and sensitive list under various bilateral and regional agreements are considered as an NTB. These lists should be revised and reviewed in a time bound manner to expand the number of tradable items, particularly between India and Pakistan. For example, the import of spinning equipment to Pakistan is allowed under the positive list except for the import of the ring frame, which too should be included. Similarly, the sensitive list under SAFTA should be reviewed to reduce the number of items in it.
- The SAARC countries must not impose quotas on products to limit trade. This ultimately leads to imports from the West, which increases costs and time. For example, India has a restrictive quota on river sand and metal aggregates. When the quota is used, the construction industry in the Maldives comes to a standstill. This quota is to be removed and import of Indian standard sand should be allowed which is cheaper than importing from western countries.

- The import of textiles and textile articles is permitted in India but subject to the condition that they do not contain Azo dyes. For this purpose, a pre-shipment inspection certificate from a textile testing laboratory accredited to the National Accreditation Agency of the country of origin has been declared acceptable. In cases where such certificates are not available, the consignment is cleared after getting the sample of the imported consignment tested and certified from the notified agencies in India. The test is conducted for each and every colour and for every consignment. Pakistan has banned the import of Benzidine (Azo) Dyes but Pakistan exports are still tested. According to an EU study, at times, certificates issued even by the EU accredited labs have been rejected by Indian customs and such consignments have been subjected to repeat tests in India. Apart from the costs, such tests take anything from 7 days to three months.

- Standards in all SAARC countries must be simplified to facilitate trade. For example, the cement import registration process in India is too cumbersome and confusing and needs to be practicable and easy. Moreover, India imposes strict marking requirements for yarns, fibres, fabrics and clothing products imported into the country. These include producer identification and product composition, the colour and even the form, size and colour of letters and signs. In many cases these restrictions and regulations can result in stoppage of imports into India.

7. Others

- India awarded Pakistan the "Most Favoured Nation" (MFN) status in 1996, however Pakistan till date has not reciprocated. Pakistan has been pressurised to grant India the MFN status, in which Pakistani trade policies formally afford India the same treatment, in terms of tariffs and trade regulations that it gives to other WTO members. However, Pakistan continues to trade on basis of the positive list, which identifies a limited number of goods that may be legally imported from India.

- There should be a level playing field in the areas of investment and joint ventures and country specific restrictions should be eliminated. There are still no Indo-Pakistan joint ventures despite strong business interest on both sides due to the absence of an enabling environment for such investment. For example, there are no institutional mechanisms for bilateral investment guarantees.

- Regional investments should be promoted. Although Pakistan has no official ban against Indian investments, however, it is difficult to promote Indian investments in Pakistan.

- There is considerable lack of information and awareness in the region about the trade regimes, commercial policies, and business and regulatory procedures in the other SAARC countries. The SAARC governments and the chambers of commerce should play an active role in disseminating trade-related information to improve transparency.

- The National or Bilateral Chambers and the SAARC Chamber of Commerce and Industry, as representatives of the private sector, should be made a part of on-going bilateral negotiations and all other regional trade related negotiations at the level of the SAARC Secretariat.

Trade in Services under SAFTA: complementarities and potential

With growing global trade and investment flows in services along with technological advances, the service sector presents South Asian countries with opportunities to diversify their economies as well as their export baskets and markets, to tap emerging segments that leverage their inherent and acquired sources of comparative advantage, and to address domestic concerns of service quality, accessibility, and economic efficiency. According to a recent Commonwealth study (2008), the expansion of the service sector has created opportunities for developing countries and LDCs to improve overall efficiency and capacity to export both goods and services, as well as to diversify their means for foreign exchange earnings.[13] The common factors that can contribute to growth in the service sector include policy reforms, deregulation of commodity and factor markets, and privatisation of state owned enterprises. In addition, exogenous developments due to technological advancement, increased tradability of many services, and the pattern of global demand have also shaped trends in the service sector of all these economies. Almost all the countries in the Commonwealth study highlight the fact that services have become an increasingly attractive destination for foreign investment.

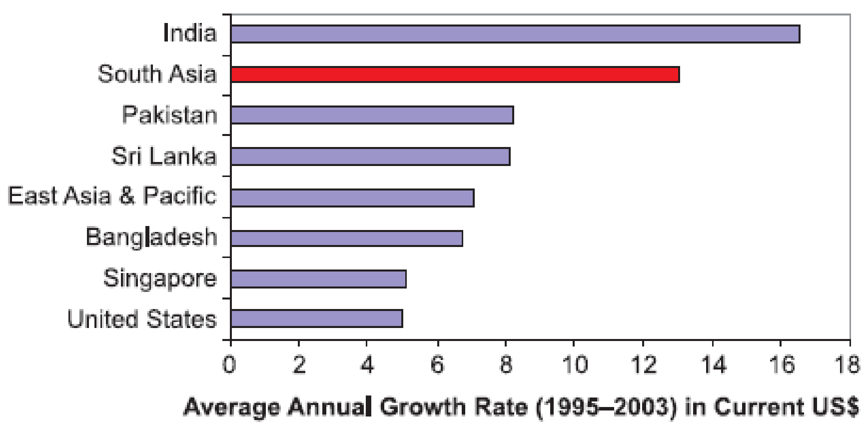
Many services are key inputs to all or most other key businesses in South Asia e.g. infrastructure services such as energy, telecommunications and transportation; financial services which facilitate transactions and provide access to finance for investment; health and education services which contribute to a healthy, well-trained workforce; and legal and accountancy services which are part of the institutional framework required to underpin a healthy market economy. These service sectors are thus a key part of the South Asian

[13] the Commonwealth (2008) examined cross-country experience with domestic regulation of services and liberalisation of services trade and investment in six developing countries including two in South Asia (Bangladesh, The Gambia, India, Jamaica, Kenya and Zambia) in the financial, telecoms, education, health, ITC and wholesale trade and distribution service sectors

investment climate, and can have a much wider impact on overall business performance and the level of investment, and hence growth and productivity in the regional economy.

Unlike East Asia, South Asia appears to have done well in the services sector, benefiting from outsourcing and specialisation. South Asia is the fastest growing region in the export of services. Exports of services from South Asia grew at 14% per annum over the period 1995–2003 compared to less than 8% for East Asia (Figure 2). It is not only India that did well, but Pakistan and Sri Lanka, too, which have grown faster than East Asia in service exports. Bangladesh services exports have also grown fairly rapidly, averaging about the rate in East Asian economies. India and Bangladesh have performed well in the exports of computers and information communications and other commercial services, while Pakistan has done well in the export of transport services and Sri Lanka in travel services. However if services are the fastest growing sector in all South Asian countries, trade in services has not significantly developed in the region. However services trade be brought under SAFTA for trade creation.

Figure 2 South Asia Has Done Well in Service Exports



In terms of composition of overall trade in services in South Asia, imports of services were higher than exports of services for the SAARC region until 2004, but thereafter total exports have become higher than the total imports of services in the region (UNCTAD 2007: Handbook of Statistics). This is an important change in the composition of trade in services for the region; however this has been mainly led by India. Interestingly, in 2006, India had higher imports of services as compared to its exports across countries; exports are highest in computer and information services from India, followed by Sri Lanka and Pakistan. In terms of imports, India is the only country that has substantial imports of computer and information services. Travel services are an important service in terms of exports, as almost all South Asian countries have positive net exports apart from Bangladesh and Pakistan. For countries like Nepal and Maldives travel services have the major share in their total exports of services. With respect to transport services, all the South Asian countries are net importers of transport services, with India being the biggest importer followed by Pakistan. India and Pakistan are also net importers of insurance, financial and other business services. Almost all South Asian countries are net exporters of communication services.

One of the reasons for the changing composition of trade in services for the region is the fact that trade liberalisation in services is increasingly taking place in many of the SAARC countries. Sectors like higher education, health and banking and insurance, which were mainly under state monopolies in most of these countries, are gradually liberalising. Increased tradability of services due to technological advancement is also an important factor in increasing the trade volumes of the region.

The rising homogeneity in the production structures and trade liberalising policies with respect to services in the SAARC countries provide a more favourable environment for regional integration in services compared with that for goods. Services trade, for example, involving education and health already takes place through informal channels. Annual payments made by Bangladeshi nationals to access education and health services in India could be about US$100 million, an overwhelming proportion of which goes unrecorded in the official balance of payments.

The cultural and linguistic ties and geographic proximity among countries in South Asia make it easier for trade in services to take place. Furthermore, countries with similar levels of development, like those in South Asia, are likely to find it easier to make the compromises required for negotiating agreements on trade in services.

South Asia now needs to take advantage of its geographical proximity and build new partnerships in various sectors including the capital markets, banking, IT and telecommunications. The inclusion of services within SAFTA framework is a necessity, if members are to realise the benefits of a free trading area. There are many reasons that demand for an immediate inclusion of services within SAFTA. First, the capacity of SAARC members, except India, in producing and trading manufactured goods is weak while services are emerging as the most potential sector in all member countries and potential for intra regional services trade are huge. Therefore members are more optimistic on the issue of trading services rather than manufactured goods. Second, the availability of services (especially tourism, health, education, and labour) within the region will help to attract consumers from other parts of the world. So, an advanced services infrastructure within the region will boost the regions' share in global services trade. SAFTA may play an instrumental role in developing such an advanced services infrastructure within the region. Third, in any economy, the competitiveness of producers largely depends on access to efficient services such as banking, telecommunications, and transport facilities (services). Moreover services are an integral part of other economic activities so their liberalisation will produce strong and positive spill-over effects on other economic activities, especially in the case of sectors like finance, telecommunications and transport.

In South Asia the contribution of services' value added to GDP is 40% on average. This varies among SAARC countries from the lowest ratio of 38% in Nepal to the highest ratio of 57% for Sri Lanka. The service sector is the second most important sector (after agriculture) in providing employment for South Asian countries. Recently, remittances have assumed particular significance. At present South Asia is the second largest remittance recipient (20%) after Latin America and the Caribbean combined while India has topped the list of countries receiving worker remittances in the world since 1993.

South Asia as a whole has a strong comparative advantage vis-à-vis the rest of the world in commercial services, especially exports of semi-skilled/unskilled labour. A great deal of this advantage however, is due to the sheer size of India's service sector. The services sector is gradually becoming the backbone of the Indian economy. Almost 60% of the overall growth rate of the Indian economy in the last one decade has been accounted for by this sector. Exports from this sector have also been impressive at 20% per annum in the decade of the 1990s. However, exports are mainly concentrated in IT and BPO but sectors such as health, education and financial services, retail, and tourism too possess immense potential.

South Asian countries have a competitive edge in different categories of services. In transport services, Pakistan and Sri Lanka have a competitive advantage while India has a competitive advantage in construction services, computer and information services and other commercial services. Maldives and Nepal are more competitive in travel services while Bangladesh has a higher competitive edge in financial services. South Asia's export interests lie in the area of labour-intensive and manpower-based services and import interests in the area of capital and technology intensive services. Construction, education, tourism and health services are of special significance both from export as well as import interests.

The size of trade in services from South Asia however, belies the sector's importance in the region. In 2000, South Asia's contribution was only 1.5% of the total world exports of services while industrialised countries together contributed 72%. Export figures for South Asian countries during 1993 to 2003 show that except for India and Sri Lanka, some of the other countries like Bangladesh, Nepal and Pakistan have experienced a decline in export of commercial services. On the side of imports, the region's share in global imports of services stood at 1.3% (WTO 2000). It is clear from above, that South Asia is currently only a marginal player in the global services trade. Intra-regional trade in services is so minimal that it is not even documented properly. However this is also part of the wider problem of capturing services trade data on a bilateral basis. Currently, intra-regional trade in services includes sectors such as tourism (including religious tourism), consultancy, education, health, among others. Against such a grim scenario of services trade regionally there is an increasingly compelling case for this sector's inclusion in SAFTA.

The ADB study on SAFTA (2008) found that, in relation to services, by integrating with other countries smaller countries may gain more. While bigger countries have the economies of scale and they might not bank on their smaller partners for import/or export, the smaller countries need the support to even overcome their supply constraints apart from seeking market access for their exports and hence they are more likely to gain from imports as well as exports.

Any trade liberalisation would be incomplete without liberalisation of the services sector given the economic rationale behind it. There are immense complementarities and rich potentials for intra-regional trade cooperation in the services sector in the South Asian region. The 14th SAARC Summit in New Delhi in April 2007 was a landmark summit as it underlined the collective vision of South Asia of an inter-connected region where there would be free flow of peoples, goods, services and ideas. Some of the sectors that were identified for potential trade were tourism and education services. These and other sectors having high potential of cooperation are set out in Table 6 below.

