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# Quantification of Benefits from Economic Cooperation in South Asia



Asian Development Bank  
United Nations Conference on Trade and Development



# **QUANTIFICATION OF BENEFITS FROM ECONOMIC COOPERATION IN SOUTH ASIA**

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UNCTAD headquarters contributed to reviewing the draft and clearing it. We gratefully acknowledge the contribution of Lakshmi Puri, Mina Mashayekhi, Anne Miroux and Taffere Tesfachew.

Contributions to individual chapters were provided by R.V. Anuradha, Consultant; Rajat Kathuria, Professor, Indian Council for Research on International Economic Relations; Kailas Karthikeyan, former Trade Officer, UNCTAD; and Shailendra Kumar, Under Secretary, Ministry of Finance, GOI. Assistance of Shruti Sharma, R. Srinivasulu and Arpita Khanna is acknowledged.

The team also acknowledges valuable guidance from the reviewers: Rupa Chanda, Professor, Indian Institute of Management, Bangalore; I.N. Mukherji, Professor, Jawaharlal Nehru University, New Delhi; Shigeru T. Otsubo, Professor, Nagoya University, Japan; Rajan Sudesh Ratna, Professor, Indian Institute of Foreign Trade, New Delhi; A. Razzaque, Professor, University of Dhaka; and Nisha Taneja, Senior Fellow, ICRIER, New Delhi.

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Asian Development Bank



UNITED NATIONS

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*First published, 2008*

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Guwahati Hubli Hyderabad Jaipur Lucknow Madurai  
Nagpur Patna Pune Thiruvananthapuram Visakhapatnam

Companies and representatives throughout the world

ISBN 10: 0230-63637-3

ISBN 13: 978-0230-63637-8

Published by Rajiv Beri for Macmillan India Ltd.  
2/10, Ansari Road, Daryaganj, New Delhi 110 002

Printed at Baba Barkha Nath Printers  
37, MIE, Bahadurgarh, Haryana 124 507

**UNCTAD/DITC/2008/3**

This Report was prepared under Asian Development Bank's Technical Assistance TA 4780: Knowledge Management and Capacity Building and UNCTAD-MOIC-DFID project on "Strategies and Preparedness for Trade and Globalisation in India".

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# Preface

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Our consultations with senior policy-makers and think tanks in the region, over the past few years had underlined the need for a comprehensive quantification of the benefits from regional cooperation in South Asia, in order to build greater confidence in the SAFTA process and combat the negative perceptions about its outcomes. This study was consequently initiated by ADB's India Resident Mission in partnership with UNCTAD in 2006. We would like to particularly acknowledge the role of Veena Jha, former coordinator of the UNCTAD India program, for readily agreeing to join the study and seeing it through its early phases.

The main conclusion of the study, carried out over a period of one-and-a-half years, is that SAFTA will continue to contribute to stronger economic growth in the region. The result is corroborated by a variety of modelling techniques that have been employed to overcome the shortcomings of using one methodology alone. An optimistic scenario is revealed with SAFTA – although some sectors lose and some sectors gain in each country – a result in contrast to earlier studies. The welfare gains from trade in goods arise on account of improvements in complementarity within the region over the past few years, implying the fact that exports of countries are becoming increasingly regional. The study also clearly establishes that gains are much higher if efficient systems are simultaneously established for regional trade, transportation, and infrastructure.

Consultation seminars were organised by leading think-tanks in the region to seek views from all stakeholders, including senior policy-makers, industry representatives, and academia. Seminars were held across five South Asian capitals, with representation from all eight countries, starting at Colombo in March and concluding at Islamabad in May this year. We received excellent feedback from each of these seminars which has been incorporated into this final version of the report.

We wish to acknowledge our deepest appreciation for the efforts of Saman Kelegama, Executive Director, Institute of Policy Studies, Colombo; Manab Majumdar, Senior Director, Federation of the Indian Chambers of Commerce and Industry, New Delhi; Mustafizur Rehman, Executive Director General, Centre for Policy Dialogue, Dhaka; Navin Dahal, Executive Director, South Asia Watch on Trade, Economics, and Environment, Kathmandu; and Safdar Sohail, Director General, Foreign Trade Institute of Pakistan, Islamabad and the efforts of their teams who were instrumental in organizing these consultations.

We also wish to place on record our gratitude to SAARC Secretary-General Sheel Kant Sharma and Director, Trade, Vinay Kwatra for sparing valuable time to discuss the Study at Kathmandu. We hope this work will be of use to the SAARC Secretariat and member countries in taking SAFTA forward.



**Kunio Senga**

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# Executive Summary

## ■ OBJECTIVE

This study provides an in-depth assessment of the likely changes induced by South Asian Free Trade Agreement (SAFTA) on South Asian countries and on the region as a whole. The emphasis of the analysis is 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 study undertakes both quantitative and qualitative assessments of the outcomes of SAFTA. Economic modeling has been used to assess the quantitative impacts of SAFTA. The analysis of the impact is preceded by the analysis of changing competitiveness and complementarity among SAFTA member countries. The change in inter-industry and intra-industry trade over time among the member countries is also examined. An attempt has been made to assess the likely consequences of SAFTA on effective additional market access (EAMA) that member countries may obtain. The impact of various SAFTA scenarios is simulated on variables such as prices, income and welfare at the regional level as well as at the country level. Further, the study examines the impact of deepening of SAFTA by including investment cooperation and trade in services. This is done by analysing the impact of SAFTA on inward foreign direct investment (FDI) flows into the region and possibility of rise in intra-regional FDI flows. The study includes analysis of the benefits that would accrue from transport and trade facilitation under four identified infrastructure projects, viz., road, air, rail, and port enhancement for the region.

Deepening integration in South Asia to include

trade in services and possibilities of mutual recognition agreements (MRAs) with respect to some sub-sectors in services has been examined. An in-depth analysis has been undertaken for identifying restriction on trade in services like health and related services, higher education, tourism and travel-related services, telecommunication services and construction and related services.

Along with the benefits of SAFTA, an important cost of SAFTA, which is revenue loss for the member countries, has been examined in detail. Simulations for different scenarios have been undertaken to estimate the extent of revenue loss for each member country.

Besides providing a prognosis, the study will help in the formulation of concrete policy measures to ensure greater gains while mitigating potential negative impacts. The study also aims to lead to the development of ideas for technical assistance and on issues of co-operation. It provides economic and social assessments using analytical tools and rational causal chain analysis.

## ■ METHODOLOGY AND KEY RESULTS

Various econometric methodologies have been used by the study to arrive at its quantitative results. The tools of analyses include revealed comparative advantage (RCA) indices; complementarity indices; intra-industry trade indices; panel data estimations; gravity model estimations; simulations using smart simulations and global trade analysis project (GTAP) modeling. The GTAP model provides sophisticated analysis of possible direct effects of SAFTA including various feedback effects across several sectors and countries. The modeling results offer valuable quantitative information. The fact that some of the policy scenarios have already been set, and implementation has commenced, adds to the greater precision with which the GTAP model can be used as a predictive tool.<sup>1</sup> To estimate the gains by transport facilitation, benefit

<sup>1</sup> The latest GTAP 6.02 (limited release) version has been used. The advantage of this version is that it includes Pakistan, the second largest economy in the region, as a separate entity. In the earlier version 6.00, Pakistan was clubbed with 'Rest of

cost analysis (BCA) for four projects has been undertaken.

### Results with Respect to Competitiveness and Complementarity

The RCA indices are estimated for an average of two time periods, i.e. 1991–93 and 2004–06 for four major trading economies of SAFTA, viz., Bangladesh, India, Pakistan and Sri Lanka at SITC five-digit level. The competitive product basket for all the four countries, i.e. where a country is more competitive ( $RCA > 1$ ) with respect to other three has been arrived at for the two time periods. The results show that the competitive basket has changed substantially over time. 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. Studies found the value of complementarity index low for SAARC region. However, using three year averages for the period 1991–93 and 2003–05, complementarity indices has been estimated for the four major trading partners 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 is Pakistan. The improved complementarity indices indicate strong possibilities of higher intra-regional trade with SAFTA.

To examine the products which may be traded within the region, intra-industry trade indices have been estimated using Grubel Lloyd index. Intra-industry trade has been found to have increased drastically in sectors like agriculture raw materials, chemicals and textiles. Within textiles, we find that the intra-industry trade has increased in some of the sub-sectors of textiles

among the four major trading partners of the region. This indicates that even within textiles, countries specialise in products at different stages of production or in differentiated products. The possibility of establishing supply chains within the region exists in some sectors.

The results of the economic analysis therefore strongly suggest that there exists enormous potential for intra-regional trade among the SAFTA economies. The study further estimates the extent of additional market access each country may gain and the total intra-regional trade that may result from SAFTA.

### Results with Respect to Effective Additional Market Access due to SAFTA

To gauge the benefits of a regional trade agreement it is essential to identify the EAMA that it creates for its members. There is a catena of unilateral, bilateral, regional and sub-global level tariff concessions which operate among the SAFTA economies. These include concessions related to the Bangkok Agreement, global system of trade preferences among developing countries (GSTP), least developed countries (LDC), the Indo-Bhutan, Indo-Nepal and Indo-Lanka Pakistan-Lanka bilateral free trade areas (FTAs). Several more agreements like the Bangladesh-Pakistan FTA and BIMSTEC are at various stages of negotiation. Given the history of multiplicity of agreements in concessions among South Asian countries, all concessions have to be considered to determine the benefits that SAFTA offers over and above these.

In this context, the study attempts to capture EAMA that is created as a result of SAFTA for its various members Table 1 (a)–(c). Two aspects determine the EAMA. The first is the sensitive list decided upon and the second is the identification of those non-sensitive products for which concessions are effectively provided. SAFTA adopts a negative list approach to tariff liberalisation. This implies that countries will liberalise tariffs in all products, except those specified in the negative lists (that have been negotiated and agreed upon by all members).

The EAMA is determined through the following three measures:

- The proportion of global value of imports of non-

South Asia', along with Afghanistan, Bhutan Maldives, and Nepal (ABMN), and hence results could not be discretely attributed to Pakistan. In the present GTAP model ABMN are a single aggregation.

**Table 1 EAMA Created by SAFTA****(a) Partners in Global Imports (%)**

	India	Bangladesh	Pakistan	Sri Lanka	Nepal	Bhutan	Maldives
India		85	86	1	0	0	85
Bangladesh	23		23	23	23	23	23
Pakistan	70	72		70	72	72	72
Sri Lanka	1	35	34		35	35	35
Nepal	0	52	46	46		52	52
Bhutan	0	68	66	66	66		68
Maldives	34	35	34	34	35	35	

**(b) Bilateral Imports (%)**

	India	Bangladesh	Pakistan	Sri Lanka	Nepal	Bhutan	Maldives
India		92	90	0	0	0	97
Bangladesh	25		22	45	76	9	25
Pakistan	86	69		66	74	47	100
Sri Lanka	1	10	8		82	0	52
Nepal	0	71	0	0		82	0
Bhutan	0	6	0	0	22		0
Maldives	26	0	33	26	100	0	

**(c) Concession Receivers Global Exports (%)**

	India	Bangladesh	Pakistan	Sri Lanka	Nepal	Bhutan	Maldives
India	18	57	4	0	0	60	
Bangladesh	51		44	33	44	10	5
Pakistan	70	23		28	44	62	80
Sri Lanka	2	92	50		63	66	34
Nepal	0	15	23	21		26	40
Bhutan	0	10	23	33	37		26
Maldives	69	78	82	74	82	75	

sensitive items to total global imports of concession giver.<sup>2</sup>

- The proportion of bilateral value of imports of non-sensitive items to total bilateral imports of the concession giver from the concession receiver.<sup>3</sup>
- The proportion of value of global exports of sensitive items (notified by opposite concession giver) to total global exports of concession receiver.<sup>4</sup>

### Results from Computable General Equilibrium Analysis

Simulations have been carried out using GTAP to estimate the effect of tariff reduction on each member country of SAFTA under various scenarios. The GTAP simulations take a base scenario that reflects most favoured nation (MFN) tariffs at the commencement

<sup>2</sup> This measure essentially looks at the entire global import basket of a concession-giving country and sees what is the import coverage of items that it has designated as non-sensitive. India offers EAMA to Bangladesh, Maldives and Pakistan, concessions on products which constitute 85% of its global imports. The figure is either 0 or close to 0 in the case of EAMA that India gives to Nepal, Bhutan and Sri Lanka because India has already nearly completely liberalised imports vis-à-vis these countries. Also note, sensitive items always refer to sensitive items of concession giver.

<sup>3</sup> This measure gives an indication of the EAMA afforded to products which are already being bilaterally traded between a pair of countries. For instance India provides an EAMA to the extent of 92% of value of its present bilateral imports from Bangladesh, and 90% and 97% in the case of Pakistan and Maldives respectively. However it is limited as it looks at bilateral trade prior to the FTA; given that the intra-SAARC trade basket is limited, and that most of the existing trade may be taking place in products in which are outside the sensitive list, this measure is not adequate by itself.

<sup>4</sup> This measure is more comprehensive than the first two, because it captures the trade specialisation of the concession-receiving country and determines whether it receives access (to concession giver's market) in products which constitute most of its (the concession receiver's) global exports. In the case of India and Bangladesh, it is seen that the negative list of India has the effect of allowing EAMA to Bangladesh in items that constitute only about 18% of its global exports. This is largely because India's

of SAFTA implementation, i.e. as on 1 January 2006.<sup>5</sup> The GTAP database was updated till 2005 based on tariff changes obtained from trade analysis and information systems (TRAINS). The database was also subjected to shocks to incorporate the significant grant of concessions by India to Sri Lanka under the Indo-Lanka FTA.

This equilibrium was shocked to take into account what may be described as Phase I of SAFTA implementation, which includes:

- Reduction of tariffs by developing countries to 20% by 2008
- Reduction of tariffs by LDCs to 30%
- Reduction of tariffs of developing countries vis-à-vis imports from SAARC
- LDCs to 0–5% by 2009
- Reductions in first three categories above, subject to the sensitive lists.

The results provide an updated database that simulates the equilibrium of 2008–09. The 2008–09 base was then shocked completely to equate a 2013–16 situation where all SAFTA duties are brought to 0. A best case scenario of complete elimination of sensitive lists is also assumed in this shock, i.e. Phase II of SAFTA.

The study makes two key assumptions. First, all members will fully comply with their tariff reduction obligations that they agreed to in the SAFTA document. Second, all countries will fully liberalise their sensitive lists over the next nine years. The study also assumed that Afghanistan will have the status of a full member of SAARC in the near future.

Using the general equilibrium analysis, the impact of SAFTA on production, employment, trade and welfare for each member country has been estimated.

### *Afghanistan, Bhutan, Maldives and Nepal*

Though the ABMN group gets zero duty access to the developing countries by 2009 itself, its gains are limited on account of their inability to access agricultural products markets, which are blocked by the sensitive lists of the developing countries.

There are gains in primary commodities with complete liberalisation in 2016. With the removal of sensitive lists in a full liberalisation scenario, ABMN

**Table 2 Impact of SAFTA on ABMN Gains (per cent)**

	Output	Effect on Unskilled Employment	Exports to South Asia	Global Exports	Global Imports
2008-09	0.03	-0.0004	20.82	0.74	1.96
2016	0.26	0.0002	60.32	7.89	11.99

see good export growth in agriculture products and primary commodities (Table 2). 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.

### *Bangladesh*

Bangladesh's welfare gains are one of the highest in South Asia. This may be attributed to the complete liberalisation of high MFN tariffs, which generates consumptive benefit for both the user industries as well as household consumers. Bangladesh has also seen an increase in global exports by a 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 countries (Table 3).

**Table 3 Export Gains for Bangladesh in SAFTA Market (per cent)**

	Output	Effect on Unskilled Employment	Exports to South Asia	Global Exports	Global Imports
2008-09	-0.01	0.0001	38.08	0.19	0.27
2016	-0.03	0.0001	14.43	4.31	5.47

The lack of strong growth may be attributed to India's sensitive list, but it is in fact seen in the full liberalisation scenario (where all countries liberalise tariffs even on sensitive list items), Bangladesh does not make any significant regional export gains despite liberalisation of sensitive list items including garments. However, the most interesting result is that its global exports has seen a significant 5% rise in the second phase. Most of this growth is to regions outside South Asia.

negative list for LDCs impedes EAMA in several garments products, which actually do form the bulk of Bangladesh's global exports. The concessions which Pakistan and Maldives receive in the Indian market vis-à-vis each of their global exports is higher at 57% and 60% respectively.

<sup>5</sup> The implementation of SAFTA commenced on 1 July 2006.

## India

A full SAFTA will help India nearly doubled its exports to South Asia. India's export gains from SAFTA are limited to a few agricultural sectors and the auto sector where it is seen to have a relative comparative advantage vis-à-vis the rest of South Asia.

**Table 4 Export Gain for India in SAFTA Market (per cent)**

	Output	Effect on Unskilled Employment	Exports to South Asia	Global Exports	Global Imports
2008-09	0	-0.00001	3.41	0.09	0.11
2016	0.08	0.00002	90.44	1.19	1.68

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, where output in 'other meat products' shows an increase of over 100%, indicative of the high level of demand of poultry and also its protection in the region.

## Pakistan

Like India, a full SAFTA for Pakistan will help double its exports to South Asia. Pakistan sees positive results for important employment-intensive agricultural sectors like wheat, horticulture, meat products (mainly poultry) and other food products. The textiles sector, which is very important to the economy, has seen an output expansion of about 0.5%.

**Table 5 Export Gain for Pakistan in SAFTA Market (per cent)**

	Output	Effect on Unskilled Employment	Exports to South Asia	Global Exports	Global Imports
2008-09	0.01	0	5.52	0.17	0.19
2016	0.02	-0.0001	102.41	0.77	1.54

## Sri Lanka

Sri Lanka's gains in the first phase of liberalisation is almost nil. This is largely because Sri Lanka already has nearly free access to the Indian market, and also because LDCs and developed countries have not committed to substantial liberalisation vis-à-vis Sri Lanka in the first phase.

Sri Lanka's gains improve in the second phase, when all countries participate fully (and remove their negative

**Table 6 Export Gain for Sri Lanka in SAFTA Market (per cent)**

	Output	Effect on Unskilled Employment	Exports to South Asia	Global Exports	Global Imports
2008-09	0.1	0	2.52	0.05	0.14
2016	0.55	-0.000107	58.78	0.72	1.98

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 the total output in Sri Lanka has seen a growth of about 4%.

## Results from Trade Potential due to SAFTA

To validate the results of the above section, another methodology has been adopted to arrive at the trade potential due to SAFTA. A gravity model is estimated using bilateral trade flows between SAFTA members and factors that may explain trade with respect to gravity. Inter-regional tariffs have been included in the model. The results of the model show that the estimated trade is much higher than the actual trade indicating a huge potential for intra-regional trade.

The estimates show that the potential trade between the SAFTA member countries as predicted by the gravity model is 120% more than the actual trade. A number of studies have estimated potential trade as the difference between trade predicted by the gravity model and actual trade. The entire difference between predicted and actual trade has been attributed to tariffs and it has been argued that removal of tariffs will increase trade to the predicted level. However, the entire difference between the predicted trade and actual trade may not be due to tariffs. The results show that even if tariffs are not removed a 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 a further 40% if other factors affecting trade are addressed, such as non-tariff barriers and political constraints.

## 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. Using software for market analysis and restrictions on trade (SMART) simulations, i.e. partial equilibrium analysis, the study estimates the impact on welfare, trade and revenue on each of the SAFTA member countries. The country-wise results show the following:

### *Bangladesh*

Revenue loss to Bangladesh is estimated to be about \$0.9 billion on the basis of SMART simulation while it is \$0.5 billion on the basis of weighted average tariff and \$0.23 billion in case of simple average. There are welfare gains for Bangladesh and other South Asian Association for Regional Cooperation (SAARC) countries from 100% tariff reduction by Bangladesh. Bangladesh creates trade of approximately \$0.27 billion.

### *Bhutan*

Revenue loss to Bhutan is about \$7.3 million on the basis of SMART simulation while it is also approximately \$2.3 and \$2.6 million on the basis of simple and weighted average tariff. There are welfare gains for Bhutan and other SAARC countries from the 100% tariff reduction by Bhutan. Due to this reduction, trade increases by approximately \$17 million.

### *India*

Revenue loss to India is about \$0.12 billion on the basis of SMART simulation while it is also approximately \$0.1 billion on the basis of simple and weighted average tariff. Results are consistent in both the approaches. There are welfare gains for India and other countries from 100% tariff reduction by India. In India, trade increases by approximately \$0.7 billion.

### *The Maldives*

Revenue loss to Maldives is about \$0.016 billion on the basis of SMART simulation while it is also approximately \$0.026 and \$0.023 billion on the basis of simple and weighted average tariff. There are welfare gains for Maldives and other SAARC countries from the 100% tariff reduction by Maldives. In case of Maldives, trade increases by approximately \$0.026 billion.

### *Nepal*

Revenue loss to Nepal is about \$0.053 billion on the basis of SMART simulation while it is also approximately \$0.1 billion on the basis of simple and

weighted average tariff. There are welfare gains for Nepal and other SAARC countries from the 100% tariff reduction by Nepal. For Nepal, trade increases by approximately \$0.012 billion.

### *Pakistan*

Revenue loss to Pakistan is about \$0.055 billion on the basis of SMART simulation while it is \$0.085 and \$0.052 billion on the basis of simple and weighted average tariff. There are welfare gains for Pakistan and other SAARC countries from the 100% tariff reduction by Pakistan. For Pakistan trade increases approximately \$0.11 billion.

### *Sri Lanka*

Revenue loss to Sri Lanka is about \$0.1 billion on the basis of SMART simulation while it is \$0.12 and \$0.11 billion on the basis of simple and weighted average tariff. There are welfare gains for Sri Lanka and other SAARC countries from the 100% tariff reduction by Sri Lanka. For Sri Lanka it trade increases approximately \$0.17 billion.

## **Impact of SAFTA on inward Foreign Direct Investment**

The impact of deepening of SAFTA by including investment and services cooperation has been examined. FDI flows into the region are argued to be positively influenced by regional cooperation. This happens due to several reasons. Greater regional cooperation lowers the risk of investments; foreign investors can choose least cost investment location and cater to a larger market due to low tariff barriers; there is better opportunity to increase the extent of product fragmentation to the investors which may induce vertically integrated FDI in the region. The study undertakes panel data estimations for seven member countries of SAFTA considered over the period 1980 to 2006. The impact of intra-regional tariffs and intra-regional trade on inward FDI flows is estimated after controlling other determinants of FDI.

The results show that the economic fundamentals of a SAFTA member country have a significant impact on the inward FDI. Domestic market size, low cost of labour and availability of skills attract FDIs from outside the region. Higher trade openness also attracts higher FDI. Tariffs with respect to other SAFTA member countries has a negative impact which indicates that lowering of tariffs following SAFTA will attract FDI from outside the region into the region. The coefficient

indicates that the impact will be significant, i.e. 30% of the rise in inward FDI may be because of lowering of intra-regional tariffs. This indicates that SAFTA may encourage FDI inflows into member countries and consequently into the region as a whole.

To assess whether SAFTA will encourage vertical FDI, the impact of the share of SAFTA member countries in imports of intermediate goods on inward FDI is examined. The results show that the imports of intermediate goods in the host country have a significant impact on the inward FDI. In other words, higher the probability of importing intermediate goods into the host country more attractive will be the destination for inward FDI. SAFTA may therefore encourage vertically integrated FDI. However, share of SAFTA member countries in total exports of the destination country does not have any significant impact indicating that inward FDI may not necessarily be attracted to countries with higher exports to SAARC as a proportion of total exports.

## ■ IMPACT OF TRADE AND TRANSPORT FACILITATION

Benefits from improved transport and trade facilitation measures bring obvious win-win outcomes for all trading partners. High trade costs such as transportation charges, documentation requirements, and clearance delays at the borders have a discouraging impact on trade and production similar to trade restrictions such as tariffs and quotas. Trade and transport facilitation measures targeted at improved trade logistics through simplification of customs procedures and enhanced connectivity bring direct benefits to exporters and consumers such as faster clearance and release of goods, increased transparency, and improved competitiveness. The benefits in the form of times savings and reduced costs to the trading partners benefits the economy as a whole. In South Asia, although lowering border tariffs was integral trade policy liberalisation since the 1990s, restrictive trade and transport facilitation have hampered intra-regional trade.

Given the various issues of trade and transport facilitation in South Asia, a quantification of gains from identified regional infrastructure projects using BCA is performed. Although regional in nature, the benefits are computed for one country which is undertaking the project on its territory to demonstrate the extent of benefits that can accrue. The four projects include: Upgrading of the Kolkata-Petrapole/Benapole corridor and Customs Facilities; Development of Bagdogra

Airport as a Gateway and Hub; Railway Improvement at between Lahore and Wagah; and Colombo Port Expansion.

The positive impact of all projects is intuitive. As compared to national projects, these projects have the added benefit of high trade and tourism potential. The BCA for the projects in different scenarios demonstrates that the projects have high economic rates of return. Cost and time savings and increased exports from enhanced connectivity brings in high returns. The projects are immensely beneficial for the country undertaking the project and extension of infrastructure facilities could be considered by the countries jointly. Further, the importance of a supportive overall policy framework for the promotion of transport, trade, and tourism is underlined.

## ■ SAFTA AND TRADE IN SERVICES

Historically, the case for inclusion of services as part of SAFTA has been a strong one. As long as SAFTA is confined to goods, the member countries are far from progressing towards full regional economic integration. In this context, the 14th SAARC Summit at New Delhi was a landmark 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 included tourism and education services.

The present study analyses five services sectors – construction and related services, higher education services, telecommunication services, health and related services and tourism and travel related services in seven South Asian countries, namely India, Pakistan, Sri Lanka, Bangladesh, Nepal, the Maldives, and Bhutan. Six of these seven countries are already part of the multilateral trading system where they have taken commitments to liberalise these sectors and still they are contemplating to further liberalise during the ongoing services negotiations. Bhutan, the only one of the seven countries from the region not yet part of the WTO, is also actively involved in accession negotiation and has submitted its services offer to undertake commitments in various services sectors including perhaps the three being discussed here.

In this regard, while the study argues that all seven countries should make liberal commitments under the General Agreement on Trade in Services (GATS), they should be willing to undertake more liberal commitments at the regional level in order to reap the full benefits of liberalisation. There could be two specific

reasons why these countries should be undertaking wider and deeper commitments than they would do under GATS. First, as the group is small – having just seven players – as compared to the entire WTO membership there is higher probability of early harvest thereby benefiting from the liberalisation fairly quickly. Second, the real or perceived risk of opening up of the services sector would be drastically reduced at the regional level as compared to that at a multilateral level. This scenario will be more conducive particularly for small countries and LDCs which are otherwise reluctant to open up their services sector under GATS.

The study intends to provide an assessment of the regulatory requirements that impede import of services in these five sectors in each of the countries. It also examines countries' schedules of commitments under GATS and the initial and revised offers submitted during the ongoing services negotiations. In construction and related services, higher education and tourism, while India, Pakistan, and Nepal have made/offered relatively high level of commitments and Sri Lanka has not offered any substantial improvement over its limited commitments, Bangladesh and the Maldives have neither made liberal commitments nor have they yet proposed to do so. However, Bhutan, an acceding WTO member country, is likely to undertake liberal commitments. Overall, the existing regime in these countries is more liberal than what has been committed/proposed under GATS. In the light of this, the study argues that SAFTA provides an ideal forum to undertake wider and deeper commitments without apprehensions regarding the adverse implications of liberalisation.

As some trade is already taking place, any move to reinforce the process is likely to bring about large positive externalities owing to the nature of these services but for that to happen, the Mode 4 regime ought to be made conducive to the extent possible to ensure equity in the increased trade. The main thrust of the study, however, is on developing MRAs that seem essential to ensure market access for Mode 4 and given the level of homogeneity this region has, this should not be too ambitious a task. Finally, the study unequivocally argues that by integrating with other countries smaller countries gain more. While larger countries have economies of scale and might not bank on their smaller partners for import or export, the smaller countries need the support of larger countries to overcome their supply constraints apart from seeking market access for their exports, hence they are more likely to gain from imports as well as exports.

With respect to health services, there are very few regulatory constraints to investments in the SAARC countries. 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. However, there are several other issues pertaining to supply of services under each mode, which need to be addressed. The study puts forward the following recommendations to encourage trade in health services:

- Ensure that the relevant medical, dental and nursing councils from each SAARC country recognise medical and dental qualifications provided in other SAARC countries: This aspect needs to be addressed at the national level in each country.
- Facilitate registration with the relevant medical, dental and nursing councils.
- MRA among the relevant medical and dental councils in the SAARC region, recognising the principles of recognition of qualifications and registration will formally concretise these aspects. Such an MRA should also address standards of service delivery.
- Ensure portability of insurance coverage and recognition of foreign medical degrees by insurance companies: This aspect needs to be addressed at the national level in each SAARC member.
- Provide expedited medical visas. 'Medical visas' as a separate category is recognised under the Indian regulations pertaining to immigration and visas. Expedited mechanisms for consideration and grant of medical visas between all SAARC members need to be considered.
- Enter into MRAs for recognition of qualifications and registration with the relevant medical council: In order to provide a more concrete framework for services under Mode 1, recognition of qualifications and criteria and recognition of standards of service delivery, are principal aspects that need to be addressed in an MRA.

With respect to the telecommunications sector, the benefits are no longer thought to be confined only to the sector. The role of telecommunications as essential to the facilitation of international trade, economic development, and the enrichment of citizens' lives has become widely accepted. Many emerging economy governments which joined in making GATS commit-

ments on basic telecommunications viewed inadequate telecommunications networks and services as an impediment to achieving their full economic potential. The framework developed by GATS, under the WTO regime, has caused basic changes in the market structure of the telecommunications sector across the world.

The region offers significant investment opportunities in Telecom. While mobile teledensity has surpassed fixed lines and is in the range of 20–30% (excluding Maldives), it is still below the industrialised world average. South Asia is home to 24% of the world's population but contributes only 2% to world GDP. In terms of sectoral contribution to GDP, telecommunication revenue in SAFTA countries is also below the world average of 3.1%. Finally, the growth of the knowledge-based sector is directly dependent on the speed of development of telecom network. Hence, countries need investment in this key infrastructure sector.

It has been demonstrated that foreign equity is important for the growth of the telecommunication sector since it leads to better incentives for technology transfer and improved management leading to lower prices and better services. When FDI was first allowed in this sector, it helped domestic players in two ways. First, operators were able to share risks. Getting equity from abroad was an attractive source of capital for domestic players in the early stages since it was a costless form of finance until profits were made. Second, domestic operators imported most of the equipment from abroad and foreign equity was able to finance it. Easing entry restrictions and increasing the threshold for foreign equity will further enable new investments especially in Bangladesh and Pakistan, two countries with large populations and enormous unmet demand.

The popularity of prepaid mobile in the region accounting for as much as 70% of customers, has lowered barriers to telecom use by the financially constrained. Besides wireless, technological and business innovations that make possible the current levels of participation and that will enable millions more to participate need increased investment; what has held back investment for the most part has been the unsatisfactory policy and regulatory environment (Samarajiva 2007). Unsupportive policy and regulatory environments drive up the costs of supplying telecom services by increasing regulatory risk.

An uncertain and discretionary policy and regulatory environment constrain investment. In all countries of South Asia, the regulator responds to political economy pressures. In India, Telecom Regulatory Authority of India (TRAI) powers have been restricted

by the government and they have been hard pressed to try and establish its independence. The Pakistan Telecommunication Authority (PTA) has been recently created and needs to ensure that lessons from India are truly incorporated into the institutional design.

