

**FUTURE  
OF  
TRADE  
POLICY**

# 10

## STRATEGIES FOR SOUTH ASIA

Time is ripe for South Asian countries to take cognizance of their trade policies at the unilateral, bilateral, regional and multilateral levels and engage in strategic liberalization according to domestic development priorities.

■ **Saman Kelegama**

South Asia was a latecomer in pursuing a liberal trade strategy vis-à-vis East Asian countries. By the time South Asian countries gradually opened up their trade regimes in the 1980s, an import substitution trade structure with licensing, quantitative restrictions, and controls was well entrenched into their trade regimes.

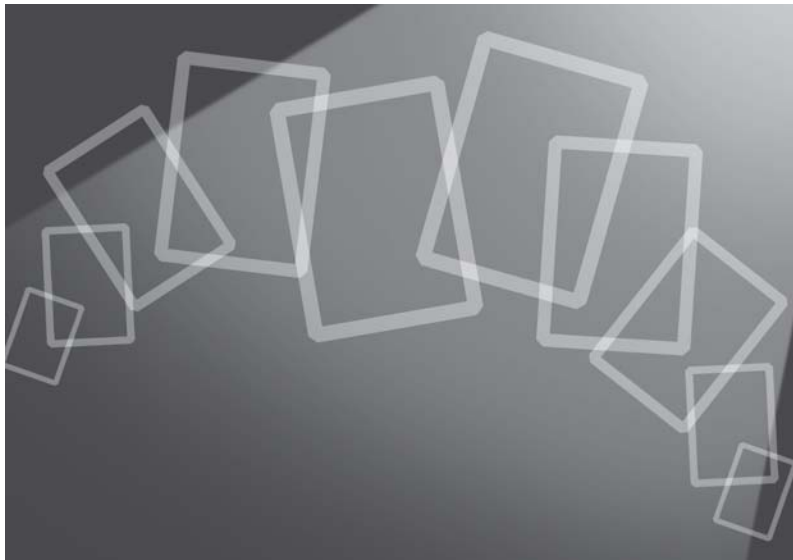
Consequently, there was resistance to trade liberalization by those who benefited from the 'licensing raj', and the trade liberalization process slowed down after the initial reforms. Moreover, South Asian countries could not reap the same benefits from the global trading environment as the East Asian countries did during the late 1960s and 1970s, as the trading environment during the 1980s and 1990s had become far more competitive with more players in the global market.

The unilateral trade liberalization initiatives of South Asia in the 1980s were supported by multilateral

and regional trade liberalization initiatives from the mid-1990s onwards, with both the World Trade Organization (WTO) and the SAARC Preferential Trading Arrangement (SAPTA) coming into operation. Although the Uruguay Round was a *fait accompli* for South Asian countries just as it was for all developing countries, the region together with other developing countries fought its way to work out the Doha Development Agenda (DDA) in the WTO in late 2001 that brought to the centre the 'development dimension' in the multilateral trading system.

Despite the current stalemate in WTO negotiations, South Asia can be content with how it shaped the multilateral trading agenda as articulated by DDA and currently negotiated under the July 2004 framework. The same cannot be said, however, about South Asian regional trading via the SAPTA framework. It was a disappointing experience from the very beginning.

Although there was evidence from Latin American countries and the Association of South-east Asian Nations (ASEAN) that a 'positive list' approach to preferential tariff reduction is cumbersome and time consuming, and three South Asian countries (viz., India, Sri Lanka and Bangladesh) had experienced the problems of the 'positive list' approach under the



Bangkok Agreement two decades before SAPTA came into operation, SAPTA blindly embraced the 'positive list' approach in late 1995 and continued with that approach till the Agreement on South Asian Free Trade Area (SAFTA) came into force in July 2006. The end result was that SAPTA proved to be an ineffective framework in boosting trade in South Asia during its decade of operation.

Among other reasons, it was this slow progress of SAPTA that led to bilateral free trade agreements (BFTAs) within South Asia (e.g., India-Sri Lanka FTA, India-Nepal FTA and Pakistan-Sri Lanka FTA), trans-regional FTAs (e.g., Bay of Bengal Initiative for Multi-Sectoral and Technical Cooperation Free Trade Area (BIMSTEC FTA), Indian Ocean Rim-Association for Regional Cooperation (IOR-ARC) and Asia-Pacific Trade Agreement (APTA), which is the new name of the Bangkok Agreement), and trans-regional BFTAs (India-ASEAN FTA, India-Singapore Comprehensive Economic Cooperation Agreement, etc.). Most of these FTAs were not comprehensive, although they did contribute to stimulating trade flows among the member nations.