Table 6 Sectoral opportunities for services trade in South Asia

SECTOR	COMMENT
1. Telecomms and IT[14]	• Global cross border trade in IT is estimated to be over US$900 billion annually, whereas in the South Asia region it is roughly US$30 billion, but hardly any intra region trade exists. Cross border barriers to trade in services for the IT and telecom sector include restrictions on FDI, less access to domestic markets and discrimination against foreign service providers. To improve trade, clear communications channels, professional work ethics, perception of stability and trust need to be established. Complementarities in South Asia exist given different levels of infrastructure available in the member countries. • While mobile teledensity has surpassed fixed and is in the range of 20-30% (excluding Maldives), it is still below the industrialised world average. In terms of sectoral contribution to GDP, telecommunication revenue in SAFTA countries is also below the world average of 3.1%. • Bharat Sanchar Nigam Ltd (BSNL, India) marked its entry into international long distance services by commissioning a direct digital microwave link to Sri Lanka. BSNL will now carry the voices of telephone callers between India and Sri Lanka on its own infrastructure rather than depending on other carriers, which meant an additional expense to BSNL. Also, the direct link will offer better quality to callers. BSNL expects to offer broadband services during the current year and carry voice, data and video. Thus, telecomms and IT is one area which offers tremendous scope for cooperation and regional trade. This sector appears amenable to inclusion in SAFTA as some countries of the region have the necessary infrastructure whereas others do not have. Tapping such complementarities will on the one hand enable smaller countries to have access to such services that are quite capital-intensive and on the other, extend market access to service providers. This may help reduction in per unit cost of exporting these services as well. Given the nature of such services, trade in goods would also get an impetus. • There are already several IT-related regional initiatives in South Asia. In IT further cooperation could include areas such as Regional Software Technology Parks, e-governance including government intranet, multipurpose telecentres, IT education and training, e-commerce, design, development and database management, Portal Programming and Open Source Application development. • From many South Asian countries it is cheaper to call the US or Europe than to call one its neighbours. In July 2008, the cost of a one minute call from Pakistan to Sri Lanka was 22 US cents and only 3 cents to call the UK. From India it cost 28 cents to call Nepal but only 17 cents to call the US. The cheapest intra-SAARC price was four times that of the cheapest extra-SAARC price.

[14] In the Commonwealth study (2008) the telecoms sector commonly emerges as the service sub-sector that experiences the most gains and also contributes significantly to the rest of the economy, indicative of its importance in output and its key role as a producer service input to a wide range of tradable services. The liberalisation gains include increased teledensity and traffic volumes, improved profitability and returns on assets, greater efficiency, increased investment, adoption of new technologies, service convergence, and consumer gains due to improved quality, increased access, and reduction in calling rates. Innovation and technological change have also played an important role in shaping these gains. However, there are also challenges that have been common across countries undertaking liberalisation of this sector. These challenges pertain to rapid technological developments and the emergence of new segments and opportunities, the presence of multiple operators within the sector, continued government intervention in regulatory decision making, resistance of incumbents to entry of new players, conflicts of interest between regulators and incumbents, and difficulties faced by regulators in balancing commercial objectives and social obligations such as universal service provision. The country studies seem to indicate that the content and process of liberalisation and regulatory reform are equally important. Where institutional and regulatory frameworks have been introduced to support the liberalisation process, with well-defined functions and objectives, the

<table>
<tr><td>SECTOR</td><td>COMMENT</td></tr>
<tr><td colspan="2">1. Telecomms and IT</td></tr>
<tr><td>MARKET</td><td>TELECOM MARKET PROFILE AND PROSPECTS</td></tr>
<tr><td colspan="2">Of the 1.1 billion mobile subscribers in Asia by March 2007, 245 million of these were to be found in South Asia. The growth of the mobile telephony and data markets across South Asia has been dominated by the strong activity in the more heavily populated countries of the sub-region - India, Pakistan and Bangladesh. There was also surprisingly strong activity in the mobile sector in the strife-torn market of Afghanistan, as a competitive market ensured 100% annual subscriber growth. In fact, all eight countries in South Asia have been experiencing booming mobile markets.</td></tr>
<tr><td>MARKET</td><td>TELECOM MARKET PROFILE AND PROSPECTS[15]</td></tr>
<tr><td>Afghanistan</td><td>In 2003, the second GSM mobile service in the country was launched, while another two mobile licences were issued in September 2005. Expansion has continued at around 100% annual growth rate and by early 2007, there were an estimated 2.2 million mobile subscribers. New operator Areeba also had about 250,000 subscribers by early 2007.</td></tr>
<tr><td>Bangladesh</td><td>Bangladesh ranks among the most densely populated countries on the globe, but its fixed-line teledensity remains the lowest in South Asia. With teledensity at less than 1%, only a relatively small proportion of the population has had access to any telecom facility. Almost 99% of homes lack a telephone and there is a four year waiting list for a fixed-line service. The situation is worse in the rural villages, with more than 90% of Bangladesh's telephone services located in urban areas. This has set the scene for a massive expansion of the country's mobile market. There have been a number of consecutive years of strong growth (138% in 2005, 90% in 2006), and growth was continuing at 100%+ coming into 2007. Mobile penetration was still only 16% (20 million mobile subscribers) by March 2007.</td></tr>
<tr><td>Bhutan</td><td>Bhutan has proceeded to invest relatively heavily - to the tune of around US$27 million - in telecommunications infrastructure between 1996 and 2002 to provide the country with a modern fixed line network. In late 2003, the country's first mobile service was launched by Bhutan Telecom (b-mobile) and by early 2007 was claiming 64,000 subscribers, giving a mobile penetration of about 3% (ITU reports a higher figure).</td></tr>
<tr><td>India</td><td>India continues to be one of the fastest growing major telecom markets in the world, with mobile growth being central to the expansion of the sector. The mobile sector has grown from around 10 million subscribers in 2002 to more than 150 million (including both GSM and CDMA services) by early 2007. The growth has been on the back of a mix of higher subscriber volumes, lower tariffs and falling handset prices. Despite the already substantial mobile subscriber base, this represented only around 14% of India's one billion plus population. The telecom regulator, the TRAI, says that the rate of market expansion would increase with further regulatory and structural reform.</td></tr>
</table>

experience has been more favourable. Where the process has been marked by lack of transparency, absence of independent regulatory oversight, absence of incentives to promote operational efficiency, failure to promote competition in key segments and to define responsibilities across multiple agents who may be involved in regulation, lack of prior planning and clear objectives, and failure to garner domestic stakeholder support, gains have been limited and liberalisation has been subject to much debate and criticism. For instance, it has been seen that privatisation may not necessarily result in greater competition and could actually formalise the creation of private monopolies if an important prerequisite to effective competition, i.e., non discriminatory access to the telecommunications network is absent. The country experiences underscore the importance of the regulatory set up and its explicit independence from the government, the regulator’s ability to balance commercial and social interests as well as the interests of incumbents and new players, and the need to instil confidence among consumers and investors. Another important point that emerges in the telecoms services sector is the impetus that can be provided to the domestic liberalisation and regulatory reform process by pre-commitments and adoption of regulatory principles under the WTO.

[15] source: Research and Markets (2007)

SECTOR	COMMENT
2. Telecomms and IT	
MARKET	TELECOM MARKET PROFILE AND PROSPECTS
Maldives	As well as operating the fixed-line network, Dhiraagu, the country's incumbent telco, has also been operating an extensive mobile service. Dhiraagu's monopoly status was officially set to run out in 2008, but, in 2004, a second mobile licence was issued by the government. The new operator, Wataniya Telecom, launched its service in the second half of 2005. By March 2006, it had signed up 64,000 subscribers. In the meantime, Dhiraagu had also increased its subscriber base to 164,000, having managed to grow by 23% over the previous 12 months. With the increased competition, the overall market had reached an striking 73% penetration by March 2007.
Nepal	Nepal has been moving steadily towards a more liberalised telecom market. This included the incumbent telco losing its monopoly status in the market. By April 2006, over 170 operators had been authorised to provide a wide range of telecom services, including two for basic telephony and two for the all-important mobile telephone service. Mobile services are provided in the country by two operators - Nepal Telecom and newcomer Spice Nepal. With Spice providing some serious competition to the incumbent, the total mobile subscriber base had reached 600,000 by March 2006 (penetration 2%), after the market had expanded by 100% in 2005. This rate of expansion continued and by March 2007, there were 1.2 million mobile subscribers in the country.
Pakistan	After a period in which the country slowly transitioned from one dominated by a regulated state-owned monopoly to a comparatively deregulated competitive structure, Pakistan's telecom sector had finally begun moving and looked set for an era of phenomenal growth. Pakistan's mobile sector, which had started to grow strongly over the last few years, has been continuing its rapid expansion. After growing by almost 170% in 2005 and 123% in 2006, the mobile subscriber base had reached over 48 million (30% penetration) by early 2007. The government's reform plans were being progressively implemented and this is certainly starting to have some impact on the market. The country's four mobile operators have been joined by two new operators - Warid Telecom and Telenor Pakistan - following a decision by the government to issue two additional mobile licences. Both these new operators became very active in the market. By end-2006, after less than two years operation, Telenor had 6.6 million subscribers and Warid Telecom was claiming 7.6 million.
Sri Lanka	Sri Lanka has been demonstrating considerable determination in its efforts to develop the country despite its ongoing political problems. With a modern progressive telecommunications sector high on the list, the sector looked to be well positioned for vigorous growth. The country's mobile sector expanded by almost 60% in 2006 and by March 2007 mobile penetration was 30%.
According to Juniper Research, South Asia will be the driving force behind the growth of Mobile WiMax, or the 802.16e standard. WiMAX (a telecommunications technology aimed at providing wireless data over long distances in a variety of ways, from point-to-point links to full mobile cellular type access). Pakistan, being among the first countries in the world to roll-out a functional WiMax service, is experiencing tremendous growth in demand after Wateen Telecom's launch of its WiMax service and roll-out plans announced by Mobilink. India's state-owned Bharat Sanchar Nigam Limited is rolling out a Wimax network for broadband access in response to government requirement that 20 million broadband lines be in service by 2010. Given the pent-up demand for the Internet access and the ubiquity of mobile phones, Wimax roll-out will likely spur the largest adoption of mobile Internet in South Asia first. At the 14th SAARC Summit in Delhi in April 2007, 'Heads of Government agreed to take steps to facilitate rationalisation of telecom tariff on a reciprocal basis. They also agreed that national and regional telecom infrastructure should be upgraded to boost people-to-people connectivity in the region.'	

SECTOR	COMMENT
2. Banking[16]	There is an urgent need to strengthen cooperation in the banking sector to dispense with the increasing trade transactions in the coming years, which if not materialised could harm growth of trade among SAARC countries. Financial services facilitate economic transactions and when these functions take place across the border they facilitate trade. This is the main reason for the presence of local banks in foreign countries. Several Pakistani banks including the National Bank of Pakistan, Muslim Commercial Bank, United Bank Limited plan to open branches in India when the State Bank of India and Punjab Bank in India are also interested in opening branches in Pakistan.
3. Aviation	• There is increased cooperation to increase flights which complements tourism, transport and trade (through air cargo) in general. An MOU on the Air Services Agreement was signed between India and Nepal in June 1997. It increased the air seat capacity from 4000 per week to 6000 per week; India also gave two additional destinations for the designated airlines of Nepal, to Lucknow and Bangalore. Such cooperative arrangements need to be effected on a regional basis with intra-regional tie-ups among the national public and private airlines, as the case may be. This may give boost to not only trade in aviation services but also trade in tourism services and trade in goods at large. Thus, this sector which offers huge trade potential needs to be covered under the SAFTA Treaty. • In February 2008 Pakistan and India signed a MOU for increasing air services co-operation. They agreed to double the number of weekly passenger flights between the two countries and to expand the number of destinations served by the flights and to allow more airlines to operate the routes. Currently a total of 12 flights a week link Delhi and Mumbai with Lahore and Karachi respectively. At present, only one airline from each country - Indian Airlines and Pakistan International Airlines - is allowed to fly between the four cities. The new deal will enable each side to designate up to three airlines for all the routes, including private operators. The number of routes will itself be increased to include Islamabad and the Chennai. The deal will pave the way for direct flights between the capitals of both countries.
4. Air cargo	The fastest growing sectors identified for high value / air trade (pharmaceuticals, automotive components, consumer electronics, and retail goods) to 2020 all have strong presence and potential in South Asia. The benefits are clear as surplus capacity at Karachi seaport can be filled jointly by forwarders in Delhi and Lahore; an air freighter coming in to Madras can be jointly shared by Karachi and Mumbai. Optimal use can made of seasonal fluctuations for agricultural produce and exports as the high season for mangoes in India ends when Pakistan starts[17] (capacities in Pakistan during the low season can be filled by Indian forwarders at Karachi, Lahore, Islamabad, Sialkot, Peshawar and vice versa with capacities in India utilised by Pakistani forwarders). Demand of extra capacity at Delhi Airport can be assisted by Lahore or the new Sialkot Airport. Bangladesh can forward its high yield freight via Delhi Airport. At Colombo and Male Airports there is a substantial amount of capacity available due to tourist inflows which can be used for ocean-air movements by other countries in South Asia.