## ■ CONCLUSION

The empirical evidence and economic modeling suggest that the net economic impacts of SAFTA are beneficial, as a whole.

- Gains to least developed countries (LDCs) are modest in the first phase of liberalisation.
- LDC gains are significant in the second phase, provided there is complete liberalisation.
- SAFTA may give Afghanistan increased access to Pakistan market.
- ABMN, gain in some agricultural and chemical products but witness losses in manufacturing including textiles and apparel.
- Overall employment effects are positive for Bangladesh and ABMN.
- Largest trade gains for India and Pakistan do not come from each other, but from Bangladesh, which emerges as the biggest regional market for both.
- 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.
- By 'locking in' uniform trade and investment policies among member countries, a regional trade agreement (RTA) may help promote policy credibility. Group action may influence all members to abide by a common reform agenda.
- 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. This is also due to the fact that India's MFN tariffs are among the highest in the region.
- The economic benefits from an RTA have been justified in terms of greater trade creation than trade diversion by its members. Net trade creation offers dynamic gains from trade and provide the fundamental argument for free trade and economic growth. The GTAP modeling results point to net welfare gains for the region as a whole and suggest that SAFTA will prove trade-creating.

- SAFTA may promote greater rapprochement and stability. GTAP results suggest that all countries experience welfare gains, but it would be important to give flexibilities for countries to protect the vulnerable sectors – this is particularly the case for manufacturing sectors in the smaller LDCs.
- SAFTA by including services may be able to harness much higher gains than otherwise.

The main conclusion of the study is that SAFTA will contribute to increase in intra-regional trade and that, while some sectors will lose and some sectors gain in each country, the net effect on the economy of individual countries of the region, is positive. The results suggest that in order to maximise welfare gains, it

would be important to give flexibility to countries to protect employment intensive manufacturing sectors in the smaller LDCs. The adoption of a transparent and effective regional safeguard mechanisms 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 scope for intra-regional trade in energy, improving road, rail and air links within the region, building modern border customs crossings, developing sophisticated telecommunications links are all vital to this endeavour.

Part I

**BENEFITS FROM TRADE, INVESTMENT  
AND TRANSPORT FACILITATION**



# 1 ■ Introduction

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## ■ THE CONTEXT

South Asia comprises eight economies – Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka – which are members of the South Asian Association for Regional Cooperation (SAARC). Afghanistan is the newest entrant to SAARC. The seven SAARC countries concluded the South Asian Free Trade Agreement (SAFTA) on 6 January 2004 which marked the consolidation of their efforts to pursue and greater economic integration in the region.

The objectives of the treaty are sought to be achieved in the following ways:

- Eliminating barriers to trade and facilitating cross-border movement of goods.
- Promoting conditions of fair competition and ensuring equitable benefits, taking into account their respective levels and patterns of economic development
- Creating effective mechanisms for the implementation and application of the agreement, for its joint administration and the resolution of disputes
- Establishing a framework for further regional cooperation to expand and enhance mutual benefits.

While the steps towards regional cooperation began with the setting up of SAARC, it did not cover issues specifically pertaining to greater trade and economic cooperation. Initially, SAARC's focus was confined to nine areas of regional cooperation which included transport, communication, science and technology, education, culture, health, population, sports and arts. However, with the rise in regional agreements and economic cooperation around the world and the reforms in the region towards liberalisation, there was increased consensus on the need to deepen economic relations and specifically increase trade integration among economies in South Asia. This led to the signing of the South Asian Preferential Trading Agreement (SAPTA) in 1993 at the seventh SAARC summit held

in Dhaka. SAPTA came into force in December 1995 after the first round of negotiations was concluded in April 1995. Though concessions were agreed on a large number of products under this agreement, there was no substantial increase in trade under this agreement.

The idea of creating SAFTA came about at the 19th session of the SAARC Ministerial Council in December 1995. The SAFTA was duly signed on 6 January 2004 during the 12th SAARC Summit.

This study aims to provide an in-depth assessment of the likely changes induced by SAFTA on South Asian countries and South Asia region as a whole. The emphasis of the analysis has been 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

An assessment of the economic rationale of SAFTA is made and likely consequences of various tariff reduction scenarios on the region as a whole and on individual member countries of SAARC is computed. The impact of SAFTA on variables such as trade, inflows and outflows of investments, production, prices, revenues, income and welfare has been estimated. The impacts of SAFTA on trade and foreign direct investments into the region have been estimated using the gravity model and panel data estimations. The study also examines the revenue implications for the region and assesses the possibilities of whether trade creation and consequent revenue generation will offset losses due to reductions in tariffs. The implications of SAFTA for less developed countries (LDCs) of the region, in particular, have been examined.

Econometric modelling has been used to assess the quantitative impacts of SAFTA. Different econometric/statistical techniques, like revealed comparative advantage (RCA); complementarity index; intra-industry trade (IIT) index; computable general

equilibrium (CGE); gravity model; SMART (software for market analysis and restrictions on trade) model; and panel data estimations have been employed. The fact that some of the policy scenarios have already been set (and in fact implementation of them has already commenced), adds to the greater precision with which the global trade and analysis project (GTAP) model can be used as a predictive tool.

Given the various issues of trade and transport facilitation in South Asia, a quantification of gains from identified regional infrastructure projects using benefit cost analysis (BCA) is undertaken. Although regional in nature, the benefits are computed for the country which is undertaking the project on its territory to demonstrate the extent of benefits that can accrue. The four projects include: Upgrading of the Kolkata-Petrapole/Benapole corridor and Customs Facilities; Development of Bagdogra Airport as a Gateway and Hub; Railway Improvement at between Lahore and Wagah; and Colombo Port Expansion.

There is also the view that in the new generation of free trade agreements (FTAs), services, investment, and rules (SAFTA++) are the key to the way in which countries gain through region-wide organisation of production and sourcing.<sup>1</sup> This study also examines the SAFTA++ scenario under which it identifies sectoral and modal comparative advantages in trade in services of each of the member countries and determines the extent to which complementarities exist. This is corroborated with the analysis of the service sectors in which cross-border trade potential exists and trade restrictions prevent in actualising this potential. Further, the study examines the potential for trade as well as the ways of accelerating the existing trade. Detailed analysis is undertaken for identified services sectors, which are health and related services, higher education, construction and related services, travel and tourism related services and telecommunication services. The possibility of mutual recognition agreements (MRAs) in these service sectors has been explored which may boost the trade in services within the SAFTA region.

The study attempts to measure both qualitative and quantitative assessments of the outcomes in the affected sectors. Apart from providing a prognosis, the study will help in the formulation of concrete policy measures that will ensure more gains and mitigate potential

negative impacts. Based on the existing domestic policies of the countries under review, suggestions have been made on what complementary measures could be introduced to mitigate the negative impacts and enhance positive impacts of SAFTA. The study provides economic assessments using analytical tools and rational causal chain analysis and clearly outlines the way forward for SAFTA in terms of policy directions.

The study is organised as follows: The rest of the chapter provides the background of SAFTA and prevailing economic situation in the member countries with some discussion on the existing trade regimes. Chapter 2 presents a review of literature and the debates on the rationale for SAFTA. It discusses both qualitative as well as quantitative studies undertaken with respect to regional cooperation focusing on SAFTA.

Chapter 3 estimates a number of indices that indicate the extent and change in the competitiveness and complementarities between member countries of SAFTA to arrive at the economic rationale for SAFTA. Chapter 4 estimates the impact of SAFTA on trade in the region. Using the negative lists of member countries of SAFTA it presents results of the impact of different SAFTA scenarios on effective additional market access that will accrue to the member countries with SAFTA. Chapter 5 estimates the gravity model to arrive at the potential trade that may be achieved due to SAFTA for the region as a whole and also for each member country. Bilateral trade potentials are also estimated. The chapter further highlights the extent of increase in trade by removal of tariffs and non-trade barriers.

Chapter 6 uses GTAP analysis to estimate the impact of different scenarios of SAFTA. The impact is analysed on exports, imports, output change, employment change and welfare change. Sector-wise impact analysis is also undertaken and sectors where each member-country will lose or gain are identified. Chapter 7 estimates the costs of SAFTA in terms of revenue loss to each member country. SMART simulations have been used which also indicate the extent of consumer welfare gain or loss. Chapter 8 analyses impact of deepening of SAFTA by inclusion of investments. Impact of regional cooperation through SAFTA on inward foreign direct investments (FDI) has been estimated. Chapter 9 provides results with respect to quantification of benefits from transport facilitation

<sup>1</sup> The point is important, because it has also been argued that to the extent that the New Regionalism in Latin America and elsewhere is significantly about these deeper aspects of integration, the traditional analysis of costs and benefits of RTAs, which focus mainly on barriers at the border, while ignoring differences in national institutions and domestic regulations, is seriously deficient.

in SAARC using BCA. Volume II, Chapter 10 provides an overview of trade in services in SAFTA region. Five service sectors have been identified as having export potential within SAFTA. These are construction and related services (chapter 11), tourism and travel related services (chapter 12), higher education services (chapter 13), health and related services (chapter 14) and telecommunication services (chapter 15). A detailed analysis of each sector is undertaken and possibilities of areas for MRAs have been identified and presented. Chapter 16 discusses cross-cutting issues and concludes the study. Finally, chapter 17 provides the way forward in terms of policy directions.

## ■ THE BACKGROUND

Established in 1985, SAARC is a group of seven countries, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. Subsequently, Afghanistan became a member of SAARC. SAARC's activities were initially confined to nine areas of regional cooperation and economic cooperation was deliberately kept outside its purview. In the early 1990s, there was a surge in regional arrangements. The experience of the growth and consolidation of various regional blocks brought to fore the realisation that core economic areas need to be brought within the scope of SAARC activities if the objective of bringing about accelerated social and economic development in the region through mutual cooperation was to materialise. The sixth summit at Colombo in 1991 declared commitment to initiate cooperation in economic areas initially in trade and agreed to formulate an agreement on an institutional framework for trade liberalisation among themselves. Recognising its great economic strength in terms of its market potential, rich natural resources and capable human resources, and the possibility of enhanced intra-regional trade and investment flows, a trade blocks among SAARC members was formed with the signing of SAPTA during the Seventh Summit held in Dhaka in April 1993. The Agreement reflected the desire of the member States to promote and sustain mutual trade and economic cooperation within the SAARC region through the exchange of concessions. SAPTA made a distinction between the least developed and other developing member countries with the former consisting of Bangladesh, Bhutan, Maldives and Nepal and the latter consisting of India, Pakistan and Sri Lanka.

Being a preferential trade agreement, the negotiations for SAPTA during each round were held on the

basis of 'request and offer' approach; where the exporting party came up with a 'country-specific' request list of its exportable (real as well as potential) items on which it would seek preferential market access. The other party would then make an offer on items from 'request-list' and indicate the extent of tariff concessions in terms of margin of preference (MoP). In each round the coverage of products under tariff concessions were expanded and the MoP on products under concessions were also increased. At the end of each round, these offers were multilateralised to all SAARC members which thereby expanded the items on which concessions were offered by each member. The LDC members got concessions on a large number of products with deeper MoP, without reciprocating with equivalent concession to other developing countries under the special and differential treatment (S&DT) provision of SAPTA. In four rounds of negotiations that were held under SAPTA, tariff concessions on around 5000 products at 6-digit HS level were exchanged. It has been found that though a number of products exported by LDCs were limited, tariff concessions were made available to them on a wide range of products. The opportunity to expand the basket of products for exports to SAARC member countries (SMC) was not fully utilised. Some attribute this to the non-tariff barriers (NTBs) imposed by other members; the supply-side constraints of LDCs; and the lack of intra-regional investment flows and the absence of backward-forward linkages amongst the industries.

SAPTA was initially viewed as an instrument that could transform the South Asian trade landscape through a greater regional integration. This optimism began to wane with the slow progress of SAPTA under the four rounds of trade negotiations, as it did not increase the volume of intra-regional trade and investment flows. This was mainly because of the limited tariff preferences extended to a country's trading interest, limited depth in tariff cuts, and prevalence of NTBs. Contrary to general belief, the rules of origin of SAPTA were much more liberal as compared to other PTAs as a product would be considered as originating from a country if it generated a local value added content of 40% (30% for LDCs). This also included profit made not only by the manufacturers but also by the traders. The non-qualifying/minimal operations were confined to packaging and transportation operations only. For SAFTA to be successful, therefore, several lessons from SAPTA need to be learnt so that the pitfalls are not repeated.

## ■ SOUTH ASIAN FREE TRADE AREA

The decision for establishing a FTA in SAARC was taken in the 9th SAARC Summit in May 1997 in Male. At the 10th SAARC Summit held in Colombo in July 1998, it was decided to set up a Committee of Experts (CoE) to draft a comprehensive treaty framework for creating a free trade area within the region, taking into consideration the asymmetries in development within the region and bearing in mind the need to fix realistic and achievable targets. Subsequently, at the 11th SAARC Summit at Nepal in January 2002, the Heads of State or Government directed the Council of Ministers to finalise the text of the Draft Treaty Framework by the end of that year.

The CoE first met in August 1999 but it took four years to reach an agreement on SAFTA which was finally signed on 6 January 2004 during the 12th SAARC Summit in Islamabad and was implemented with effect from 1 January 2006, though the tariff liberalisation started from 1 July 2006. This was due to the fact that the sensitive lists, rules of origin, mechanism for compensation of revenue losses for LDCs and areas for technical assistance were negotiated subsequently. Further, there was a delay in commencement of trade liberalisation programme due to procedural requirements for ratification of the Agreement. Despite the delay, it was agreed that time frame for reduction of tariffs would remain unchanged.

### Salient features of SAFTA

SAFTA has six core elements: Trade liberalisation programme; Sensitive lists; Rules of origin; Non-tariff and para-tariff barriers; Revenue compensation mechanism for the LDCs; and Technical assistance for LDCs.

### Trade Liberalisation Programme

The Agreement provides for the following schedule of tariff reduction:

- Non-LDC of SAARC (India, Pakistan and Sri Lanka): Non-LDCs would reduce their existing tariffs (for MFN tariffs more than 20%) to 20% within a time-frame of two years from the date the Agreement comes into force. If the actual MFN tariff rates are below 20% then there shall be an annual reduction of 10% on MoP basis for each of the two years. The subsequent tariff reductions from 20% or below to 0–5% shall be done within of the next five years by India and Pakistan and six years by Sri Lanka. Therefore the trade liberalisation programme (TLP) allowed the tariffs to be reduced to 0–5% in a total time-frame of seven years to India and Pakistan, and eight years to Sri Lanka.
- LDCs of SAARC (Bangladesh, Bhutan, Maldives and Nepal): The LDCs would reduce their existing tariff (for MFN tariff more than 30%) to 30% within a time-frame of two years from the date the Agreement comes into force. If the MFN tariff rates are below 30% there will be an annual reduction of 5% on MoP basis for each of the two years. The subsequent tariff reductions from 30% or below to 0–5% shall be done within the next eight years, thus allowing them a time-frame of a total of ten years to reduce their tariffs to 0–5%.

The two phases of tariff liberalisation programme as envisaged in SAFTA are summarised in Tables 1.1 and 1.2.

Notwithstanding the above provisions, the non-LDCs shall reduce their tariffs to 0–5% for the products of the LDCs within a period of three years beginning from the date of coming in to force of the Agreement.

### Sensitive Lists

The Agreement allows member countries to maintain sensitive lists, consisting of items which are not subject to tariff reduction. The size of the sensitive list was negotiated in COE and it was agreed that it would be

**Table 1.1 Tariff Reduction Plan under SAFTA: First Phase**

Countries	Existing Tariff Rates* (%)	Tariff Rates Proposed under SAFTA	Time Schedule (from 1.1.2006)
Developing Countries	More than 20	20 (maximum)	Within 2 Years
	Less than 20	Annual reduction of 10	Each of 2 Years
Least Developed Countries	More than 30	30 (maximum)	Within 2 Years
	Less than 30	Annual reduction of 5	Each of 2 Years

\* The tariff rates on the date of enforcement of SAFTA.

NB: All tariff rates are applied tariff rates and not bound tariff levels.

Source: SAARC Secretariat

**Table 1.2 Tariff Reduction Plan under SAFTA: Second Phase**

Countries	Existing Tariff Rates (%)	Tariff Rates Proposed under SAFTA (%)	Time Schedule (from 1.1.2008)
India Pakistan	20 or below	0–5*	within 5 years
Sri Lanka	20 or below	0–5*	within 6 years
Least Developed Countries	30 or below	0–5**	within 8 years

\* In equal annual installments, but not less than 15% annually.

\*\* In equal annual installments, but not less than 10% annually.

Source: SAARC Secretariat

25% of the total number of items at 6-digit HS level. The Agreement also provides that LDCs can seek derogation for removal of items of their export interest from the sensitive list of developing country members. This meant that a SAARC member could maintain two sets of sensitive lists: a larger list for the non-LDCs and a shorter list for the LDCs. However, only three members, namely Bangladesh, India and Nepal maintain different sensitive lists for LDCs and non-LDCs. Besides, the LDCs were allowed to maintain a bigger size of sensitive lists than the non-LDCs. The sensitive lists are subject to review after every four years or earlier with a view to reducing the number of items which are to be traded freely among the SAARC countries. The number of tariff lines (at 6-digit HS codes) of SAFTA members for the sensitive lists are given in Table 1.3.

**Table 1.3 Sensitive Lists in SAFTA**

Country	Total Number of Sensitive Lists		Coverage of Sensitive List as % of Total HS Lines	
	Non-LDCs	LDCs	Non-LDCs	LDCs
Bangladesh	1,254	1,249	24.0	23.9
Bhutan	157	157	3.0	3.0
India	865	744	16.6	14.2
Maldives	671	671	12.8	12.8
Nepal	1,335	1,299	25.6	24.9
Pakistan	1,191	1,191	22.8	22.8
Sri Lanka	1,079	1,079	20.7	20.7

Source: SAARC Secretariat

### Rules of Origin

The rules of origin agreed under SAFTA are general (i.e. one criterion for all products) barring 191 products for which product specific rules are applied. Thus, SAFTA rules of origin prescribe for an application of twin criteria of sufficient transformation through a change in tariff heading (CTH: change at 4-digit HS level between the non-originating inputs and the final

export product) and achieving a local value-added content of at least 40% as a percentage of free on board (FoB) value. However, local value-added content requirement is lower for Sri Lanka and LDCs, which is 35% and 30% respectively. Unlike SAPTA, there are detailed minimal/non-qualifying operations. Therefore, the Rules of Origin of SAFTA is more stringent than SAPTA. There is also a provision relating to Regional Cumulation wherein inputs from other SAARC members can be sourced. Under this provision a higher value-added content of 50% for the entire region has been prescribed, of which 20% value-added content should be done in the exporting country. The condition of CTH applies on the non-originating inputs. In order to avoid fraudulent practices detailed operational certification procedures have been adopted.

### Non-Tariff and Para-Tariff Barriers

The Agreement provides that no quantitative restrictions would be maintained by SAARC members, if they are not allowed under GATT 1994. With respect to other non-tariff measures and para-tariff measures, the Agreement prescribes that the countries notify their measures to the SAARC Secretariat on an annual basis and SAFTA COE will review them and make necessary recommendations for their elimination. The Agreement further prescribes that the initial notification shall be made within three months from the date of coming into force of the Agreement and the COE shall review the notifications in its first meeting and take appropriate decisions. For its implementation a sub-group on non-tariff measures has already been established, which is engaged in addressing the NTBs.

### Mechanism for Compensation of Revenue Loss

A mechanism has been established to compensate the revenue loss to be incurred by the LDCs due to reduction of tariffs. The mechanism for compensation of revenue loss (MCRL) for the SAARC LDCs prescribes the following:

- The compensation to LDCs would be available for four years. However, for Maldives it would be available for six years.
- The compensation would be in the form of grant in US dollars.
- The compensation shall be subject to a cap of 1, 1, 5 and 3% of the customs revenue collected on non-sensitive items under bilateral trade in the base year, i.e. average of 2004 and 2005.
- The compensation shall be administered by the COE.

This scheme initially generated a lot of attention when the SAFTA was signed but upon its finalisation, it did not appear to have met the expectations of LDCs due to the limited scope and period of application. By the time the LDCs would grant duty-free market access to other members of SAFTA, thereby incurring major revenue losses, the mechanism will no longer be in operation.

#### *Technical Assistance for LDCs*

There are provisions for technical assistance for LDCs at their request. Areas of technical assistance as agreed upon are as follows:

- Capacity building (trade related)
- Customs procedures related measures
- Development and improvement of tax policy and instruments
- Legislative and policy related measures, assistance for improvement of national capacity
- Studies on trade-related physical infrastructure development, improvement of banking sector, development of export financing.

In addition to the above core areas, the Agreement also provides for the following:

*Trade Facilitation:* The Agreement prescribes for harmonisation of standards, reciprocal recognition of tests and accreditation of testing laboratories, simplification and harmonisation of customs procedures, customs classification of HS coding system, import licensing and registration procedures, simplification of banking procedures for import financing, transit facilities for efficient intra-SAARC trade, macro economic consultations, development of communication systems and transport infrastructure and simplification of business visas.

*Institutional Mechanism:* SAFTA Ministerial Council (SMC) is the highest decision making body and is responsible for the administration and implementation of the Agreement. The SMC is supported by the CoE which will monitor, review and facilitate implementation of the provisions of the Agreement.

*Safeguard Measures:* To protect the domestic industry from surge in imports of products covered under SAFTA concessions causing or threatening to cause serious injury to the domestic industry due to increased preferential import, the Agreement provides for a partial or full withdrawal of preference granted for a maximum period of 3 years. Safeguard measures cannot be applied against the product of LDCs if share of import from an LDC of the product concerned in total import of importing country is less than 5%.

*Dispute Settlement Mechanism:* The Agreement provides for settling the disputes that may arise due to the interpretation and application of the provisions of SAFTA or any instrument adopted thereunder. It provides for a bilateral consultation to be held within 30 days upon a request made by any member. If dispute cannot be settled through bilateral consultation, the matter will be referred to the COE for its recommendation within 60 days. The COE may consult with a panel of experts for peer review. Any decision of the COE can be appealed to SMC for its decision within 60 days. The decision of the SMC will be final.

## ■ ECONOMIC AND TRADE PROFILE OF SAARC COUNTRIES

The member countries in SAARC, not only have close cultural and historical ties, but also followed similar trade policies after their independence. With the exception of Sri Lanka, which had undertaken significant liberalisation in the late 1970s, restrictive trade policies remained dominant in this region for nearly four decades. Recognising the importance of international trade, unilateral trade liberalisation policies began to be introduced in the second half of the 1980s. However, a more systematic liberalisation started in the 1990s in almost all countries. The change contributed to a more rapid expansion of trade of India, Pakistan, Bangladesh and Nepal not only with the outside world but also in the region as well. Economic growth accelerated in many of these countries in the post-1990s and the average annual growth of GDP per capita improved in almost all countries in the period 1996–2006 as

**Table 1.4 Average Annual Growth of GDP, GDP Per Capita, Exports and Imports of Goods and Services, 1986 to 2006 (%)**

Country	1986–96				1996–2006			
	GDP	GDP per capita	Export of Goods and Services	Import of Goods and Services	GDP	GDP per capita	Export of Goods and Services	Import of Goods and Services
Bangladesh	4.2	1.8	11.7	7.5	5.4	3.4	10	6
Bhutan	4.6	4.7	7.2	6.8	7.2	4.5	3.8	6.3
India	5.5	3.5	11.8	10.8	6.4	4.7	13.4	9.9
Nepal	5.1	2.6	–	–	3.6	1.3	–	–
Sri Lanka	4.7	3.4	7.5	6.2	4.4	3.7	5.5	7
Maldives	–	–	–	–	6.9	4.1	7.3	6.5
Pakistan	5	2.3	8	4.3	4.2	1.8	8.2	3.1

Source: WDI

compared to 1986–96, except for Nepal and Pakistan (Table 1.4).

During the period 1986–96, India recorded an average annual growth rate of 5.5%, followed by Nepal at 5.1%, Pakistan at 5%, while growth rate of Bangladesh, Bhutan and Sri Lanka averaged at around 4%. High GDP growth rates did not contribute to the improvement in per capita income in these countries, reflecting a higher population growth rate, with Bhutan being an exception. While Bhutan displayed a phenomenal improvement in the average growth rate of GDP during 1996–2006, the growth rate of Pakistan, Nepal and Sri Lanka decelerated. India and Maldives recorded an average growth rate of around 6%. During the second phase, India maintained high growth rates of both exports and imports. Higher GDP growth rate of Bangladesh and Bhutan was not matched by the growth rate of export and import of goods and services in the second phase.

In terms of trends in GDP, Maldives, in 1986, recorded the lowest GDP of US \$ 0.14 billion, followed

by Bhutan, while India recorded the highest GDP of US \$246 billion (Table 1.5). The GDP of Pakistan was much lower vis-à-vis India. However, it was higher as compared to other South Asian economies. While, the GDP of all the economies more than doubled over a 20 year period starting from 1986, India still recorded the highest GDP of US \$911 billion in 2006. However, the per capita income of India still remains low. Maldives, though being amongst the lowest in terms of GDP, has shown significant improvement in terms of per capita GDP which stood at \$2,328 in 2005, the highest in South Asia. Sri Lanka followed the same trend, with its per capita GDP increasing from US \$384 in 1986 to US \$1,132 in 2005 which was the second highest vis-à-vis other South Asian economies.

In 1980s, in almost all South Asian economies, the contribution of agriculture to GDP was higher than the contribution of the manufacturing sector (Table 1.5). The share of agriculture in GDP was the highest in Nepal, followed by Bhutan, while the contribution of the manufacturing sector was the lowest in both the

**Table 1.5 GDP Trends during 20-Year Period (1986–2006) in South Asian Economies**

Country	1986					1996					2006				
	GDP (US \$ Billion)	as % of GDP				GDP (US \$ Billion)	as % of GDP				GDP (US \$ Billion)	as % of GDP			
	X	M	Ag	Mfg	X	M	Ag	Mfg	X	M	Ag	Mfg			
Bangladesh	21.2	5.4	12.2	31.9	14	40.7	11.1	18.7	25.7	15.4	61.9	19	25.2	19.6	17
Bhutan	0.21	17	50.9	42.7	5	0.31	35.7	45.9	32.8	11.7	0.93	–	–	–	–
India	246	5.3	7.1	30	16.4	388	10.5	11.7	27.4	17.5	911	23	25.8	17.5	16
Nepal	2.9	11.7	20.3	51.5	6.2	4.5	22.3	40.5	9.4	37.2	8.1	18.6	39.5	7.7	39
Sri Lanka	6.4	23.7	35.3	27.1	15.2	13.9	35	43.9	22.4	16.2	27	31.6	43.2	16.5	14
Maldives	0.14	68.1	60.7	–	–	0.45	91.7	73.1	–	–	0.93	–	–	–	–
Pakistan	38.1	10.3	16.9	27.6	16.3	76.2	14	17.8	24.7	15.2	126	15.3	23.3	19.4	19.5

Note: X: exports; M: imports; Ag: agriculture, Mfg: manufacturing.

Source: World Development Indicators

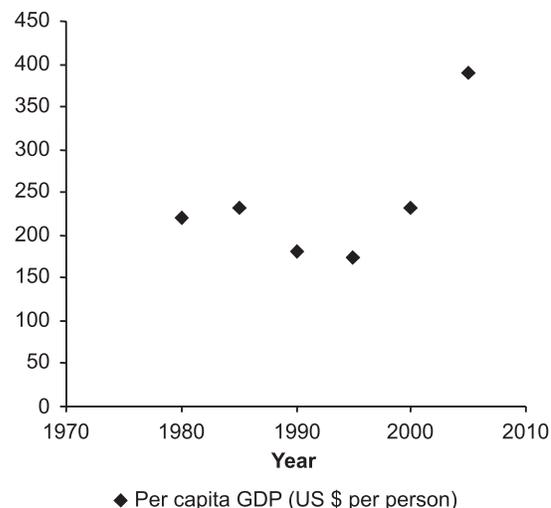
countries. However, this trend was reversed over the 20-year period. The share of agriculture in GDP decelerated to 7.7% in Nepal, the lowest as compared to other South Asian countries, however, the contribution of the manufacturing sector was the highest in this country. The share of agriculture decelerated in almost all the economies. While, the manufacturing sector maintained its share of less than 20% (with Nepal being an exception). This is indicative of the relatively rapid expansion of the service sector in almost all the economies (the exception being Nepal). With respect to the trade openness, Maldives has remained a relatively open economy, followed by Sri Lanka and Bhutan. The share of exports and imports to GDP was the highest in Maldives in the 1980s and 1990s, while the share remained low in Bangladesh and India. The share of imports and exports in GDP has increased in almost all the South Asian economies over the 20-year period starting from 1986, reflecting a transition towards a more open and liberalised economy.

We now examine in greater detail the country-wise economic and trade profiles.

## Bangladesh

At the time of its independence in 1971, Bangladesh was a low income and overpopulated country. However, it has progressed rapidly in terms of attaining higher growth. The per capita GDP has more than doubled since 1975 (Fig 1.1).

Until 1989, GDP per capita grew at a positive but mediocre average yearly rate of 1.2%. However, in 1990, various reforms were introduced in the areas of macro-liberalisation, trade liberalisation and financial deregulation. These broad-based, market-oriented reforms and macro-stabilisation measures introduced in the 1990s propelled both private investment and technology infusion. Per capita GDP attained a growth rate of 3.3%. The strong growth is characterized by high overall GDP growth rate facilitated by a sharp decline in population growth rate. However, in terms of the absolute levels of the GDP, Bangladesh still ranks low. As seen in Table 1.6, growth averaged at 5.4% over 2001–05, which has been the highest 5-year average since the country's independence. This growth



**Fig 1.1 Per capita GDP(US \$) in Bangladesh**

Source: WDI

was underpinned by resurgence in private investment, large remittance inflows which fueled growth in construction and service sectors, impressive macro-economic stability, relatively high saving and investments and higher pace of human development.

The economic advances during the 1990s underpinned and benefited from progress on human development. Poverty rate has declined by 20% since early 1990s. Unemployment rate is only 4% and have been consistently low.

**Trade Policy Regime in Bangladesh:** Trade liberalisation has been one of the major policy reforms in Bangladesh. It has been implemented as part of the overall economic reform programme, namely the structural adjustment programme (SAP), which was initiated in 1987 and formed the component of ‘structural adjustment facility’ (SAF) and ‘enhanced structural adjustment facility’ (ESAF) of the IMF and World Bank.

Bangladesh initially followed a strategy of a highly restricted trade regime. This was characterized by high tariff and non-tariff barriers to trade and an overvalued exchange rate system which was supported by the import substitution industrialisation strategy of the government. The trade policy during 1972–80 consisted of significant import controls. The instruments employed to implement the import policy were the

**Table 1.6 Annual growth rate of GDP in Bangladesh: 1997–2005**

Year	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Annual growth rate of GDP	5.23	4.87	5.94	5.27	4.42	5.26	6.27	5.96	6.63

Source: *Statistical Yearbook of Bangladesh*, 2006: Bangladesh Bureau of Statistics

foreign exchange allocation system and the import policy orders (IPOs). Under IPOs, it was specified whether items could be imported, prohibited or required special authorisation. With the exception of a few cases, licenses were required for all other imports. The regime was also characterised by a high degree of anti-export bias. The inward looking strategies failed to deliver the desired outcomes and also led to rising internal and external imbalances. Therefore, trade policy reforms were introduced in 1980s, when a policy of moderate liberalisation was implemented. A significant change was made in the import policy regime with the abolition of import licensing system and permission of imports against letters of credit. There were significant changes in the import procedures and IPOs with respect to the contents and structure. The latest import policy, IPO 2006–09, reiterates the government’s commitment to continued liberalisation of the import regime in Bangladesh. (Raihan, 2008)

The liberal import policies led to a surge in imports into Bangladesh. In 1989–90, total imports stood at US \$3,226 million, which rose to US \$6,612 million in 1995–96, and increased further rapidly to US \$14,576 million in 2004–05 (Fig 1.2). There has also been rise in share of imports in GDP. It rose from only about 12% in early 1990s to more than 20% in more recent periods.

