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The Case for Trade within South Asia

This policy brief presents a case for enhanced cooperation and collaboration in trade within the South Asian countries in order to increase their economic growth and human development. It particularly addresses the following questions:

Factors that restrict intra-regional trade

- **Indo-Pak hostility:** A key impediment to regional trade in South Asia is the persistent hostility between India and Pakistan. Trade between these two countries has been abnormally low. Pakistan accounts for less than 1 per cent of India's trade and India accounts for approximately 5 per cent of Pakistan's trade. Trade integration between the two economies is affected by political antagonism which is reflected in high tariff and non-tariff barriers. Pakistan has not implemented the South Asia Free Trade Agreement (SAFTA) provisions to Indo-Pakistan trade and maintains a narrow positive list of goods that India can export to Pakistan. It has also not extended the most favored nation (MFN) status to India. Similarly, India has maintained high tariff rates and non-tariff barriers on goods of particular interest to Pakistan. Bureaucratic regulations and restrictions have made trade so costly between the two countries that they have led to significant informal trade through a third country or through smuggling.
- **High similarity in tradable products:** The low level of intra-regional trade can largely be attributed to a fairly high export similarity among the South Asian countries. The export similarity encourages South Asian countries to protect their local industries behind tariff walls, thereby narrowing the scope for intra-regional exports. It also hampers specialization in different products across various locations within the region.
- **Low complementarities in production network:** Another deterrent to enhanced regional trade is the low level of trade complementarity among South Asian countries. The composition of intra-regional trade hardly makes a case for strong regional linkages of production networks. The tradable products are mainly of primary, resource-based and low-technology nature. But as South Asia is facing increasing levels of competition in global markets, of production in

Key Points

- South Asian countries have undertaken significant trade reforms for deeper integration with the global economy. However intra-regional trade opportunities remain largely unexplored.
- Both political and structural factors contribute toward poor trading cooperation within South Asia.
- Without enabling trade policies, major impediments to intra-regional trade in South Asia will remain unaddressed. There is a need for policy makers of South Asia to work collaboratively to overcome these obstacles

- What is the current state of intra-regional trade and why?
- What could be the possible benefits of enhanced intra-regional trade?
- What are the minimum steps needed to facilitate trade within South Asia?

South Asian countries have undertaken significant trade reforms with liberalization of tariffs and deeper integration with the global economy. However, trade within the South Asia region has continued to remain rather insignificant, particularly when compared to other regional blocks. In 2008 South Asia's export within the region was only 6.29 percent of total export of South Asia, and import within the region was even lower at 3.94 percent of total South Asia's import. South Asian trade outside the region (extra-regional trade) accounted for about 93 per cent of the region's total exports and 96 per cent of the region's overall imports in 2008. Most of South Asia's exports are oriented towards developed regions, such as Europe and North America, which accounted for 23 and 16 per cent of the region's total exports, respectively. This trend of stronger trade ties with other regional blocks than within South Asia is also followed by Pakistan.

Thus despite the fast pace of global integration of South Asian economies, intra-regional trade opportunities remain largely unexplored. Trade within South Asia is dominated by India, which accounts for 65 per cent of total intra-regional trade. For Pakistan, the share of intra-regional trade has declined from 24.5 per cent in 1980 to 19.8 per cent in 2008. There are several reasons, both political and structural, for this poor trading cooperation with neighbours in South Asia.

the value chain across various countries in the region can help cut costs and improve export competitiveness of all the countries of South Asia.

- **Preferential and bilateral trading agreements undermine intra-regional trade initiatives:** South Asian countries have increasingly resorted to bilateral and preferential trade partnerships with economically strategic regional blocs. Currently, South Asia has 22 multilateral and 21 bilateral agreements within and outside the region. Though these agreements boost trade amongst signatory countries, they undermine the interests of other countries in the region. Such initiatives, like the India–EU FTA, not only erode intra-regional trade but also hurt South Asian countries that are not a part of the agreement, create regional hostilities and cast significant doubts over the relevance of SAFTA.
- **Slow implementation of SAFTA:** The South Asia Free trade Agreement (SAFTA) will not be fully operational before 2016, and its effectiveness will largely depend upon members' compliance with their commitments on the reduction of tariffs. Currently, the effectiveness of SAFTA is undermined by the sluggish process of its implementation. The slow pace of its tariff liberalization programme, limited product coverage, a large sensitive/negative list and the prevalence of non-tariff barriers further weaken its significance. SAFTA is more structurally rigid than most bilateral trading agreements signed by South Asian countries and its rules, like the Rules of Origin (RoO), provide less scope to enhance regional trade. Such constraints encourage member countries to negotiate bilateral trading agreements both within and outside the region.
- **Services trade not covered under SAFTA:** Trade in services has been a cornerstone in South Asia's recent progress in international trade. However, it has remained outside the ambit of regional cooperation. South Asia can benefit a lot from regional cooperation in trade in services, especially in telecommunication and information technology, medical services, aviation