[16] the Commonwealth country studies demonstrated that well-implemented regulatory measures in the form of improved quality of supervision, stronger bankruptcy laws, improved consumer protection mechanisms, and other prudential measures can help address such problems as reduced access to credit in rural areas, rise in non-performing loans, and higher cost of credit that have been faced by some countries following the opening up of the financial services sector. The country experiences also reveal that the expansion of the banking sector and entry of foreign players need not yield the expected efficiency gains or improved access to credit if domestic players are not well equipped to access this growth. Liberalisation may also aggravate inequities, especially in terms of the public-private and the rural-urban mix of financial services delivery and performance, thus affecting the realisation of social and developmental objectives that are the mandate of the public sector. For instance, liberalisation of the banking sector may shift low-risk businesses away from public sector banks to foreign and domestic private sector banks and worsen inequities in credit allocation.

[17] The example of mangoes was cited by Pakistan's Foreign Minister at an address on South Asia in London on 24 July 2008

SECTOR	COMMENT
5. Surface Transport	About 78.5% of the Mahendra Raj Marg, a highway that runs the entire length of Nepal (1024 kms.) from the east to the west along the southern terai, has been constructed with assistance by India. In addition, roads from Kathmandu to Dakshinkali, Trishuli, Balaju, Godavari and Raxaul via Hetauda, Sunauli to Pokhara, Rajbiraj to Koshi Barrage and Janakpur town road are contributions of Indian assistance. India has also constructed a number of bridges on these roads and separately two bridges on the river Bagmati at Kathmandu and one on the river Mohana. The bridge on the river Sirsiya between the towns of Raxaul on the Indian side and Birgunj on the Nepalese side has also been completed and opened for traffic movement. These illustrations are indicative of the potential that exists in the region to enhance trade in surface transport services facilitating movement and trade in goods. One merit of giving focus to this sector is that it will have positive implications of creating trade in consultancy services and construction services. It also has favourable implications for intra-regional investment cooperation.
6. Tourism	This sector offers ample scope for cooperation as the region is well endowed with natural locales like sea and hill tourism with significant complementarities. Recently, man-made tourism has also been developing fast in some countries. Countries like Bhutan, India, Nepal, Pakistan and Sri Lanka offer scope for hill-tourism whereas India, Bangladesh, Maldives and Sri Lanka are known for their sea-coasts. Luxury resort tourism is already very successful in the Maldives. Eco-tourism has been developing in Bhutan and Sri Lanka. Similarly, health-tourism has been growing fast in India and Sri Lanka. In addition, tourism potential needs to be tapped given the historical and religious locations spread all over the region. There is potential in religious tourism (eg. Buddhism: Bodh Gaya in India, Lumbini in Nepal, Taxila in Pakistan and several ancient temples in Sri Lanka), and the beaches of Southern India, Sri Lanka and the Maldives. Not only would trade in tourism services be augmented on an intra-regional basis but inclusion of this sector in SAFTA could help attract international tourists from outside the region. Such an initiative would create the need for upgrading tourism infrastructure and generate demand for related goods to be sourced from the region. With the increased supply of tourism infrastructural services the cost of such services are expected to decrease as in the case of hotel accommodation services and this may generate a second round of increased trade in tourism services. Liberalising within the region could also have positive effects on extra-regional tourism.
7. Medical Services[18]	• Given the fact that the South Asian region is still stuck in poverty traps, malnutrition, communicable diseases and lack of adequate access to high-quality health services, this sector needs to be accorded top priority in terms of regional trade and investment cooperation. On the other hand, in various parts of the region valuable progress has taken place in terms of competent medical service providers like doctors, nurses and other supporting semi-skilled workers. The region has also made strides in terms of manufacturing cheaper medicines at a large scale, information-dissemination and their distribution mechanisms. However, the developments in the health sector have been asymmetric in the region and only points to the existence of complementarities. By including this sector in SAFTA, trade in health services would be more organised and through appropriate regional mechanisms the direction of trade in this sector could be oriented in such a manner that their overall effect is welfare-enhancing. For instance, if trade and investment between India and Sri Lanka in this sector is enhanced by way of setting up more specialised hospitals in Sri Lanka, access of medical services to Maldives may

[18] In the Commonwealth study benefits arising from the liberalisation of health services in the form of increased access, quality, and availability are not automatic. They are to a large extent shaped by existing capacity, the structure of the sector, and the existing regulatory and policy environment affecting all players, domestic and foreign. In some countries, the opening up of health services and greater private involvement and foreign ownership in the health sector has been fraught with debates on social and equity grounds concerning increased public-private divide, reduced affordability of healthcare to the poor, and worsening of existing inequities and shortages in the sector. The public segment needs to play a complementary role to private health care delivery, if social objectives have to be balanced with commercial interests.

	improve as it would be easier for people to travel to Sri Lanka for accessing health services. Similarly, capacities built in Sri Lanka through this process may help them extend such services to other countries like Bangladesh in future. • there are very few regulatory constraints in the SAARC countries in respect of investments in the health sector. The regulatory framework in each country is also conducive to arrangements for recognition of foreign medical and dental qualifications. There are no regulatory constraints on movement of patients from one country to another for treatment. • Overall there are asymmetries in capabilities with India leading the field. There are positive external shocks which have important ramifications for the development process. Specialist medical services can be accessible more directly to South Asian consumers through health service sector liberalisation.

In the area of services it is not possible to undertake across-the-board liberalisation. Thus, the above list is only illustrative of the complementarities that exist in South Asia for including services trade into SAFTA. This is not to deny that potential exists in various other services sectors. The sectoral examples above are only meant to provide a focus since trade in services differ from trade in goods.

It needs to be highlighted that despite concerns that the economies of the region are not yet developed enough to venture into liberalising the services sector, there are enough non-LDCs in the group to make service liberalisation a viable option. Furthermore, SAFTA could adopt a 3+x system of liberalisation similar to that of BIMSTEC, where if three or more countries feel they are ready to liberalise a sector they can go ahead without having to wait for the rest to be ready. However, such an approach could have its own drawbacks in a regional setting. For instance, if four countries could frame a system of service liberalisation according to their interests and requirements, the other three countries will opt out due to being unprepared at the time. However, a decade later, one or more of the other three countries may be ready to liberalise services, but would now have to be party to an agreement that they had no role in framing.

At the 14th SAARC Summit in Delhi in April 2007, Heads of Government 'stressed that to realise its full potential, SAFTA should integrate trade in services. They called for a finalisation of an Agreement in the services sector at the earliest. They also directed that the Agreement on Investment Promotion and Protection be finalised.' As SCCI pointed out on the eve of the 15th SAARC Summit, this could have significant spillover effects as 'the inclusion of the services sector will greatly benefit to uplift the socio-economic level of the region through enhanced investment in the education and health sectors. The collaborative partnership in areas such as finance and banking, insurance and Information Technology would help in promoting greater cooperation and fiscal measures which would lead to the formation of common capital market.'

Whilst 2007 was a significant step forwards, policy issues that still need to be addressed include:-

- Compatibility in the long-term with broader integration in WTO GATS

- The South Asian economies should decide whether to make horizontal commitments (eg. under GATS, for each of the four modes of supply of services, member countries can schedule commitments across all services sectors) or sectoral commitments (commitments in a specific sector/sub-sector) and decide to what extent market access barriers and/or national treatment barriers can be removed

- Sequencing and prioritisation of policy initiatives and sectors. SAFTA would do well to follow the approach adopted by the Indo-Lanka CEPA where the "softer" areas (tourism, etc.) are liberalised first, following the successful completion of which more advanced sectors could be considered

- Building data on intra-regional trade in services for smooth negotiations

- Taking account of the fact that a mode-wise approach does not fully reflect the economic reality of simultaneously supplying services through multiple modes and linkages between modes of supply for the delivery of services. Barriers to one mode translate into actual/potential barriers to other modes.

Service sector liberalisation is not without its challenges. It may result in some initial instability as in the case of financial services, or may give rise to problems of introducing independent regulators and creating effective competition as in the case of telecommunications, or may give rise to public-private segmentation and equity issues as in the case of health services. Moreover, countries may need to adapt their regulations to the outcomes of liberalisation, especially in the initial phases, and also take a holistic approach to liberalisation by adopting and amending regulations in other areas.

Timely and well-enforced domestic regulation backed by a sound, transparent, and unambiguous regulatory framework is a prerequisite for service sector liberalisation. Without these prerequisites, South Asian countries are unlikely to gain to the extent possible from services liberalisation and may in fact be faced with unforeseen and adverse consequences. This is particularly important in sectors where volatility could give rise to wider economic instability. While the issues and challenges may vary depending on the nature of the service sector, this precondition is applicable to all services in different forms and to different degrees.

Often the real issues do not concern whether ownership is domestic or foreign but whether ownership is private or public. Where supporting infrastructure requirements exist or where prudential regulations are required, the government has a vital role to play in shaping the liberalisation process and the ensuing outcomes.

The Commonwealth findings (2008) on liberalising services in developing countries are worth noting. Although there are benefits from liberalising trade and investment flows in such services, there have also been unforeseen outcomes mainly due to lack of adequate preparedness and institutional capacity on the regulatory front. Moreover, the challenges associated with liberalisation vary across infrastructural and social services. Different groups or classes of services have different regulatory issues and concerns, which may require different approaches. Hence, it may not be advisable to adopt a standard approach to liberalisation across different service sub-sectors.

Growing trade and investment flows in services, and the liberalisation and deregulation of trade and investment regimes can pose regulatory challenges and raise a number of concerns. These relate to issues of consumer protection, universal service provision, equity-efficiency trade-offs, and the need for institutional and regulatory reforms and measures to support liberalisation and to ensure that the potential benefits are realised and risks mitigated. There is also the challenge of deciding the right balance between public and private delivery of services, the right degree of regulation so as to ensure competition and efficiency without compromising on various public policy objectives, the need to put in place the right kind of institutional structures so as to balance commercial, social and other concerns, and issues of institutional capacity. These challenges are further compounded by the lack of quality data on services in South Asia.

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

Trade in Energy: opportunities and needs

South Asia is enjoying unprecedented economic growth. The growth, however, is becoming constrained by significant shortages in energy supply and unless corrective steps are urgently initiated and implemented it may be difficult to sustain the achieved and aspired growth rates. Fostering of cross border energy investments and promotion of regional energy trade in order to take full advantage of the energy resources available within the region and its neighbourhood are important elements of the solution to this problem. This is being increasingly recognised both by the region's political leaders and its business community. Moreover throughout the region, extreme poverty persists which is exacerbated by a lack of access to electricity. Despite apparent synergies and opportunities existing for cross border energy cooperation, the energy and power trade in the region is extremely low.

In the energy sector the countries in the region rely on a significant level of imports. These fuel imports constitute about 18% of the total value of imports into the region. The import of fuel by India and Pakistan is now in the range of 20-21% of the value of their respective imports.

The South Asian region represents 22% of the world's total population comprising over one billion, of which 30-40% live below the poverty line of which only 40–50% have access to electricity. Despite the development, the countries of South Asian region are energy starved. To meet the growing energy requirements, energy trade between these countries is essential. But South Asia's current cross border energy trade is limited to Bhutan, India and Nepal. Recently, energy trade between Bangladesh, India and Pakistan has been proposed, in line with the construction of liquefied natural gas pipeline from Myanmar to India through Bangladesh, and Iran to India through Pakistan. These proposed energy trade projects, if implemented successfully, will contribute to integrate regional economies.

The rationale for regional energy trade in South Asia is clear. Such widespread regional energy trade provides a win-win situation to all the participants and is a logical and rational public policy choice because of:-

- The mismatch between energy demand growth and energy resource endowments. Relatively smaller economies (Tajikistan, Kyrgyzstan, Nepal, Bhutan, Myanmar, Turkmenistan) and Iran have hydropower or hydrocarbon resources far in excess of their energy demand. The remaining countries (India, Pakistan, Bangladesh, Sri Lanka and Afghanistan) have energy demand growth far outstripping domestic supply and in the foreseeable future the demand-supply gap would become wider unless the domestic supplies are supplemented by imports.

- Implications of trade to energy security. Reliance on energy trade for meeting a part of the domestic demand can actually enhance national energy security by diversifying energy forms and supply sources and lowering the cost of energy supply.

- The substantial benefits to the smaller exporting economies. Energy exports could make dramatically significant contribution to the GDP growth of economies like Bhutan, Nepal, Myanmar, Tajikistan and Kyrgyzstan and enable their export led growth. For example, Bhutan's electricity export in FY2007 is expected to constitute nearly 25% of its GDP and 60% of its state revenues.

- The significant relief from energy constraints to rapid economic growth. This is especially true in the importing economies, India, Pakistan and Afghanistan. For example, in India alone, the volume of unserved electricity in FY 2007 is estimated at 54,916 GWh valued at $12.1 billion on the basis of the short term marginal cost in the Indian grid. The value of the corresponding industrial production foregone would be several times more.

- The environmental imperatives. This is especially relevant for India which relies very heavily on domestic coal. Its carbon dioxide emissions will rise from 4% of the world total today to about 13% by 2030 unless low carbon strategies are adopted. Imported hydropower and natural gas would help in moderating this increase to some extent.