From the late 1980s, the tariff regime has become increasingly liberalised. One of the important aspects of the tariff structure in Bangladesh relates to the use of import taxes (para tariffs) which have a protective impact over and above the protection provided by custom duty. Similarly, while VAT is supposed to be trade neutral, exemptions for specified domestic products have also resulted in it having some protective content.

Since 1985, many export policy reforms have also been implemented. A few sectors especially the

readymade garments (RMG), have been the beneficiary of these reforms. The reforms have also provided exporters with unrestricted and duty-free access to imported inputs, financial incentives in the form of easy access to credit and credit subsidies, and fiscal incentives such as rebates in income taxes and concessionary duties on the imported capital machinery. They were also aimed at strengthening the institutional framework for export promotion. Major export promotion policies in Bangladesh have been the export performance licensing scheme, special bonded warehouse scheme, duty drawback system, back-to-back letter of credit (L/C) system, export promotion fund, fiscal incentives, export credit guarantee scheme, cash compensatory scheme, and institutional development for export promotion. Extensive export promotion measures and favourable market access in the European Union (EU) and United States of America (USA) has enabled its exports to rise remarkably in the last 20 years. In 1989–90, total exports stood at US \$1,524 million, which increased to US \$3,883 in 1995–96, and further to US \$9,902 million in 2004–05.

With a considerable rise in export earnings at a rapid pace, the export orientation ratio ( the ratio of exports to GDP) also rose significantly from around 7% in the mid-1980s to more than 15% in 2003–04. The export growth is overwhelmingly dominated by the dynamism in the readymade garment sector alone. The growth of RMG exports is largely attributable to international trade regime in textiles and clothing, which until 2005 was governed by multi fibre arrangement (MFA) quotas. Also, duty-free access to Bangladesh’s RMG products in the EU has greatly supported the growth of the sector. Apart from RMG, export response of all other major commodities such as raw jute, jute goods, frozen food, shrimps, tea, leather and leather products has not been very strong.

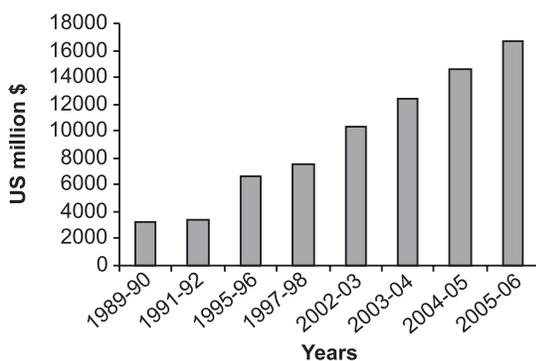


Fig. 1.2 (a) Total Imports of Bangladesh: 1989–2006

Source: Foreign Trade Statistics, Bangladesh Bureau of Statistics.

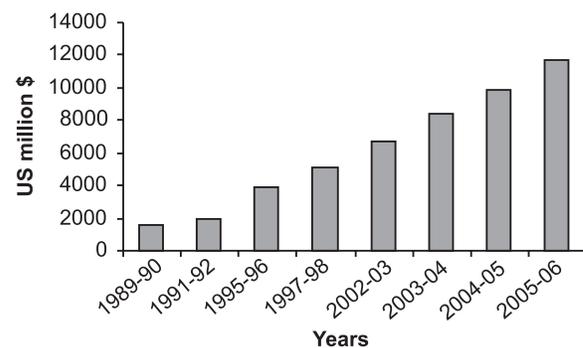


Fig 1.2 (b) Total Exports from Bangladesh: 1989–2006

Bangladesh, which historically relied on tariffs and quantitative restrictions to protect domestic activities and raise revenue, introduced trade reforms in 1990. The reforms included substantial reduction and rationalisation of tariffs, removal of quantitative restrictions, move from multiple to unified exchange rate and from fixed to flexible exchange rate system, current account convertibility, and an overall outward orientation of the trade policy regime. The liberalisation programmes were implemented at a fast pace. In fact, it experienced one of the most rapid reductions in tariffs. In consequence, Bangladesh's trade-GDP ratio has risen from 19% in 1985 to 32% in 2004 (Table 1.7).

**Table 1.7 Trade-GDP ratio, 1980–2004 (%)**

Years	1980	1985	1990	1995	2004
Trade-GDP ratio	19	19	20	28	32

Source: Foreign Trade Statistics, Bangladesh Bureau of Statistics.

Since the mid-1990s, however, movement towards a lower and uniform tariff rate slowed due to concerns over budgetary revenues, the balance of payments and possible adverse effects of trade liberalisation on import-competing industries. Some trade-related quantitative restrictions still impede import flows. Also, the range between the top and lowest tariff rates is still very wide, with very high nominal protection rates applying to competing final goods.

Over the last two decades, Bangladesh has followed a unilateral approach as the principal avenue to liberalise its trade policy, while remaining active in the ongoing WTO multilateral trade negotiations, particularly as a leader in the LDC coalition under the Doha Development Round. Bangladesh is actively seeking participation in regional FTAs which could be used as platforms for further multilateral liberalisation. It is a member of SAFTA which it signed in 2004. There is an ongoing discussion between India and Bangladesh under Bay of Bengal Initiative for Multi Sectoral Technical and Economic Cooperation (BIMSTEC). It is also discussing details of an FTA with Malaysia.

## Bhutan

Bhutan is a small landlocked country. The economy of Bhutan, one of the world's smallest and least developed, is based on agriculture and forestry, which provide the main livelihood for more than 60% of the population. Agriculture consists largely of subsistence farming and animal husbandry. The industrial sector is technologically backward, with most production of the cottage

industry type. Bhutan's hydropower potential and its attraction for tourists are its key resources. Hydroelectric power has been the major source of economic growth. The hydroelectric sector accounts for some 12% of GDP and 45% of government revenue. As a least developed country, Bhutan depends on foreign aid for financing its development programmes and its establishment cost. India has been the largest donor of external aid and its main development partner. India has also helped Bhutan in the development of its hydropower resources.

Bhutan has made great progress in improving the living standards of its people since it first set forth on a plan for modernisation in the early 1960s. Bhutan's per capita GDP has increased over time, however, its still low vis-à-vis other South Asian economies.

Economic activity, vigorous for the past years, was robust in 2001 as GDP grew by 6.8% from 6.0% during the 1990s (Table 1.8). The country's close link with India helped Bhutan avoid the direct impact of the global economic slowdown. The main driving force of the high economic growth was the construction of three hydropower projects. In the services sector, electricity continued to lead the economy and maintained 12.5% of GDP. Tourism, which registered double-digit growth in the 1990s, witnessed a drop of 14.5% in tourist numbers and a decrease of \$1 million in revenue in 2001 due to the aftermath of 11 September, poor weather earlier in the year, and logistic difficulties with air transport. Agricultural growth was lower than in 2000, when investment targeted improving access to agricultural farming inputs. Bhutan's economy saw a healthy growth in 2002 with the GDP climbing to 10.9%. The renewable natural resources sector which includes livestock, forestry, logging and major cash crops like mandarin and apple, continued to dominate the share of the GDP. It remains the most significant sector, employing about 75% of the country's labour force.

**Table 1.8 Growth rate of GDP in Bhutan: 2000–2006**

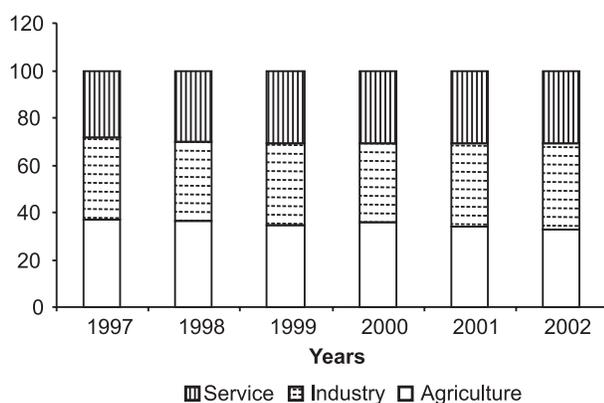
Year	2000	2001	2002	2003	2004	2005	2006
GDP growth rate	7.2	6.8	10.9	7.2	6.8	7	8.5

Source: National Account Statistics, 2000–06.

Construction and electricity were also key sectors in 2002, contributing 17% and 9.7% respectively. The growth rate in GDP decelerated in 2003 due to the low growth rate experienced in the agriculture sector. During 2003, growth in trade at 17.7%, power at 10% and manufacturing at 7.1% were the main drivers of

growth. The increase in government expenditure on construction activities was also one of the positive factors behind growth. The growth rate in 2005 was 7% against the growth rate of 6.8% in 2004. The growth rate in 2005 could be attributed to better performance by the financial sector followed by private, social and recreational services, hotel and restaurant and wholesale and retail trade. The GDP growth rate accelerated to 8.5% in 2006 owing to the improved performance in the electricity sector (35.3%) followed by mining and quarrying (63%), hotels and restaurant (32.3%) and finance, insurance and real estate (17%). It is envisaged that the construction of joint India–Bhutan hydropower stations will positively shape the economic growth in the Tenth Five-Year Plan (2008–09 to 2012–13) period, which would facilitate to maintain the projected GDP growth of average ratio of seven percent, as electricity exports to India from current and prospective projects would provide a fairly stable source of development to the economy.

The structure of Bhutanese economy has undergone significant changes over the past few years. The share of agriculture in GDP has been declining from 37% in 1997 to 32.9% in 2002 (Fig 1.3). The share of industrial sector in GDP has increased marginally over the period, 1997–2002. Within the industrial sector, the share of manufacturing has reduced marginally. There has been a significant expansion in the contribution of service sector to overall economic growth of the country from 28.4% in 1997 to 30.7% in 2002.



**Fig 1.3 Share of Agriculture, Industry and Services in GDP in Bhutan: 1997–2002**

Source: *Country Economic Review*, Bhutan

**Trade Policy Regime in Bhutan:** Like any other small and developing economy, Bhutan is constrained by limited resources and a small market. Therefore, the international trade and gradual integration into global trading system is of paramount importance and is thus

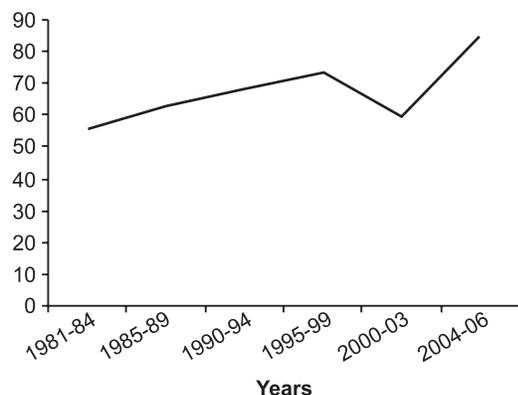
a key objective of the government. The government is pursuing a more liberal and open policy towards international trade.

The most important trade policy instrument employed by the government is the bilateral FTA with India. Since India accounts for about 95% of its exports and 80% of imports, this agreement ensures that Bhutan follows more or less an open economic policy. Bhutan also has a PTA with Bangladesh, which is Bhutan's second largest export market. Trade with countries other than India used to be controlled by the rigidly quota system until the early 1990s and now the quota system has been replaced by the tariff system in a move to a more liberalised system.

Presently the tariff regime comprises Bhutan sales tax (BST) and the custom duty. The BST is a trade-neutral tax since it is imposed on a commodity regardless of its origin and thus does not have a protective effect. It is primarily a revenue-raising instrument. Custom duty is the only tax with protective and trade distorting effect but the actual impact of custom duty is, however very minimal as it is not applicable for trade with India (accounting for 70–80% of all imports). Therefore, neither its revenue effect nor its trade distorting effect is large enough to make a difference to the course and the structure of the Bhutanese economy. As such Bhutan has liberalised its trade policy by replacing quantitative restrictions with tariffs and by integrating into the various bilateral, multilateral and international trade agreements, it has not tried to bring down the tariff rates unlike the other liberalising countries.

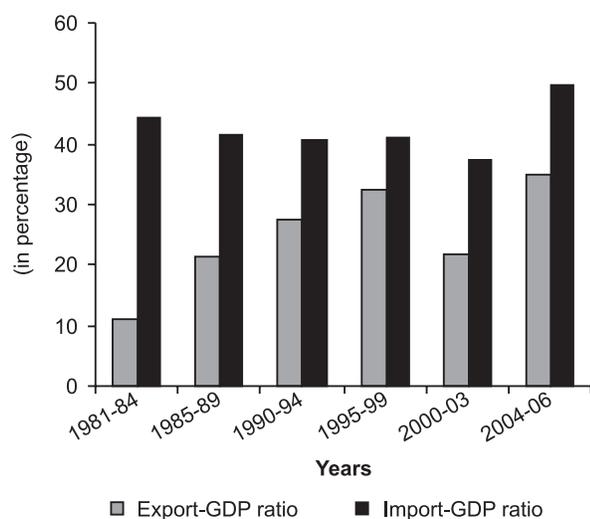
On the contrary, the present sales tax and custom duty were revised upwards by an average of 30% in September 2004. Nevertheless, Bhutan still has transformed itself from a virtually closed economy in the 1960s into a classical case of a small open economy characterized by a high degree of dependence on trade. The trade GDP ratio in the early 1980s was around 55% (Fig 1.4), a far greater trade ratio than the rest of South Asia. The trade ratio declined for the period 2000–03, however it increased and reached 84.4% in 2004–06, reflecting government's commitment to liberalise trade policy. The trade sector was the highest contributor to national revenue and accounted for one third of the total national revenue in 2005–06.

Almost all the increase in trade ratio came from a faster growth of exports rather than imports (as shown in the Fig 1.5). The import to GDP ratio declined slightly from 44.3% in early 1980s to 41% in the late 1990s, while the export to GDP ratio tripled during the same period rising from 11 to 33% and thereafter,



**Fig 1.4 Trade-GDP ratio in Bhutan: 1981–2005 (%)**

Source: Estimated from ADB (1999, 2000) and RMA (2000, 2004, 2005), Trade-Poverty Nexus in Bhutan



**Fig 1.5 Export-GDP and Import-GDP ratios: 1981–2005**

Source: Estimated from ADB (1999, 2000) and RMA (2000, 2004, 2005), Trade-Poverty Nexus in Bhutan

both the export and import to GDP ratio declined. However, with the commissioning of the Tala Project, these ratios return to its upward trend. Despite rapid growth of exports, trade deficits remained large as a result of very high level of imports, which stems from continued disability of Bhutan's economy to expand its productive base.

Bhutan is a member of two regional economic cooperation SAARC and BIMSTEC which seek to promote free trade in the region. Bhutan continues to participate in the progressive trade liberalisation initiatives under SAFTA. Besides Bhutan has bilateral trade agreements with India and Bangladesh. Initiatives are underway to establish bilateral trade agreements with Nepal and Thailand. Despite the efforts of diversification, India continues to be the major trading partner constituting 97% of export and 90% of import (Table

1.9). This is mainly due to the free trade agreement between the two nations, its geographical proximity, free current account convertibility between its currency and Indian rupees and generous grants from India.

**Table 1.9 Top Export Markets of Bhutan  
(in Million Nu), 2000–03**

Countries	2000	2001	2002	2003
India	4376.95	4700.47	5153.78	5188.23
Bangladesh	164.72	222.38	222.97	120.83
Nepal	28.44	41.51	32.79	14.19

Source: Department of revenue and customs, Article: Trade Logistic Service Liberalisation in Bhutan

The regional market will continue to be of significant importance to Bhutan in view of the underdeveloped domestic transport infrastructure and network. Bhutan's prospects of benefiting from other international markets other than regional markets are limited to those goods of high value low volume which could overcome the diseconomies of transport costs. In order to enhance market access opportunities through trade liberalisation initiatives at bilateral as well as regional levels, the Regional and Bilateral Trade Section through its concerned department and ministry would continue to work towards enhancing trade between Bhutan and India under the existing FTA between the two countries. Bilateral consultations on transport, transit and other procedural aspects will be initiated with India from time to time to facilitate Bhutan's third country trade.

## India

India, with a GDP growth rate of 9.4% in 2006–07, is one of the fastest growing economy in the world. When measured in terms of purchasing power parity, India has the world's fourth largest GDP at US \$4.726 trillion. India, at the time of independence was characterized by low level of living, low level of productivity, high rates of unemployment and population growth rate and significant dependence on agriculture production. From less than 1% rate of growth of GDP prior to 1951, Indian economy recorded a growth rate of 3.5% in first decade of planning and over 5% in 1980s. However, the high growth phenomenon of the 1980s could not be sustained, as the experience of the crisis in 1991–92 revealed, when the annual average GDP growth rate declined to 3.3%. After 1991–92, the GDP recorded a growth rate of over 6% which has been accompanied by government policies of liberalisation, privatisation and globalisation.

The period from 1992–93 and 1993–94 was the period of recovery from the crisis while the period from 1994–95 to 1996–97 was marked by the high growth of economy (Table 1.10). The growth rate of GDP averaged as much as 7.5% per annum in the latter, higher from 5.5% in the former. This was the only period in India's economic history during which real GDP growth exceeded 7% consecutively over a period of three years. The sharp acceleration in the rate of growth of overall GDP was the result of phenomenal growth of 10.8% per annum in the industrial sector.

**Table 1.10 Growth rate of GDP at Factor Cost at constant prices in India, 1992–2006 (%)**

Year	Growth Rate of GDP at Factor Cost
1992–93	5.1
1993–94	5.9
1994–95	7.3
1995–96	7.3
1996–97	7.8
1997–98	4.8
1998–99	6.5
1999–00	6.1
2000–01	4.4
2001–02	5.6
2002–03	4.3
2003–04	8.5
2004–05	6.9
2005–06	9.0
2006–07	9.2

Source: *Economic Survey*, various issues.

The phase from 1997–98 to 2002–03 was marked by a general deceleration in growth with the average rate of growth during this period turning out to be 5.3%, which was much lower than the average growth of 7.5% per annum recorded during the period of high growth from 1994–95 to 1996–97. The reason is attributed to the steep decline in industrial growth, led by a severe slowdown in the manufacturing sector.

Within this second phase, real GDP growth, after dipping to 4.8% in 1997–98, recovered during the years 1998–99 and 1999–2000 to over 6%. One of the factors contributing to this recovery was the high growth emanating from service sector, and within the service sector, the growth of 'community, social and personal services', particularly 'public administration and defence' in 1997–98, with its lagged effect persisting till 1999–2000. In 2000–01, growth of overall GDP dipped to 4.4%. This was a result of poor performance of agriculture, coupled with significant deceleration in the growth rate of GDP from the service sector, particularly 'finance, insurance, real estate and business

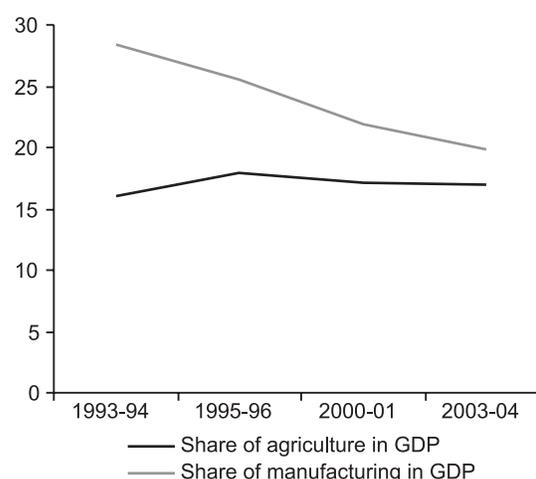
services'. In 2002–03, the rate of growth registered was again 4.3% as compared to 5.8% in 2001–02, which has been an outcome of a sharp fall in agricultural growth to a negative of 3.1% owing to the drought conditions.

Buoyed by a rebound in agriculture sector, and strongly helped by improved performance in industry and services, the economy registered a growth rate of 8.5% in 2003–04. In spite of a deficient south-west monsoon, hardening international prices of oil and steel and extensive damage of life and property caused by tsunami, the economy managed to maintain the growth momentum, with the growth recorded at 6.9% in 2004–05. The growth of 9% and 9.2% in 2005–06 and 2006–07, respectively surpassed expectations. While the uneven pattern in agriculture continued with growth estimated at 6% and 2.7% in the two recent years, services maintained its vigorous growth performance. There were distinct signs of sustained improvements on the industrial front.

The economy has moved decisively to a higher growth phase, with the growth in GDP exceeding 8% each year since 2003–04. The projected economic growth of 8.7% for 2008–09 is in line with this trend.

The contribution of agriculture to overall growth of economy has decelerated from 28.4% in 1993–94 to 19.8% in 2003–04. The share of manufacturing remained between 16–17%. The major impetus to growth has come from service sector. The service sector accounted for 38.6% of GDP in the 1980s and 44.3% in the 1990s. It rose to 54.1% in 2001–02.

India, in the initial era of planning adopted an 'inward looking' strategy of industrialisation. India



**Fig 1.6 Share of agriculture and manufacturing in GDP: 1993–2003**

Source: *National Account Statistics*

maintained one of the most restrictive trade regimes in the world. It imposed a system of high tariffs and stiff NTBs such as licensing and quotas, which virtually closed the economy from the international trade arena. Far from viewing foreign trade as an engine of economic growth, Indian planners sought to minimize import demand and viewed exports mainly to generate the foreign exchange earnings to meet that part of the import bill not covered by external assistance. They created an elaborate administrative regulatory machinery to control both imports and exports. As a consequence, both exports and imports as a percentage of GDP declined. The 1980s can be viewed as a period of growing uneasiness with the policies of excessive protectionism. The import needs became stronger as the industrial growth showed an accelerating trend. Also, it was realised after the first oil shock of 1973 that India had to step up exports to finance the rising import bill on account of an increase in oil prices.

The 1980s is marked by a clear shift in the trade strategy towards reduction of quantitative restrictions on imports. Exports and imports as per cent of GDP showed an upward trend in 1980s. While the signs of liberalised trade policy became visible in the latter half of the decade, it was only in 1991 that the country embarked on a truly liberalised trade policy with a short negative list of exports and imports and with quantitative controls over imports withdrawn for all, except consumer goods. The reforms included liberalisation of import licensing, reduction in tariffs, abolition of cash subsidies for exports, devaluation of the rupee, introduction of partial convertibility of the rupee on the current account and later full convertibility of the rupee on the current account. As a result exports as a per cent of GDP rose from over 6% level to over 8% in 1990s (Table 1.11). The export momentum slowed down since 1996–97 due to both global and domestic factors, however, it again picked up in 2001–02. There was a significant increase in the share of imports alongside except for 1991–92 due to the severe import curbs introduced after the payment crisis of 1991–92.

It can be safely asserted that India's trade has been open now compared to that of the pre-reform period, as the trade to GDP increased from 14.4% in 1980 to

22.8% in 2000. However, when it comes to an international comparison, India's trade to GDP ratio is low. For example, in the People's Republic of China, share of trade rose from 12.6% in 1980 to 37% in 1999. India is an active member of WTO. Although India has been a strong supporter of multilateral liberalisation, it has also sought out RTAs in recent years. Since signing the Bangkok Agreement in 1975, India has signed trade agreements mainly with other developing countries such as the global system of trade preferences (GSTP), SAFTA, and an FTA with Sri Lanka. India has also signed a comprehensive economic cooperation agreement (CECA) with ASEAN, European Union, Japan and Korea.

### The Maldives

Maldives is a small island developing nation in the Indian Ocean. Since its independence in 1965, the Maldives has achieved commendable economic development. While the country was one of the poorest in South Asia in the early 1970s, it now has the highest per capita income in the region. Maldives per capita GDP rose from US \$266 in 1980 to US \$995 in 1990, the highest as compared to other South Asian economies. It recorded the per capita GDP of US \$2328 in 2005.

The country's economy is dependent on fishing, tourism and foreign imports. Tourism is the largest industry in Maldives, accounting for 20% of GDP and more than 60% of foreign exchange receipt. It powered current GDP per capita to expand 265% in the 1980s and a further 115% in 1990s. Fishing is the second leading sector in Maldives. While the contribution of fisheries has been declining over time, it remains vital to the economy, because it is the main provider of food items and employment in a number of atolls. Agriculture and manufacturing play a minor role in the economy, constrained by the limited availability of cultivable land and shortage of domestic labor. Most staple foods are imported.

During 1996–98, the Maldives' economy grew by 8–9% as a result of favourable development in transportation, communication, utilities, tourism, fisheries, and manufacturing, particularly garments. In 1999, growth was estimated at 8.5% (Table 1.12). This

**Table 1.11 Exports and Imports as % of GDP, 1980–2003**

Year	1980–81	1990–91	1995–96	1996–97	1999–2000	2001–02	2003–04
Exports as % of GDP	4.9	5.8	9.1	8.9	8.4	9.4	10.8
Imports as % of GDP	9.5	8.8	12.3	12.7	12.4	12.0	13.3

Source: Economic Survey, various issues, and Department of Economic Analysis and Policy, RBI.

Table 1.12 GDP growth rate in Maldives: 1995–2006

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
GDP growth rate	7.8	9.1	10.4	9.8	8.5	4.8	3.6	6.5	8.5	9.5	-5.5	13

Source: *National Accounts*, Ministry of Planning and National Development.

growth was a result of growth in tourism, which in turn facilitated the expansion of construction, the growth of transportation sub-sectors, and the development of basic infrastructure facilities. Until 2000, the Maldives' economic performance was favourable, but it showed a downward trend partly due to adverse global developments. Tourist arrivals decline by 1.3% in 2001 and for the first time in the 30 year history of Maldives' tourism, the sector experienced zero growth. The downturn of the tourism sector had spillover effects on other sectors, and contributed to weak economic performance as a whole. The GDP growth rate for 2001 was 3.6%. However, the growth rate picked up in 2002 and the country recorded the rate of 9.5% in 2004. In 2005, as a result of tsunami, the GDP contracted by the about 5.5%. However, the economy rebounded in 2006 with a 13% increase.

The share of primary sector as a whole reduced marginally from 10.5% in 1997 to 9.8% in 2003. Within the primary sector, the share of agriculture decelerated marginally from 3.2% to 2.6%. Fisheries accounted for a major share within the primary sector. Its share remained at around 6% between 1997 and 2003.

The share of manufacturing increased marginally from 7.6% in 1997 to 8.3% in 2003 (Fig 1.7). The major stimulus to the economic growth has come from the service sector with its share in GDP remaining around 78–80% during this period.

Within the service sector, a major share was accounted by tourism. The share of tourism accounted

for around 30% between 1997 and 2003. Therefore, it may be concluded that most of the growth came from tourism and fishing.

**Trade Policy Regime in Maldives:** The Maldives has a very open economy due to its high dependence on imports and the need to earn foreign exchange from tourism and exports of fish products to finance its imports. The economic reform program by the government in 1989 lifted import quotas and opened some exports to the private sector. Subsequently, it has liberalised regulations to allow more foreign investment. The openness index has risen from 64% in 1984 to 85% in 2004. There has been a significant rise in total imports over the period 1990–2005, making the economy vulnerable to external factors like economic development in EU countries that are the major markets for tourism, security situation in the region, and international fish prices. It has been observed that the share of intermediate capital goods in total imports is greater than the share of consumer goods.

Singapore accounts for a major import market, with its share remaining constant between 24–26% (Table 1.13). The share of Sri Lanka has decelerated, however, the share of Thailand, Malaysia and India has increased only marginally between 2000 and 2006. There has been a significant increase in the share of UAE from 8% in 2000 to 21% in 2006.

Table 1.13 Maldives' Major Import Markets, 2000–06 (% share)

	2000	2003	2004	2005	2006
Singapore	26	25	25	24	24
Sri Lanka	14	14	11	6	6
India	9	10	10	11	10
Malaysia	1	8	8	7	7
UAE	8	8	10	16	21
Thailand	3	5	4	4	6

Source: *Key Indicators*, Ministry of Planning and National Development, Maldives

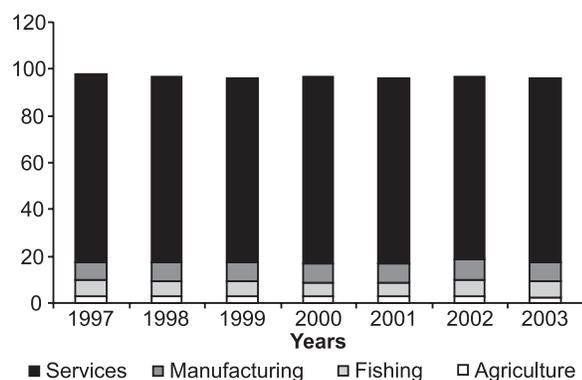


Fig 1.7 Share of Agriculture, Fishing, Manufacturing and Services in GDP in Maldives: 1997–2003 (%)

Source: Ministry of Planning and National Development, *Country's Economic Review*.

In Maldives, imports of goods outweigh exports of goods. The export base is very narrow, almost totally dependent on the marine sector. In 2002, garment exports constituted 38% of the total exports earnings but declined to zero with the expiration of the MFA in 2004. In the 1990s, developed nations like USA and

the UK were amongst the favoured destinations for its exports, however, their shares have gradually reduced, with the US accounting for only 1% share in 2006 (Table 1.14). The share of Thailand has increased, and the share of Sri Lanka remained 13–15%.

**Table 1.14 Major Destinations in Exports, 1990–2006 (% share)**

	1990	2000	2003	2004	2005	2006
USA	24	44	32	27	1	1
Thailand	18	6	16	23	22	26
Sri Lanka	13	18	14	12	15	13
Other countries	7	21	11	16	27	36
Japan	8	4	10	12	22	15
UK	18	7	10	10	14	10

Source: *Key Indicators*, Ministry of Planning and National Development, Maldives.

Tariffs are the main trade policy instrument and are a major source of revenue, accounting for about two-third of tax receipts. Relatively high tariffs are levied. The export regime is relatively open; export controls, regulations and taxes are minimal. Also, no duty is levied on imports of staple foods of flour, rice and sugar. Tariffs are ad valorem except for cigarettes on which there exists a specific duty.

Maldives is a founding member of World Trade Organization (WTO). It is party to the 17th Uruguay Round Agreements and its many associated decisions and declarations. This means that all Maldives' trade is governed by the international rule based system, and its numerous commitment and obligations, which sets the framework within which national policies and actual trade takes place. However, as a least developed country, Maldives has enjoyed greater flexibility and consideration (special and differential treatment provisions) in the application of these rules, obligations and commitment. Maldives is a member of only one regional association, SAARC. It is also a founding member of SAPTA, which has now been superseded by SAFTA. Maldives will fully implement SAFTA by 2017.

## Nepal

A small landlocked country in South Asia, Nepal is one of the least developed countries in the world. The country's per capita income at US \$220 in 2000 is one

of the lowest vis-à-vis other South Asian economies. An isolated, agrarian society until the mid 20th century, Nepal entered the modern era in 1951 without many of the amenities like schools, hospitals, roads, telecommunication, electric power or industry. The per capita income has been growing at slightly over 2% per annum in a situation where close to nine million people are currently estimated to be living in absolute poverty.