and unskilled labour services

Possible benefits of expanding intra-regional trade

- Encouraging regional trade within South Asia could help overcome some supply side constraints such as shortage of energy and investment capital.
- It could also help diversify the export market and thus reduce dependence on European and American markets.
- By creating regional supply chains, South Asia can move from being an exporter of low value added products to exporting high value added agricultural, manufacturing and services products.
- Regional trade could contribute to employment and income generation which can help alleviate poverty, improve consumption, increase expenditure on health and education, and thus promote human development in South Asia.

Policy recommendations to facilitate intra-regional trade in South Asia

Without enabling trade policies, major impediments to intra-regional trade in South Asia will remain unaddressed. Key policy recommendations to overcome these obstacles include:

1. **Adopt trade facilitation initiatives:** Adopt policies to improve trade facilitation by reducing trade related transaction costs and easing cross-border trade procedures, regulations and processes. This involves policy initiatives such as: the SAARC Single Window initiative; custom-to-custom cooperation to harmonize procedures; and reviewing existing laws to modernize legal and regulatory frameworks related to trade facilitation.
2. **Enhance Indo-Pak trade:** Significant levels of intra-regional trade can only be achieved by boosting trade between India and Pakistan. Short-term measures include: easing business visa processes; increasing the number of border crossings; and improving regional road, rail and port links. Medium-term measures involve: Pakistan granting the MFN status to India and allowing transit trade; and India reducing the tariff rate on products of trading interest to Pakistan and reducing non-tariff barriers, especially on agricultural products.
3. **Promote cross-border energy investment and regional energy trade:** The main challenge that South Asia, and specifically Pakistan, face today is meeting an ever-increasing demand for energy.

About Mahbub ul Haq Human Development Centre

Under the umbrella of Foundation for Human Development in Pakistan, Mahbub ul Haq Human Development Centre was set up in November 1995 in Islamabad, Pakistan by the late Dr Mahbub ul Haq, founder and chief architect of UNDP Human Development Reports. With a special focus on South Asia, the Centre is a policy research institute and think tank, committed to the promotion of the human development paradigm as a powerful tool for informing people-centred development policy, nationally and regionally.

Economic growth has been, and continues to be constrained by a severe dearth in energy supply. In order to meet the growing demand for energy, trade in energy (electricity, gas and coal) has to be taken seriously by the policy makers. Nepal and Bhutan have the potential to generate surplus hydro-energy to export to India and possibly onwards to Pakistan. Similarly, Pakistan can import energy, specifically gas, from Central Asia and Iran, and forward it to India. Developing a regional power and gas grid in the long run could help cope with the rising energy demands of the region.

4. **Strengthen SAFTA and include trade in services:** Policies to enhance intra-regional trade encompass the effective implementation of SAFTA rules. Such policies should concentrate on accelerating the process of regional integration and removing SAFTA's shortcomings. These include:

- Accelerate and stringently follow the schedule for tariff cuts.
- Reduce the sensitive list to broaden coverage.
- Include commitments and specify a time frame to reduce non-tariff barriers as they can nullify any positive impacts of tariff reduction.
- Improve the mobility of people by opening the visa regime within SAARC. This can facilitate business development and employment opportunities, especially for low skilled workers
- Incorporate trade in services within the framework of SAFTA. Since trade in services does not involve the movement of goods, it is easier to implement. Significant complementarities exist in information technology, communication and aviation businesses, and prioritising the liberalization of these sectors can yield quick benefits.

- Financial markets within the region should be broadened and cross-border investment must be promoted. Local banks should be encouraged to open branches in neighbouring countries to facilitate traders' involvement in intra-regional trade.

This policy brief is based on the chapter on 'Regional Trade in South Asia' authored by Dr Khondaker Golam Moazzem and Dr Kazi Mahmudur Rahman of Centre for Policy Dialogue, Bangladesh. Umer Akhlaq Malik, a senior research fellow at MHHDC has prepared this short version.

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- 2007 A Ten-Year Review
- 2008 Technology and Human Development in South Asia
- 2009 Trade and Human Development

Other Books on Human Development

- 1995 Reflections on Human Development by Mahbub ul Haq
- 2002 The South Asian Challenge by Khadija Haq (editor)
- 2003 Readings in Human Development by Sakiko Fukuda-Parr and A. K. Shiva Kumar (editors)
- 2008 Pioneering the Human Development Revolution: An Intellectual Biography of Mahbub ul Haq by Khadija Haq and Richard Ponzio (editors)