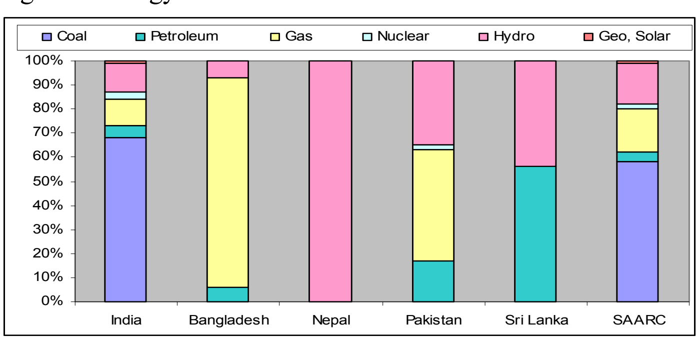
- Climate change imperatives. Carbon emissions are increasing and Himalayan glacial resources are shrinking. The management of regional water resources and the use of other primary energy sources have to be optimised for the benefit of the region as a whole, and trade enables such optimisation for the benefit of all.

- Reduction of supply costs. Trade could reduce system development costs and enable lower cost supply. Nepal, for example, could dramatically reduce its cost of power supply (compared to its attempt to meet its demand by the expensive all hydro generation option) by optimising its power system with sale of hydropower to, and import of thermal power from, India.

- Cash flow implications. Often energy import options improve cash flow and enable postponement of lumpy and large domestic capital investment needs, to avoid crowding out other important investment needs (the classic make or buy choice).

Power and energy are major inputs that determine the speed and the nature of economic activities and growth in energy and power use is closely related to growth in industry. The fast growing South Asian region is well established on a high growth path, which has led to a rapid increase in energy consumption. In 2003, South Asia accounted for about 4% of the total world energy use up from 3.1% in 1993 (World Development Indicators, 2006). However, despite rapid growth in energy demand, the South Asian energy scenario is marked by low levels of per capita energy consumption, high energy intensity, and high levels of energy consumption per unit of GDP. The Energy Information Administration (EIA) estimates that South Asia's primary energy consumption showed an increase of 52% between 1993 and 2003.

Figure 3 Energy Mix in South Asian Countries



The countries of South Asian region are energy starved. To meet the growing energy requirements, energy trade between these countries is essential. However South Asia's current cross border energy trade is limited to Bhutan, India and Nepal. Recently, energy trade between Bangladesh, India and Pakistan has been proposed, in line with the construction of liquefied natural gas pipeline from Myanmar to India through Bangladesh, and Iran to India through Pakistan. These proposed energy trade projects, if implemented successfully, will contribute to integrate regional economies.

Coal and petroleum are the predominant sources of energy in the region however there are variations among the countries. Bangladesh is dominated by natural gas (86% in 2005), India by coal (55% in 2006), Maldives on petroleum (100%), Sri Lanka on hydroelectric power and petroleum (50% and 46% respectively in 2005). Pakistan is diversified with petroleum (33%), natural gas (30%) and hydroelectric power (33%) whereas Bhutan and Nepal rely heavily on hydroelectric power (99% and 92%, respectively in 2004). The variation in the energy mix in the individual South Asian countries provides a unique opportunity to enhance energy security in the region through mutual cooperation.

The countries of South Asia share similar conditions and the energy sector is no exception. South Asian countries are faced with rapidly rising energy demand coupled with increasingly insufficient energy supplies. Because of the economic and political ramifications arising from energy and power shortfalls, improving the supply of energy, particularly the supply of electricity, is an important priority of the South Asian economies. Only 59% of the population is connected to the electricity grid and most of the rural population relies on biomass to meet its energy needs. The demand-supply situation is bound to get worse as the proportion of population with no excess to electricity increases in the region with economic development.

Regional cooperation can play an important role in addressing the problem of energy needs in the region. Energy endowments differ among the South Asian countries, but energy trade in the region is low. Only India, Bhutan, and Nepal currently trade in electricity. Bangladesh is endowed with natural gas reserves, but gas trade is constrained by the region's inadequate infrastructure and political misconceptions. Pakistan and Afghanistan can play an important role as transit states for the rest of South Asia, as they provide the best route for access to Central Asia's energy. There exists great potential in the region for energy cooperation and mutually profitable opportunities which will thereby increase regional energy security and give the region greater resilience against energy shortages. Currently, only India, Bhutan and Nepal trade electricity and that too at a miniscule scale compared to the need and potential for energy cooperation.

South Asia has considerable potential for mutually advantageous energy cooperation / trade[19]:-

- India is short of indigenous gas and is importing expensive LNG. It has a good amount of known reserves of coal at 204bn. tonnes

- Bangladesh has a gas reserve of 10.6 Tcf and an 'undiscovered reserve' of 32.1 Tcf (source: US Geological Survey) and a coal reserve of 2.7bn. tonnes

- Nepal and Bhutan have large untapped hydro potential of 43,000 MW and 30,000 MW respectively (source: US Energy Information Administration, EIA)

- Pakistan has a gas reserve of 27 Tcf (substitution oil by gas) and lignite (source World Energy Council) with a coal reserve of 185bn. tonnes

[19] Japan-SAARC Symposium, Islamabad 10-11 June 2008

Some of the countries of the region are well adjoined by the land surface. They have access to road to move from one country to another. Bangladesh can export natural gas to India and Nepal if the pipeline construction from Bangladesh to Nepal via India would be successful. Bangladesh can import electricity from Nepal via India if the transmission lines are constructed. The energy trade between the nations becomes a need today as the countries of South Asia are facing power shortages. For this, joint ventures for the development of gas pipeline and transmission lines should be investigated and established. To meet the growing energy requirements, energy trade between these countries is essential. Nepal can sell its abundant electricity to other South Asian countries and, in turn, buy coal and natural gas and oil from other respective countries.

There is a strong need for energy cooperation amongst the electricity markets of the South Asian countries to mitigate their energy security risks which can be done through the development of a regional electricity grid as well as gas and oil pipelines. The economic and technical advantages of a network of electricity grid and regional gas pipeline are numerous. Such networks increase the reliability and security of energy in the region, reduce the required reserves capacity to meet peak demand, reduce cost through large economies of scale, reduce cost of fuel transportation, and allow regional resources to be harnessed more efficiently. In addition, such a system will bring substantial benefits in terms of environmental protection through reduced consumption of fuel wood and low quality coal.

South Asian countries are faced with the challenge of energy security which may be achieved by diversifying traditional energy supplies, promoting additional foreign investment for energy infrastructure development, improving energy efficiency, reforming and privatising energy sectors, building cross-border linkages and promoting and expanding regional energy trade and investment.

The focus of energy policy in most countries of the world has usually been to ensure adequate energy supplies to meet their own demand, except for the energy resource rich countries with large export potential. The South Asian nations have traditionally been meeting their energy needs from domestic sources, such as firewood, biomass and hydropower in almost all of the countries, and coal as well in India. Oil became an important source of energy during the past 80 years, and natural gas during the past forty. In spite of a tripling of the region's population, and a doubling of per capita income over the last few decades, the South Asian countries have been able to meet their energy requirements largely from domestic resources. However, the the increased use of biomass, in general, and also coal in India are the major factors in rising air pollution, deforestation, land degradation, and loss of ecosystems. Switching over from "traditional" modes of transportation to motor vehicles that used oil products contributed not only to air pollution but also to greater dependence on imported oil. Further, it helped change the nature of South Asian cities by following the pattern of industrialised countries in the form of urban sprawl, clogged roads, and long daily commutes.

The creation of a South Asian energy market and cooperative development of the available diverse energy sources in the region can also help increase the level of energy security in the region and thus can subsequently contribute to achieving a sustained higher economic growth. This could lead to a South Asian regional power and gas market and competition among power and gas producers both public and private that ensure economic and efficient delivery of services to the consumers in the region. At the same time, the power system networks of Bangladesh, Bhutan, India, Nepal, Pakistan and even Sri Lanka can be interconnected to achieve greater efficiency and economy in the overall system.

As in many other parts of the world, policies in South Asia are usually designed on a sector-wide basis, eg. there is a policy for energy, one for environment, another for transportation, and yet another for technology development. Further, the relations between the South Asian countries were usually determined by political issues, rather than by those relating to economic development, where the role of energy is crucial. There is a need for a more integrated approach to energy policy, both in terms of integration across sectors, and across the countries of South Asia.

Energy trade between the countries of South Asian region also has significant scope for advancing regional economic development. It will contribute towards increasing energy access and supply to achieve desired economic development by individual countries and, hence, by the region as a whole. The more important possible outcome is to improve and secure energy security, reliability and quality in the individual country and then in the region. The regional energy trade will produce significant results in the quality of life of great majority of people. The countries of the region can maximise benefits from the potential financial gains from energy trade. The energy trade will facilitate regional resource management, particularly of the forests and water. The conservation of forests and harnessing of water resources in a sustainable manner would benefit the people of the region. It will bring about broader regional integration in terms of economic, financial, environmental and socio-economic framework.

Regional cooperation by itself is not a sufficient condition for harnessing resources more efficiently; a necessary precondition is market reforms in individual countries, which would remove existing bottlenecks and create a more conducive climate for attracting investment into the energy and power sector. All South Asian governments need to continue embracing market reforms and policies supporting cross border energy trade and power sector investments as a necessary step in meeting the energy demand. These reforms and policies, if properly implemented, can have a snowballing effect on the investment climate and pave the way for harnessing hitherto unexploited resources.

Potential, prospects and a pathway ahead

SAFTA still offers a great potential for having positive effects in the region if its trade is effectively liberalised. On the one hand, several studies have pointed out the positive gains on trade, competitiveness, and income that could arise from effective SAFTA liberalisation (cited in World Bank, 2007). On the other hand, it is important to bear in mind that SAFTA is an agreement that provides a framework for taking measures to facilitate investment, improve the harmonisation of standards in the region, and facilitate customs and transit for efficient intra-SAFTA trade among others. Indeed, facilitating customs and intraregional transit is particularly important because the average numbers of days to clear customs in South Asia is one of the highest of all regions. The number of days for imports to clear customs in South Asia is 42, compared to 24 in East Asia and 28 in Latin America. For exports, the situation is similar, though the difference with respect to other regions is not as large as for imports. Only Sub-Saharan Africa has a worse performance that South Asia.

Inadequate trade facilitation mechanisms create obstacles to the potential of intraregional trade. For example, Nepal's trade with other countries in the region depends on transit facilities provided by India. These facilities often involve high handling and transportation charges and delays in delivery, thus hampering the flow of trade between Nepal and its trading partners in the region. It will be beneficial for South Asia to look at trade facilitation more closely, especially given that the region hosts three landlocked (including Afghanistan) and two island countries. Trade facilitation measures at times can generate more trade than tariff liberalisation. Transport networking through better connections via eg. sea, air and land, better ICT connectivity, deregulated customs procedures can significantly facilitate trade among countries. If trade facilitation is done with the objective of harmonisation of standards at entry points in the region, a number of non-tariff barriers could also be eliminated.

The extent to which SAFTA will indeed provide the adequate mechanisms to deliver positive outcomes in terms of promoting investment and facilitating trade will depend basically on how the agreement is implemented. It is important to point out that just the mere fact that SAFTA contains a provision envisaging measures on these areas constitutes an important difference with respect to SAPTA. In this sense, the framework provided in the design of SAFTA has the elements that could allow the agreement to offer South Asia an opportunity to reap the benefits from liberalisation through different channels (more investment, better terms of trade, increased productivity, lower prices, etc.). For this purpose, it is crucial that South Asian countries focus their efforts on delivering effective liberalisation and reducing trade barriers in general so that trade creation dominates and, thus, the expansion of intraregional trade yields gains in production specialisation, efficiency, and improved quality of exports, which will benefit all the member countries.

There are important additional gains from pursuing a coordinated approach to deeper economic integration. Some of South Asian's members are currently pursuing individual trade agreements with NAFTA and with other Asian countries, however the added complexity of cascading trade barriers could turn this approach into a losing proposition for not only the region as a whole but also for, ironically, the very negotiating countries

What is the potential for SAFTA? A recent report from the Exim Bank (2008) has undertaken an empirical examination of trade flows in SAARC which reveals important points of potential. According to the Exim study, for a 1% increase in GDP of the exporting (importing) country, bilateral export flows would increase by 0.88% (0.79%). Intra-SAARC trade could rise if the SAARC countries could maintain strong economic growth and countries with high per capita income being likely to trade more. For a 1% increase in openness, bilateral export flows increase by 1.16%. This indicates that it is possible that increased openness of SAARC member countries could boost intra-regional trade in the region. Further in an extra-SAARC context, it reveals the absence of trade diversion in the SAARC region.

Empirical analysis in the Exim Bank study reveals the importance of specialisation in the region based on the principle of comparative advantage. The presence of bilateral trade agreements in the SAARC countries increases trade by 152.2%. The common border demonstrates a positive and statistically significant effect. If two countries share a common border, the export flows between them increases by 32.4% than if this is not the case.