Remittances by the Nepalese workforce employed overseas, is an important source of income and economic growth for Nepal. Also, its economy is closely tied to India. Nepal's geographical position and the scarcity of natural resources used in the production of industrial goods means that its economy is subject to fluctuations resulting from changes in its relationship with India. For example, real economic growth averaged 4% annually in the 1980s, but the 1989 trade and transit dispute with India adversely affected economic progress, and economic growth declined to only 1.5 percent that year as the availability of imported raw materials for export industries was disrupted.

Agriculture accounts for about 40% of Nepal's GDP and employs 76% of the work force. Agricultural domination of the economy had not changed by 1991. Industrial activity there largely confined to the processing of agricultural products. Since the 1960s, investment in the agricultural sector has not had a parallel effect in productivity per unit of land. Agricultural production continued to be influenced by weather conditions and the lack of arable land and has not always kept pace with population growth. Economic growth was largely undermined by poor harvest and underdeveloped infrastructure.

Responding to the liberalising reforms of the 1990s, GDP growth averaged around 5% during the decade. However, the growth of agricultural sector remained at 2.5% less than the population growth. Therefore, there was not much improvement in the income level of the rural households where the incidence of poverty is the highest.

Since 2001, a loss of momentum in exports have forced the economy on a lower growth path. The economic performance of Nepal was exceptionally weak in 2002–03, registering a negative growth rate for the first time in the past two decades (Table 1.15). The growth rate of GDP fell to –0.5% (the lowest in

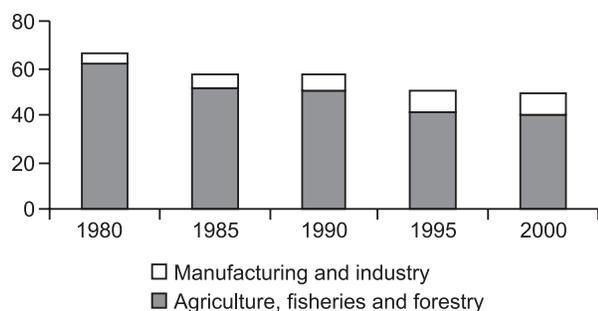
**Table 1.15 Annual Growth Rate of GDP, 2000–05 (%)**

Years	2000–01	2001–02	2002–03	2003–04	2004–05	2005–06
Annual growth rate of GDP	6.0	4.6	(–0.5)	3.04	3.19	2.05

Source: *Central Bureau of statistics*, Nepal.

South Asia) in 2002–03 from 4.6% in 2001–02. Agricultural output slipped to 2.2% in 2002 due to irregular monsoon, after strong performance in 2000 and 2001. Industry and tourism were hit hard by the weak external demand. Service sector growth was kept down by domestic security problems and declined by 1.4% in 2002 after expanding by 5.3% in 2001. Growth picked up in 2003–04 to settle at a meager 2.05% in 2005–06.

There has been slow change in the structure of economy over the years. The share of agriculture in GDP is declining about 1% annually since 1974–75 in favour of the non-agricultural sector. All sectors except agriculture have increased their share in GDP. From 72% of the GDP in 1975, the share of agriculture has come down to 51% in 1990 and further down to 39% in 2000 (Fig 1.8). After 2000, the share has been shrinking and came down to 37% in 2001. The share of manufacturing sector has grown the fastest, particularly during 1990s. From 5% on average in the early 1980s the share of manufacturing in GDP went up to 9% during 1990s. This is attributed to the expansion of export oriented industries in the 1990s due to widened export opportunities and liberalisation of the economy.



**Fig 1.8 Share of Agriculture and Manufacturing in GDP in Nepal: 1980–2000 (%)**

Source: *Economic Survey*, MOF (various issues)

**Trade Policy Regime in Nepal:** Nepal is among South Asia's most open and trade-dependent economies with trade-GDP ratio at over 40% currently. There are no quantitative restrictions or licensing requirement trade, no foreign exchange restriction on current account payment. Tariff rates have substantially reduced over the last decade. Nepal's meaningful international trade began only since 1960s. Nepal began trade diversification in early 1960s with introduction of incentives on third country export at a time when more than 95% of the country's trade was confined to India. Following this, exports grew by over 14% on average

during first half of 1970s. However, the oil shock dampened the export market in the second half of 1970s. Despite this, share of exports remained at less than 5% of GDP in 1960s and early 1970s. In the 1980s, there was an expansion in international trade. The trade-GDP ratio went up to 23% in this decade from less than 16% in 1970s. Both exports and imports grew at a rate of 18–19%. There was a large scale depreciation of the Nepalese rupee during this decade, which supported export growth.

In 1990s, various policy reforms were carried out, which included removal of quantitative restrictions, reduction on duty rates, rationalisation of tariff structure and liberalisation of foreign currency regime. The progress in trade especially in export in the aftermath of reforms has been quite impressive. Exports grew at an average of 27.5% per annum whereas imports grew by 20.2% on average. In the latter half of 1990s, imports witnessed compression, mainly because of massive depreciation of the rupee and because of a decline in a demand of third country goods. The expansion of both exports and imports increased the trade-GDP ratio to 33.6% in the first half and further to 40.7% in the second half of 1990s (Table 1.16). The growth in exports in second half of 1990s is strongly attributable to the Nepal–India Trade Treaty of 1996, which allowed Nepalese manufactured goods duty free access.

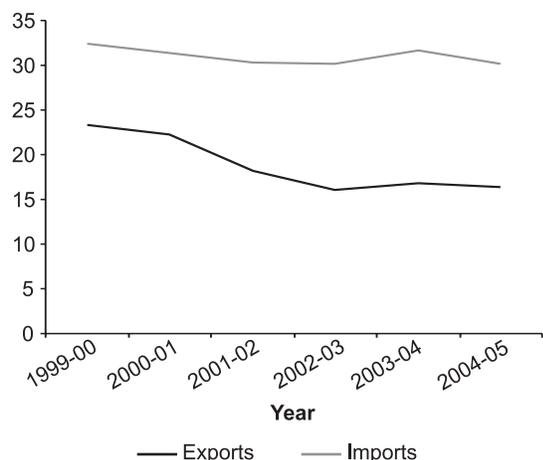
**Table 1.16 External Sector Indicators as Per cent of GDP, 1976–2000**

as % of GDP	1976–80	1981–85	1986–90	1991–95	1996–2000
Total trade	18.9	21.9	23.7	33.6	40.7
Export	6.0	4.9	5.3	9.0	10.1
Import	12.9	17	18.4	24.6	30.6

Source: *Economic Survey*, MOF and *Quarterly Economic Bulletin*, various issues, Nepal Rastra Bank.

Nepal saw a sharp decline in exports as well as imports in 2002 (Fig 1.9). Growth in the dollar value of merchandise exports declined significantly. This decline was due to sharp decline in exports of readymade garments and woolen carpets. The dollar value of imports continued to decline. Poor import performance reflected the sharp deceleration of manufacturing and sluggish development.

The rescinding of MFA quotas at the end of 2004 has dramatically changed prospects for Nepal's garment industry that accounted for 18% of total exports in 2003–04 and exports in the sector have already



**Fig 1.9 Exports and Imports as a percentage of GDP in Nepal: 1999–2004**

Source: *National Accounts*, Central Bureau of Statistics.

plummeted by 40% in the first ten months of 2005 compared to same period of 2004.

Nepal's trade with India has increased substantially. Within a decade, share of India in Nepal's trade has more than doubled. It reached about 68% of the trade in 2007 against 28% in 1995. Trade with India is facilitated by free and unlimited convertibility of the Nepalese rupees against Indian currency. Trade treaty with India allows duty-free market access to primary goods and selected manufacturing goods to Indian market. Imports from India are also subject to low tariff.

Nepal became the member of the WTO in 2004, as the first LDC to join the WTO since its inception on 1 January 1995. It has opened up trade opportunities for Nepal as a member of multilateral trading system. Nepal is a founding member of SAARC, under which SAFTA has been launched from January 2006. Nepal is also part of BIMSTEC. With the signing of the framework agreement, Nepal has agreed to enter into negotiations for eliminating tariff and NTBs with a provision of maintaining negative list and dual tracks (fast and normal) for liberalisation. Nepal's entry into liberal global trading regime through WTO, SAFTA and BIMSTEC has widened its export opportunities.

## Pakistan

Pakistan is a nation with a diverse economy that includes textiles, chemicals, food processing, agriculture

and other industries. It is the 25th largest economy in the world. Pakistan is witnessing a growing middle class population and poverty levels have declined by 10% since 2001.

Pakistan was predominately an agricultural country when it gained independence in 1947. Pakistan's average economic growth since independence has been higher than the average growth rate of the world economy during the period. Historically, Pakistan's overall GDP has grown every year since its 1951 recession. Despite this record of sustained growth, Pakistan's economy, until a few years ago, had been characterised as unstable and highly vulnerable to external and internal shocks. However, the economy proved to be unexpectedly resilient in the face of multiple adverse events like the Asian financial crisis, global recession and a severe drought.

Average annual real GDP growth rates were 6.8% in the 1960s, 4.8% in the 1970s, and 6.5% in the 1980s. Average annual growth rate fell to 4.6% in the 1990s with significantly lower growth in the second half of that decade. Between 1997 and 2002, the real GDP grew by a meager 3% on average. The near stagnant economy grew steadily after 2002 (Table 1.17). Pakistan's economy has grown by more than 6.5% per year since 2003. While income inequality has increased somewhat, poverty has declined significantly. A wide-ranging program of economic reforms launched in 2000 (fiscal adjustment, privatisation of energy, telecommunications, and production, banking sector reform and trade reform) have played a key role in the country's economic recovery. The external environment of low interest rates, abundant liquidity, and robust external demand, has also been favourable for the country's growth.

The contribution of agriculture to GDP declined from 25.9% in 1999–2000 to 21.3% in 2005–06, whereas the share of manufacturing increased from 14.7% in 1999–2000 to 18.9 in 2005–06 (Fig 1.10). The major stimulus to economic growth has come from service sector with its share in GDP rising over 50%.

**Trade Policy Regime in Pakistan:** Pakistan has made substantial progress over the past decade in constructing a more open and transparent trade policy regime. The trade policy in Pakistan, like in many other developing

**Table 1.17 Growth rates of GDP, 1997–2005 (%)**

Fiscal Year	1997	1998	1999	2000	2001	2002	2003	2004	2005
Real GDP(at factor cost)	3.5	4.2	3.9	1.9	3.1	4.7	7.4	8.9	6.6

Source: *Federal Bureau of Statistics*

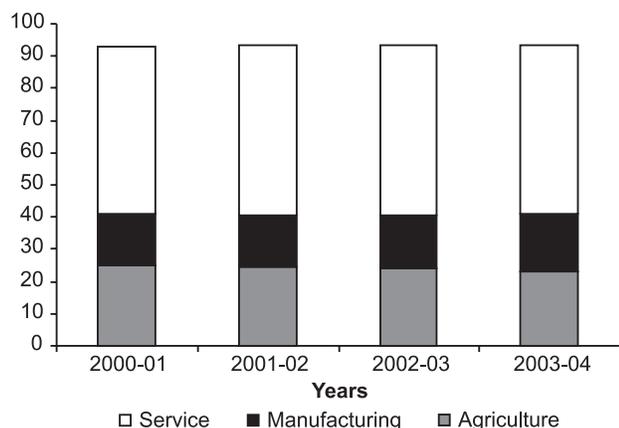


Fig 1.10 Share of Agriculture, Manufacturing and Services in GDP in Pakistan: 2000-03 (%)

Source: Federal Bureau of Statistics.

countries, has changed over time. In the initial phase after independence in 1947, import substitution policies were adopted to expand limited industrial base and establish non-existent consumer goods industries. However, industrial base remained weak, inefficient, and concentrated, and it increased the vulnerability of economy to external shocks. The policy focus changed to export expansion. Imports licensing, foreign exchange controls and bilateral trade agreements were used to regulate imports.

In recent years, the trade policy has changed significantly. The emphasis is on import liberalisation and opening of the domestic market. Also, with a view to diversify exports of goods and of trading partners, to generate exportable surplus and with focus on export-oriented industries, various measures were undertaken. The measures included compensatory rebates on various items, standardisation of tariff rates, excise and sales tax rebates, export financing scheme, duty-free imports of machinery for balancing, modernization, and replacement (BMR) for export units and setting up export processing zone (EPZ) in Karachi and Lahore. Trade regime later changed and exports of high value-added products were again priority. Pakistan's long-term growth depends on export diversification but limited success has been achieved in this direction. Textile and clothing still accounts for around 60% of its exports.

Many trade policy initiatives and related measures have been adopted like rise in availability of finances for exporters, trade facilitation services, and simplification of duty draw back system and rationalisation of tariff rates with lowering of the tariff slabs to four with maximum tariff rate of 25%. Pakistan is a founding WTO member. The government has reduced

tariff rates across the board. Quantitative restrictions, exchange controls, and other direct state interventions into trade have been largely eliminated. Many special regulatory orders that provided discretionary exemptions to firms or industries have been eliminated, thus leveling the playing field and making the trade regime less complex.

Trade is an important part of Pakistan's development and poverty reduction strategy. Trade policy has been focused on reducing protection, achieving a more outward oriented trade regime, obtaining better market access for Pakistan's exports, and promoting greater integration into the global economy through increased economic efficiency, and thus international competitiveness, which would contribute to export led growth. The trade policy of 2007-08 with a view to facilitate imports, focused on improving the registration and standardisation of imports, facilitation of trade fairs, provision for imports of used machinery and pharmaceuticals and chemical products for domestic industry. Despite various efforts, the gains in terms of import-GDP ratio remain modest. The ratio declined from 18.6% in 1989-90 to 13.7% in 2002-03 and increased to 17.1% in 2004-05. However, the composition has changed over time. The share of consumer goods in total imports witnessed a decline. However, the share of capital goods in total imports saw upward trend.

Despite fluctuations in the export-GDP and import-GDP ratios, the overall trade-GDP remained stagnant around 30% indicating no significant openness of economy despite liberalisation of trade and reduction in quantitative and qualitative trade barriers. Pakistan has participated actively in the Doha round and attaches high priority to an effective rule based trading system. Nevertheless, its trade policy has focused recently on regional trade liberalisation by deepening and expanding existing plurilateral commitments, e.g. with SAFTA, Organisation of the Islamic Conference (OIC), the Developing 8 (D8) and Economic Cooperation Organisation (ECO). At the same time, it has been expanding its network of bilateral FTAs, including with the People's Republic of China, Iran, Malaysia, Mauritius and Sri Lanka.

### Sri Lanka

With an economy of \$27.4 billion and a per capita GDP of about \$4,700, Sri Lanka has enjoyed strong growth rates in the post-2000 period. The main economic sectors of the country are tourism, tea export, apparel, textile, rice production and other agricultural products.

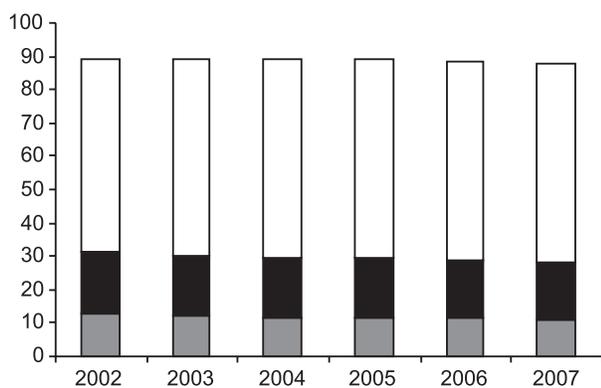
The GDP grew at an average annual rate of 5.5% during the early 1990s, until drought and security concerns lowered growth rate to 3.8% in 1996. The economy rebounded in 1997–2000, with average growth of 5.3%. The average GDP growth in 1999 was slightly lower, 4.3%, than the 4.7% in 1998 (Table 1.18). This growth was also below the average rate of 5.2% for the past 10 years (1990–99). The Sri Lankan economy started to recover in the second half of 1999, and the recovery accelerated in 2000. Sri Lanka has experienced continuous acceleration in the growth rate of GDP after the period of recession in 2001. The GDP growth rate in 2006 stands at 7.7%, much higher than the GDP growth rate in 1980s and 1990s. It now has highest per capita income in South Asia, after Maldives.

**Table 1.18 Growth Rate of GDP at 1998 Prices, 1998–2002 (%)**

Years	1998	1999	2000	2001	2002	2003	2004	2005	2006
GDP	4.7	4.3	6	(1.4)	4	5.9	5.4	6.2	7.7

Source: Department of Census and Statistics, Sri Lanka

The contribution of agriculture to GDP has reduced from 12.7% in 2002 to 10.8% in 2007. The share of manufacturing in GDP has remained more or less between 17–18% during 2002–07 (Fig 1.11). However, the major stimulus to growth has come from services sector, with its share remaining above 55%.

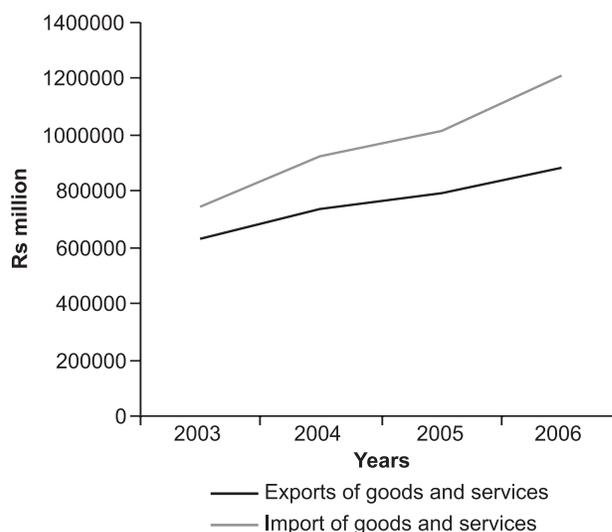


**Fig 1.11 Share of Agriculture, manufacturing and Services in GDP in Sri Lanka: 2002–07**

Source: National Accounts of Sri Lanka, 2007.

**Trade Policy Regime:** Being a small island economy with the limited domestic market, the role of international trade has been significant. Sri Lanka's trade policy objectives include moving towards a more outward oriented trade regime and improving market access for its exports.

Sri Lanka began trade liberalisation policies in the late 1970s following a period of import substitution in the 1960s and 1970s. Since then Sri Lanka has operated a unified exchange rate under a 'managed float' system which became fully floated in January 2001. Most quantitative restrictions were removed in the 1980s and by the end of 1990s only a few remained on selected agricultural and industrial commodities. However, these were eventually removed in 1998 following a review by WTO. Sri Lanka's trade integration, measured by the trade-GDP ratio stood at 82% of GDP in 2004. Also, unilaterally Sri Lanka's applied tariffs are relatively low. This openness has resulted in the rapid growth of both exports and imports in recent years. Imports have increased at a faster rate than exports resulting in widening trade deficit (Fig 1.12). A major cause for the faster rate of import growth is the increase in price and consumption of oil. Exports have grown rapidly as well, led by apparel exports and a resurgence of export earnings from agricultural agreements such as tea, buoyed by commodity price booms in 2007.



**Fig 1.12 Exports and Imports of Goods and Services in Sri Lanka, 2003–06**

Source: National Accounts of Sri Lanka, 2007

Over the past three decades, Sri Lanka has become increasingly open to trade—undertaking unilateral, multilateral and regional trade liberalisation. Sri Lanka joined GATT in 1948 and the WTO at its inception in 1995. In more recent years, Sri Lanka has implemented FTA with India and Pakistan and is party to the SAFTA along with many other RTAs including BIMSTEC and Asia Pacific Trade Agreement (APTA).

A major concern in the trade pattern is the limited export diversification both geographically and in terms

of products. As of 2007, 62% of Sri Lanka's exports were destined for the USA and the EU. In terms of products, garments made up 43% of Sri Lanka's exports and tea made up 13.2% of total exports. No other export product category contributed over 10% of exports. Such a lack of diversification of products leaves Sri Lanka vulnerable to fluctuations in global market conditions in these products categories.

With the abolition of the MFA since January 2005, Sri Lanka faces additional challenges to remain competitive in the market place. Therefore, it will be important for Sri Lanka to further strengthen external sector policies and address remaining 'behind the border constraints' such as infrastructure bottlenecks and labor regulations.

## 2 ■ Literature Review and Rationale for SAFTA

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### ■ LITERATURE REVIEW

RTA and FTA objectives include: market access; investment attraction; strengthening domestic policy reform and positive signaling to investors; increased bargaining power vis-à-vis third countries (a particularly strong motivation in the case of Mercosur; the actual or potential use of regional agreements for tactical purposes by countries seeking to achieve multilateral objectives and strategic objectives. (Slazar-Xirinachs, 2002)

RTAs, as frequently pointed out in the literature, are measures that allow countries to 'lock-in' reforms, both in trade and non-trade areas, and therefore function as good commitment mechanisms, enhancing the credibility of policy reform and sending positive signals to global markets. But how effective RTAs can act as commitment mechanisms depends on the credibility of the threat of action if rules are broken. In the context of SAFTA, since judicial and enforcement mechanisms have not been explicitly spelt out given the national sensitivities, member to member resolution of disputes may be the best option.

Another positive link between RTAs and domestic reforms occurs to the extent that RTAs accelerate domestic reforms that reduce price distortions because countries can no longer maintain substantial price differentials when they open up their economies. In other words, RTAs put pressure on countries to eliminate domestic distortions that are incompatible with free trade, and in this sense they serve as building blocks towards multilateral liberalisation.

A third type of positive influence of RTAs on domestic policy reform, for which there is a fair amount of anecdotal evidence, is that these agreements have induced positive behavioural changes in the traditionally rent-seeking behaviour by the business communities. In many countries, the prospect and the reality of increased import competition has led the local

business communities to be more interested in reducing domestic distortions in transportation costs, the costs of telephone calls, electricity rates, and interest rates that hinder their ability to compete with firms from countries with which FTAs have been entered. SAFTA, to the extent that it reduces rents for high tariff protected intermediate products, will reduce costs for downstream finished products manufacturers, and make them more costs competitive both regionally and globally. Regional trade agreements can therefore help countries build on their comparative advantages, sharpen their industrial efficiency, and act as a spring-board to integrate into the world economy.

In the context of RTAs, there have been several studies that have examined the likely impacts of SAFTA. However, the debates on rationale of SAFTA have focused on its desirability, feasibility and implementation.

Jayatillake (2001) addresses the question of desirability of SAFTA using a global computable general equilibrium (CGE) model. The study identifies three types of viewpoints on SAFTA (optimistic, pessimistic and moderate) and supports the pessimistic view. The study examines six conditions highlighted in the PTA literature for the successful implementation of a PTA. These are: geographical proximity; high pre-PTA tariffs; high level of intra-regional trade; the existence of trade complementarity; differences in economic structure based on competitiveness; and less political tensions among member countries. Examining the conditions in South Asia in the context of these prerequisites indicates that the conditions required for creating a successful, trade promoting PTA might be lacking in the region.

Further, the study uses a standard GTAP model to evaluate the effect of SAFTA. Two opposite policy simulations are performed, i.e. a unilateral trade liberalisation scenario and a preferential trade liberalisation scenario. The results show that while the impact of

preferential trade liberalisation is very small the impact of unilateral liberalisation is significant. Under preferential liberalisation small countries would loose and India would be the sole significant winner. Hence, the economic analysis indicates that SAFTA would not benefit the region economically.

Hirantha (2002) examines the progress of SAPTA and the prospects of SAFTA using trade data for 1996 to 2002 using a gravity model. The Gravity model results are quite in contrast with the previous studies and show strong evidence of trade creation in the region under SAPTA with no trade diversion effect as far as trade with non members is concerned. Hence, the study supports the proposition that further regional integration will bring about substantial benefits to SAARC region.

Pitgala (2005) addresses the issue of whether the South Asian countries possess the requisite conditions, defined by empirical evidence, required to become a successful trading block. The methodology used by the paper is the 'natural trading block' hypothesis. The study uses three definitions of the 'natural trading block' hypothesis, i.e. the trade volume, geographic proximity and the complementarily approaches and makes a comprehensive study supported by empirical evidence. The trade volume approach, suggests that members of a regional agreement should trade disproportionately with each other in order to be a successful bloc. Based on this characterisation, the South Asian economies fall short. The only exceptions are the land locked countries like Bhutan and Nepal which maintain strong trade links with India. However it must be taken into account that these estimates are based on official data and once the estimates of the informal trade are taken into account the intra regional trade figures improve. The estimates of informal trade however are likely to suffer from high error margins.

The evidence from the South Asian countries does not support the 'geographical proximity' hypothesis (reflected by the trade intensity index (TII)) either, with the South Asian countries demonstrating an increased tendency to trade with industrial countries due to cultural ethnic or religious affiliations.

The third criterion, i.e. the complementarity criterion (measured with the complementarity index) tests how well the structures of exports and imports match, i.e. whether a country imports what its trading partner exports. Here again, the measured degree of complementarity amongst countries was very low. There were few exceptions, India's, and to a limited extent Pakistan's, more efficient exports (defined by RCA indices greater than complement the import demands

of a number of countries in the region, particularly those of Bangladesh and Sri Lanka. The lack of complementarities can be attributed to the fact that most of the countries in the region are competitors in the export market, dominated by textile and apparel exports.

Further, the study demonstrates that there are several inconsistencies in the regions' trade patterns. Firstly, there is a significant divergence between products that are exported to the region and to the rest of the world. While primary products dominate intra-regional trade, manufactured goods dominate exports to the rest of the world. Secondly, the exports of most member countries, with the exception of India, seem to be confined to a few products. The likely success of any FTA is contingent on the range of products prospective members have the capacity to import or export. Thirdly, the extent to which the regional share of relative trade can be increased depends to the extent to which countries dynamic exports are represented in regional trade. In this context, the prospects for greater regional exports for Bangladesh, Nepal and Sri Lanka do not appear to be encouraging. However, it must be kept in mind that this paper deals solely with static effects. Many economists have argued that the benefits of an FTA such as SAFTA stem from dynamic gains. Hence, although the study points to trade structures that may hinder the rapid and successful implementation of SAFTA, unilateral/multilateral liberalisation would likely to help South Asia to evolve new comparative advantages, thus creating the requisite environment for successful implementation of SAFTA.

Krueger (2004) puts forward a largely pessimistic view which indicates that although potential gains exist from SAFTA, the South Asian region does not meet most of the theory-based criteria for successful trade agreements. Therefore, it is unlikely that large welfare gains will be realised from this agreement. A detailed study on the characteristics of regional trade shows that although most of the South Asian countries trade in similar goods, apparel and textiles being the major export item and crude oil being the major import item, there exists potential opportunities for increased trade. However, throughout the negotiations of SAPTA, the participating regions have not granted concessions on such highly traded goods. The study takes a comprehensive look at the optimistic and pessimistic predictions relating to SAFTA before arriving at a conclusion. The study concludes that even though SAFTA could lead to growth in the South Asian region, it has limited capability to increase intra-regional or extra-regional trade for its member states.

Baysan and Panagriya (2006) examine the economic case for SAFTA. They study SAFTA in the light of the preferential trading arrangements in the region, particularly ISFTA, in order to draw lessons. Subsequently they examine the qualitative and quantitative arguments to assess the feasibility of SAFTA. The results are mostly pessimistic. The following qualitative arguments fail to provide a strong case in favour of SAFTA. Firstly, the economies are relatively small as compared to the rest of the world both in terms of GDP and trade flows. The economic size of the region remains small: less than one-twentieth of the world in terms of GDP. If we exclude India, this figure drops to 0.4%. Consequently, the probability that the most efficient suppliers of the member countries are within the region is slim. Hence an FTA is likely to be largely trade diverting.

Secondly, the level of protection amongst SAARC countries is very high with the exception of Sri Lanka. If a country participating in a regional arrangement were not open they are likely to suffer from welfare losses due to trade diversion. The third reason which makes the economic case for SAFTA weak is political economy of selection of the excluded sectors and rules of origin (ROO) issue. This leads to inefficient selection as domestic lobbies make sure that the sectors that do not withstand competition are excluded from tariff preferences and lobbies go along free trade in sectors in which they are competitive. A similar pattern is observed in case of ROO. A common argument advanced in favour of SAFTA is that there is substantial informal trade between countries. There are three arguments relating to this issue. First, if the real costs associated with informal trade are higher, benefits of such cost saving need to be weighed against cost of trade diversion. Second, an FTA might make formal trade even more expensive than informal trade by adding to the costs of complying with the ROO. Third, all the informal trade between India and Pakistan may not be due to restrictions that preclude trade at the MFN terms and a part of it may try to evade even the MFN tariff.

Apart from the theoretical arguments, quantitative studies that have estimated the impact of SAFTA have used mainly three types of models, that are either gravity models; or general equilibrium models; or partial equilibrium models. The studies employing gravity models predict that the impact of a South Asian FTA will be small for India and much larger on the smaller countries. Second, amongst studies using CGE models to SAFTA, there are two important studies, Pigato et al. (1997) and Shakur and Rae (2005). Pigato et al.

find that the unilateral trade liberalisation yields larger gains than SAFTA. Shakur and Rae find that SAFTA leads to a 0.21% gain in real income in India, 0.03% gain for Srilanka and a loss of 0.10% for Bangladesh. The largest gain of 0.21% is too low and the authors conclude that the South Asian countries will gain much more from unilateral/multilateral liberalisation.

The third types of studies have employed partial equilibrium models. Govindan (1994) concludes that liberalisation would yield welfare gains through increased trade within the region. Derosa and Govindan (1996) further demonstrate that the gains are much larger when liberalisation is on a non-discriminatory basis. Given, the pessimistic economic assessment the study indicates that the move toward SAFTA gained momentum due to political reasons such as with the entire world moving ahead with more and more PTAs, there is an element of following a trend around the world. Also, SAFTA is seen as a vehicle for promoting political ties between India and Pakistan. The case of India and Pakistan is often compared to France and Germany but the differences in the two situations raise serious doubts about the validity of the argument.

On the whole, it can be said that the pessimism with respect to gains from SAFTA arises mainly because of lack of economic conditions for success of RTA, which are trade complementarities and differences in competitiveness of the countries. Empirical literature suggests that the existence of complementarities is needed to enhance the probability of a regional trade arrangement to be net trade-creating, rather than net trade-diverting. The statistical measures such as the complementarity index argue that the higher the observed values of the index between partners, the more likely is it that a proposed regional trade agreement will succeed (Michaely 1996). Indices of trade complementarity developed by Drysdale (1969) have been used by Kemal et al. (2000) to estimate the complementarity indices for all five leading South Asian countries using time series trade data. It was found that there is a lack of strong trade complementarity in the bilateral trade structures of South Asia. Lack of trade complementarities raises the questions on the future prospects of SAFTA.

To identify different countries' competitiveness among different commodity groups, the export revealed comparative advantage (XRCA) indices have been estimated by some studies at the three-digit level (Samaratunga 1999 and Kemal et al. 2000), which show that the comparative advantage countries in South Asia have an almost identical pattern of comparative advantage in a relatively narrow band of commodities.

The lack of trade complementarity in bilateral trade flow and the similarity of the pattern of comparative advantage in the region have been identified as some of the main constraints for the growth of intra-regional trade (Kemal et al. 2000).

Daniel (2007) evaluates the SAFTA within the global structure of overlapping RTAs using modified gravity equation. First, it examines the effects of the Trade Liberalisation Program (TLP) which started in 2006. SAFTA would have a minor effect on regional trade flows and the impact on custom duties would be a manageable fiscal shock for most members.