Although SAFTA—based on a 'negative list' approach—came into operation in 2006, it has a number of shortcomings such as a large negative list, a long tariff liberalization period compared to competing regional trade agreements (RTAs) and BFTAs (thus losing its relevance), and a time-consuming dispute settlement mechanism. Studies have shown that due to the large negative list, 53 percent of regional imports are excluded from SAFTA tariff preferences.

Thus, the attempts to create more BFTAs and move beyond the RTA still prevail in South Asia, as described above. Meanwhile, very little progress is visible at the multilateral level due to the standstill at the WTO since July 2006.

Above all, the unilateral liberalization initiatives have also slowed down in South Asia in recent years. Trade reforms have been frozen at current levels and there are attempts to obtain more 'policy space' to pursue national development agendas in most South Asian countries. In fact, the World Bank's 2004 Trade Policy Review of South Asia shows that with the proliferation of para-

tariffs and other trade-related taxes, some South Asian countries have become more protectionist in mid-2000 than during the 1990s.

Clearly, trade policy in South Asia is at a crossroads, and there is an urgent need to take a serious look at the current status and future of trade policy in the region. Is there a clear direction for trade

policy in South Asia? Is the region stuck in a global 'spaghetti bowl' of overlapping trading arrangements? Is the region reacting to global events without having a proactive, well-defined trade strategy? These are some of the relevant questions in the contemporary dialogue on South Asia's trade policy.

## Ten strategies

South Asian countries should capitalize on the current stalemate in WTO negotiations to formulate strategic trade policies and put their house in order by addressing the 'behind-the-border' problems. In this respect, the countries in the region should take into account the following 10 strategies while determining the direction of their trade policies in the future.

## Rescuing the WTO

South Asia is a small player in global trade. The region's share in global exports is 1.5 percent compared to 18 percent of the European Union, 9 percent of the United States and 6.2 percent of Japan. South Asia, thus, has a long way to go in integrating

Given its stake in the rules-based multilateral trading system, South Asia should make every effort to rescue the WTO from the current state of affairs and put the Doha Round of trade negotiations back on track

## South Asian countries need to assess the relevance and effectiveness of North-South bilateral free trade agreements because such agreements may restrict the policy space they need to achieve their development objectives

with the global trading system and, for this purpose, a non-discriminatory rules-based trade regime will be helpful to the region. South Asia should, therefore, make every effort to rescue the WTO from the current state of affairs and put it back on track. A well-functioning WTO will prevent political forces of the developed world from concluding trade deals that jeopardize the interest of the developing world, including South Asia.

### Seeking policy space

Individual South Asian countries should position their respective trade policies in the context of their overall development strategies. Trade policy should be the servant not the master of the overall development strategy. Trade policy-determined industrialization and agriculture development have come to an end with the emergence of the post-Washington consensus. In other words, 'policy space' has become an important issue for South Asia and this may be carved out for industrial and agriculture development, and the trade policy could be fine-tuned accordingly. However, on the basis of seeking 'policy space', South Asian countries should not go to the extreme and reverse the existing trade reforms.

### Prioritizing supply-side reforms

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. Some of these weaknesses feature in the Global Competitiveness Report of the World Economic Forum and the Doing Business Report of the World Bank; both of which do not rank South Asia well in the global context.

The area of supply-side reforms and development also needs atten-

tion in 'Aid for Trade' negotiations in the WTO and 'SAARC Development Fund' utilization discussions in the South Asian Association for Regional Cooperation (SAARC), in particular for LDCs. When the supply-side issues are addressed, South Asian countries can confidently open up their trade regimes further without fears of de-industrialization or erosion of the productive base in agriculture.

### Capitalizing on India's growth

South Asian countries should so design their trade policies as to benefit from India's high growth. The bulk of the regional trading of South Asian countries is with India, which is bound to grow in the coming years. As the cost of production in India goes up, Indian investors will source some of their inputs and products from cheaper South Asian countries.

Currently, this phenomenon is visible in China, where investors are moving westwards as the cost of production in the eastern coast is gradually increasing. In order to exploit this investor movement, the rest of South Asia should strengthen the trade-investment nexus and this is best done by improving stability, consistency and predictability in the macroeconomic policy regime. When this is the case, it gives investors a clear signal on expected returns and thereby more confidence to invest. The trade-investment nexus can be consolidated after SAARC Investment Area comes into operation with double taxation and investment protection agreements, but for the time being, working on the macroeconomic policy regime can pay rich dividends.

### Enhancing trade policy-making capacity

South Asian countries should consider developing their trade policy-making capacity. Legal frameworks and institutional structures are still not in

place in most countries of the region to deal with WTO agreements. For example, legal frameworks on competition policy, industrial property, plant variety protection and farmers' rights, access and benefit sharing, etc., are still in their infancy.