Several policy implications arise from the Exim study in relation to SAFTA and the prospects for regional trade:-

- since import growth of SAARC is more than the export growth, more emphasis could be given to boost exports in order to reduce the trade deficit experienced by the SAARC region.
- More diversification is essential based on the comparative advantage.[20]
- The direct relationship between bilateral exports and GDP reveals that the higher the GDP, the higher is the intra-SAARC exports. This shows the potential for export-led growth in the region.
- When the openness of the economy increases, bilateral exports also increase.

[20] SCCI has recently pointed out in a meeting with the ADB on SAFTA that 'in respect of comparative advantage in addition to traditional and non-conventional items, the potential for intra-regional trade also exists even in such sectors where all the major trading countries are competitive.'

- There is a very significant and positive relationship between the bilateral trade agreement and bilateral export flows in the SAARC region which supports the case for bilateral agreements in the region.

- Specialisation could be promoted based on the principle of comparative advantage.

- Stronger economic relations can be used to reinforce improving political relations, especially the key relationship between India and Pakistan[21]

A recent IMF study (2007) found that extending SAFTA to other RTAs including NAFTA, EU, Plus 3 or ASEAN confers benefits. Two features of South Asian countries' trade pattern generate the result that looking outside the region to form RTAs would be beneficial. First, except for Bhutan and Nepal, South Asian countries rely more heavily on non regional partners for their trade relations. Second, on average, South Asian countries have a more restrictive trade policy toward non-regional partners (Figure 2). In fact, three out of the seven countries apply lower tariffs to SAFTA members than to any other bloc. The results of the simulation are provided for three indicators (trade flows, trade balance and customs revenue) for South Asia as an aggregate and for individual countries in South Asia. The relative attractiveness of each hypothetical RTA varies across individual countries. Trade agreements with NAFTA, EU or ASEAN would generate higher trade flows than SAFTA. An expansion toward ASEAN - considered to be the most natural candidate for South Asia further liberalisation efforts would likely generate smaller trade flows than NAFTA or EU. Once again an important determinant is the fact that current trade relations with the European Union and NAFTA are of greater importance than bilateral flows with ASEAN members; however, an additional factor worth further exploration is the similarity between the main exports and imports of South Asia and ASEAN's members that would make their offerings of goods and services substitutes rather than complements. The IMF found that new imports will be the driving force in all but one of these RTAs. In general most of the countries in the sample already have low tariff barriers for South Asian goods, so that the 50% reduction would have a minor effect in their imports (SAFTA's exports). Furthermore, the sensitivity to South Asian tariffs ranks second to last, only larger than the corresponding to Plus 3 goods. In fact, at least 80% of the new trade flows from RTAs with NAFTA or EU would be in the form of new imports. In comparative terms, SA + NAFTA generates both the largest increase in trade flows and the biggest decrease in the trade balance, while SA + Plus3 shows the smallest increase in trade.

The ADB study on SAFTA concluded that SAFTA will contribute to stronger economic growth in the region and that, while some sectors will lose and some sectors gain in each country, the net effect on economic output is positive. In order to maximise welfare gains, ADB felt that it would be important to give flexibilities for countries to protect employment intensive manufacturing sectors in the smaller LDCs. The adoption of a transparent and effective regional safeguard mechanism for agriculture products could help to take care of sensitivities in agriculture that are bound to exist. Much higher gains for the region can be secured if SAFTA is simultaneously implemented with measures to reduce transaction costs and create more efficient regional transportation and infrastructure networks. Increasing the

[21] There is a recent realisation and recognition of realpolitik in this context. Pakistan's new foreign minister Shah Mehmood Qureshi recently told Dawn News that despite Kashmir, there are 'areas like trade…where we need to move on to our mutual benefit and advantage' adding 'let's call a spade a spade. If enhanced trade can be used as an important confidence-building (measure) to create a more enabling environment for our movement from conflict management to conflict resolution, we should not shy away from that' (Mint, 23 April 2008). In London on 24 July 2008 at a meeting on South Asia Minister Qureshi pointed out that trade with India was at a record high and that this was one of the key 'do-ables' in strengthening the bilateral relationship he had said to Indian leaders during a recent visit to Delhi adding that 'economic links create an enabling environment and builds trust.'

scope for intra regional trade in energy, improving road, rail and air links within the region, building modern customs/border crossings, developing sophisticated telecommunications links (like optic fibre) are all vital to this endeavour.

The Institute of Policy Studies in Colombo have suggested several lessons for SAFTA from the India–Sri Lanka Free Trade Agreement (ILFTA):-

1. bilateral deals will work if there is strong political will
2. a 'win-win' situation could be worked out in an FTA between a small and a large country by incorporating providing special and differential (S&D) treatment in favour of the smaller country
3. in such an FTA, dormant complementarities could be invigorated
4. NTB removal should be made mandatory with tariff liberalisation; and all NTBs should be clearly defined in FTA
5. when exporting to India it is better to negotiate for a number of entry points to India without confining to just one port of entry as it had been so in the case of ILFTA
6. deep economic integration with a fast growing large economy could contribute to sustainable growth rates for neighbouring South Asian countries and therefore India's rise should not be seen as a threat but as a significant opportunity in promoting growth and development in the region.

Furthermore in determining the future of Indo-Lanka economic ties, six important lessons have been identified by RIS and IPS (2007), drawn from the ILFTA, that are worth noting in relation to SAFTA's success. First, both governments have displayed the political will to forge ahead towards economic integration which is reflected in the growing share of both partner countries' bilateral trade in world trade in all categories of concessions exchanged (with the exceptions of Sri Lankan tea and garments). Second, considerable size disparity between two countries does not hinder bilateral free trade when appropriate special and differential treatment is accorded to the smaller country. Third, FTAs can invigorate dormant complementarities, as Sri Lanka discovered when its comparative advantage in producing a number of consumer goods that found entry to the Indian market for the first time following the exchange of preferences. Fourth, a bilateral FTA activates unilateral liberalisation measures that are unrelated but complementary to the agreement, creating deeper economic integration; this is clearly visible in the tourism and air travel sectors of India and Sri Lanka. Fifth, the ILFTA's conciseness is a likely reason for its success; it is a 14-page document devoid of excessive rules and regulations. Finally, the economic benefits of free trade can and do override political problems; the ILFTA has done much to clear the acrimonious political atmosphere that marked Indo-Lanka relations during the 1980s.

However what do key people think of SAFTA?

Any strategy for the future needs to take account of views of key actors towards SAARC and SAFTA. A major recent research study[22] on many opinion formers across South Asia sheds critical light on domestic support for regional cooperation during at a time of changing relationships from the period of a nuclear-charged stand-off between India and Pakistan in May 2002 to the SAARC Summit in Islamabad in January 2004. The relevance of this is clear as South Asian opinion formers are aware of the extensive nature of regional cooperation

[22] This was conducted by Dr. Kishore Dash at Thunderbird School of Global Management, US based on primary data derived from extensive open-ended face to face interviews in Bangladesh, India, Nepal, Pakistan and Sri Lanka between May 2002 and November 2004 with 780 opinion makers / elites drawn from 107 active and retired civil servants; 203 journalists; 224 scholars; 147 business executives; and 99 others comprising religious leaders, trade union leaders, NGO leaders, retired military personnel, judges and lawyers. About 20% of the respondents were women. About 75% of respondents were in the 35-55 age bracket and 25% in the 56-70 age bracket.

policies as well as the interdependence of regional and domestic politics. Thus they remain more interested and involved in the formulation of regional cooperation policies. In addition they have greater potential to influence indirectly the course of government policy as well as the capability to politicise issues, mobilise masses and even increase saliency of particular issue by means of debates, media writing and discussion.[23]

In exploring views on positive issues of SAARC, it was significant that SAFTA initiatives were mentioned as the third most positive aspect of SAARC by nearly half of the respondents (48%), after the practice of holding regular meetings between senior government figures (78%) and cultural, technical and scientific cooperation (53%).[24] Given the low level of intraregional trade and their trade dependence on traditional areas – as well as the issues highlighted with SAFTA in this report – this finding is encouraging and marks a shifting attitude toward deeper trade cooperation in South Asia. However while more than half of the respondents from India (56%) and Sri Lanka (66%) supported expansion of intraregional trade cooperation – which provides a platform to build on - there was low support for SAFTA from Nepal (33%), Bangladesh (44%) and Pakistan (38%) which needs to be addressed.

There are possible explanations for the varying levels of lower support for SAFTA. Nepal's trade agreement with India and the realisation that it has nothing more to gain through intraregional trade due to its relatively smaller economic size might have contributed to a lack of enthusiasm on this issue among Nepalese respondents.[25] Bangladesh's fear of Indian goods dominating the country's market and India's high rate of tariff and non tariff barriers as well as the lack of any unilateral openness to Bangladeshi products likely explain the existence of a low level of support for trade liberalisation under SAFTA. In fact many respondents in Bangladesh observed that since India is the largest economy in South Asia and makes up 80% of the region's GDP, it should unilaterally open its markets and grant its neighbours concessions without expecting reciprocity. Similarly the low support among Pakistani respondents for SAFTA reflects the country's fear of India's economic domination in the region and Indian goods swamping Pakistan markets.[26]

A four-track policy can help seize the moment borne of the initiative that created SAFTA. These tracks can be delinked from each other - since each will bring potential benefits and at the same time contribute positive synergies to the other area.

1. *Indo–Pakistan trade.* If as Pakistan's Foreign Minister recently acknowledged, 'Pakistan-India relations have in the past been a major impediment in the progress and prosperity of the South Asian region,' as SCCI pointed out on the eve of the 2008 SAARC Summit, 'the future of South Asia depends on the relationship between India and Pakistan as the two major players.' Despite recent rhetoric on challenges for bilateral relations in the wake of terrorist incidents in 2008, there is still a need - and an opportunity - to capitalise on what Pakistan's Foreign Minister has referred to as

[23] it is worth adding the largely anecdotal but abundant reports of overwhelmingly positive experiences during cricket tours by India and Pakistan in each others countries in 2004-06, with around 9,000 visas being issued a month during the tours, provided an unprecedented level of people to people contact amongst a younger and largely post 1947, 1965 or 1971 generation

[24] next to SAFTA initiatives, people to people contact received much support and a little less than half of the respondents mentioned SAARC's positive role in enhancing people top people contact; after this a little less than one third of respondents supported SAARC's efforts for visa relaxation to facilitate more interaction among South Asian people

[25] In 2008 post the new administration in Nepal a review of the Trade Treaty with India has begun with a process emerging for a more comprehensive partnership agreement (CEPA) covering a wide range of sectors with both sides hinting that the economic cooperation must go beyond the scope of the existing treaty

[26] interestingly this latter fear of Indian goods swamping Pakistan markets is abating according to Pakistan's Foreign Minister during an address in London on South Asia on 24 July 2008

'an appreciable improvement in the atmospherics between the two countries since 2004' with an Agreement between India and Pakistan to renew direct cross-border trade which would advance regional integration, build trust, and lay the foundation for progress in SAFTA. For SAFTA to be the catalyst for this process of integration, the two economies that remain the least integrated in the SAARC region – ie. India and Pakistan – will need to enforce an expanded trade liberalisation programme. Early moves toward ending the prohibitions on trade could facilitate all movements of goods and services across the border, and would ease the adjustment to RTAs that might take effect in later years. This can be done on an MFN basis and requires no change in the trade code other than the trade-specific elements introduced vis-à-vis between India and Pakistan. Converting existing trade now routed through Dubai and formalising trade now smuggled across the border will lower costs to both economies and promote growth.

2. *Trade facilitation.* A second track, independent of the first, is collaborative movements to improve trade facilitation customs, and ports. Pakistan is already making progress in its efforts vis-à-vis Afghanistan. Turning its attention to the ports and customs in Karachi and turning its attention to the potential border crossings with India would also facilitate expanded trade on both the MFN basis and any preferential basis that would follow. Bangladesh has significant delays and inefficiencies in its customs on both the export and import side, as well as in the ports. Moving forward with ideas currently in discussions would reduce the heavy implicit tax imposed on the competitiveness of the Bangladeshi economy. India, Nepal, Sri Lanka, and the other economies of the region likewise have considerable room for improvement in trade facilitation. Regional collaboration and unilateral initiatives could motivate reforms. All would benefit from regional trade and MFN trade.

3. *Bilateral and plurilateral trade agreements with countries outside South Asia.* India and Pakistan have embarked on a series of bilateral initiatives with other countries. While these cannot substitute for multilateral initiatives, they may - depending on design - offer some new market-widening opportunities. The risks should not be underestimated, however. First, they may fall victim to the same pressures to formulate a politically attractive agreement, if with only small-market liberalising consequences. Second, if signed among small-market countries, they are unlikely to generate the volume of trade that would have a measurable development impact. Third, there is some risk that scarce negotiating capacity will be siphoned away from more promising regional and multilateral arrangements. Finally, the risk is great that multiple bilateral arrangements complicate customs administration, create added delays at ports and border crossings, and opens border transactions to ever-greater discretion for customs agents, a recipe for aggravating corruption. Still, if major players in South Asia were to negotiate bilateral or plurilateral arrangements with China or ASEAN behind lower tariffs, this could contribute to widening trade and competition throughout the region.