However, there exist studies that argue in favour of SAFTA. Raihan and Razzaque (2007) using CGE modeling estimate the trade creation and trade diversion effects of SAFTA. They show that a full implementation of SAFTA will lead to welfare gains for India, Sri Lanka and rest of South Asian countries, though Bangladesh suffers from welfare loss. Bangladesh's welfare loss is mainly driven by the negative trade diversion effect. Simulation results also suggest that the negative trade diversion effect can be undermined by some associated unilateral trade liberalisation measure. It is also important to note that trade diversion for Bangladesh and possibly for other LDCs under SAFTA is inevitable. Bangladesh and other LDCs in South Asia will have to raise their export share into the Indian market substantially in order to increase welfare through positive terms of trade effect. Export diversification in this regard is very important.

World Bank Study (1997) analyses the static welfare consequences of preferential liberalisation. Using an integrated general equilibrium model of the world economy (Global Trade Analysis Project, GTAP) it shows that regional trade liberalisation would increase the welfare between 0.5% of GDP for India and one percent for the rest of South Asia. The welfare gains from regional liberalisation are the sum of trade creation effects (increased trade between countries in the region) from lower barriers minus trade diversion losses caused by replacing non-South Asian imports with now preferred South Asian goods plus the terms of trade gains associated with increased access to each other's still protected markets. The benefits to the rest of South Asia are larger than to India because the former gains free access to many highly protected markets of latter which results in a significant improvement in terms of trade. The study does not, however, estimate individual country impacts except for India

RIS (2004) reports the result of studies conducted in the framework of gravity model. It suggests that

complete elimination of tariffs under SAFTA may increase the intra-regional trade 1.6 times. It further suggests that in the dynamic framework the gains from liberalisation are at least 25% higher than the static gains.

Kumar and Saini (2007) estimate different scenarios for SAFTA and its implications welfare on each country. They find that a South Asian Free Trade Area, as envisaged under the SAFTA scenario, does not result in welfare gains for all the member countries. SAFTA results in small welfare gains for all the South Asian countries except Bangladesh. Rest of South Asia (RSA) gains most by about half a billion dollars, while India gains by about US \$204 millions and Sri Lanka by just US\$89 millions only. Bangladesh on the other hand suffers welfare loss of about US\$225 millions. The gains in welfare for RSA, India and Sri Lanka are basically due to gains in terms of trade, and to a lesser extent from improvements in allocative efficiency in the case of RSA and Sri Lanka. Bangladesh loses out both in terms of allocation efficiency and terms of trade by US\$104 and US\$106 millions, respectively.

In sum, there exists a debate in the literature on the possible gains of SAFTA. Studies using different methodologies arrive at different results. Most of the studies have examined the impact of lowering tariffs to zero under SAFTA though few studies have also examined the impacts under alternative scenarios. The main objective of this study is to give a holistic picture of the effects of SAFTA on trade, inward investments and welfare aspects. More importantly, the study has focused on the potential of trade in services in the region and explored the ways of harmonising the regulations existing in different modes of trade in the identified services sectors. Possibilities of arriving at MRAs in different services sectors are delved on.

In arriving at the conclusions on impacts of SAFTA, the study adds to the existing literature in three important ways. First, it estimates the change in the extent of complementarity and competitiveness at SITC five-digit level of the South Asian region for the years 1991 and 2004 to assess the change in the composition of competitiveness basket as well as their complementarities. The change in the complementarity and competitive baskets overtime to a large extent is able to resolve the differences arrived at by the studies estimating the impact of SAFTA using pre and post 2000 trade data. The impact on each country's trade and welfare is analysed using CGE modeling which is followed by the estimates of trade creation and trade diversion following SAFTA using the gravity model. The study

further estimates the impact of SAFTA on inward FDI into the region. Cost-benefit analysis is undertaken for four transport facilitation projects.

## ■ RATIONALE FOR SAFTA

The costs and benefits of a Free Trade Agreement are strongly premised on whether they are trade creating or trade-diverting. An FTA would be trade-creating if liberalisation by a member country allows it to replace the higher cost domestic supply by a lower cost partner country supply. This creates enhanced efficiency and is therefore beneficial to the member countries of the Agreement. It would be trade-diverting if preferential liberalisation by a member country leads to replacing the lower cost supply from non-partner member countries by higher cost supply from a partner country. In the case of SAFTA both these phenomena would simultaneously take place and whether on balance it is net trade-creating or net trade-diverting would depend on small and large country situations.

To determine the real benefits of SAFTA, however there is a need to examine whether proximity and preferential trade is an issue which would change the economic geography and commercial policy of the region. This cannot be easily explained by using standard trade theory even when account is taken of SAFTA imperfections due to limited enforceability. Alternatively, simple models of horizontal multinational enterprise combined with limited enforceability produce a strong inverse relation between physical transportation costs and trade policy cooperation, thereby introducing a preference for regional agreements such as SAFTA (Ludema 1998). The possible role of regionally generated MNC's makes such agreements viable even if the Preferential Trade Agreement (PTA) generates trade flows which are small. It would be even more useful to extend similar analysis to other models of trade that exhibit strong home market effects. These have produced welfare enhancing effects even though limited. Ludema argues that some progress has been made in extending such analysis to the oligopolistic and monopolistic models of Venables.

Theory argues that RTA's with one high income hub country could lead to convergence to high income level among members in the region (Venables). This could be true for SAFTA with India playing the role of the high income growth pole. Theory also argues that FTA's will tend to raise trade for countries that are near each other on account of two major reasons: First, because transportation costs would be low and second

because economies of scale would accrue easily and multinational production would take place (Ludema 1998). This explains the EU and North Atlantic Free Trade Area (NAFTA) welfare effects but equally applies to Mercosur and ASEAN. For it to apply to the SAFTA region considerable openness in the policy framework will be required particularly with respect to investment. Understanding the geography of trade agreements should include an analysis of transport costs, economies of scale and imperfect competition, all of which would point to increased commercial activity in the SAFTA context. The study estimates the extent of potential trade that exists intra-regionally as well as bilaterally. Further, an estimate is made of increased trade in the region due to removal of factors other than tariffs, e.g. non-tariff barriers.

Studies on Mercosur and ASEAN have found that they tend to be net trade creating though the range of trade effects vary from low to high depending on the initial level of liberalisation of the member countries. The more important effects however have been in terms of FDI because FTA's alter the incentives facing firms for both those located within and outside the FTA direct investment flows are affected. Investments in some cases anticipate the effects on trade. FDI is motivated by foreign investors seeking to exploit input or output markets located in activities where operating of foreign affiliates seem the most efficient strategy. Some other investment project might be undertaken to reap economies of scale or because of increased competition. In fact a study by the World Bank argues that a 10% increase in market size associated with an RTA produces a 5% increase in FDI (World Bank, 2004a). Earlier empirical work on regional integration on FDI have focused primarily on the effects of EU integration which show that EU share of worldwide inward FDI increased from 28 to 33% consequent to the single market programme. FTA might also promote technological spillover among members affecting efficiency of sectors that produce accumable factors such as knowledge creation. This issue needs further examination in the context of SAFTA.

On evaluating the diverse implications on FDI of FTA's, Blomstrom and Koko in the case of Mercosur suggest inclusion of provisions on FDI in RTA's. Further by providing certainty and credibility on future policies and economic environment there is a possibility of an increase in private domestic investment. Yet another study on the positive welfare effects of FTA's (Shiff's and Winters) points to the political dimensions and argues that as a tool of commercial diplomacy FTAs

unambiguously increase welfare by reducing security tensions and conflict. This would appear to apply to the SAFTA case as well.

Thus, it is quite clear that to analyse the impact SAFTA would have on the members as well as on the region, it is essential to step beyond the confines of traditional theory. The possibilities of intra-regional trade networks and vertical specialisation need to be

taken into account. There also has to be an investigation of the incentives for FDI created by the regional agreement. This study attempts to evaluate SAFTA in this light. The study attempts to estimate the impact on inward FDI into the region due to SAFTA. The quantitative modeling used in this study includes both a CGE modeling and a gravity model. The study also examines the effect of SAFTA on trade in services.

# 3 ■ Competitiveness and Complementarities

## ■ INTRODUCTION

The extent of competitiveness and complementarity, to a great extent, reflects the probability of success of a regional trading agreement. It has been argued, as discussed in Chapter 2, that greater the extent of competitiveness among the member countries the lower is the probability of a regional trading agreement to succeed. Countries with different comparative advantages and therefore greater complementarities, in principle, have more opportunities to trade with each other compared with those with similar comparative advantage profiles.

Studies that have estimated the extent of competitiveness at the three-digit level (Samaratunga 1999 and Kemal et al. 2000) have estimated Revealed Comparative Advantage indices (RCA). These studies show that the countries in South Asia have almost an identical pattern of comparative advantage in a relatively narrow band of commodities. This indicates that a regional trade agreement may not lead to large benefits in terms of higher exports. With respect to the complementarities that may exist in the trading pattern, it is argued that the extent of complementarity is higher if the export profile of one country, or a group of countries, matches the import profiles of others in the region. Studies have not found high complementarity in the trade profiles of South Asian countries.

World Bank (1995) evaluates the importance of trade complementarity for the success of policy-driven RTAs. The results show the trade complementarities are higher for successful arrangements such as the European Economic Commission (EEC), Canada-US Free Trade Area, and NAFTA; and lower trade complementarities emerge for unsuccessful arrangements such as Latin America Free Trade Area (LAFTA) and the Andean Pact. In terms of the computed value of trade complementarity, APEC was regarded as having the potential to succeed. The extent of complementarity is measured using the complementarity index. Further-

more, changes in the index over time can help determine whether their trade profiles are becoming more, or less, compatible.

In this chapter, we estimate the extent of competitiveness and complementarities at five digit standard international trade classification (SITC) level between the four major SAFTA member countries, i.e. Bangladesh, India, Pakistan and Sri Lanka taking an average of three years for the period 1991–93 and 2004–06. The main objective of this exercise is to examine whether there has been a change in the composition of competitiveness/complementarity baskets of the region over time, especially given the fact that many of these countries have undergone a significant change in their production structures and there has been a shift away from agriculture towards manufacturing in most of the countries, while in India the shift has been more towards the services sector.

## ■ INTRA-REGIONAL TRADING PROFILES OF SAFTA MEMBER COUNTRIES

South Asia as a region has lagged behind in terms of its openness to trade in spite of the fact that most of the South Asian countries have undertaken substantial trade reforms during 1990s. Consequently intra-regional trade has remained low as compared to other regions, e.g. ASEAN region. Further, bilateral trade within the region has been impeded by a number of factors like political tensions, high tariffs, large extent of informal trade, etc.

A cursory examination of the intra-regional trade shows that India has the largest share in total intra-SAARC exports at 74.4% (Table 3.1). On the other hand, Maldives' share in exports of the region is abysmal 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 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 (Table 3.2). This is followed

by India at 17.3% and Nepal at 14.9%. Further, with the exception of Bhutan and Nepal, SAARC countries' imports from other member countries is very low as compared to the imports from the rest of the world.

### ■ EXTENT OF COMPETITIVENESS IN SOUTH ASIA

Several studies have estimated competitiveness using

**Table 3.1 Share in Intra-Regional Exports of South Asian Countries in 2004**

Reporter	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	Total	Country-wise Share (%) in Intra-SAARC Exports
Bangladesh		3.9	105.2		0.7	44.7	10.2	164.7	2.8
Bhutan									
India	1593.3	83.9		42.2	736.9	505.1	1344.1	4305.4	74.4
Maldives			0.5			0.0	17.3	17.8	0.3
Nepal*	1.9		296.8	0.0		3.4	0.1	302.2	5.2
Pakistan	197.7	0.2	158.5	1.9	3.0		134.7	496.0	8.6
Sri Lanka	13.4		385.8	60.1	0.3	39.3		498.8	8.6
TOTAL SAARC	1806.3	88.0	946.8	104.2	740.9	592.4	1506.3	5784.9	100.0
World	9979.0	240.7	73529.7	544.7	1249.7	15907.5	7136.0	108587.3	
Intra-regional exports as (%) of SAARC exports to world	18.1	36.6	1.3	19.1	59.3	3.7	21.1	5.3	

Source: COMTRADE

Note: \* indicates the data source from IMF-DOT 2005. Data consolidated from estimated monthly/quarterly partner countries records. Data for Bhutan not available.

**Table 3.2 Share in Intra-Regional Imports of South Asian Countries in 2004**

Reporter	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	Total	Country-wise Share (%) in Intra-SAARC Imports
Bangladesh*		6.05	1,278.71	0.00	0.13	142.38	9.57	1,436.84	26.9
Bhutan									
India	58.75	70.40		0.00	342.88	91.95	361.31	925.30	17.3
Maldives	0.01	0.00	65.83		0.00	2.20	68.46	136.51	2.6
Nepal**	5.05		785.05	0.00		3.35	0.31	793.76	14.9
Pakistan	45.08	0.08	454.41	0.06	3.71		45.66	549.00	10.3
Sri Lanka	7.70		1,360.08	19.84	0.08	108.06		1,495.77	28.0
TOTAL SAARC	116.59	76.54	3,944.09	19.90	346.81	347.94	485.31	5,337.17	100
World	10,073.65	77.05	87,099.75	213.29	684.21	11,999.67	5,998.27	116,145.89	
Intra-regional imports % of SAARC in world exports	1.16	99.33	4.53	9.33	50.69	2.90	8.09	4.60	

\*\* indicates the data source from IMF-DOT 2005 Note: identifies data consolidated from estimated monthly/quarterly partner countries records

\* indicates Bangladesh, import from Bhutan data which is extracted from IMF-DOT 2005 statistic. Data for Bhutan not available.

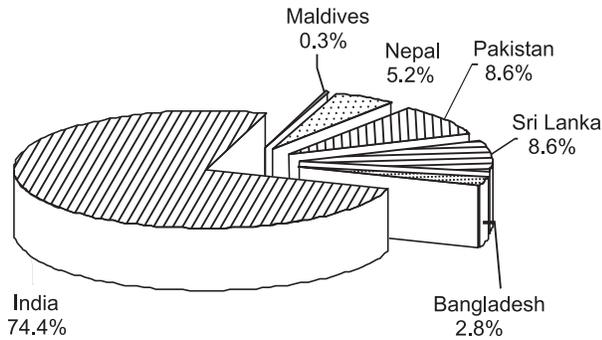


Figure 3.1 Country-wise Share in Intra-SAARC Exports in 2004.

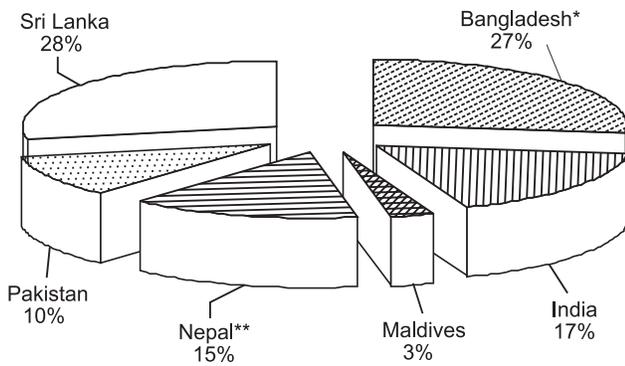


Figure 3.2 Country-wise Shares in Intra-SAARC Imports in 2004

revealed comparative advantage based on two existing theories of trade, namely, the Ricardian theory and the Heckscher-Ohlin (H-O) theory. The Ricardian theory assumes that comparative advantage arises from differences in technology across countries while the H-O theory suggests that technologies are the same across countries. Instead, the H-O theory attributes comparative advantage to cost differences resulting from differences in factor prices across countries.

Balassa (1965) derived an index (called the Balassa Index) that measures a country's comparative advantage. The Balassa Index identifies whether a country has 'revealed' comparative advantage rather than to determine the underlying sources of comparative advantage. However, since first suggested by Balassa (1965), the definition of RCA has been revised and modified such that excessive number of measures now exist. Some studies measure RCA at the global level (Vollrath 1991), others at a sub-global/regional level (Balassa's original index), and while some others evaluate the measurement as bilateral trade between two countries or trading partners (Dimelis and Gatsios 1995).

To examine the change in competitive basket in major trading partners in SAFTA, the revealed comparative advantage is estimated which is a ratio of the share of a given product in a country's exports to its share in world exports (Balassa 1965) and is defined as:

$$R_{ih} = \frac{X_{ih} / X_{it}}{X_{wh} / X_{wt}}$$

where  $R_{ih}$  = Revealed comparative advantage ratio for country  $i$  in product  $h$

$X_{ih}$  = Country  $i$ 's exports of product  $h$

$X_{it}$  = Total exports of country  $i$

$X_{wh}$  = World exports of product  $h$

$X_{wt}$  = Total World exports

The index of revealed comparative advantage ( $RCA_{ij}$ ) has a relatively simple interpretation. If it takes a value greater than unity, the country has a revealed comparative advantage in that product. If it is less than unity, the country is said to have a comparative disadvantage in the commodity/industry. The advantage of using the comparative index is that it considers the intrinsic advantage of a particular export commodity and is consistent with changes in an economy's relative factor endowment and productivity. It is argued that the RCA index is biased due to the omission of imports especially when country-size is important (Greenaway and Milner 1993). Some other limitations of the index are: it cannot distinguish improvements in factor endowments and pursuit of appropriate trade policies by a country. In addition, it specifies the advantages in a product in a particular year only.

Using the RCA index, the competitive basket has been estimated for four major trading partners of the region, i.e. Bangladesh, India, Pakistan and Sri Lanka. For each of the country a competitive basket has been estimated where the RCA is greater than one for that country but less than one for the other three trading partners. The competitive basket for the average period 1991–93 and 2004–06 for each of the countries has been listed in Table 3.1 (Appendix III). The results show that the competitive basket has expanded over-time for almost all the countries in 2004. This indicates that not only the potential of trade within the SAARC region has increased but also the products in which the countries can increase their intra-regional exports. India's and Sri Lanka's competitiveness within the region has increased substantially. In fact, some of the new products have entered their competitive basket. India has become more competitive vis-à-vis other SAARC countries in dyes, pharmaceuticals, yarns, etc.,

while Sri Lanka has become more competitive in sacks and bags, cork products, transformers and resistors, etc.

A list of products where all four countries are competitive, i.e.  $RCA > 1$  is presented in Table 3.2 (Appendix III). Textile products are still the products where all four major trading partners of the region compete in the third country market. However, these countries have also gained competitiveness in products like shrimps, spices, woven carpets, cotton yarn wastes, etc.

The competitiveness analysis therefore indicates that the potential for intra-regional trade has increased substantially in 2004 as compared to a decade back. Countries have gained competitiveness in different products and at a more disaggregated level, the products which can be exported within the region by the four major trading partners have increased substantially in number. However, whether the competitive edge of a country leads to higher exports within the region also depends on whether other countries in the region import these products or not? The next section examines the complementarities within the region.

### ■ INTRA-REGIONAL COMPLEMENTARITIES

For intra-regional trade to expand it is important that the trade profiles of the countries match, i.e., what is exported by one country should be imported by the region as a whole. It is therefore important to examine whether the countries' export and import profiles within the region have become similar over time and, therefore, facilitate growth in intra-regional trade or not. The estimated 'trade complementarity index' (TCI) shows how well the export profile of one country, or group of countries, matches the import profiles of others (Yeats and Ng 2003). Furthermore, changes in the index over time can help determine whether their trade profiles are becoming more, or less, compatible.

We estimate the complementarity index between South Asian countries with SAARC as a region. The index of trade complementarity between two countries  $k$  and  $j$  ( $C_{kj}$ ) is defined as,

$$C_{ikj} = 1 - \frac{\sum (|M_{ik} - X_{ij}| \div 2)}{\sum (M_{ij} + X_{ik})} \quad (1)$$

$$C_{ijk} = 1 - \frac{\sum (|M_{ij} - X_{ik}| \div 2)}{\sum (M_{ij} + X_{ik})} \quad (2)$$

where  $k$  is a SAARC country,  $j$  is the SAARC region, and  $i$  represents product category. This index takes the value of one when a composition of import needs in an importing country matches perfectly with the export bundle of the region. At the other extreme, where an export bundle of an exporting country has no relevance to the import needs of the region, the index takes the value of zero. As such, it is assumed that higher the index value more favourable is the prospect for a successful trade arrangement in the region.

Michaely (1994) used the index to assess prospects for Latin American trade arrangements, while Yeats (1998) employed the measure to analyse the compatibility of Sub-Saharan African countries' intra-regional trade. For SAARC region the trade complementarity index has been estimated by Nag and Nandi (2003) for the years 1997 to 2001. They find that there is a significant rise in TCI of India during this period for SAARC countries. But find rising TCI for Pakistan and Sri Lanka in the SAARC region.

We estimate the TCI taking averages of the years 1991–93 and 2002–04 (Table 3.4). The indices are computed based on the United Nations/COMTRADE bilateral trade flow data at the SITC (Rev 3) five-digit level.

The TCI for the two time periods indicate that, except for Pakistan, complementarities of Bangladesh, India and Sri Lanka vis-à-vis SAARC region as a whole has increased overtime. The TCI in terms of exports of India and Sri Lanka to SAARC region has almost doubled in this time period (from 0.05 to 0.1 and from 0.21–0.50) while TCI in terms of exports of SAARC region to countries has also increased overtime. This strongly indicates that there exist possibilities of intra-regional trade expansion.

Trade complementarity index has been further estimated for total trade for each country for the two time periods (Table 3.5). The results show that TCI for total trade has also improved drastically for Bangladesh,

Table 3.4 Complementarity Index – Export and Import

Country	1991(Avg Yr 1991–93)					2004 (Avg Yr 2002–04)				
	SAARC	Bangladesh	India	Pakistan	Sri Lanka	SAARC	Bangladesh	India	Pakistan	Sri Lanka
SARRC		0.05	0.22	0.25	0.08		0.06	0.31	0.10	0.12
Bangladesh	0.17					0.27				
India	0.05					0.10				
Pakistan	0.38					0.24				
Sri Lanka	0.21					0.50				

Sri Lanka and India. Pakistan is the only country where the value of the index declines.

In short, it can be said that increase in competitiveness of the major trading partners in the region has also been accompanied by a rise in the trade complementarities within the region. There is therefore an economic justification in suggesting that intra-regional trade in South Asia has a potential to increase substantially. To examine whether the countries are at different stages of production within an industry, which might further strengthen the argument for rising potential of intra-regional trade, we estimate intra-industry trade indices.

**Table 3.5 Trade Complementarity Index for Total Trade**

Country	Complementarity Index for Total Trade	
	1991	2004
Bangladesh–SARRC	0.22	0.33
India–SARRC	0.28	0.41
Pakistan–SARRC	0.63	0.34
Sri Lanka–SAARC	0.29	0.62

## ■ INTRA-INDUSTRY TRADE IN SAFTA REGION

Intra-industry trade arises if a country simultaneously imports and exports similar types of goods or services. Similarity is identified here by the goods or services being classified in the same ‘sector’. It is customary to distinguish between two different types of intra-industry trade, each warranting a different type of explanation, namely:

- *Horizontal Intra-industry Trade:* This refers to the simultaneous exports and imports of goods classified in the same sector and at the same stage of processing. This is likely to be based on product differentiation.
- *Vertical Intra-industry Trade:* This refers to the simultaneous exports and imports of goods classified in the same sector but at different stages of processing. This is likely to be based on the increasing ability to organise ‘fragmentation’ of the production process into different stages, each performed at different locations by taking advantage of the local conditions.

### Measuring Intra-Industry Trade: The Grubel-Lloyd Index

The most often used method for determining the extent of intra-industry trade (IIT) was proposed by Grubel

and Lloyd (1975). This measure, now known as the Grubel–Lloyd index, is simple to calculate and intuitively appealing. It is calculated as:

$$GL_{sector\ i} = 1 - \left( \frac{|export_{sector\ i} - import_{sector\ i}|}{export_{sector\ i} + import_{sector\ i}} \right)$$

If the country only imports or only exports goods or services within the same sector, such that there is no intra-industry trade, the second term on the right-hand side of equation is equal to one, such that the whole expression reduces to zero. Similarly, if the export value is exactly equal to the import value, the second term on the right-hand side of equation is equal to zero, such that the whole expression reduces to one. For simplicity, we multiplied by 100, therefore the Grubel–Lloyd index varies between zero (indicating pure *inter*-industry trade) and 100 (indicating pure *intra*-industry trade).

We estimate intra-industry trade using the industry classification (eight industries) provided in WITS for the years 1991 and 2004. The results of intra-industry trade indices have been presented in Table 3.6. Country-wise analysis show that:

### *Sri Lanka*

In 1991, Sri Lanka had high IIT with Pakistan in the agricultural materials sector which, in 2004, has remained close to the same (Table 3.6). In the agricultural raw materials sector, IIT was high in 1991 between Sri Lanka and Pakistan at 94.2, but the figure fell drastically to 6.1 by 2004. Instead, IIT between Sri Lanka and India has risen in this sector from 42.1 in 1991 to 93.4 in 2004. In the food sector, IIT between Sri Lanka and Pakistan fell from a high 93.5 in 1991 to 68 in 2004. Sri Lanka’s IIT with Bangladesh has increased in the manufactures sector (from 24.8 in 1991 to 93.4 in 2004), Textiles sector (up to 80.3 in 2004) and the other manufactures sector (from 57.3 in 1991 to 86.7 in 2004).

Based on the rise in IIT in 2004 in relation to 1991, there is a large potential for trade between Sri Lanka and Bangladesh in the Manufactures, Textiles and Other Manufactures Sectors. Further, there is potential between Sri Lanka and India and Sri Lanka and Pakistan in the Agricultural Raw Materials and Agricultural Materials sectors respectively.

### *India*

In the agricultural raw materials sector, India’s IIT increased sharply with Bangladesh (from 17.49 in 1991 to 96.3 in 2004) and with Sri Lanka, too, increased considerably (from 42.1 in 1991 to 93.4 in 2004). In

Table 3.6 Intra-Industry Trade, 1991 and 2004

Sector	Reporter/ Partner	IIT (1991)				IIT (2004)			
		Bangladesh	India	Pakistan	Sri Lanka	Bangladesh	India	Pakistan	Sri Lanka
Agricultural Materials	Sri Lanka	16.4	23.1	97.6		2.2	52.9	94.5	
Agricultural Raw Materials	Sri Lanka		42.1	94.2		0.3	93.4	6.1	
Chemicals (SITC 5)	Sri Lanka	31.1	16.6	11.8		42.6	28.4	10.3	
Food (SITC 0 + 1 + 22 + 4)	Sri Lanka		20	93.5		4	47.5	68	
Manufactures	Sri Lanka	24.8	4.1	3.8			32.9	9.8	
Machinery & Transport Equipment	Sri Lanka		0.1	19		32.1	33.6	20.9	
Textiles as 26 + 65 + 84	Sri Lanka		3.5	3.2		80.3	33.9	9.4	
Other manufactures (SITC 6 + 8-68)	Sri Lanka	57.3	61.5	78.6		86.7	37.9	35.8	
Agricultural Materials	India	6.24		74.5	23.1	9		69.5	52.9
Agricultural Raw Materials	India	17.49		22.9	42.1	96.3		32.65	93.4
Chemicals (SITC 5)	India	6.18		11.9	16.6	41		1.36	28.4
Food (SITC 0 + 1 + 22 + 4)	India	5.04		96.9	20	4.4		76.58	47.5
Manufactures	India	2.63		90.8	4.1	15.9		14.19	32.9
Machinery & Transport Equipment	India	7.97		49.1	0.1	4		8.24	33.6
Textiles as 26 + 65 + 84	India	1.28		8.2	0.2	21.5		89.69	17
Ores & Metals (SITC 27 + 28 + 68)	India			18.9	61.5	9.8		3.07	37.9
Other manufactures (SITC 6 + 8 - 68)	India	0.74		31.7	3.5	10.3		55.77	33.9
Agricultural Materials	Bangladesh		6.24	70.6			9	76	2.2
Agricultural Raw Materials	Bangladesh		17.49	62.5			96.3	77.9	0.3
Chemicals (SITC 5)	Bangladesh		6.18		16.4		41	37.2	42.6
Food (SITC 0 + 1 + 22 + 4)	Bangladesh		5.04				4.4	71.4	4
Manufactures	Bangladesh		2.63	6.1	31.1		15.9	3.1	93.4
Machinery & Transport Equipment	Bangladesh		7.97	18.9			4	6.5	32.1
Textiles as 26 + 65 + 84	Bangladesh		1.28	35.7	14.3		21.5	28.6	80.3
Ores & Metals (SITC 27 + 28 + 68)	Bangladesh						9.8	9.2	
Other manufactures (SITC 6 + 8 - 68)	Bangladesh		0.74	5.8	24.8		10.3	1.6	86.7
Agricultural Materials	Pakistan	70.6	74.5		97.6	76	69.5		94.5
Agricultural Raw Materials	Pakistan	62.5	22.86		94.2	77.9	32.65		6.1
Chemicals (SITC 5)	Pakistan		11.87		11.8	37.2	1.36		10.3
Food (SITC 0 + 1 + 22 + 4)	Pakistan	95.9	96.88		93.5	71.4	76.58		68
Manufactures	Pakistan	6.1	90.77		3.8	3.1	14.19		9.8
Machinery & Transport Equipment	Pakistan	18.9	49.14		19	6.5	8.24		20.9
Textiles as 26 + 65 + 84	Pakistan	35.7	8.21		2.3	28.6	89.69		3.6
Ores & Metals (SITC 27 + 28 + 68)	Pakistan		18.86		78.6	9.2	3.07		35.8
Other manufactures (SITC 6 + 8-68)	Pakistan	5.8	31.72		3.2	1.6	55.77		9.4

the manufactures sector, India's IIT with Pakistan fell (from 90.8 in 1991 to 14.19 in 2004) while it increased in the textiles sector (from 8.2 in 1991 to 89.69 in 2004).

There is thus potential for trade between India and Bangladesh and India and Sri Lanka in the agricultural

raw materials sector, and between India and Pakistan in the textiles sector.

### *Bangladesh*

Intra-industry trade increased in the agricultural raw materials sector between Bangladesh and India (from

17.49 in 1991 to 96.3 in 2004) and between Bangladesh and Pakistan (from 62.5 in 1991 to 77.9 in 2004). In the manufactures sector, IIT between Bangladesh and Sri Lanka increased (from 31.1 in 1991 to 93.4 in 2004). IIT between them also increased in the textiles sector (from 14.3 in 1991 to 80.3 in 2004) and other manufacturing sectors (from 24.8 in 1991 to 86.7 in 2004).

Potential thus exists for increased trade between Bangladesh and India and Bangladesh and Pakistan in the agricultural raw materials sector. It also exists between Bangladesh and Sri Lanka in manufactures, textiles and other manufactures sectors.

### *Pakistan*

Pakistan maintained high IIT with Sri Lanka in the Agricultural Materials sector between 1991 and 2004 (97.6 in 1991 and 94.5 in 2004). However, its IIT with Sri Lanka in the agricultural raw materials sector fell sharply (from 94.2 in 1991 to 6.1 in 2004) while registering a marginal increase with Bangladesh (from 62.5 in 1991 to 77.9 in 2004). In the food sector, Pakistan's IIT fell with respect to Bangladesh (from 95.9 in 1991 to 71.4 in 2004), India (from 96.88 in 1991 to 76.58 in 2004) and Sri Lanka (93.5 in 1991 to 68 in 2004). In the manufactures sector, Pakistan's IIT with India declined drastically (from 90.77 in 1991 to 14.19 in 2004) while in the textiles sector it showed an appreciable rise (from 8.21 in 1991 to 89.69 in 2004).