Moreover, the region faces a formidable challenge in analysing and synthesizing proposals and submissions made by other WTO Members. India, for instance, has taken a proactive stance and considerably developed its trade analysis capacity during the last decade. It stands as an example for the rest of the region to emulate. It may be noted that many South Asian 'second track' documents and research reports are available to assist such an exercise, but very little use of them seems to have been made in the official process.

### Reviewing BFTAs and CEPAs

South Asia may need to rethink its aggressive pursuit of BFTAs and Comprehensive Economic Partnership Agreements (CEPAs) as most of them are worked out for the sake of being in line with some competitors rather than in anticipation of actual trade gains. Most BFTAs and CEPAs are costly and a strain on the officials working at the ministries and departments of commerce. Many overlapping BFTAs can be confusing for investors and customs officers, and thus may not produce the desired results.

In fact, some of these agreements have not lived up to expectations. For instance, the India-Singapore CECA has not lived up to the initial euphoria in mid-2005 at the time of its implementation. Similarly, the India-Sri Lanka CEPA has still not materialized even after the completion of the main report in 2003, due to controversy over vegetable oil and pepper exports from Sri Lanka to India. Thus, it may be prudent to work on the existing BFTAs and CEPAs, and im-

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prove and fine-tune them rather than embarking on new ones and complicating the trading environment.

### Rethinking North-South BFTAs

South Asia should seriously reconsider some BFTAs contemplated with developed countries. North-South BFTAs such as the proposed US-Pakistan BFTA are likely to be on a WTO-plus mode and consequently may impose severe conditions on Pakistan limiting its 'policy space'. At first sight, such North-South BFTAs may look attractive, but when considering the *quid pro quo* for the Southern partner, they may be costly, restricting the policy space Southern countries need to achieve their development goals. Moreover, if the conditionalities such as implementing TRIPS-plus obligations or negative list-based services liberalization are accepted by the Southern partner at the insistence of the Northern partner, then the bargaining position of the Southern partner with other trading partners, especially in bilateral negotiations, reduces substantially.

### Improving trade facilitation measures

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 liberalization. Transport networking through better connections via sea, air and land, better information and communications technology (ICT) connectivity, deregulated customs procedures, etc., can significantly facilitate trade among countries. If trade facilitation is done with the objective of harmonization of standards at entry points in the region, a number of non-tariff barriers could also get eliminated.

### Maintaining transparency in trade regimes

While improving economic connectivity, South Asian trade authorities should make every attempt to make the trade regimes as transparent as possible. Cleaning up the trade regime by minimizing bureaucratic procedures, minimizing para-tariffs, and formulating firm rules and regulations can be more effective than preferential tariff liberalization in stimulating trade. This area received much attention in the 2004 Trade Policy Review of South Asia by the World Bank, but little action seems to have been taken by South Asian countries.

### Stimulating services trade

The future trade policy of South Asia should seriously consider stimulating trade in services. Services are the fastest growing sector in all South Asian countries, but trade in services has not significantly developed in the region. Intra-regional services trade is already taking place with whatever unilateral liberalization measures that the individual South Asian countries have implemented.

At the 13th SAARC Summit held in Bangladesh in 2005, Heads of State or Government requested a study to explore the possibility of services liberalization under the SAFTA framework. This study is currently being undertaken by the Research and Information System (RIS), New Delhi with partner institutions. It will be prudent to explore how services could be incorporated under a General Agreement on Trade in Services (GATS)-plus framework in SAFTA.

South Asian countries are reluctant to open up their services sector without a proper regulatory framework in place. At present, a lot of work needs to be done to get these regulatory frameworks in place. While addressing 'behind-the-border'

problems, this area should receive priority in South Asian countries. Needless to say, liberalization of services under SAFTA would have been easier if deep economic integration in the region had already taken place under the SAPTA/SAFTA frameworks.

Unfortunately, this has not been the case and a possible way forward is to use Article 7.2 of the SAFTA Agreement and request willing countries to move forward (under the 3 + x formula) with progressive and sequential liberalization of services and other South Asian countries can join when they are ready.

### Conclusion

Time is ripe for South Asian countries to take cognizance of their trade policies at the unilateral, bilateral, regional and multilateral levels and engage in strategic liberalization according to domestic development priorities. It is also important to take a hard look at 'behind-the-border' problems or supply-side issues and address them while improving the trade policy-making capability in the individual countries.

With the existing trade regimes in South Asian countries, even without further trade liberalization they can gain much more if the supply side is developed and put in a more responsive mode. The natural market integration taking place via the process of globalization is a strong force, and with improved connectivity, it can increase trade flows in the region even without preferential tariffs. Attention to all these issues can prepare South Asia to face the new challenges when the multilateral trade negotiations under the WTO resume. ■

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