4. *SAFTA.* Beginning the SAFTA discussions with a clear objective of increasing cross-border trade and new import competition in national markets is paramount. While apparently obvious, the history in South Asia and other regions demonstrates that it is easy to lose the game before it is begun if defensive interests gain primacy at the outset.

   This simple and obvious precept has nontrivial implications:-

   - All countries have to limit the number of excluded tariff lines to be included on the sensitive lists that are provided for in the SAFTA agreement.

- Keep rules of origin simple and transparent, so these do not become devices of protection and impediments to trade.

- Keep aspirations for investment and other ancillary protocols limited. Ambitious agreements to establish detailed investors' protections and separate dispute panel resolution systems have delayed progress in other agreements and often for limited economic gain. This arguably is the case with the FTA of the Americas.

- Limiting antidumping actions against regional partners could steer protectionist tendencies toward the preferred instrument of safeguard positions. If the private sector through the antidumping mechanisms are allowed to veto the benefits of the SAFTA arrangements, it will substantially weaken the positive growth effects that would otherwise come about. India, in particular, has taken frequent recourse in antidumping suits, and a proliferation of early cases could easily derail the regional trade. The SAFTA arrangement has clearly spelled out well designed mechanisms to deal with surges and imports and disruptive trade patterns that may come about because of SAFTA.

The lack of progress in multilateral negotiations has come as a blessing in disguise for developing countries, including those in South Asia. They should utilise this hiatus to identify and address the supply-side constraints that limit their potential to benefit from market access opportunities rather than merely pursue regional and bilateral agreements for trade liberalisation. Improvements in infrastructure, trade facilitation measures, institutional arrangements and legal regimes are key to addressing such constraints.

On the eve of the 15th SAARC Summit, **SCCI** set out a comprehensive and bold memorandum and proposed **roadmap for effective implementation of SAFTA**. Sharing the aspirations of the people of South Asia for a better life and collectively to face the challenges posed by globalisation and meeting the demands of the WTO regime though enhanced regional cooperation have agreed to pursue the following guidelines:-

1. The SAFTA agreement is only the first stage on the road to deepening cooperation; its effective implementation will depend on the space created for trade, economic collaboration and development across our frontiers. However, if South Asia's economies are to be integrated it will require the development of transnational infrastructure.
2. Trade cooperation would point to monetary cooperation thereby suggesting the need for coordination among central banks. Sustained trading links would require investment, cooperation, both public and private, through joint ventures.
3. The Customs Union could lead on to a common exchange rate policy and eventually a common currency underwritten by coordination of macro-economic management across the region.
4. Energy cooperation could evolve into a common energy grid across the region with integrated electricity and gas systems. Transport cooperation would lead to an integrated transport infrastructure which permits for uninterrupted travel from Peshawar to Chittagong and from Kathmandu to Colombo and connecting the abutting regions - Central Asia, the Persian Gulf, South East Asia and China - with South Asia.
5. Investment flows would culminate in regional corporation with production facilities located across the region through vertically and horizontally integrated production systems. Shares of both national and regional companies would be quoted on the stock exchanges across the region as capital moves without hindrance across national boundaries to underwrite investment in any part of the South Asia region through a South Asia Development Bank.
6. The regional economic cooperation, investment in transnational physical infrastructure, transportation, communication, energy grid, sharing of water on an equitable and efficient

basis and efforts at poverty alleviation would not produce tangible results unless the following criteria are adopted: a) The concerns of LDCs are genuinely addressed; b) the negative list is kept at the minimum to protect the most vulnerable sectors; c) tariffs are brought down, as agreed, and non-tariff and para-tariff barriers are minimised; d) economies are gradually opened up to each other with a recourse to investment-trade linkage that takes care of trade deficits between partners through investment flows and capital account; e) vertical and horizontal integration of industries that benefits from relative advantages, economies of scale and provides global competitiveness.

7. To realise such a transformation in the investment climate in each of these countries, preconditions will have to be created to overcome perceptions of political hostility and the attendant security threats will have to be addressed.
8. The proposal for a dedicated South Asian Development Fund could also be encouraged. One fund should be dedicated to financing infrastructure and development projects most beneficial to the adjoining regions. A second fund should be established as an Investment Fund, serviced by both public and private capital, to finance private sector investment as well as projects for serving regional markets.
9. The main obstacle to improving connectivity remains political. The prevailing barriers to cross-border movements make neither commercial nor logistical sense and originate in the pathologies of interstate, as well as domestic, politics. The political leaders of South Asia should, therefore, dismantle the political barriers to regional integration.
10. If South Asia's energy scenario were to be re-defined within a regional context, its energy needs would expect to be served through a common distribution system integrated within a single energy grid of power and gas lines extending across and among the abutting regions.
11. South Asian nations should look beyond the traditional nations of security and focus on cooperative security; the nation of cooperative security recognises the profound condition of interdependence that binds South Asia and calls on the states of the region to act in their own enlightened self-interest to resolve the current problems facing them through peaceful means.
12. Beyond cooperative security, South Asian nations must ultimately move towards human security by placing people - their well-being and rights to peaceful life and development - at the centre of security concerns, rather than continuing with the arms race.
13. There is a greater need to allow greater interaction among policy-makers, parliamentarians, business people, media practitioners, professionals and the leaders of civil society. To enable this to happen, it is necessary that India, Pakistan and Bangladesh, who have restrictive visa regimes, drastically revise their visa policy and remove impediments to free movement of people.
14. To overcome information deficit about the countries of the region, it is imperative that all restrictions on across to and free flow of information are removed forthwith and media persons and products are allowed free movement across frontiers; the media, on their part, should give special attention to coverage of the countries of South Asia that remain under-reported.
15. It is imperative for South Asian countries to agree to a uniform human rights code and set up institutions under the Paris Principles, and call upon the member countries of SAARC to purposefully set about creating the required mechanisms.

The following **recommendations** were made at the conclusion of a roundtable entitled, ‘SAFTA: An Enabler of South Asian Regional Integration’, organised by the SAARC Chamber of Commerce and Industry on 17-18 April 2007 in Bhurban, Pakistan:-

1. Non-tariff barriers and Para tariff barriers that have been hindering trade among the SAFTA contracting states should be identified and removed.
2. Travel and visa restrictions between the member countries should be expedited and eased so there is freedom of mobility for increase business activity.

3. There should be simplification and harmonisation of custom rules and tariff structures to encourage business activity in the region.
4. The services sector needs to be included in the SAFTA framework as in other prevailing regional and bilateral FTAs.
5. Bilateral and other regional FTAs prevailing in the region should act as a building block to SAFTA.
6. Regional transport, infrastructure, IT links, and telecommunication systems (international roaming etc.) between all the SAARC countries should be improved so that trade and people to people movement can be facilitated.
7. The free flow of media, information and publication should be allowed and there should be an establishment of a South Asia news agency.
8. The media should play a positive role in changing the mindsets of the people
9. The sensitive list should be revised and reviewed in a time bound manner to reduce the number of items in it.
10. There should be an acceptance of international quality standards and certification regimes.
11. The SAARC Chamber, as the apex and lead representative of the private sector, should be made part of on-going SAFTA negotiations and all other trade related negotiations at the level of the SAARC Secretariat.
12. Pakistan and India, being the two larger and more developed countries in the region should lead the way for the implementation of SAFTA. They must make the deepest concessions to open up their import regime to regional countries and help the smaller countries to enhance and diversify their production.

With regard to strengthening SAFTA, the following **recommendations** made at the CBC-SCCI Regional Roundtable on Trade Liberalisation in SAARC in Islamabad in May 2006 should be taken forward:

1. The sensitive list under the SAFTA framework contains a large number of products that will curtail the effectiveness of SAFTA. Hence, the number of items in the sensitive list should be reduced to an amount where it will be beneficial for the member countries.
2. The rules of origin should be kept simple and transparent so that complexities do not arise.
3. The replacing of anti-dumping with safeguards provisions should be considered to ensure minimal trade diversion in the region.
4. The service sector should be included in the SAFTA framework as in other prevailing regional and bilateral FTAs.
5. There should be a simplification and harmonisation of custom rules and tariff structures. These steps would lead to enhanced trade and business activity between the member countries.
6. Pakistan and India, being the two larger and more developed countries in the region should lead the way for the implementation of SAFTA. They must make the deepest concessions to open up their import regime to regional countries and help the smaller countries to enhance and diversify their production.
7. Regional transport and transit system should be improved so that goods can be easily transported within the region.
8. Travel and visa restrictions between the member countries should be eased so there is freedom of mobility for increased business activity in the region
9. Awareness should be created about the potential benefits of SAFTA among people and business people in the region so there is an eagerness for its successful implementation.

From the very narrow perspective of trade flows, the economic characteristics of the South Asia region, such as the small regional market relative to the world both in terms of GDP and trade flows, and the high level of protection, would suggest that focusing on regional integration alone will not generate the beneficial productivity and growth effects of integration. South Asia is a relative newcomer to global integration. Despite recent liberalisation, it lags other regions such as East Asia in terms of openness. When external protection is high, trade diversion is likely to dominate trade creation, and so the risks that regional integration will be a drag on growth in South Asia is high.

Once external linkages reach a certain level of intensity, there will be pressure from producers to lower or remove the various barriers to intraregional trade, including bureaucratic red tape and conflicting legal restrictions and administrative procedures, as well as demands for better transport and communications infrastructure. Areas of such active regional cooperation can include apparently simple measures, such as trade and transit facilitation and the dissemination of commercial information. However it is precisely the lack of such measures that are often a major hindrance to closer integration. Regional cooperation in the planning and financing of transport infrastructure to enable physical cross-border trade and reduce its costs is an equally important ingredient for development. Regional management and investment projects in the crucially important areas of energy and water supply, which in South Asia represent serious bottlenecks, are other instances where regional cooperation can serve development.

Regional cooperation among developing countries actually involves a good deal more than the search for common ground on external policies; it also involves the provision of regional public goods and a reconfiguration of policy space. At the same time, new political challenges, including the unequal influence of members, and in particular the ability of stronger members to bypass collective agreements, will have to be dealt with. This implies that regional arrangements, as much as those of national State formation, will have to develop acceptable levels of competence, legitimacy and trust, which is likely to take time. The European experience of regional cooperation suggests that such cooperation is unlikely to follow some established blueprint, that it takes considerable time to evolve, and that the steady build-up of institutional capacity is a critical dimension of success.

Nevertheless, regional integration is desirable from other perspectives. Regional cooperation can be an effective tool in addressing energy shortages, ensuring that no region/country is left behind, landlocked regions/countries have full access to markets, and peace and stability are promoted. Above all, there is a need for greater people-to-people contact through improved connectivity, phasing out of visa restrictions, and liberalising the restrictions on the trade of services (for example, tourism, education, and health) where the risk of trade diversion is low. There is a need to first identify the complementarities in services trade and then liberalise these areas on a priority basis. SCCI has highlighted the need for sectoral studies which could support decision-making by companies – both local and international – in relation to market entry. These initiatives would help increase investment and growth by reducing the infrastructure constraint and by lowering transaction costs. Better regional cooperation and integration can also increase welfare by improving the regional political environment, thereby reducing conflicts and associated social and economic costs.

In practically all regional blocs involving developing and transition economies, regionally produced manufactures, including the more skill and technology-intensive product categories, find markets more easily in countries in the same region than in international markets further away. There is therefore considerable scope for developing economies in South Asia to benefit from advantages of geographical and cultural proximity when seeking to develop their industries and upgrade their production. Regional industrial cooperation does not preclude integration into the wider global economy, but it may serve as a vehicle to achieve global competitiveness. However a regional dynamic will rarely be triggered by trade liberalisation alone. For regional integration to be viable in the long run in South Asia, as elsewhere, some common regional policies and institutions may need to be developed to prevent greater income divergence among and within South Asia as a result of integration, which might trigger defensive measures on the part of the disadvantaged members and weaken the integration process.

Deep integration involves reductions in non-tariff impediments to trade such as differences in customs procedures, regulation and standards. This creates more significant economic gains by permitting niche market specialisation and stable value chains. Greater complimentarity between South Asian markets will be needed for the benefits of deep integration to be fully realised. This would involve improvements in technology and the level of similarity between industrial sectors in the region. The rate of industrial development, growth in the middle classes and general pace of change in the region are all positive drivers in this context. Efficiency-seeking industrial restructuring has already begun in South Asia to a small extent: in ISFTA, several Indian firms have set up businesses in Sri Lanka to export back to India, taking advantage of the liberal trading environment. In more advanced regional integration schemes such as the EU, this phenomenon has been more significant.