There is thus large potential in trade between Pakistan and Bangladesh in the agricultural materials sector and between Pakistan and India in the textiles sector.

In short, the results show that intra-industry trade has increased in many sectors for the major trading partners of SAFTA region in the year 1991 as compared to 2004. Intra-industry trade between Sri Lanka and India has increased in almost all sectors, especially in chemicals, machinery and textiles. India and Bangladesh have increased intra-industry trade in chemicals, agricultural raw materials and textiles. Bangladesh and Sri Lanka have increased their intra-industry trade in chemicals and textiles. With respect to Pakistan, we find that intra-industry trade with most of the major trading partners of SAFTA region has declined in many sectors. Textile is the only sector where intra-industry trade of Pakistan has improved with respect to other major trading partners. This indicates that the region has the potential to integrate its production structures in many sectors and improve its global

competitiveness. Intra-regional trade can lead to better allocation of resources in the region; allow economies of scale and improve efficiency in production.

### **Intra-industry Trade in the Textile Sector**

We examine in greater detail the possibility of intra-regional trade in a sector where the countries of the region are at different degrees of competitiveness and compete in the third market, i.e. the textiles sector. This detailed analysis is undertaken using UNIDO dataset. However, at the industry level the trade data is not bilateral therefore intra-industry trade with respect to the rest of the world was studied for India, Pakistan, Bangladesh and Sri Lanka in 1991 and 2004. Since these four countries are also major exporters in the world in textile sector some inferences are drawn on the basis of the analysis. The trends as observed are presented in Table 3.7.

**Spinning, Weaving and Finishing Textiles Sector:** India's IIT increased from 0.2 in 1991 to 0.4 in 2004. At the same time Pakistan and Sri Lanka's IIT have remained low at 0.1 while Bangladesh's IIT fell from 0.5 in 1991 to 0.3 in 2004. There is thus scope of trade between India and each of these countries.

**Manufacture of Made-Up Textile Goods Except Wearing Apparel:** Intra-Industry Trade for all countries is very low for this sector. There is thus not enough potential for increasing trade between these countries in this sector.

**Knitting Mills:** Sri Lanka shows high IIT in this sector with the other countries experiencing very low IIT with respect to the rest of the world. There is thus large potential for trade to expand between Sri Lanka and the other countries in the study.

**Manufacture of Carpets and Rugs:** India and Pakistan show no IIT in this sector with Bangladesh's IIT remaining low at 0.2 between 1991 and 2004. Sri Lanka's IIT fell from 0.9 in 1991 to 0.5 in 2004 which highlights deterioration in IIT for Sri Lanka. There is thus an insufficient case for increasing trade between these countries in this sector.

**Cordage, Rope and Twine Industries:** India, Pakistan and Sri Lanka exhibit high IIT in this sector. It is noteworthy however, that both India and Sri Lanka's IIT fell from 0.9 in 1991 to 0.6 in 2004. With

Table 3.7 Intra-industry Trade in Textiles

Sector	Countries	IIT (1991)	IIT (2004)
Spinning, weaving and finishing textiles	India	0.2	0.4
	Pakistan	0	0.1
	Sri Lanka	0.1	0.1
	Bangladesh	0.5	0.3
Manufacture of made-up textile goods except wearing apparel	India		0
	Pakistan		0
	Sri Lanka		0.1
	Bangladesh		0.1
Knitting mills	India	0	0.1
	Pakistan		0
	Sri Lanka		0.8
	Bangladesh		0.3
Manufacture of carpets and rugs	India		0
	Pakistan		0
	Sri Lanka	0.9	0.5
	Bangladesh	0.2	0.2
Cordage, rope and twine industries	India	0.9	0.6
	Pakistan		0.8
	Sri Lanka	0.9	0.6
	Bangladesh	0	0.1
Manufacture of textiles not elsewhere classified	India	0.9	0.7
	Pakistan	0.3	0.6
	Sri Lanka	0	0.1
	Bangladesh	0.4	0.8

Bangladesh having low IIT at 0.1 in 2004, the other three countries have a large potential for trade with it.

**Manufacture of Textiles (not Elsewhere Classified):** India's IIT fell from 0.9 in 1991 to a reasonable 0.7 in 2004. Further, Pakistan showed an increase in IIT from 0.3 in 1991 to 0.6 in 2004 and Bangladesh showed an increase from 0.4 in 1991 to 0.8 in 2004. Sri Lanka's IIT remained low from 1991 to 2004. There is thus large scope for India, Pakistan and Bangladesh to increase trade with Sri Lanka.

On the whole, though it is difficult to draw conclusions for the textile sectors on the basis of the above arrived results, it can be inferred that in some of the sub-sectors of textiles, like spinning, weaving and finishing textiles and manufactures of textiles not elsewhere classified there has been a rise in intra-industry trade in the SAARC countries and this does indicate that there is a possibility, even within the sector where the countries compete, for countries to trade.

## ■ CONCLUSION

The analysis of competitiveness and complementarities in SAFTA region reveals that there has been a distinct

change in the trade patterns of major trading partners in the region with respect to intra-regional trade. The revealed comparative advantage (RCAs) indices show that the competitive basket has changed overtime. Countries within the region have become competitive vis-à-vis other countries in the region in different products. The results of complementarity index show that as compared to an average of 1991–93 in 2004–06 period there has been a drastic increase in complementarity indices 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 period as compared to 1991 period. 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, we find that the intra-industry trade has increased overtime. This indicates that in many sectors including textiles, countries can specialise in products at different stages 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.

# 4 ■ Effective Additional Market Access under SAFTA: Countrywise Analysis

## ■ INTRODUCTION

To gauge the benefits of a regional trade agreement it is essential to identify the effective additional market access that it creates for its members. There is a catena of unilateral, bilateral, regional and sub-global level tariff concessions which operate between members of SAFTA today. These include concessions related to the Bangkok Agreement, GSTP, GSTP (LDC), the Indo-Bhutan, Indo-Nepal, Indo-Lanka and Pakistan-Lanka bilateral FTAs. Several more like the Bangladesh-Pakistan FTA and BIMSTEC are at various stages of negotiation. Given the history of multiplicity of agreements in concessions between South Asian countries, these concessions have to be considered to determine the benefits that SAFTA offers over and above these.

In this context, this chapter tries to capture the effective additional market access that is created as a result of SAFTA for its various members. Two aspects would determine the EAMA. The first would be the sensitive list decided upon and the second would be the identification of those non sensitive products for which concessions are effectively provided. SAFTA adopts a negative list approach to tariff liberalisation. This implies that countries will liberalise tariffs in all products, except those specified in negative lists (that have been negotiated and agreed upon by all members). This is as opposed to a positive list approach, like that adopted in SAPTA, where countries liberalise tariffs only in products that they specifically commit to, with status quo maintained on all products not committed.

The contents of the Sensitive Lists scheduled by countries play a defining role in the extent to which the FTA will lead to Intra-SAFTA trade gains. The negative list of SAFTA has been specified at the 6-digit level. There are a total of 5224 lines at the 6-digit level in the entire HS Code. If one were to look at the number of items in the negative list as a measure of restrictiveness, then even the country (Pakistan) with the largest number of items (1,183) in the negative list, would not appear to be restrictive since only 23% of the total items in the HS Code would be excluded from tariff liberalisation. This would however not be the correct way of assessing the extent to which the negative list affects trade gains. When global trade (export) statistics are examined, it is seen that 80% of the world trade takes place in only 950 HS 6-digit lines (18% of all HS 6-digit products).<sup>1</sup> In the case of South Asia, where exports are less diversified than the rest of the world, 80% of South Asia's global exports takes place through only 368 HS 6-digit products (7% of the total HS Code (7% of all HS 6-digit products)

Thus the extent of trade and trade potential items in the negative lists of members are more important, than the number of items. In order to assess the implications of the negative lists of each of the countries, the items were extracted from the notified sensitive lists.<sup>2</sup> After taking into account errors in HS coding/reporting, a revised table indicating the number of products has been prepared. (see Table 4.1)

Even after the sensitive list is accounted for there is a need to determine the products in which tariffs are

<sup>1</sup> Based on 6-Digit HS Export Data from WITS/COMTRADE for year 2004.

<sup>2</sup> It must be noted that the manner in which the negative lists have been notified (SAARC website), has room for considerable improvement. Though the HS Coding System obliges all WCO members to adopt exactly the same HS Code System at the 6 digit level, there are variances in format of reporting of 6 digit HS Codes between SAARC members. Apart from differences in the formatting of codes, there are some errors in the codes notified. Some countries have reported HS Codes and products that do not appear in the HS 2002 code as prescribed by the WCO. This could be the subject of technical cooperation on harmonisation of HS Codes between SAARC countries.

Table 4.1 Percentage of Tariff Lines Covered Under Negative Lists

Sl. No.	Name of the Contracting States	Number of Tariff Lines for LDCS	Number of Tariff Lines for Non-LDCS	Number of Tariff Lines for All SAFTA Members (single list)	Therefore % of Tariff Lines covered by Negative List*
1	Bangladesh	1249	1254		24
2	Bhutan			136	3
3	India	763	884		17
4	Maldives			669	13
5	Nepal	1299	1332		25
6	Pakistan			1182	23
7	Sri Lanka			1058	20

\*Wherever a country has two negative lists, the larger is considered.

effectively liberalised. That is to say, products in which concessions are more than what they are at present. For instance, if a country A gives zero duty access to country B in a product X because of the AB Free Trade Agreement, then even though country A binds its duty to zero under SAFTA, there is no additional market access for country B in product X because Country B already had zero duty access for product X under the pre-existing AB FTA.

Therefore products, in which tariffs can be said to be effectively liberalised, are determined from:

- The sensitive lists of members.
- Whether or not the tariff liberalisation by a member to another member is deeper than any pre-existing concessions.
- It is important not to construe products which are already trading at zero MFN duty, as products in which SAFTA will create market access. Therefore, it is examined whether products in which concessions are made already have 0–5 MFN duty.

## ■ EFFECTIVE ADDITIONAL MARKET ACCESS: RESULTS

Once the products in which actual concessions are determined on a bilateral basis, the Effective Additional Market Access or EAMA, is determined through three measures:

1. The proportion of global value of imports of non sensitive items (sensitive items refer to sensitive items of the concession giver) for which effective additional market access is created to the total global value of imports of the concession giver.

What this measure essentially looks at is the weight of the global value of the imports of the lines in which additional market access is created

between any two members in the total global value of imports of those items of the concession giver. For instance, as can be seen from Table 4.2 (a), items for which India provides Bangladesh effective additional market access constitutes 85% of the value of its global imports. This ratio is calculated for every member in relation to every other member.

When considering the effective market access created in terms of global imports India and Pakistan are the two countries which provide the largest EAMA as a result of SAFTA. While India provides EAMA to the extent of 86% to Pakistan and 85% to Bangladesh and Maldives, Pakistan provides EAMA to the extent of 70–72% for almost all the member countries. India provides only 1% of EAMA to Sri Lanka, the reason being that under the Indo-Lanka agreement India is already providing substantial concessions to Sri Lanka. For countries such as Nepal, Bhutan and Maldives India has already nearly completely liberalised imports from them hence the additional market access to be created as a result of SAFTA is zero. After India and Pakistan, Bhutan and Nepal provide the largest EAMA to the member countries, with Bhutan providing around 66–68% of and Nepal that of 46–52% of their global imports respectively. Both the countries provide no EAMA to India since concessions already exist under pre-existing trade agreements. Sri Lanka provides market access to the extent of 34–35% for all the members except India. But this again is because of the abovementioned fact of the Indo-Lanka FTA. Maldives provides EAMA to the extent of only 35% of its global imports. This implies that Maldives's sensitive list contains products which constitute 65% of its global imports. Bangladesh provides the lowest EAMA to the extent of only 23% to the SAFTA members. This gives the

Table 4.2 (a) EAMA Created by SAFTA (Partners Global Imports in %)

	India	Bangladesh	Pakistan	Sri Lanka	Nepal	Bhutan	Maldives
India		85	86	1	0	0	85
Bangladesh	23		23	23	23	23	23
Pakistan	70	72		70	72	72	72
Sri Lanka	1	35	34		35	35	35
Nepal	0	52	46	46		52	52
Bhutan	0	68	66	66	66		68
Maldives	34	35	34	34	35	35	

indication that Bangladesh's sensitive list is extremely restrictive. But only when the EAMA under the next two measures are considered can a proper picture emerge on this count.

These findings give us an idea of how much of additional market access is created by each member for each of the other members in terms of their global imports. But since this measure is limited to looking at the global value of EAMA created it might not really be indicative of the benefit to the member who receives the concession. Therefore it is essential to look at the EAMA created in terms of bilateral trade. Hence the next measure looks at the EAMA created in terms of bilateral trade between two members.

2. The proportion of value of bilateral imports of non-sensitive items for which additional market access is created to the total bilateral imports of concession giver from concession receiver.

This measure gives an indication of the EAMA afforded to products which are already being bilaterally traded between a pair of countries. For instance, India provides an EAMA to the extent of 92% of the value of its present bilateral imports from Bangladesh and 90% and 97% in the case of Pakistan and Maldives respectively [Table 4.2 (b)]. A higher figure tends to demonstrate a good result.

This measure is however limited as it looks at bilateral trade prior to the FTA ; given that intra-SAFTA trade basket is limited, and that most of

the existing trade may be taking place in products in which are outside the sensitive list, this measure is not adequate by itself.

Both the above measures look at the EAMA created from the point of view of the concession giving country. But in order to obtain an authentic idea of the EAMA created, it is essential to look at the weight of the value of those items in the export basket of the concession receiving country. The following measure does this.

3. The proportion of concession receiver's value of global exports of non sensitive items in which EAMA would be created to their total global exports.

This measure is more comprehensive than the first two, because it captures the trade specialisation of the concession receiving country and determines whether it receives access (to concession giver's market) in products which constitute most of its (the concession receiver's) global exports. In the case of India and Bangladesh, it is seen that the negative list of India has the effect of allowing EAMA to Bangladesh in items that constitute only about 18% of its global exports (Table 4.3). This is largely because India's negative list for LDCs impedes EAMA in several garments products, which actually do form the bulk of Bangladesh's global exports. The concessions which Pakistan and Maldives receive in the Indian market vis-à-vis each of their global exports is higher at 57% and 60% respectively.

Table 4.2 (b) EAMA Created by SAFTA (Bilateral Imports in %)

	India	Bangladesh	Pakistan	Sri Lanka	Nepal	Bhutan	Maldives
India		92	90	0	0	0	97
Bangladesh	25		22	45	76	9	25
Pakistan	86	69		66	74	47	100
Sri Lanka	1	10	8		82	0	52
Nepal	0	71	0	0		82	0
Bhutan	0	6	0	0	22		0
Maldives	26	0	33	26	100	0	

**Table 4.3 EAMA Created by SAFTA (Concession Receivers Global Exports in %)**

	India	Bangladesh	Pakistan	Sri Lanka	Nepal	Bhutan	Maldives
India		18	57	4	0	0	60
Bangladesh	51		44	33	44	10	5
Pakistan	70	23		28	44	62	80
Sri Lanka	2	92	50		63	66	34
Nepal	0	15	23	21		26	40
Bhutan	0	10	23	33	37		26
Maldives	69	78	82	74	82	75	

In sum, when considering the effective market access created in terms of global imports India and Pakistan are the two countries which provide the largest EAMA as a result of SAFTA. While India provides EAMA to the extent of 86% to Pakistan and 85% to Bangladesh and Maldives, Pakistan provides EAMA to the extent of 70–72% for almost all the member countries. India provides only 1% of EAMA to Sri Lanka, the reason being that under the Indo-Lanka agreement India is already providing substantial concessions to Sri Lanka. For countries such as Nepal, Bhutan and Maldives India has already nearly completely liberalised imports from them hence the additional market access to be created as a result of SAFTA is zero.

After India and Pakistan, Bhutan and Nepal provide the largest EAMA to the member countries, with Bhutan providing around 66–68% of and Nepal that of 46–52% of their global imports respectively. Both the countries provide no EAMA to India since concessions already exist under pre existing trade agreements. Sri Lanka provides market access to the extent of 34–35% for all the members except India. But this again is because of the above mentioned fact of Indo-Lanka FTA. Maldives provides EAMA to the extent of only 35% of its global imports. This implies that Maldives's sensitive list contains products which constitute 65% of its global imports. Bangladesh provides the lowest EAMA to the extent of only 23% to the SAFTA members. This gives the indication that Bangladesh's sensitive list is extremely restrictive. But only when the EAMA under the next two measures are considered can a proper picture emerge on this count.

## ■ EFFECTIVE ADDITIONAL MARKET ACCESS: COUNTRYWISE ANALYSIS

All the three measures discussed above are calculated for each member vis-à-vis each other member. In this

section the paper tries to highlight the EAMA for each member.

### Bangladesh

When observed in terms of its global imports Bangladesh's sensitive list does appear to be quite sensitive since it only provides EAMA of 23% to all the other member countries. But when the EAMA created in terms of bilateral trade with each member is concerned, the picture does change. In fact, Bangladesh provides EAMA up to 76% for Nepal, which is the highest. The weightage of the EAMA created for the other members in terms of its bilateral imports is 9% for Bhutan, 25% for India, 25% for Maldives, 22% for Pakistan and 45% for Sri Lanka. When the EAMA created by Bangladesh is analysed in terms of the value of the exports of the members who receive concessions it can be seen that while for countries such as India (51%), Nepal (44%), Pakistan (44%) and Sri Lanka (33%) it is quite high, for countries such as Bhutan (10%) and Maldives (5%) it is quite low.

### Bhutan

Bhutan provides EAMA to the extent of only 66–68% of its global imports. That is to say, that Bhutan's sensitive lists contain products which constitute 44% of its global imports.

When looked at from the point of view of its present bilateral imports from South Asian partners, the EAMA provided is 6% for Bangladesh and 22% for Nepal. India gains no EAMA to Bhutan since it already has an FTA with Bhutan. Bhutan did not trade with the other South Asian countries for the year under consideration (2004).

When looked at from the point of view of the global exports of South Asian partners, the EAMA created by Bhutan is 10% for Bangladesh, 26% for Maldives, 37% for Nepal, 23% for Pakistan and 33% for Sri Lanka.

## India

India provides EAMA to the extent of 85% of its global imports. Looked at from this point of view, India's sensitive list appears to be liberal. The products in which EAMA is granted are those for which there is a high level of import demand in India. Hence there may be benefits of increasing or instituting production of these products in other South Asian countries. When looked at from the point of view of its bilateral imports from South Asian partners, the EAMA into India is 92% for Bangladesh, 97% for Maldives, and 90% for Pakistan. All the other countries already have complete access to India's market in terms of this measure. This measure gives a very optimistic assessment of EAMA for all the three countries. However this may not be a good measure, since regional trade has been historically confined to few products, when compared to global trade. One important *raison d'être* for RTAs is that countries seek to expand to basket of products in which regional trade can take place. Thus looking at whether EAMA is substantial in terms of global exports of partner countries is important. When looked at from this point of view it can be seen that the EAMA into India is only 18% for Bangladesh, 60% for Maldives, 57% for Pakistan and 4% for Sri Lanka. Thus it may be inferred that India's sensitive list impedes EAMA in products which constitute 82% of global exports. This is a logical result, since a substantial portion of India's sensitive list consists of garments, which are the main products of export interest to Bangladesh.

## Maldives

Maldives provides EAMA to the extent of only 35% of its global imports. That is to say, that Maldives' sensitive list contain products which constitute 65% of its global imports. However when looked at from the point of view of its bilateral imports from South Asian partners, the EAMA into Maldives is 26% for India, 100% for Nepal, 33% for Pakistan and 26% for Sri Lanka. Maldives did not trade with Bangladesh, and Bhutan for the year under consideration (2004). When looked at from the point of view of the global exports of South Asian partners, the EAMA into Maldives is quite substantial. It is 75% for Bhutan,

78% for Bangladesh, 69% for India, 82% for Nepal, 82% for Pakistan and 74% for Sri Lanka.

## Nepal

Nepal provides EAMA to the extent of about 50% of its global imports. When looked at from the point of view of its bilateral imports from South Asian partners, the EAMA into Nepal is 71% for Bangladesh and 82% for Bhutan. India already has an FTA with Nepal. Nepal did not trade with Maldives, Pakistan and Sri Lanka for the year under consideration (2004). When looked at from the point of view of the global exports of South Asian partners, the EAMA into Nepal is minimal. It is 26% for Bhutan, 15% for Bangladesh, 40% for Maldives, 23% for Pakistan and 21% for Sri Lanka.

## Pakistan

Pakistan provides EAMA to the extent of 72% of its global imports. Pakistan offers substantial concessions in terms of this measure. When looked at from the point of view of its bilateral imports from South Asian partners, the EAMA into Pakistan is 69% for Bangladesh, 47% for Bhutan, 86% for India, 100% for Maldives, 74% for Nepal, and 66% for Sri Lanka. When looked at from the point of view of the global exports of South Asian partners, the EAMA into Pakistan is 23% for Bangladesh, 62% for Bhutan, 70% for India, 80% for Maldives, 44% for Nepal and 28% for Sri Lanka.

## Sri Lanka

Sri Lanka provides EAMA to the extent of only 35% of its global imports. When looked at from the point of view of its bilateral imports from South Asian partners, the EAMA into Sri Lanka is 10% for Bangladesh, 1% for India, 52% for Maldives, 82% for Nepal and 8% for Pakistan. Sri Lanka did not trade with Bhutan for the year under consideration (2004). When looked at from the point of view of the global exports of South Asian partners, the EAMA into Sri Lanka is 92% for Bangladesh, 66% for Bhutan, 2% for India, 34% for Maldives, 63% for Nepal and 50% for Pakistan.

# 5 ■ Estimation of Potential Trade under SAFTA with the Gravity Model

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## ■ INTRODUCTION AND REVIEW OF LITERATURE

The possibility of higher intra-regional trade has been revealed by the competitiveness, complementarity and intra-industry indices. The effective additional market access that countries may get due to SAFTA also indicates that SAFTA has an economic rationale. To further substantiate this argument we estimate the trade potential created under SAFTA using the standard gravity model. The difference between the predicted trade by the gravity model and the actual trade reflects the potential trade.

Since Tinbergen (1962) and Pöyhönen (1963), it has been well known that the simple gravity equation, in which the volume of trade between two countries is proportional to the product of their masses (GDPs) and inversely related to the distance between them, is able to explain bilateral trade to a large extent. In the literature, the basic gravity equation has been extended by a number of economists. In extended the Gravity Model, other explanatory variables typically included are level of development represented by per capita GDP and dummy variables reflecting contiguity; geographical and cultural proximity such as common borders and common language, and also participation in various regional trading arrangements. However, it is often argued that the Gravity Model suffers from the absence of a cogent derivation based on economic theory. Bhagwati (1992, 1993) and Panagariya (1995) have argued against proximity being an important determinant of international trade. On the other hand, there are several economists who have provided theoretical foundations for the Gravity Equation [Linnemann (1966), Anderson (1979), Bergstrand (1985, 1989), Helpman and Krugman (1985), Eaton and Kortum (2002), Harrigan (2002)]. Despite the existing debate, gravity models have produced statistically consistent results for the applied analysis

of international trade. It offers a systematic framework for measuring the patterns of bilateral as well as regional trade throughout the world and can be easily amenable to the analysis of regional influence in international trade (Frankel, Stein and Wei 1995).

With respect to the SAARC countries, there is a stream of literature which predicts potential trade in the region using different variations of gravity model. Hassan (2001) using 1997 data found that under SAFTA, the seven SAARC economies will not only reduce trade among themselves but also with the rest of the world (ROW). The study uses both panel and cross sectional data for 1996–2002 period to estimate trade creation and trade diversion effects under the present SAFTA regime, using the gravity model. This study found evidence of trade creation among the SAARC member countries, without any trade diversion with the rest of the world. Srinivasan (1994) and Srinivasan and Canonero (1995) used gravity models to estimate the gains of preferential trade agreement to South Asian countries and arrived at the results indicating that unilateral trade liberalisation may yield more gains for the region as compared to preferential trade agreement. Rahman et al. (2006) investigates the trade creation and trade diversion effects and find that intra-bloc export increases at the costs of reduction in extra-regional export. The extent of intra-bloc export creation in SAPTA member countries was found to be much lower than that of several other notable RTAs, viz., NAFTA, SADC, CAN, EAC and MERCOSUR.

Mehta and Bhattacharya (2000) have used the Srinivasan and Canonero (1993) type model to estimate the future trade flows, if SAPTA turns into SAFTA. In this model, bilateral trade has been regressed on GNP, per capita GNP, distance, tariff rates and real exchange rate. A log-linear version of unbalanced panel data model has been estimated, along with a cross-section and time-specific coefficients. The simulation results of this study show that the complete removal of tariffs

would enhance intra-regional trade by 160%. Ghosh (2003) has estimated the Gravity Model to capture the nature of India's trade with respect to different regions (NAFTA, EU, ASEAN, SAARC, etc.). The model is used for total trade, export and import functions separately. For export equation, NAFTA, EU, ASEAN as a region produced a positive and significant coefficient. For other countries and regions it has registered a negative sign, implying that those regions produce some kind of trade barrier for India's export to these countries.

With respect to South Asia and SAFTA, studies have argued that the potential trade is much higher than that what has been harnessed by South Asian countries. Frankel (1997) opined that South Asia behaves against the natural blocs' argument and may be the only exception. The estimates of Frankel and Wei (1995) indicate that trade between India and Pakistan is 70% lower than two otherwise identical economies. The issue of 'inverse regionalism' has been raised by Lahiri (1998) with respect to trade between India and Pakistan considering the role played by quantitative and administrative restrictions and political process. This notion has also been supported by ADB (Development Outlook, 2002, www.adb.org). According to it, intra-SAPTA exports were only 4.8% in 2000, the lowest of any of the PTAs. The model estimated by ADB was with respect to intra-SAPTA exports.

## ■ METHODOLOGY

The approach adopted in this study is to estimate a standard gravity model by including tariff faced by the exporting member country of SAFTA vis-à-vis the bilateral member partner country. The model is estimated with tariffs included. Given high tariff rates in South Asian countries, especially in their agriculture sector it becomes important to include tariff to explain bilateral trade flows. The coefficient of tariffs estimates the impact of tariffs on bilateral trade among SAFTA member countries. The potential bilateral trade is estimated without tariffs.

To estimate the effects of SAFTA among its members, we build on a standard gravity model, specified as follows:

$$\begin{aligned} \text{Log } T_{ijt} = & \beta_0 + \beta_1 \log (\text{GDP}_{it} * \text{GDP}_{jt}) + \beta_2 \log D_{ijt} \\ & + \beta_3 \log (\text{POP}_{it} * \text{POP}_{jt}) \\ & + \beta_4 \log (1 + \text{Tariff}_{ijt}) \\ & + \beta_4 \log (1 + \text{Tariff}_{ijt}') + e_{ijt} \end{aligned} \quad (1)$$

where  $T_{ijt}$  is the bilateral trade between countries  $i$  and  $j$  at time  $t$ ,  $\text{GDP}_{it}$  and  $\text{GDP}_{jt}$  are the gross domestic

product at constant prices of countries  $i$  and  $j$ .  $D_{ijt}$  is the distance between the two partners,  $\text{POP}_{it}$  and  $\text{POP}_{jt}$  are the populations in country  $i$  and country  $j$  at time  $t$ .  $\text{Tariff}_{ijt}$  is the tariff rate faced by the exporting country in the partner importing country while  $\text{Tariff}_{ijt}'$  is the tariff imposed by importer country  $i$  to country  $j$ .

Panel data for seven countries for a ten-year period, i.e. 1995–2005 is used to estimate the model, the utilisation of which requires special treatment of the error terms shown in equation (1). A more general expression of the error term can be written as follows:

$$e_{ijt} = u_i + v_j + w_t + \mu_{ijt} \quad (2)$$

where  $u$  and  $v$  are country specific effects;  $w$  is temporal effect and  $\mu$  is random effects.

The first two explanatory variables capture the idea that larger and richer countries trade more than small and poor countries. The *product of GDP* of trading countries measures the size of the economy of trading partners while the product of populations captures the per capita purchasing power in the country. This reflects the country's stage of development. According to Martinez-Zarzoso and Nowak-Lehmann (2003) the coefficient of *population* of the exporters may have negative or positive sign depending on whether the country exports less when it is big (absorption capacity) or whether a big country exports more compared to a small country (economies of scale). For similar reasons the coefficient of importer *population* may have negative or positive sign. *Distance* indicates the impact of geographical proximity on bilateral trade flows lesser the distance lower will be the transport and information costs. A negative coefficient is expected in the distance variable and positive coefficients in all other variables.

Annual data on bilateral trade flows for the period 1995–2005 for SAARC countries has been collected from WITS data set (World Bank). GDP (at constant prices) data has been gathered from World Development Indicators (World Bank). The information on distance variable has been downloaded from <http://www.cepii.com/distance>. We estimate an augmented gravity equation in (1) using panel data for year 1995–2005. Matyas (1997), Matyas (1998) and Egger (2000) demonstrated that a panel data approach obtains better results compared to a cross-section approach since the former allows capturing business cycle phenomenon faced by the trading partners, and helps to disentangle time-invariant country-specific effects. Incorporation of country-pair specific fixed effect is the best way to control for heterogeneity in gravity model (Cheng and Wall 2005). Accordingly, the

gravity model developed in this paper is estimated by using panel data approach with country-pair specific as well as year-specific fixed effects.

We estimate Fixed Effect Model (FEM) and Random Effect Model (REM). According to the literature (Egger 2000) FEM is better suited to when estimating typical trade flows between ex-ante predetermined selections of countries. We also use Hausman Test to arrive at the more appropriate model. The test is undertaken for the null hypothesis of no correlation between the individual effects and the regressors. The test also indicates FEM to be more appropriate. Likewise results of FEM are reported.

Since the effect of variables that do not change overtime, e.g. distance cannot be estimated directly by FEM as inherent transformation drops the variable, we use two step method, i.e. we estimate in second step using individual effects as dependent variable and distance and other dummies as explanatory variables.

## ■ THE EMPIRICAL RESULTS FROM THE GRAVITY MODEL

This section examines whether the factors indicated in the gravity equation make a significant contribution to an explanation of the trade flows in the SAFTA region. The gravity model has been tested both for the aggregate bilateral trade and also for product level trade. In the literature, aggregate gravity model has been estimated using different data set by Wang and Winters (1991), Hamilton and Winters (1992), Baldwin (1994), Breuss and Egger (1999), etc. Bergstrand (1989) and Feenstra et al. (2001) has estimated product specific models. In the present study, it was not possible to

estimate gravity model for all sectors due to non-availability of sectoral data for the period under consideration. Therefore, the gravity equation is fitted on aggregate data and on some selected sectors. The results for gravity equation are presented in the Table 5.1.

The results presented in Table 5.1 (Column 1) show that the coefficient of GDPs in both the exporting country and the importing country has a significant positive impact on the bilateral trade between the two countries. The coefficient of the product of populations of the two countries captures the per capita purchasing power in the country and reflects the country's stage of development. The coefficient is positive and significant indicating that countries with higher level of development are trading more with each other. Weighted tariffs are found to have a statistically significant negative effect as expected. Column 2 of Table 5.1 is estimated, which includes tariffs as one of the explanatory variable. The results with respect to GDP and population are found to be robust as they do not change with specification.

Using the two-step approach, distance dummy is found to have a significant negative impact on bilateral exports (Column 3). Distance is indicative of transport cost between the partner countries. The coefficient for the land border dummy (D4) is not found to be significant. It implies that common border is not an important variable in the SAFTA region in explaining the existing trade flows. A number of political and economic explanations can be attributed to this effect. It is also well known that there is huge informal trade between adjoining countries but has not taken formal route due to political differences in major economies.

Table 5.1 Gravity Model Estimates for member countries in SAFTA

Dependent Variable: $\ln \text{Exports}_{ijt}$	Column 1	Column 2	Column 3 (Fixed Effects from Equation 2)
$\ln (\text{GDP}_i * \text{GDP}_j)$	0.44*** (3.45)	0.41** (2.82)	
$\ln (\text{Pop}_i * \text{Pop}_j)$	0.34** (2.79)	0.34** (2.06)	
$\ln (\text{Tariffs weighted } ji)$	–	–0.22** (–2.18)	
$\ln (\text{Tariffs weighted } ij)$	–	–0.22** (–2.18)	
Distance dummy	–	–	–0.001* (–1.89)
Border dummy	–	–	–1.37 (–0.64)
Language dummy	–	–	3.22** (2.22)
Constant	–	–	13.29*** (4.90)
Number of observations	231	198	42
Log Amemiya prob cr	–1.96	1.97	
R-sq (between)	0.71	0.59	0.20
Akaike Info. Crt.	1.25	1.36	

\* is significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%.

However, common ethnic language is found to influence bilateral trade amongst the SAFTA member countries. This may imply that common cultures lead to higher trade between countries.

## ■ ESTIMATES OF POTENTIAL TRADE

Potential intra-regional trade under SAFTA is estimated using the coefficients (Equation 1) arrived at by the fixed effect models presented in Table 5.1. The results are presented in Table 5.2.

**Table 5.2 Trade Potential in SAFTA (US Bn \$), 1995–2005**

	Potential Trade	Actual Trade	GAP (% of Actual Trade)
Using coefficients of equation 2 (without tariffs)	85.1	38.5	120
Using coefficients of equation 1 (with tariffs)	54.0	38.5	40
For the year 2004	9.0	5.8	55

The estimates show that the potential trade among the SAFTA member countries as predicted by the gravity model is 120% more than the actual trade. A number

of studies have estimated potential trade as the difference between trade predicted by the gravity model and actual trade. The entire difference between predicted and actual trade has been attributed to tariffs and it has been argued that removal of tariffs will increase trade to the predicted level. However, the entire difference between the predicted trade and actual trade may not be due to tariffs. The results show that 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.

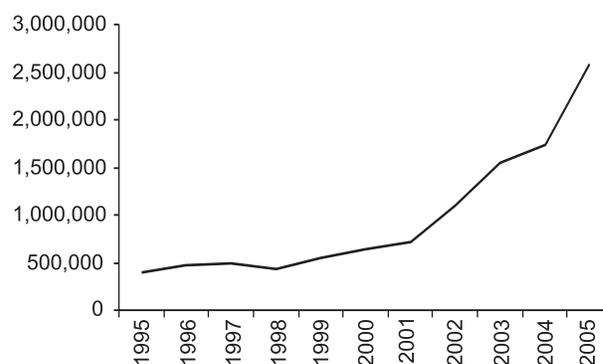
Table 5.3 presents potential and actual bilateral trade (taking average of the period 1995–2005) for different trading partners in SAFTA. The results show that the gap between actual and potential trade on an average for each trading partner is of around 55%. The trading partners have very little bilateral trade and can increase their trade by almost 100%. These are Bhutan and Maldives; Bhutan and Sri Lanka; Maldives

**Table 5.3 Bilateral Potential and Actual Trade: Average (1995–2005)**

Trading Partners		Potential Trade (US\$)	Actual Trade(US\$)	GAP between Actual and Potential Trade (%)
Bangladesh	Bhutan	74,122,629	1,851,748	97.5
Bangladesh	India	1,649,726,827	1,169,270,758	29.1
Bangladesh	Maldives	62,313,028	33,754	99.9
Bangladesh	Nepal	260,668,335	5,151,398	98.0
Bangladesh	Pakistan	707,113,385	176,874,180	75.0
Bangladesh	Sri Lanka	337,726,970	17,630,354	94.8
Bhutan	India	203,427,095	89,076,530	56.2
Bhutan	Maldives	7,757,506	794	100.0
Bhutan	Nepal	31,459,064	301,755	99.0
Bhutan	Pakistan	84,788,140	369,448	99.6
Bhutan	Sri Lanka	39,226,671	3,192	100.0
India	Maldives	172,314,889	26,263,194	84.8
India	Nepal	699,049,061	571,226,702	18.3
India	Pakistan	1,884,185,017	340,488,988	81.9
India	Sri Lanka	871,776,252	969,255,660	-11.2
Sri Lanka	Pakistan	383,773,384	127,775,924	66.7
Sri Lanka	Maldives	35,445,306	59,066,225	-66.6
Sri Lanka	Nepal	142,559,703	1,375,802	99.0
Maldives	Nepal	27,397,294	468	100.0
Maldives	Pakistan	73,840,899	1,988,579	97.3
Nepal	Pakistan	299,656,776	3,955,535	98.7
Average Intra-Regional Trade		8,048,328,229	3,561,960,989	55.7

and Nepal; and Bangladesh and Maldives. On the other hand, some trading partners are trading more than their potential trade, e.g. India and Sri Lanka and Sri Lanka and Maldives. A free trade agreement between India and Sri Lanka in 2000 increased the trade substantially. Between 2000–05, there was almost a 300% increase in trade between the two countries (as seen in Figure 5.1).

However, signing of an FTA, i.e. reducing tariffs in itself may not imply that the entire potential to trade may be exhausted as can be seen in the case of Sri Lanka and Pakistan. After an FTA between Sri Lanka and Pakistan in 2002, trade between the two countries increased manifold but still remains low and can be further increased by 66%. Highest trade potential exists between India and Bangladesh followed by India and Pakistan. Though India and Bangladesh have realised



**Fig 5.1 Bilateral Trade between India and Sri Lanka: 2000–05 (US\$'000)**

*Source:* World Integrated Trade Solutions (WITS).

their trade potential to a large extent, India and Pakistan are still to realise around 80% of their trade potential.

# 6 ■ Impact of SAFTA on Member Countries: General Equilibrium Analysis

## ■ INTRODUCTION

To assess the economic-wide impact of various SAFTA scenarios on the member countries the study uses a CGE model. The latest GTAP Version 6.02 (limited release) version has been used for this purpose. The advantage of using this version is that it includes Pakistan, the second largest economy in the region, as a separate entity. In the earlier Version 6.00 Pakistan was clubbed with the Rest of South Asia (with ABMN), and hence results could not be discretely attributed to Pakistan.

ABMN are counted as one aggregation in the present GTAP model, and labeled as ABMN. Bangladesh, India and Sri Lanka are the other separate entities that have been taken in the aggregation. In order to get as disaggregated sector level results as possible, no sectoral level aggregations were created in the prepared database.

The following steps have been undertaken to estimate the economy-wide impact of various scenarios of SAFTA on the member countries.

1. SAFTA implementation takes place as per applied MFN tariffs subsisting on 1 January 2006. The implementation commenced on 1 July 2006. The GTAP simulations must take a base that reflects this position. In this case the GTAP database was updated till 2005 (based on tariff changes obtained from TRAINS). The database was also subjected to shocks to take incorporate the significant grant of concessions by India to Sri Lanka under the Indo Lanka FTA. Since the GTAP base database was of 2001, it was assumed that all other concessions (since they pre-dated 2001) were taken into account in the base equilibrium of the model.
2. This equilibrium was shocked to take into account what may be described as the 1st phase of SAFTA implementation

- Reduction of tariffs by developing countries to 20% by 2008
  - Reduction of tariffs by LDCs to 30%
  - Reduction of tariffs of developing countries vis-à-vis imports from SAARC LDCs to 0–5% by 2009
  - Reductions in three categories above (a, b & c) all subject to the sensitive lists.
  - The results provide an updated database that simulates the equilibrium of 2008–09.
3. The 2008–09 base was then shocked completely to equate a 2013–16 situation where all SAFTA duties are brought to zero. A best case scenario of complete elimination of sensitive lists is also assumed in this shock.

## ■ IMPACT OF SAFTA

The GTAP model provides sophisticated analysis of possible direct effects of SAFTA including various feedback effects across several sectors and countries. The modeling results offer valuable quantitative information. The fact that some of the policy scenarios have already been set (and in fact implementation of them has already commenced), adds to the greater precision with which the GTAP model can be used as a predictive tool. A word of caution is required in interpreting the results of the model. Given the various limitations of this technique, the results of the model should be taken only as indicative about the direction of the impact. More importantly, the results with respect to welfare gained should be interpreted in terms of marginal gains or losses as the term ‘welfare’ itself is ambiguous.

The simulations indicate that welfare effects of SAFTA will be high for countries like India and Bangladesh while Pakistan and Sri Lanka will only gain marginally in terms of welfare. There is an indication of welfare loss for the rest of the world with SAFTA progressing (Table 6.1).

**Table 6.1 Impact of SAFTA on Welfare**

Country	Welfare Effects
Bangladesh	265.8
India	366.0
Pakistan	82
Sri Lanka	13.8
Rest of South Asia	130.7
Rest of the World	-438.8

The results for each of the following countries are as follows:

### Bangladesh

Bangladesh's welfare gains are one of the highest for South Asian countries. Its high welfare gains like that of India,<sup>1</sup> may be attributed to the complete liberalisation of high MFN tariffs, which generate benefits, for both user industries as well as household consumers. Bangladesh also experiences significant rise in global exports, i.e. 4.31% on account SAFTA (Table 6.2). Export gains for Bangladesh in SAFTA markets in the 1st phase of liberalisation (2008–09) are significant, but not as high as the peak export growths to SAFTA seen by other members.

**Table 6.2 Impact of SAFTA on Output, Employment and Trade: Bangladesh (% change)**

Year	Output	Effect on Unskilled Employment	Exports to South Asia	Global Exports	Global Imports
2008-09	-0.01	0.0001	38.08	0.19	0.27
2016	-0.03	0.0001	14.43	4.31	5.47

The lack of strong growth may be attributed to India's sensitive list, but it is in fact seen in the full liberalisation scenario (where all countries liberalise tariffs even on sensitive list items), Bangladesh does not make any significant regional export gains despite liberalisation of sensitive list items, including garments. However, the most interesting result, is that its global exports see a significant 5% rise in the second phase. Most of this growth is to regions outside South Asia.

These results are not very surprising. A disaggregated look at global export data shows Bangladesh's global exports grow largely due to increased exports of wearing apparel. 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. If Bangladesh's actual 2005–06 apparel exports are

considered global exports of Wearing Apparel show increase of nearly US\$ 500 million, of which only US\$ 6 million are apparel exports to South Asian countries. Thus 98% of the increase wearing apparel exports are to countries outside South Asia.

A plausible explanation for rise in imports of Bangladesh in wearing apparels may be that the wearing apparel industry in Bangladesh gains by being able to source lower cost textiles from South Asia (since tariffs in all items including intermediate products like textiles are removed in simulated Phase II of SAFTA). A look at weighted tariff data also shows that Bangladesh has the highest level of tariffs in textiles among the bigger countries in the region (see Table 6.3). This is also corroborated by the fact that in SAFTA Phase II, India's textiles exports to Bangladesh go up by 84%, and that 90% of India's total South Asian textile exports increase go to Bangladesh. Similarly with Pakistan 95% exports rise of textile go to Bangladesh. The results also show that Bangladesh's global imports of textiles rise by about 10% and a reduction in import prices of textiles to the extent of about 3.3%.

**Table 6.3 Trade Weighted Tariffs in Textiles in South Asia**

Country	Ad Valorem Rates
Bhutan	27
Bangladesh	25
India	26
Sri Lanka	0
Maldives	20
Nepal	10
Pakistan	17
Average South Asia	17

The total output of Bangladesh does not show any significant change, but SAFTA induces a reallocation of output, with major production increases seen in wearing apparel (5.5%) and leather sectors (3%). This is a positive result since these sectors tend to be highly employment-intensive. In fact, it appears that 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.

In terms of impact on employment, we find that the sectors that gain most due to SAFTA are wearing

<sup>1</sup> Note: Both countries also have the highest tariffs in the region.

**Table 6.4 Bangladesh Employment Gaining Sectors  
(% change)**

Winning Sectors	Employment Increase
Wearing apparel	5.90
Leather products	3.60
Chemical, rubber, plastic products	2.32
Cereal grains n.e.c.	1.48
Wood products	1.25
Forestry	1.20
Metals n.e.c.	1.12
Beverages and tobacco products	0.81
Processed rice	0.73

apparels, leather products, chemicals, cereal grains, wood products, forestry, metal (n.e.c), beverages and tobacco products and processed rice (Table 6.4). While sectors which lose out on employment due to SAFTA are petroleum products, meat products, transport equipment, electronic equipment, dairy products, metal products, gas, crops, sugar cane and sugar beet (Table 6.5).

**Table 6.5 Bangladesh Employment-Losing Sectors  
(% change)**

Losing Sectors	Employment Decrease
Petroleum, coal products	-48.82
Meat products n.e.c.	-26.92
Transport equipment n.e.c.	-16.00
Electronic equipment	-6.21
Dairy products	-5.67
Metal products	-2.88
Machinery and equipment n.e.c.	-2.66
Gas	-2.17
Crops n.e.c.	-2.10
Sugarcane, sugarbeet	-1.95

## India

A full SAFTA will help India to nearly double its exports to South Asia (Table 6.6). 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, where output in 'Other meat products' shows an increase of over 100%, indicative of the high level of demand of poultry and high levels of protection of the same in the region. 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

**Table 6.6 Impact of SAFTA on Output,  
Employment and Trade: India (% change)**

Year	Output	Effect on Unskilled Employment	Exports to South Asia	Global Exports	Global Imports
2008-09	0	-0.00001	3.41	0.09	0.11
2016	0.08	0.00002	90.44	1.19	1.68

in this sector increasing by 10–40%. This result is validated by the fact that countries like Bangladesh and Pakistan do maintain high tariffs in the auto industry. India's global wearing apparel imports increase by 7% and with its output declines by 2.5%. The increase in imports is not significant in absolute terms; because India's global import base is low (about \$30–35 million in 2004). The decline in output is therefore largely attributable to loss in exports to the rest of the world (about 3.3% decline), which may be attributed to an increased competitiveness of Bangladesh in the wearing apparel sector.

India's auto sector grows by 1–4% on account of SAFTA, with its exports to the region increasing by 10–40%. This result is validated by the fact countries like Bangladesh and Pakistan do maintain high tariffs in the auto industry.

India's global wearing apparel imports increase by 7% and while its output declines by 2.5%. The increase in imports is not significant in absolute terms, because India's global import base is low (about \$30–35 million in 2004). The decline in output is therefore largely attributable to loss in exports to the rest of the world (about 3.3% decline), which may be attributed to an increased competitiveness of Bangladesh in the wearing apparel sector.

In terms of impact of SAFTA on employment (Table 6.7), the following sectors gain in terms of employment generation.

**Table 6.7 India Employment Gaining Sectors  
(% change)**

Winning Sectors	Employment Increase
Meat products n.e.c. (poultry, etc.)	116.67
Transport equipment n.e.c.	3.80
Petroleum, coal products	2.68
Sugar	1.33
Mineral products n.e.c.	1.19
Motor vehicles and parts	0.88
Dairy products	0.83
Paper products, publishing	0.64
Sugarcane, sugarbeet	0.63

However, SAFTA leads to loss of employment in the following sectors (Table 6.8).

**Table 6.8 India Employment-Losing Sectors**  
(% change)

Losing Sectors	Employment Decrease
Wearing apparel	-2.46
Leather products	-2.08
Manufactures n.e.c.	-1.79
Bovine meat prods	-1.37
Metals n.e.c.	-1.17
Vegetable oils and fats	-0.66
Plant-based fibers	-0.45
Wool, silkworm cocoons	-0.45
Minerals n.e.c.	-0.36
Textiles	-0.24

### Pakistan

Like India, a full SAFTA for Pakistan will help it double its exports to South Asia (Table 6.9). 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.

**Table 6.9 Impact of SAFTA on Output, Employment and Trade: Pakistan (% change)**

Year	Output	Effect on Unskilled Employment	Exports to South Asia	Global Exports	Global Imports
2008-09	0.01	0	5.52	0.17	0.19
2016	0.02	-0.0001	102.41	0.77	1.54

GTAP shows a very interesting result in the case of both India and Pakistan. 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. A detailed look at disaggregated data reveals that more than 50% of Pakistan's gains from SAFTA, are from increased exports to Bangladesh in textiles alone.

In terms of impact of SAFTA on employment, the following sectors gain in terms of employment generation (Table 6.10).

However, SAFTA leads to loss of employment in the following sectors (Table 6.11).

**Table 6.10 Pakistan Employment Gaining Sectors**  
(% change)

Winning Sectors	Employment Increase
Food products n.e.c.	5.59
Wheat	2.34
Vegetables, fruit, nuts	2.27
Wool, silkworm cocoons	1.49
Meat products n.e.c. (poultry etc.)	1.21
Machinery and equipment n.e.c.	1.01
Processed rice	0.55
Manufactures n.e.c.	0.55
Cereal grains n.e.c.	0.54
Textiles	0.48

**Table 6.11 Pakistan Employment Losing Sectors**  
(% change)

Losing Sectors	Employment Decrease
Leather products	-3.31
Wearing apparel	-3.12
Metal products	-2.28
Sugar	-2.17
Oil seeds	-2.12
Sugarcane, sugarbeet	-1.66
Chemical, rubber, plastic products	-1.20
Paddy rice	-1.08
Metals n.e.c.	-1.04
Vegetable oils and fats	-0.90

### Sri Lanka

Sri Lanka's gains in the first phase of liberalisation are almost nil (Table 6.12). 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.

**Table 6.12 Impact of SAFTA on Output, employment and Trade: Sri Lanka (% change)**

Year	Output	Effect on Unskilled Employment	Exports to South Asia	Global Exports	Global Imports
2008-09	0.1	0	2.52	0.05	0.14
2016	0.55	-0.000107	58.78	0.72	1.98

Sri Lanka's gains are 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%. While relative changes in some of the products are quite high, their absolute outputs are quite low compared to the total output of the Sri Lankan economy. Negative employment and output effects are seen for wearing apparel and some agricultural products.

In terms of impact of SAFTA on employment, the following sectors gain in terms of employment generation (Table 6.13):

**Table 6.13 Sri Lanka Employment Gaining Sectors (% change)**

Winning Sectors	Employment Increase
Oil seeds	42.22
Vegetable oils and fats	20.75
Dairy products	20.00
Transport equipment n.e.c.	11.05
Textiles	4.44
Metal products	2.23
Paper products, publishing	1.71
Raw milk	1.57
Machinery and equipment n.e.c.	1.45
Ferrous metals	0.90

However, SAFTA leads to loss of employment in the following sectors (Table 6.14):

**Table 6.14 Sri Lanka Employment Losing Sectors (% change)**

Losing Sectors	Employment Decrease
Manufactures n.e.c.	-4.27
Processed rice	-3.67
Motor vehicles and parts	-2.72
Leather products	-2.45
Paddy rice	-1.69
Metals n.e.c.	-1.45
Wearing apparel	-1.24
Food products n.e.c.	-1.20
Beverages and tobacco products	-1.05
Minerals n.e.c.	-0.81

## ABMN

Though the ABMN group gets 0 duty access to the developing countries by 2009 itself, its gains are limited on account of their inability to access agricultural products markets, which are blocked by the sensitive lists of the developing countries (Table 6.15).

There are 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

**Table 6.15 Impact of SAFTA on Output, Employment and Trade: BMNA (% change)**

Year	Output	Effect on Unskilled Employment	Exports to South Asia	Global Exports	Global Imports
2008-09	0.03	-0.0004	20.82	0.74	1.96
2016	0.26	0.0002	60.32	7.89	11.99

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. ABMN countries may therefore want to preserve the sensitive list flexibility for a longer time, especially in employment intensive sectors like apparel.

In terms of impact of SAFTA on employment, the following sectors gain in terms of employment generation (Table 6.16):

**Table 6.16 BMNA Employment Gaining Sectors (% change)**

Winning Sectors	Employment Increase
Metals n.e.c.	29.44
Meat products n.e.c.	15.31
Crops n.e.c.	11.73
Ferrous metals	10.95
Animal products n.e.c.	8.02
Chemical, rubber, plastic products	7.90
Raw milk	7.85
Vegetable oils and fats	2.97
Sugarcane, sugarbeet	2.29
Vegetables, fruit, nuts	2.12

However, SAFTA leads to loss of employment in the following sectors (Table 6.17):

**Table 6.17 ABMN Employment-Losing Sectors (% change)**

Losing Sectors	Employment Decrease
Motor vehicles and parts	-30.32
Transport equipment n.e.c.	-22.68
Petroleum, coal products	-9.09
Manufactures n.e.c.	-8.71
Wheat	-8.35
Machinery and equipment n.e.c.	-8.07
Electronic equipment	-7.07
Textiles	-6.78
Wearing apparel	-6.17
Plant-based fibers	-5.68

## ■ CONCLUSION

The results of the simulation indicate that the net economic impacts of SAFTA are beneficial, as a whole. However, the following points come out clearly:

- Gains to LDCs are modest in the first phase of liberalisation.
- LDC gains are significant in the second phase, provided there is complete liberalisation.
- Bangladesh's significant gains are in terms of higher employment in the apparel sector (5%) and leather sector (3%). Losses are there for some manufacturing products (electronics, transport and machinery/equipment).
- Bangladesh's apparel sector gains more on account of its increase in global exports.
- SAFTA may give Afghanistan an increased access to Pakistan's market.
- Interestingly, increase in gains to Bangladesh's wearing apparel sector are more on account of its improved global exports which increase as much as 6% on account of SAFTA, presumably because Bangladesh's own high textile tariffs are removed. As a result of SAFTA phase II, Bangladesh's global exports of wearing apparel show increase of about USD million 262 million, of which only USD 3 million are apparel exports to South Asian countries. Thus 98% of wearing apparel exports are to the rest of the world. This is also corroborated by the fact that in SAFTA phase II, India's textiles exports to Bangladesh increase by 84%, and from that 90% of India's total South Asian textile exports increase goes to Bangladesh. Similarly with Pakistan, where 95% of the rise in exports are to Bangladesh.
- ABMN gain in some agricultural and chemical products. There are losses in manufacturing including textiles and apparel.
- But overall employment effects are positive for Bangladesh and ABMN.
- India's gains are limited to some agricultural sectors like sugar, poultry, dairy and manufactures like motor vehicles. There are losses to sectors like wearing apparel and leather.
- Pakistan gains mainly in wheat, horticulture and textiles. Losses likely in sugar and wearing apparel.
- Sri Lanka gains are limited since it already has an FTA with India, and is about to conclude an FTA with Pakistan.
- Bhutan and Nepal may have only limited gains since they already have an FTA with India.
- India and Pakistan gain in terms of exports to Bangladesh.
- India's gains are not much if Pakistan partially participates in SAFTA.
- 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
- By 'locking in' uniform trade and investment policies among member countries, an RTA may help to promote policy credibility. Group action may influence all members to abide by a common reform agenda. Of course, RTAs do not guarantee equal distribution of benefits to members.
- 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, and could have growth enhancing effects for the region. This is also due to the fact that India's MFN tariffs are among the highest in the region.
- SAFTA will present firms in member countries with the opportunity to exploit economies of scale through access to a enlarged and diversified market.
- The economic benefits from an RTA has been justified in terms of greater trade creation than trade diversion by its members. Net trade creation offer dynamic gains from trade and provide the fundamental argument for free trade and economic growth. The GTAP modeling results point to net welfare gains for the region as a whole and suggests that SAFTA will be trade creating.
- Intra-SAARC trade was quite small till about 1999, has grown significantly since then, largely on account of increased exports from India.
- SAFTA may promote greater rapprochement, diplomacy and stability. GTAP results suggest that all countries experience welfare gains, but it would be important to give flexibilities for countries to protect their vulnerable sectors – this is particularly the case for manufacturing sector in the smaller LDCs.

# 7 ■ Revenue and Welfare Implications of SAFTA: Partial Equilibrium Analysis

## ■ INTRODUCTION

The trade theory argues that trade liberalisation enhances economic efficiency, promotes growth and helps correct domestic market failures in imperfectly competitive markets. However, these benefits have associated costs, one of which is the loss of trade tax revenue. Trade taxes constitute an important part of government revenue in developing countries. In general, it is found that countries' reliance on revenues from taxes on international trade is inversely related to their income levels (Baunsgaard and Keen 2005). Given this, tariff loss due to trade liberalisation may be substantial for SAFTA member countries, therefore welfare implications of trade liberalisation become an important issue.

Recent research suggests that for developing countries with binding government budget constraints, it is a priority to implement comprehensive reform packages of the domestic tax system to accompany trade liberalisation. Baunsgaard and Keen (2005) use panel data of over 25 years for 111 countries and show that high-income countries in fact recovered the revenues they have lost from other sources from past episodes of trade liberalisation. For middle-income countries, recovery has been in the order of 45–60 cents for each dollar of lost trade tax revenue, with signs of close to full recovery when separately identifying episodes in which trade tax revenues fell. Troublingly, however, revenue recovery has been extremely weak in low-income countries (most of which depend on trade tax revenues): they have recovered, at best, no more than about 30% of each lost dollar. The view that loss of tariff revenue may have adverse implications for tariff-dependent developing countries, as it may lead to lower government expenditure as the entire loss is not recovered by taxes, has been supported by many

studies in the literature (Emran and Stiglitz 2005, Munk 2005, Atolia 2006).

It is although argued about the loss of revenue to the government may not be fully recovered through alternative source, very few studies have actually estimated the extent of revenue loss to countries under SAFTA. In this chapter, we use the partial equilibrium model to estimate the impact of zero tariff regime on the revenue and welfare of SAFTA member countries.

## ■ REVENUE, WELFARE AND TRADE EFFECTS: METHODOLOGY

Revenue, Welfare and Trade Effects have been estimated using UNCTAD/World Bank SMART model. SMART is a partial equilibrium model simulating the impact of a tariff change on trade flows, tariff revenue and consumer welfare for a single market.<sup>1</sup> It focuses on one importing market and its exporting partners and assesses the impact of a tariff change scenario by estimating new values for a set of variables.

The theoretical framework of SMART on the export side assumes that, for a given good, different countries compete to supply a given home market. The focus of the simulation exercise is on the composition and volume of imports into that market. Export supply of a given good by a given country supplier is assumed to be related to the price that it fetches in the export market. The degree of responsiveness of the supply of export to changes in the export price is given by the export supply elasticity. SMART assumes infinite export supply elasticity – that is, the export supply curves are flat and the world prices of each variety are exogenously given. This is often called the price-taker assumption. SMART can also operate with finite elasticity – upward sloping export supply functions – which entails a price effect in addition to the quantity effect.

<sup>1</sup> SMART rests on the Armington assumptions.

To model the behaviour of the consumer, SMART relies on the Armington assumption. In particular, the adopted modelling approach is based on the assumption of imperfect substitution between different import sources (different varieties). That is, goods (defined at the HS 6-digit level) imported from different countries, although similar, are imperfect substitutes. In the SMART modelling framework, a change in trade policy (tariff liberalisation) affects not only the price index/level of the composite good but also the relative prices of the different varieties. SMART reports the results of any trade policy shock on a number of variables, including tariff revenue, consumer surplus, and welfare.

Tariff revenue change on a given import flow is computed simply as the final advalorem tariff multiplied by the final import value minus the initial advalorem tariff multiplied by the initial import value. Using SMART simulations, an attempt has been made to estimate revenue effect of tariff reduction by 100%. Revenue effect of 100% tariff reduction are also cross checked by multiplying simple and weighted average tariff with total import value of the country. Welfare and trade creation effect of 100% tariff reduction has also been estimated by SMART modelling.

## ■ REVENUE, WELFARE AND TRADE EFFECTS: RESULTS

### Impact on Bangladesh

Tables 7.1 and 7.2 indicate bilateral revenue, welfare and trade effects of zero tariffs under SAFTA for Bangladesh.

- Revenue losses to Bangladesh are estimated to be about \$0.9 billion on the basis of SMART simulation while it is \$0.5 billion on the basis of weighted average tariff and 0.23 billion in case of simple average. Maximum revenue loss of \$0.88

billion is due to tariff cut by 100% on imports from India (Table 7.1).

- There are welfare gains for Bangladesh and other SAARC countries from 100% tariff reduction by Bangladesh. Welfare gains for all seven countries amounts to \$0.8 billion and maximum welfare gains are due to tariff cuts by India and Bangladesh (Table 7.2).
- 100% tariff reduction by Bangladesh creates trade of approximately \$0.27 billion (Table 7.2).

**Table 7.2 Effect of 100% Tariff Cuts on Welfare and Trade: Bangladesh**

	(\$ '000)	
Partner Country	Welfare Effect	Total Trade Effect
India–Bangladesh	766,355	269,669
Bhutan–Bangladesh	0	0
Pakistan–Bangladesh	29,299	6,173
Sri Lanka–Bangladesh	127	3,593
Nepal–Bangladesh	32	133
<b>Total effect</b>	<b>795,813</b>	<b>279,569</b>

### Impact on India

Tables 7.3 and 7.4 indicate bilateral revenue, welfare and trade effects in case India cuts tariff by 100% for SAFTA member countries.

- Revenue losses to India are about \$0.12 billion on the basis of SMART simulation while it is also approximately \$0.1 billion on the basis of simple and weighted average tariff. Results are quite consistent in both the approaches (Table 7.3).
- There are welfare gains for India and other SAFTA member countries from 100% tariff reduction by India. Welfare gains for all seven countries amount to be \$0.8 billion (Table 7.4).
- In case of 100% tariff reduction by India, trade increased by approximately \$0.7 billion (Table 7.4).