Export and industrial diversification is necessary because of the over-dependence in a post Multi-Fibre Agreement (MFA) environment on textiles and clothing exports which still constitutes some 90% of the export base for Pakistan and Bangladesh. The MFA phasing out is posing real challenges for SAARC countries in particular given competition from China and elsewhere. One of the ways to improve competitiveness would be to identify the scope for horizontal specialisation within the region and subsequently facilitate industrial restructuring to meet this objective. There is immense scope for regional cooperation in the South Asian region for effecting efficiency seeking industrial restructuring in the textiles and clothing sector. For this purpose emphasis needs to be laid upon tapping trade complementarities, focusing horizontal specialisation, exchanging regional technologies, augmenting quantity and quality of intraregional FDI, entering into global supply chains and building technological capability through training. Moreover increased economic integration would carry with it the ability to not only secure new and larger markets for traditional products, but also enable the diversification of domestic economic structures.

An approach to regional cooperation, whether it is among developing countries in South Asia or between developed and developing countries, that focuses on trade liberalisation alone may be consistent with the view of regional agreements as building blocs for a system of global free trade and capital flows. However, if regional integration is understood as an element of a broader development strategy aimed at faster domestic capital accumulation and technological progress in the most promising industrial and service sectors according to the local circumstances, this approach is unlikely to achieve the desired results. Trade policy alone will not be enough to strengthen regional economic ties. Development of local productive capacity will also be crucial.

An alternative approach would consider regional integration in South Asia as providing a space for a development strategy based on industrialisation and private sector development. Proactive regional economic policies should also be developed that aim at fostering structural change, taking advantage of potential complementarities and specialisation among the SAARC member countries and increasing the productive capacities of the less developed members. All South Asian countries should place renewed emphasis on supply side reforms to strengthen capabilities (entrepreneurial, technological, managerial, etc.) and improve institutional and regulatory frameworks.

Indeed the wider aspects of economic co-operation such as people movement, networks and experience sharing are just as important as trade. There is not enough cross border movement which needs to be a priority agenda item in South Asia. The key will be how much people to people contact there is and once that happens en masse then people will develop trade routes. There is also significant scope to increase co-operation on economic development and poverty reduction. This could create mutual gains for SAARC members and help foster economic co-operation more widely. Efforts to support economic co-operation in South Asia will always be inextricably linked to efforts to reduce poverty and implement wider reform. At the same time progress in education in training is essential in creating a successful regional economy.

Increased trade in South Asia should not be considered an end in itself; rather it is a means to achieving faster growth. Countries should therefore also investigate innovative areas of policy-making at the regional level that could support diversification and industrialisation of their economies. This could, for example, take the form of support for industrial projects and common undertakings in research and development, knowledge generation and information dissemination, that might be too costly and risky for an individual developing country but viable if several countries were to pool their resources.

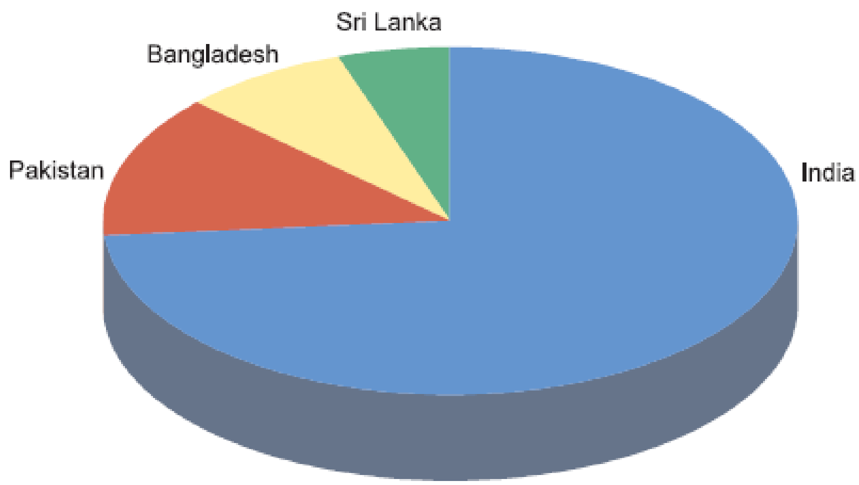
As SCCI said on the eve of the 15th SAARC Summit, 'it is the duty of the private sector of SAARC to redeem the hopes of their respective Government, particularly India and Pakistan to meet the challenges, making SAFTA and enabler of economic development of the region.' At its core factors such as the mindsets of the governments and the people in the region hinder South Asia from becoming an effective integrated bloc. Domestic liberalisation is also essential. The way forward lies less in how many treaties have been signed but in how much market development takes place on each side of each border. It is worth remembering too that SAARC was established in the first place to promote economic integration and see how a potential economic powerhouse backed by more than 1.5 billion people can perform. As SCCI recently emphasised at a recent meeting with the ADB on SAFTA, 'regional integration can go a long way towards developing market synergies, improving business linkages, contributing to sustainable economic growth, eradicating poverty and balancing the regional demand and supply in various sectors of South Asia.'

APPENDICES

Appendix 1: Characteristics of trade in South Asia

India continues to have a dominant share of the region's exports of goods as shown in Figure 4. Its exports are more diversified and include durable consumer goods, intermediate materials, and certain machinery that is competitive not only internationally but also in South Asian markets, especially Bangladesh and Sri Lanka.

Figure 4 Export Share FY, 2005



The other economies are smaller and their exports more specialised in labour-intensive products, especially textiles, garments, leather goods, seafood, and agricultural products. This difference can be seen in the proportion of exports accounted for by different commodity groups (2-digit HS code) as shown in Table 8. For India, 12 commodity categories (2-digit HS code) account for 95% of the exports by value with no category accounting for more than 22%. In contrast, in Bangladesh and Maldives, fewer than five categories account for 95% of exports. Bangladesh is the most specialised with textiles accounting for more than 85.8%. The combination of textiles and garments, leather products, fruits and vegetables, and fish and crustaceans account for 96% of the value of Bangladesh's exports and more than 80% for Pakistan and Sri Lanka but only about one-third of the value of India's exports.

Table 7 Percentage of Export Goods Trade According to Commodity Groups Based on Value (2-Digit HS Code)

India		*Nepal*		*Pakistan*		*Sri Lanka*		*Bangladesh*		*Maldives*	
Textiles	21.5	Textiles	50.6	Textiles	68.9	Textiles	53.4	Textiles	85.8	Animals	55.4
Stone	17.2	Metal	10.2	Vegetables	7.3	Vegetables	17.3	Animals	5.6	Textiles	32.0
Chemicals	10.6	Fats and Oils	9.3	Leather	5.8	Plastic	6.5	Leather	3.0	Foodstuffs	12.3
Minerals	9.1	Chemicals	6.6	Vehicles	3.0	Stone	4.7	Chemicals	1.4	Other	0.3
Metal	9.0	Vegetables	6.0	Furniture	2.8	Mechanical	3.2	Other	4.2		
Mechanical	7.0	Foodstuffs	5.5	Minerals	2.8	Metal	3.0				
Vegetables	6.4	Plastic	2.9	Animals	1.5	Animals	2.1				
Plastic	3.2	Paper	1.9	Foodstuffs	1.5	Vehicles	2.0				
Vehicles	3.1	Leather	1.4	Plastic	1.3	Foodstuffs	1.9				
Animals	2.8	Minerals	1.1	Chemicals	1.1	Furniture	1.1				
Foodstuffs	2.7	Other	4.5	Other	4.0	Other	4.8				
Leather	2.5										
Other	4.9										

Source: UN COMTRADE, http://unstats.un.org/unsd/comtrade

Each of these commodity groups have different requirements in terms of cost, time, and reliability of their logistics. Competition in the garment and textile industry has been driven by cost, but as the global outsourcing has matured and retailers have refined their supply chains, time has become increasingly important component of competitive advantage. Reduced order times permit a reduction in inventories to avoid liquidation of over stockage while guaranteeing replenishment of fast moving items so as to minimise the possibility of lost sales. Leather goods tend to be less sensitive to cost but are more demanding in terms of time and reliability, especially for semi-finished goods used in manufacturing shoes. Fruit and vegetable exports are the most time sensitive because of the shift from processed to fresh products. The challenge is to deliver the products at the proper time in their ripening cycle with high reliability and lower cost. Reliability becomes more important for large-scale retailers that schedule the days of the week on which fresh produce is placed on display. Seafood is less of a problem because most of the fresh products are shipped frozen with relatively long shelf lives. Timing and reliability are most important in the supply chain activities linking the boat and the processing plant.

The region's principal export markets are North America and the European Union. While East and Southeast Asia are important sources of supplies for the production of its manufactures, especially garments, they are less important as destinations for the exports. The principle markets for the major commodity groups are shown in Table 9. The diversity of markets served by each of the countries varies significantly, with India having a significant level of trade with the largest number of countries followed by Pakistan, Bangladesh, and Sri Lanka. The least diversity in markets occurs for exports from Nepal and Maldives.

Table 7 Major Non-Bulk Exports

	ASEAN	*European Union*	*NAFTA*
India	Vegetables	Fish, Vegetables, Textiles	Fish, Vegetables, Textiles
Bangladesh	–	Textiles	Textiles
Nepal	Textiles	Textiles	Textiles
Pakistan	Vegetables	Textiles	Textiles
Sri Lanka	–	Vegetables, Textiles	Textiles

The shares of exports based on weight, rather than value, for the principal markets and commodities are shown in Table 3. Textiles and apparel are dominant among the three major commodity groups, except for India where there is a comparable volume of fruits and vegetables and significant exports of fish and crustaceans. The European Union is the dominant market for Bangladesh while there are more balanced shipments to the EU and North America for India, Sri Lanka, and Pakistan. Only Nepal ships significantly move to North America than the EU. Although there have been fluctuations from year to year, these shares have been relatively stable over the last five years.

Table 8: Export Trade by Volume in % (2003)

	India	*Bangladesh*	*Nepal*	*Pakistan*	*Sri Lanka*
ASEAN	24	2	2	13	1
European Union	42	65	14	45	49
NAFTA	34	32	84	42	50
Fish	18	7	1	8	4
Vegetables	46	1	0	20	10
Textiles	36	92	99	72	85
Total (000 tonnes)	1,071.9	597.0	13.2	364.8	174.1

Source: UN COMTRADE data from importing countries

Appendix 2: The India–Sri Lanka Free Trade Area

The FTA between India and Sri Lanka can be characterised as an agreement where liberalisation did not apply to the "sensitive" sectors in both countries. In fact, most of the products in these sectors were included in the negative list (list of products excluded from concessions) and tariff-rate quotas (MFN tariff is applied to imports below this quota-pay preferential tariff and above it) were applied on many others. Indeed, although India granted duty-free access to 81% of the items by the third year of the entry into force of the agreement, these concessions were not significant to the extent that the majority of the products exported by Sri Lanka were either included in the negative list presented by India (15 products out of their top 20 exports to India) or were subject to quotas. Likewise, in the case of Sri Lanka, seven of India's top 20 exports to the world (which accounted for 42% of total exports) were subject to the negative list exception, four are subject to zero MFN tariff, and one more product is subject to 5% MFN tariff. In particular only three items out of the 319 on which Sri Lanka offered zero duty to India, were actually exported from India, and 68 out of 1,351 on which India offered zero duty to Sri Lanka were exported from the latter.

In addition to that, the agreement also had very strict rules of origin (40% local content, 30% for LDCs, plus substantial transformation at HS four-digit) that further handicapped the potential expansion of intraregional trade on a preferential basis.

Nevertheless, the India–Sri Lanka Free Trade Agreement (ILFTA) has led to a substantial expansion of bilateral trade between India and Sri Lanka. This was the result of an expansion of trade in products that were not traded or barely traded between the two countries before the agreements; therefore, they were not included in the negative lists. For example, in the case of the exports from Sri Lanka to India, the products that were not traded before the agreement reached a share of 38% only three years after it was implemented. Likewise, in the case of exports from India to Sri Lanka, those products that were at the bottom of the list and represented only 10% of the exports before the agreement increased their share to 39.5% two years later. However it is not clear whether this expansion represents trade creation or diversion.

A quantitative assessment of the impact of the ILFTA (South Asia Economic Journal, June 2008) found that both Sri Lanka and India will experience welfare gains from the agreement. Moreover, it was evident that the Indo-Lanka full trade liberalisation scenario ensures higher welfare to both the countries than the Indo-Lanka FTA with negative lists. Hence, the scenario with negative lists could be treated as a second best solution as 'with-negative-lists' scenario where both the countries could not reap the maximum benefits under the FTA. The study demonstrated that trade diversion effects are not especially significant due to trade liberalisation between the two countries. The industry analysis reflected that the industries, such as metal products, paper products and publishing, electronic equipment, chemical, rubber and plastic products, machinery and equipment necessaries and other primary products will benefit due to the ILFTA. However, it could be seen that the industrial sector is benefiting more than the agricultural sector due to trade liberalisation between the two countries.

There was a recognition in Sri Lanka that trading within the South Asian region eventually boiled down to trading with India as it was the largest source of imports to Sri Lanka even before the ILFTA. Under ILBFTA a product wise positive list approach to tariff preferences was abandoned in favour of a negative list approach and the tariff phasing-out was planned based on an eight year time table. Non-tariff barriers (NTBs) were removed with tariff preferences. Asymmetry between the countries was accommodated for by providing special and differential (S&D) treatment to Sri Lankan exporters. Although India became even more a dominant trade partner, the bilateral FTA actually helped reduce Sri Lanka's trade deficit with India, as the ratio of Sri Lanka's imports from and exports to India fell from 14.3:1 in

1998 to 2.6: 1 in 2005. Non-traditional export items Copper and copper products, vegetable oils, and aluminium products became the main exportable of Sri Lanka after the bilateral arrangement. The export success of these new products was mainly been due to large protection in India on the related imported raw materials, which were imported into Sri Lanka duty free before exporting to India under ILBFTA. The wide coverage of the negative list along with widespread non-tariff barriers had stifled further trade growth potential. The Institute of Policy Studies in Colombo estimates that 64% of Sri Lankan exports of ready made garments (RMGs) and tea – two principal export items from the country – were under tariff rate quotas (TRQs) and subject to other conditional entry requirements.

Exports to India since 2006 have been constrained by NTBs and some policy reversals by India with regard to preferences initially offered to Sri Lankan exporters. India reduced tariffs for inputs to manufacture copper, aluminium, chemicals, etc., as a result of which there was a dramatic reduction of these exports from Sri Lanka to India. Many Indian manufacturers operating in Sri Lanka to take advantage of the varying tariff structures in the two countries went back to India and commenced production there. In fact, while Sri Lankan exports actually fell during 2006-07, those from India continued to rise, resulting in a massive bilateral trade deficit suffered by Sri Lanka.

At the same time the ILFTA has encouraged FDI flows from a third country to take advantage of widely varying tariff structures of SAFTA members. For example China is looking for investment opportunities in Sri Lanka's EPZ where they can produce products and export to India using the benefits of ILBFTA.

> NB **The India-Nepal Treaty** of Trade was signed in 1991 and further developed in 1996 and 2002. Nepal's trade was highly concentrated with India: in 2005-06, 68.7% of all exports from Nepal was destined to India, while 64% of all imports was sourced from India and if the size of informal border trade could be taken into account, such dependence on India be rise further. The experience of the India-Nepal Trade Agreement is that because of Nepal's faster unilateral liberalisation the tariff differentials between the two countries became quite significant, giving rise to similar experience in the India-Sri Lanka FTA, as Nepalese exports to India increased through trade diversion. Export statistics showed that exports were concentrated in only a few products and there was much similarity between the export product lists of Nepal and Sri Lanka.

Appendix 3: ADB Study on Quantification of Benefits from Regional Cooperation in South Asia (2008)

Table 9 Results for Individual Countries

Bangladesh[27]	Bangladesh's welfare gains are one of the highest for South Asian countries. Its high welfare gains may be attributable to the complete liberalisation of high MFN tariffs, which generates consumptive benefits, for both user industries as well as household consumers. Bangladesh also sees an increase in global exports by a very significant 4.31% on account SAFTA. Export gains for Bangladesh in SAFTA markets in phase I of liberalisation (2008-09) are significant, but not as high as the peak export growths to SAFTA seen by other members. Its global exports see significant 5% rise in the second phase with most of this growth relating to regions outside South Asia. The wearing apparel sector grows more on account of its improved global exports which grow by as much as 6% a result of SAFTA phase II. 98% of the increase wearing apparel exports are to countries outside South Asia. SAFTA induces a relocalisation of output, with major production increases seen in Wearing Apparel (5.5%) and Leather Sectors (3%). This is a positive result[28] since these sectors tend to be highly employment intensive. The gains of Bangladesh are so significant that all other South Asian countries see a decline in their output and global exports. Its output in chemicals, rubber and plastics also rises by about 2%, while global exports go up by 10% - this is a validation of indications that Bangladesh is an emerging competitive producer in chemicals like pharma, plastics and ceramics.
India	A full SAFTA will help India to nearly double its exports to South Asia. India's export gains from SAFTA are limited to a few agriculture sectors and the auto sector where it is seen to have relative comparative advantage vis-à-vis the rest of South Asia. There are two agricultural sectors where India does gain significantly from SAFTA– poultry and sugar. In fact its highest output gain is in the poultry sector. There is a 1.33% increase in output in sugar. Pakistan will be the main market for sugar exports in the region. India's auto sector grows by 1-4% on account of SAFTA, with its regional exports in this sector increasing by 10-40%. India's global wearing apparel imports increase by 7% and with its output declines by 2.5%.
Pakistan	Like India, a full SAFTA for Pakistan will help it double its exports to South Asia. Pakistan sees good results for important employment intensive agriculture sectors like wheat, horticulture, meat products (mainly poultry) and other food products. The textiles sector which is very important to the Pakistan economy sees an output expansion of about 0.5%. Also, like India, Pakistan tends to lose in both wearing apparel and leather products sectors. It also sees losses in the sugar sector, perhaps on account of its increased imports of this product from India.
Contrary to popular intuition, India and Pakistan are not the most important markets vis-à-vis each other. More than 60% of the increase in exports to the region for both India and Pakistan are directed towards Bangladesh. This seems to indicate the relative lack of complementarities between India and Pakistan,[29]	

[27] The SDB study suggests that Bangladesh will have positive welfare gains of US$265. However a previous study found that 100% tariff cuts by SAFTA members, for their South Asian partners only, will result in a welfare loss of $184 million (Raihan and Razzaque, 2007). Further when Bangladesh eliminates all tariffs for SAFTA members only, imports from other low cost suppliers (eg. China) decline while those from India increase rapidly. Because of the replacement of low cost suppliers with high cost suppliers, trade diversion dominates over trade creation effects, resulting in adverse welfare consequences for Bangladesh. When Bangladesh undertakes unilateral liberalisation by cutting MFN tariffs by 50% along with full SAFTA liberalisation (ie. 100% tariff cuts for SAFTA members), welfare effects become positive (US$84 million).

[28] the observation that Bangladesh gains from sourcing lower cost textile intermediate products (from other South Asian countries) for its export-oriented apparel industry is questionable as their exporters currently can procure such materials duty-free from any regions.

[29] another possible explanation is that the existing level of trade between India and Pakistan is too low to generate any meaningful supply response

but the existence of complementarities of between India and Bangladesh, and Pakistan and Bangladesh. More than 50% of Pakistan's gains from SAFTA, are from increased exports to Bangladesh in textiles alone.	
Sri Lanka	Sri Lanka's gains in the first phase of liberalisation are almost nil. This is largely because Sri Lanka already has close to free access to the Indian market, and also because LDCs and DCs have not committed to substantial liberalisation vis-à-vis Sri Lanka in the first phase. Sri Lanka's gains are more improved in the second phase, when all countries participate fully (and remove their negative lists). The increase in output in vegetable oils corroborates empirical evidence of duty structures that favour manufacture of edible oils. The textiles sector which contributes to about 5% of total output in Sri Lanka sees a growth of about 4%. Negative employment and output effects are seen for wearing apparel and some agricultural products.
Afghanistan, Bhutan, Maldives and Nepal (ABMN)	The ABMN sees gains in primary commodities with complete liberalisation in 2016. With the removal of sensitive lists in a full liberalisation scenario, ABMN groups see good export growth in agriculture products and primary commodities. Given that the agriculture and forestry sector in ABMN accounts for over 50% of domestic output, and given that these sectors are employment intensive, a full SAFTA is beneficial to ABMN. However the manufacturing sectors in ABMN are by and large uncompetitive, and hence suffer output and employment losses.

Results with respect to Revenue Loss due to SAFTA

In addition to the benefits of SAFTA in terms of gains in trade, output, employment and prices, it has been argued that custom duties form an important share in the revenues of the government in these countries. ADB estimated the impact on welfare, trade and revenue on each of the SAFTA member countries.

Table 10 Results for Individual Countries

Bangladesh	Revenue losses to Bangladesh are estimated to be about $0.9 billion. Maximum revenue loss of $0.88 billion is due to tariff cut by 100% on imports from India. 100% tariff reduction by Bangladesh creates trade of approximately $0.27 billion. Maximum trade creation takes place between India and Bangladesh followed by Pakistan and Bangladesh.
India	Revenue losses to India are about $0.12 billion. Maximum revenue loss of $0.06 billion is due to tariff cut by 100% on imports from Nepal. There are welfare gains for India and other SAFTA member countries from 100% tariff reduction by India. In the case of 100% tariff reduction by India, trade increased by approximately $0.7 billion. Maximum trade creation takes place between India and Bangladesh followed by Sri Lanka and India, and Nepal and India.
Pakistan	Revenue losses to Pakistan are about $0.055 billion. 100% tariff reduction by Pakistan creates trade approximately $0.11 billion. Maximum trade creation takes place between India and Pakistan followed by Pakistan and Bangladesh.
Sri Lanka	Revenue losses to Sri Lanka are about $0.1 billion. 100% tariff reduction by Sri Lanka creates trade approximately $0.17 billion. Maximum trade creation takes place between India and Sri Lanka followed by Sri Lanka and Pakistan.
Bhutan	Revenue losses to Bhutan are about $7.3 million. In the case of a 100% tariff reduction by Bhutan, trade increased by approximately $17 million. Maximum trade creation takes place between Bhutan and India.
Maldives	Revenue losses to Maldives are about $0.016 billion. In the case of a 100% tariff reduction by Maldives, trade increased by approximately $0.026 billion. Maximum trade creation takes place between Maldives and India followed by Sri Lanka and Maldives.
Nepal	Revenue losses to Nepal are about $0.053 billion. In the case of a 100% tariff reduction by Nepal, trade increased by approximately $0.012 billion. Maximum trade creation takes place between Nepal and India followed by Pakistan and Nepal.

Appendix 4: SAARC and CBC - a common agenda for action to accelerate regional integration in trade and investment: communiqué issued at the South Asia Trade and Investment Forum, London 22-23 November 2006

FOCAL AREA	RECOMMENDATIONS FOR ACTION
Building on economic success and enhanced regional cooperation	1. Policymakers and business leaders within the region need to work together with a greater degree of urgency and direction. The SAARC summit in Delhi in April 2007 provides a real opportunity to build on economic success and enhanced regional cooperation. This can be achieved through involvement of the private sector and by realism, prioritisation and focus. CBC and SCCI are committed to work together as part of that process both up to and beyond the Summit.
Strengthening the investment climate	2. There need to be effective forums for dialogue: Government should engage in dialogue with the private sector on a wide range of investment climate reform matters such as trade policy – trade agreements between countries of the region, and at WTO level; regulatory frameworks (including tax and competition policy); and strengthening public administration. 3. Legal and regulatory systems need to cater for the areas of essential interest to business and reduce the associated costs to business: company law, contract enforcement; time taken to open and close down a business (which vary widely between countries at present); competition policy (to address restrictive practices both by dominant companies and by governments e.g. in Government procurement which must be open and transparent). Investment and trade promotion and the reputation of the region need to be proactively built in thinking, policy and practice by pursuing an integrated approach taken to investment
Opportunities in manufacturing, services, infrastructure and logistics	4. Regional sectoral opportunities should be researched and developed and more widely publicised both within the region and in key trading regions. 5. In order to develop infrastructure (in particular energy, communications, transportation and logistics) and provide wider access to rural populations and the poor, Governments should take steps to facilitate greater private sector involvement through innovative private-public partnerships and supportive legal and operating frameworks. Governments have a key role in encouraging this private investment. There needs to be intensive communication between public and private sectors on innovative partnership arrangements. International participation can help to build an enabling framework for PPP, contributing to best practice on such matters as transparency; simplified (international) tender procedures and qualifications; guidelines on operating environment.
Building New Partnerships through Trade	6. Business needs to encourage governments to accelerate and deepen SAFTA. Services and investment should be included in SAFTA as soon as possible. This will drive innovation across the region and signal that the region is serious in its desire to integrate with the global economy. It is also essential to provide for greater mobility of people, skills and transfer of knowledge.

FOCAL AREA	RECOMMENDATIONS FOR ACTION
South Asia's capital markets have a key role in mobilising investment	7. Capital market development should be a priority for business and governments in the next generation of economic reforms. Issues to be addressed include decreased regulation, currency convertibility, improving the forms of finance available, taxation reforms, investment incentives, strengthening the legal and regulatory frameworks and ensuring the availability of skilled human resources. In addition there is need to strengthen regulatory capacity and management education and training in corporate governance for public, unlisted companies and for state owned enterprises.
Support for SMEs and women entrepreneurs	8. Governments should adopt policy measures to support SMEs, increase their access to finance, to create an appropriate regulatory framework that does not overburden small businesses, and to create and maintain a competitive market environment. The private sector for its part should create more partnerships between large and small enterprises. Training for trade-related capacity building for women entrepreneurs should be provided in urban centres and rural areas.
SATIN has a distinct role and contribution to make to growth and prosperity in South Asia	9. A key component of SATIN should be engagement with diaspora and business entrepreneurs outside South Asia with the support of government and the private sector. Organisations have agreed to collaborate to support SATIN's objectives. 10. A knowledge base on trade and investment in South Asia should be developed by linking industry associations and trade promotion bodies and others including business schools and be freely available through the internet.

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