**Table 7.1 Effect of 100% Tariff Cuts on Revenue: Bangladesh**

	(\$ '000)			
Partner Country	Revenue Effect: Using SMART Simulations	Revenue Effect (using simple average)	Revenue Effect (using weighted average)	Bangladesh Imports
India–Bangladesh	–887,442	–202,676	–505,603	1,278,712
Bhutan–Bangladesh	0	0	0	0
Pakistan–Bangladesh	–25,858	–29,672	–26,098	142,379
Sri Lanka–Bangladesh	–1,954	–1,910	–2,094	9,567
Nepal–Bangladesh	0	–28	–7	129
<b>Total effect</b>	<b>–915,254</b>	<b>–234,286</b>	<b>–533,802</b>	<b>10</b>

Table 7.3 Effect of 100% Tariff Cuts on Revenue: India

(\$ '000)

Partner Country	Revenue Effect: Using SMART Simulations	Revenue Effect (using simple average)	Revenue Effect (using weighted average)	India Imports
Bangladesh–India	-15,074	-38,910	-28,516	127,533
Nepal–India*	-67,904	-13,208	-15,258	89,123
Bhutan–India*	-8,795	-13,484	-10,044	89,123
Maldives–India	-392	-275	-311	1,987
Pakistan–India	-27,536	-30,755	-38,903	180,274
Sri Lanka–India*	-2,265	-21,518	-3,132	579,993
<b>Total effect</b>	<b>-121,967</b>	<b>-118,150</b>	<b>-96,165</b>	

\* Actual revenue loss may be much lower as India allows significant imports from these countries at zero duty

Table 7.4 Effect of 100% Tariff Cuts on Welfare and Trade: India

(\$ '000)

Partner Country	Welfare Effect	Total Trade Effect
Nepal–India*	23,996	148,675
Bhutan–India*	3,247	17,490
Maldives–India	2,850	21,941
Pakistan–India	9,180	99,290
Sri Lanka–India*	13,858	162,261
Bangladesh–India	766,355	269,669
<b>Total effect</b>	<b>819,486</b>	<b>719,326</b>

\* Actual trade creation may be much lower as India allows significant imports from these countries at zero duty

Table 7.6 Effect of 100% Tariff Cuts on Welfare and Trade: Pakistan

(\$ '000)

Partner Country	Welfare Effect	Total Trade Effect
Bangladesh–Pakistan	29,299	6,173
Bhutan–Pakistan	0	0
India–Pakistan	9,180	99,290
Maldives–Pakistan	33	192
Nepal–Pakistan	19	214
Sri Lanka–Pakistan	970	7,641
<b>Total effect</b>	<b>39,502</b>	<b>113,510</b>

Table 7.5 Effect of 100% Tariff Cuts on Revenue: Pakistan

(\$ '000)

Partner Country	Revenue Effect: Using SMART Simulations	Revenue Effect (using simple average)	Revenue Effect (using weighted average)	Pakistan Imports
Bangladesh–Pakistan	-1,273	-9,948	-3,756	55,886
Bhutan–Pakistan	0	-105	-69	572
India–Pakistan	-49,483	-67,474	-43,656	576,701
Maldives–Pakistan	-35	-488	-845	3,421
Nepal–Pakistan	-219	-574	-330	4,023
Sri Lanka–Pakistan	-4,725	-7,332	-3,705	70,973
<b>Total effect</b>	<b>-55,735</b>	<b>-85,921</b>	<b>-52,360</b>	

### Impact on Pakistan

Tables 7.5 and 7.6 indicate bilateral revenue, welfare and trade effects in case India cuts tariff by 100% for SAFTA member countries

- Revenue losses to Pakistan are about \$0.055 billion on the basis of SMART simulation while it is \$0.085 and 0.052 billion on the basis of simple and weighted average tariff (Table 7.5).
- There are welfare gains for Pakistan and other SAARC countries from the 100% tariff reduction

by Pakistan. Welfare gains for all seven countries amounts to be \$39 million and maximum welfare gains are due to India and Pakistan (Table 7.5).

- 100% tariff reduction by Pakistan creates trade approximately \$0.11 billion (Table 7.6).

### Impact on Sri Lanka

Tables 7.7 and 7.8 indicate bilateral revenue, welfare and trade effects in case Sri Lanka cuts tariff by 100% for SAFTA economies.

- Revenue losses to Sri Lanka are about \$0.1 billion

Table 7.7 Effect of 100% Tariff Cuts on Revenue: Sri Lanka

(\$ '000)

Partner Country	Revenue Effect: Using SMART Simulations	Revenue Effect (using simple average)	Revenue Effect (using weighted average)	Sri Lanka Imports
India–Sri Lanka*	-99,147	-110,826	-106,652	1,439,298
Bangladesh–Sri Lanka	-652	-852	-590	8,867
Maldives–Sri Lanka	-1,210	-5,356	-2,593	42,576
Nepal–Sri Lanka	-11	-18	-10	111
Pakistan–Sri Lanka	-2,742	-11,024	-2,935	115,558
Bhutan–Sri Lanka	0	0	0	0
<b>Total effect</b>	<b>-103,762</b>	<b>-128,076</b>	<b>-112,779</b>	

\* Actual revenue loss may be much lower as India allows significant imports from these countries at zero duty.

on the basis of SMART simulation while it is \$0.12 and 0.11 billion on the basis of simple and weighted average tariff. Maximum revenue loss of \$0.09 billion is due to tariff cut by 100% on imports from India (Table 7.7).

- There are welfare gains for Sri Lanka and other SAARC countries from the 100% tariff reduction by Sri Lanka. Welfare gains for all seven countries amounts to be \$15 million and maximum welfare gains are due to India and Sri Lanka (Table 7.8).
- 100% tariff reduction by Sri Lanka creates trade approximately \$0.17 billion (Table 7.8).

Table 7.8 Effect of 100% Tariff Cuts on Welfare and Trade: Sri Lanka

(\$ '000)

Partner Country	Welfare Effect	Total Trade Effect
India–Sri Lanka*	13,858	162,261
Bangladesh–Sri Lanka	127	3,593
Maldives–Sri Lanka	531	4,029
Nepal–Sri Lanka	118	365
Pakistan–Sri Lanka	970	7,641
Bhutan–Sri Lanka	0	0
<b>Total effect</b>	<b>15,604</b>	<b>177,890</b>

\* Actual trade creation may be much lower as India allows significant imports from these countries at zero duty.

### Impact on Bhutan

Tables 7.9 and 7.10 indicate bilateral revenue, welfare and trade effects in case Bhutan cuts tariff by 100% for SAFTA member countries

- Revenue losses to Bhutan are about \$7.3 million on the basis of SMART simulation while it is also approximately \$ 2.3 and 2.6 million on the basis of simple and weighted average tariff (Table 7.9).
- There are welfare gains for Bhutan and other SAARC countries from the 100% tariff reduction by Bhutan. Welfare gains for all seven countries amounts to be \$ 3.2 million and maximum welfare gains are due to Bhutan and India (Table 7.10).
- In case of 100% tariff reduction by Bhutan, trade increased by approximately \$17 million (Table 7.10).

Table 7.10 Effect of 100% Tariff Cuts on Welfare and Trade: Bhutan

(\$ '000)

Partner Country	Welfare Effect	Total Trade Effect
Bangladesh–Bhutan	0	0
India–Bhutan	3,247	17,490
Pakistan–Bhutan	0	0
<b>Total effect</b>	<b>3,247</b>	<b>17,490</b>

Table 7.9 Effect of 100% Tariff Cuts on Revenue: Bhutan

(\$ '000)

Partner Country	Revenue Effect: Using SMART Simulations	Revenue Effect (using simple average)	Revenue Effect (using weighted average)	Bhutan Imports
Bangladesh–Bhutan	0	-993	-1,077	3,928
India–Bhutan	-7,361	-22,468	-25,385	99,549
Pakistan–Bhutan	0	-9	-6	51
Maldives–Bhutan		0	0	9
Sri Lanka–Bhutan		-1	-1	12
<b>Total effect</b>	<b>-7,361</b>	<b>-23,471</b>	<b>-26,469</b>	

Table 7.11 Effect of 100% Tariff Cuts on Revenue: Maldives

(\$ '000)

Partner Country	Revenue Effect: Using SMART Simulations	Revenue Effect (using simple average)	Revenue Effect (using weighted average)	Maldives Imports
India–Maldives	-12,821	-17,016	-14,517	83,865
Bangladesh–Maldives	-5	-	-	
Nepal–Maldives	-1	-	-	
Pakistan–Maldives	-156	-550	-194	2,875
Sri Lanka–Maldives	-3,192	-9,056	-8,558	42,576
<b>Total effects</b>	<b>-16,175</b>	<b>-26,622</b>	<b>-23,269</b>	

### Impact on Maldives

Tables 7.11 and 7.12 indicate bilateral revenue, welfare and trade effects in case Maldives cuts tariff by 100% for SAFTA member countries.

- Revenue losses to Maldives are about \$0.016 billion on the basis of SMART simulation while it is also approximately \$ 0.026 and 0.023 billion on the basis of simple and weighted average tariff. Results are quite consistent in both the approaches. Maximum revenue loss of \$0.012 billion is due to tariff cut by 100% on imports from India (Table 7.11).
- There are welfare gains for Maldives and other SAARC countries from the 100% tariff reduction by India. Welfare gains for all seven countries amounts to be \$3.4 million and maximum welfare gains are due to Maldives and India (Table 7.12).

Table 7.12 Effect of 100% Tariff Cuts on Welfare and Trade: Maldives

(\$ '000)

Partner Country	Welfare Effect	Total Trade Effect
India–Maldives	2,850	21,941
Bangladesh–Maldives	1	3
Nepal–Maldives	0	2
Pakistan–Maldives	33	192
Sri Lanka–Maldives	531	4,029
<b>Total effect</b>	<b>3,415</b>	<b>26,166</b>

- In case of 100% tariff reduction by Maldives, trade increased by approximately \$0.026 billion (Table 7.12).

### Impact on Nepal

Tables 7.13 and 7.14 indicate bilateral revenue, welfare and trade effects in case Nepal cuts tariff by 100% for SAFTA member countries.

- Revenue losses to Nepal are about \$0.053 billion on the basis of SMART simulation while it is also approximately \$0.1 billion on the basis of simple and weighted average tariff (Table 7.13).
- There are welfare gains for Nepal and other SAARC countries from the 100% tariff reduction by Nepal. Welfare gains for all seven countries amounts to be \$ 24 million and maximum welfare gains (\$23 million) are due to Nepal and India (Table 7.14).

Table 7.14 Effect of 100% Tariff Cuts on Welfare and Trade: Nepal

(\$ '000)

Partner Country	Welfare Effect	Total Trade Effect
Bangladesh–Nepal	32	133
India–Nepal	23,996	148,675
Sri Lanka–Nepal	118	365
Pakistan–Nepal	19	214
<b>Total effect</b>	<b>24,164</b>	<b>149,387</b>

Table 7.13 Effect of 100% Tariff Cuts on Revenue: Nepal

(\$ '000)

Partner Country	Revenue Effect: Using SMART Simulations	Revenue Effect (using simple average)	Revenue Effect (using weighted average)	Nepal Imports
Bangladesh–Nepal	-58	-114	-60	662
India–Nepal	-53,071	-117,232	-124,916	863,273
Sri Lanka–Nepal	-137	-63	-44	295
Pakistan–Nepal	-1	-550	-194	3,605
Maldives–Nepal	-	-	-	
<b>Total effect</b>	<b>-53,266</b>	<b>-117,960</b>	<b>-125,213</b>	

- In case of 100% tariff reduction by Nepal, trade increased by approximately \$0.014 billion (Table 7.14).

## ■ CONCLUSION

The results of SMART simulations indicate that there will be revenue losses to all member countries of SAFTA. However, 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. Whether the revenue loss following SAFTA will be recoverable through other means like increased trade and welfare is questionable, especially for small LDCs like Nepal. Revenue loss following a free trade agreement, whether bilateral or regional, needs to be approached with alternative solutions.

# 8 ■ Impact of SAFTA on Inward and Outward Foreign Direct Investments

## ■ INTRODUCTION

Linkage between trade and FDI has now been established in theoretical as well as empirical literature. Studies that link trade to FDI fall under three categories. First, those that argue that the determinants of FDI and trade are similar and, therefore, what determines trade also determines FDI flows (Ekholm 2002). Second, those that estimate econometric models in which FDI, exports and imports are determined simultaneously and argue that all three are endogenous variables and, therefore, their interactions should be taken into account (Hejazi and Safarian 2003). Lastly, those that look at the impact of regional trade agreements on FDI flows (Banga 2004, Binh and Haughton 2002, Worth 2002). Banga (2004) shows that RTAs like ASEAN and APEC can influence FDI inflows into the region as the risks associated with investments decline with greater regional integration.

Regional integration initiatives influence the level and pattern of FDI flows into the region as it lowers risk associated with investment and boost FDI flows between the member countries. The SAARC integration initiative has been accompanied by liberalisation process in all member countries. This has involved both trade and investment liberalisation. Though significant trade and investment barriers remain in place in many countries, the regional economies of SAARC are today far more open than they were until the late 1980s. There is a general acceptance that expanded trade, as well as FDI, confers large net benefits. However, though intra-SAARC trade has been quite extensively analysed, the FDI-trade nexus has received relatively little research attention in South Asia.

This chapter discusses the trends in FDI into and between the member countries of SAFTA. It provides a brief review of the studies that have analysed the impact of regional integration on inward FDI. The chapter further estimates the impact of trade within the region

on inward FDI into the region and into the member countries. It presents the methodology and results of the econometric model.

## ■ THEORETICAL FRAMEWORK AND REVIEW OF LITERATURE ON IMPACT OF REGIONAL TRADE AGREEMENTS ON FDI

Following Mundell (1957), it was long thought that FDI substitutes trade. This proposition was challenged by Agmon (1979) and subsequently a number of studies emphasised the potential complementarities between FDI and trade (Ethier 1996 and Markusen 1995). Earlier literature suggests that FDI and trade are either substitute (in the case of tariff-hopping investment) or complementary to each other (in the case of intra firm trade). However, the relationship between FDI and trade has become far more complex in the WTO regime wherein several developing countries have initiated import liberalisation process that has drastically reduced trading costs and encouraged international vertical integration and intra industry trade.

According to the theoretical literature, the H-O theory predicts that the lowering of tariff barriers in economic integration will increase income of import-competing industries due to cheaper imports in the member countries. This will increase the return on capital in the integrated area. Hence inward FDI is also expected to increase. According the theory of international production, inward FDI is a strategic response to the common external tariff of custom unions (CUs) as multinational enterprises (MNEs) substitute foreign activities for exports. Moreover, MNE will take advantage of the dynamic effects of CUs by utilising the enlarged market (i.e. economies of scale). According to the theory of CUs and the internal market the strategic response of MNEs to the creation of CUs gives rise to 'investment creation' and 'investment diversion' effects. As cited in Yannopoulos (1990), basically

investment creation refers to a surge of inward FDI from non-member countries into the CUs and is regarded as the strategic response of MNEs to the trade diversion effects. Investment diversion refers to the shifting of FDI from one member of the CUs to another as a result of the trade creation effect. More recently, the blending of trade theory and industrial organisation in models that often explicitly incorporate scale economies ('New Trade Theory') has stimulated the development of a number of analytical models of the linkages between foreign trade and foreign investment (for a review, see Markusen, 2000)

Traditionally, FDI decisions have been examined within the conceptual framework of the Ownership, Location, Internalisation model (OLI), introduced by Dunning (1958). This eclectic framework suggests that decisions of firms to engage in direct investment abroad are driven by factors related to cost advantages, market access, and the maintenance of knowledge assets internally. Locational advantages are enhanced by regionalism as with the decline in the barriers to trade and increase in the importance of networks, foreign investors find barriers to entry and less competitive environments less appealing.

Further, considering the case of foreign direct investment and trade from the viewpoint of a firm's location choices, whether FDI and trade are complements or substitutes depends on whether FDI is 'horizontal' or 'vertical'. Horizontal FDI takes place when an MNE produces the same goods and services in multiple countries, in order to avoid paying the 'trade costs' of exporting goods from one country to another, but wishes to exploit its firm-specific advantages in production. With trade liberalisation, trade costs will come down, and the incentive to produce in multiple country locations will diminish, particularly if there are significant economies of scale. In this case FDI and trade are substitutes (Markusen 1984).

Vertical FDI takes place when a firm geographically fragments production by stages, in order to take advantage of location-specific advantages such as lower factor prices in other countries. For example, FDI and trade are complements if an MNE relocates part of its production chain, e.g. its labour-intensive assembly plant, to a low-wage country, and exports headquarter services such as blueprints and management skills, and intermediate inputs to that country, and then re-exports final goods (Helpman 1984). Imports of the 'home' country increase as it imports products made by the foreign subsidiary, while its exports increase because the foreign subsidiary requires capital and intermediate

goods from the home country to undertake production in the host country.

RTAs can change the level and pattern of FDI, and thereby affect trade in ways that may not fully be captured in standard trade theoretic analyses of customs unions. Trade and investment liberalisation can change the location specific and firm-specific advantages. They can encourage geographical concentration as foreign firms can restructure their production bases to take advantage of reduced trade costs while exploiting scale economies and agglomeration advantages. This may lead to FDI outflows from countries that had earlier attracted 'tariff hopping' foreign firms to service-protected domestic markets because they can now be competitively supplied from production bases elsewhere. On the other hand, better access to a larger market may attract FDI (from within the region as well as from outside) to countries that have a strong locational advantage. Such locational advantages may arise from availability of cheaper resources, superior infrastructure, political stability, a more favourable policy regime, and a host of other factors. Ethier (1998) has shown that membership in RTAs can provide small but crucial competitive advantages to countries that can help them attract large FDI inflows.

The empirical literature corroborates the above arguments. Chakrabarti (2001) argues that after market size, openness to trade has been the most reliable indicator of the attractiveness of a location for FDI. Studies that examine the impact of openness to trade and regional agreements for trade on FDI inflows and find them to be important determinants are Gastanaga, Nugent and Pashmova (1998), Taylor (2000), Chakrabarti (2001) and Asiedu (2002). Globerman and Shapiro (1999) find that Canada-US free trade agreement (CUFTA) and North American free trade agreement (NAFTA) increased both inward and outward FDI. Blomstrom and Kokko (1997) separate the effects of RTA along two dimensions, i.e. the indirect effect on FDI through trade liberalisation and the direct effects from changes in investment rules connected with the regional trade agreements. According to them lowering inter-regional tariffs can lead to expanded markets and increase FDI but lowering external tariffs can reduce FDI to the region if the FDI is tariff jumping.

Impact of trade costs on FDI is mainly in terms of increasing and decreasing vertical and horizontal FDI. Vertical FDI is driven by availability of abundant cheap unskilled labour in the host economy. This is important for unskilled-labor intensive production activities. The main factors that govern these incentives are trade costs

and skill difference between the home and the host economies. As trade cost increases in the host country, firms with vertical FDI will have to import goods from the host country at a higher cost (Joon 2007). If the difference in skill between the home and host countries increases however, relative wages for low skilled labor will decrease, thereby increasing the incentive for firms to exploit this lower production cost by producing in the low wage economy. Consequently, vertical FDI will increase as trade costs decrease and skill difference increases (Yeyati, Stein and Daude, 2003 and Leshner and Miroudot 2006). Based on the above, the Knowledge-Capital model, analyses the impact of the given factors (market size, trade costs and skill difference between the two countries) and their intersections.

The Knowledge-Capital model was empirically tested by Carr et al. (2001), and one of the important results obtained was that trade costs positively impact FDI when the skill difference between home and host country is small and negatively impact FDI when large skill differences exist between the two countries. From their study one can infer that in the presence of small skill differences between parent and host economies, a rise in trade cost will result in the impact of an increase in horizontal FDI dominating the decrease in vertical FDI. In the presence of large skill differences. On the other hand, decrease in vertical FDI is larger than the increase in horizontal FDI, when trade costs rise.

Jang (2007) defines decreased trade costs as an FTA and tries to test this relationship. According to the Knowledge-Capital model, one may expect the decrease in horizontal FDI to be greater than the increase in vertical FDI when trade costs declines in the presence of small skill differences between the parent and the host countries, and vice versa in the presence of large skill differences. Since vertical FDI dominates horizontal FDI in countries where skill difference is large, one should expect an FTA involving member countries with large differences in skill levels to have a positive impact on FDI. Similarly, reduced trade costs act as a disincentive for building plants in the host economy, which in the presence of small skill differences, causes a decrease in horizontal FDI to dominate the increase in vertical FDI. Therefore, FTAs with member countries with small skill differences can be expected to discourage FDI between those economies.

Many empirical studies have tried to study the impact FTAs have on intra-regional and extra-regional FDI. Yeyati et al. (2003) find that regional integration on the whole contributes to attracting FDI. A study by Velde and Bezemer on the other hand, established that

the impact on FDI would be different for different types of regions and the position of countries within a region would be pivotal for attracting FDI. In the context of Korea–US FTA, Kang and Park found that FTA increased FDI by 14–35% from member countries and by 28–35% from non-member countries. Baltagi et al. (2005) conducted a study on bilateral outward FDI stocks into Europe over 1989–2001 and found that an RTA increases FDI up to 78% among European countries.

With respect to South Asia, very few studies have estimated the impact of intra-regional trade on inward and intra-regional FDI. One of the reasons for this is lack of bilateral data on FDI over time. This chapter attempts to estimate the impact of intra-regional trade on inward FDI into member countries of SAFTA and domestic investments in the member countries.

## ■ TRENDS IN INWARD AND INTRA-REGIONAL FDI IN SOUTH ASIA

### Trends in Inward FDI in South Asia

Inward FDI into South Asia has increased exponentially since the last decade. FDI inflow increased from US\$ 575 million in 1990 to US \$ 9.8 billion in 2005 and reached US\$ 22 billion in 2006. The stock of FDI increased from US \$4 billion in 1990 to US \$ 72 billion in 2006. The turn of the century marked the growth of inflow of FDI into the region. The average annual trend growth in FDI inflow from 2000 to 2006 increased to 28% from 10% in the period 1980 to 1990 and 20% in the period 1990 to 2000.

With respect to share of SAFTA member countries in inward FDI in South Asia, India receives almost 77% of the inward FDI flows. Pakistan receives around 15% and Bangladesh and Sri Lanka 5% and 3% respectively.

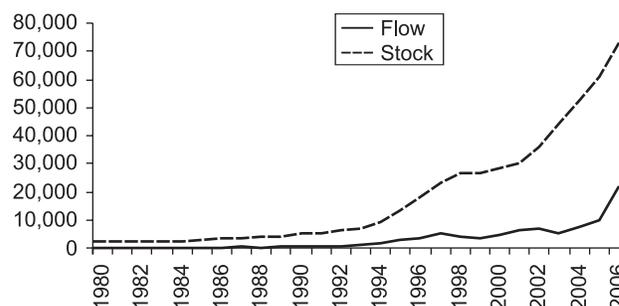
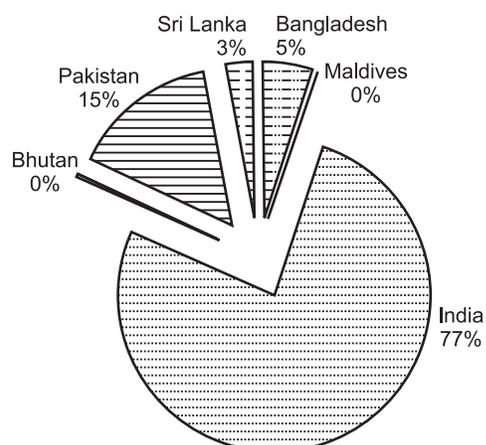


Fig 8.1 Extent of Inward FDI in South Asia: 1980–2006

Source: UNCTAD



**Fig 8.2 Share of South Asian Countries in Total Inward FDI Flows in South Asia**

Source: UNCTAD

### Trends in Intra-Regional FDI

As compared to other regions in Asia, South Asia has very low intra-regional FDI flows. Only India has been investing to some extent in the South Asian countries within the region, investments directing mainly towards Sri Lanka and Nepal. 2.6% foreign investment in Sri

Lanka has come from India, while for Nepal, Indian investments contribute to the extent of 51% of total investments in Nepal. Share of Nepal in total South Asian FDI is highest, i.e. 37%. A close look is required on each country's FDI inflows from the region and extra-region (Table 8.1).

Looking at the sectoral trends in South Asian FDI we find that South Asian FDI is mainly directed towards the industrial sector (chemical and engineering) with US\$ 1.43 million. This is reflected in the share of South Asia in the global total, which consists of 9.10% (Table 8.2).

### Bangladesh

FDI inflow to Bangladesh in 2005 was around US\$ 1 billion, registering 83.6% growth over the previous year. The top investor countries in 2005 were UK (US\$ 152.8 million), USA (US\$ 141.8 million), Singapore (US\$ 97.5 million), UAE (US\$ 55.4 million) and Norway (US\$ 543.5 million). The Netherlands FDI was US\$ 15.4 million, making the Netherlands the 14th biggest FDI source in Bangladesh (17th place in 2004).

Most of the FDIs in Bangladesh are from extra-regional sources. However, the share of South Asian

**Table 8.1 Intra-Regional FDI**

Hosts of FDI/Sources of FDI	Intra-Regional FDI (US\$ million) in 2006				
	India	Pakistan	Sri Lanka	Bangladesh	Nepal
India		n.a.	6.0 (2.6%)	0.99 (0.2%)	5.1 (51%)
Pakistan	n.a.		(0.6%)	0.59 (0.1%)	(0.03%)
Sri Lanka	(0.01%)	n.a.		0.52 (0.1%)	n.a.
Bangladesh	0.59 (0.01%)	0.79 (0.08%)	0.41 (0.18%)		n.a.
Nepal	n.a.	n.a.	n.a.	n.a.	
Share of South Asia	0.04%	n.a.	2.1%	0.4%	37.6%

Source: IPS (2000), World Investment Report (2003), Bangladesh Bank (2006), Board of Investment (2007), Moazzem K. (2006).

Note: Figures in parenthesis indicates percentage share of total FDI inflow to the respective country.

\* Data represents different sources and different time periods and may not be always comparable.

**Table 8.2 FDI Inflow 2006: Distribution by Sectors (million US\$)**

Sources	Sectors				
	Agriculture and Food	Industry	Service	Misc	Total
South Asia Total	0.15	1.43	0.52	0	2.1
India	0.15	0.84			0.99
Pakistan		0.59			0.59
Sri Lanka			0.52		0.52
Nepal					
Bhutan					
Maldives					
Global Total	5.32	15.76	469.1	0.1	490.27
Share of South Asia in Global Total	2.70%	9.10%	0.10%	0%	0.40%

Source: Compiled from Board of Investment (BOI)

**Table 8.3 FDI inflow in Bangladesh during 2005: Distribution by Source (in million US\$)**

Sources	2004		2005		2005		2005
	FDI-2004	Rank 2004	Jan-Jun	Jul-Dec	FDI-2005	Share (%)	Rank
Canada	0.4	23	–	0.7	0.7	0.08	25
The People's Republic of China	0.4	24	1.4	0.2	1.6	0.19	22
Denmark	18.8	9	6.4	11.8	18.2	2.15	13
Egypt	19.9	7	22.2	26.2	48.4	5.73	7
France	0.7	22	0.9	0.8	1.7	0.20	20
Germany	6.8	15	0.1	1.5	1.6	0.19	21
Hong Kong, China	13.9	11	27.2	25.9	53.1	6.28	6
India	6.8	16	0.8	1.9	2.7	0.32	18
Indonesia	–	28	–	1.3	1.3	0.15	23
Japan	30	5	33.8	12.7	46.5	5.50	8
Luxembourg	3	19	–	0.4	0.4	0.05	27
Malaysia	38.9	4	24.9	8.2	33.1	3.92	9
Nepal	–	29	0.1	–	0.1	0.01	30
Netherlands	8.8	13	8.4	7	15.4	1.82	14
Norway	59.6	3	24.6	28.9	53.5	6.33	5
Pakistan	3.8	17	18	7.5	25.5	3.02	12
Saudi Arabia	–	30	0.5	0.4	0.9	0.11	24
Singapore	2.3	20	97.4	0.1	97.5	11.53	3
South Korea	18.4	10	18.1	11.7	29.8	3.53	11
Sri Lanka	3.5	18	2.1	2	4.1	0.49	17
Switzerland	7.1	14	1.6	0.7	2.3	0.27	19
Taipei, China	1.3	21	10.5	0.9	11.4	1.35	16
Thailand	0.1	27	0.1	0.1	0.2	0.02	29
UAE	12.9	12	2.2	53.2	55.4	6.55	4
UK	91.1	1	92.4	60.4	152.8	18.08	1
USA	61.8	2	58.1	83.7	141.8	16.78	2
Vanuatu	0.2	26	0.1	0.2	0.3	0.04	28
ADB	29.5	6	6.1	6.6	12.7	1.50	15
IFC	19.9	8	23.5	8.2	31.7	3.75	10
Others	0.4	25	0.3	0.3	0.6	0.07	26
<b>Total</b>	<b>460.3</b>	<b>30</b>	<b>481.8</b>	<b>363.5</b>	<b>845.3</b>	<b>100.00</b>	<b>30</b>

Source: Bangladesh Bank Enterprise Survey, 2006

FDIs in the total inflow has shown upward trend during the last decade, increasing from 1.55% (US\$ 1.4 million) in 1995 to 1.60% (US\$ 9.3 million) in 2000 and reaching 3.82% (US\$ 32.3 million) in 2005. From South Asian countries, Pakistan had the largest share in FDI in Bangladesh in 2005 (3%) and ranked 12th biggest investor followed by Sri Lanka (17th) and India (18th) (Table 8.3).

Indian investment to Bangladesh was only US\$20.42 million as compared to world investment of US\$10,656.05 million during 1996 to May 2004 cumulative. In 2003, the very meager inflow of US\$1.39 million investment into Bangladesh ranks India 16th in terms of such inflows from different countries. New avenues of investment are being explored by India and Bangladesh in recent times. Indian investors are now

**Table 8.4 FDI inflow in Bangladesh from South Asian Sources (in million US\$)**

FDI Source	1995	2000	2005	2006
India	0.3 (19)	8.4 (91)	2.7 (8)	1 (47)
Pakistan	1.2 (81)	0.8 (9)	25.5 (79)	0.6 (28)
Sri Lanka	0	0.1 (1)	4.1 (13)	0.5 (25)
Nepal	0	0	0.1 (0.2)	0
Bhutan	0	0	0	0
Maldives	0	0	0	0
South Asia Total	1.4	9.3	32.3	2.1
Global Total	92.3	578.6	845.3	490.3
Share of South Asia in Global Total of Bangladesh (%)	1.55	1.6	3.82	0.43

Source: Bhattacharya, 2007, paper presented in ICRIER in March and Source. Compiled from enterprise survey conducted by Statistics Department, Bangladesh Bank.

more eager to invest in Bangladesh than before. TATA's US\$ 2 billion investment proposal is such an example. State-controlled Bangladesh Power Development Board will implement the project and the ADB has said it will provide a \$110 million loan for the project. The government also formed an expert committee to explore the possibility of a power purchase.

Within the total investment coming from the South Asia region to Bangladesh, Pakistan was the single largest source (79%) in 2005 (US\$ 25.5 million), while Indian investment of US\$ 1 million was the single largest source (47%) in 2006 (Table 8.4).

### *Sri Lanka*

Examining the bilateral trend in FDI between the SAFTA member countries we find that India is an important source of FDI to Sri Lanka and ranks amongst the top five investors with 164 projects valued at Rs 32 billion as of 2006 according to the Board of Investment (BOI). Most of the FDI (over 60%) from India has been in the services sector. Comparatively small investments have been made by Bangladesh in the services sector.

In fact, Sri Lanka has long been a priority destination for direct investment by Indian businesses within the SAARC region. Over 50% of Indian joint ventures and wholly owned subsidiaries in the region are located in Sri Lanka. Of the total equity invested by Indian companies in regional joint ventures, 54% are located in Sri Lanka. The number of approved projects which stood at 23 in 1991 with an estimated investment of SLRs 740 million was mainly confined to small and medium steel rolling mills, chemicals, rubber products and service sector projects. By the end of June 2000, however, the number of projects had leaped to 120 with an estimated investment of SLRs 12.5 billion.

The principal sectors which have attracted Indian investment are steel, cement, rubber products, tourism, computer software, IT-training and other professional services. During the past three years, leading Indian companies such as Gujarat Ambuja, Asian Paints and Larsen and Toubro have committed substantial investments, while existing companies – CEAT and Taj Hotels, for example – have expanded their operations. Sri Lanka's Board of Investment has given approval for India's largest publicly-listed telecom firm, Bharti Airtel, to be the island's fifth mobile phone operator with an investment of 150 million dollars in May 2007. Some illustrations have been given in Table 8.3. Even Sri Lankan firms are interested in investment in India.

Brandix Lanka (Sri Lanka's largest exporter with shipments exceeding US\$ 320 million), and MAS Holdings (which together with its joint venture partners has a turnover of around US\$ 700 million) are setting up textile and apparel industrial parks offering a one-stop-shop to potential investors. These parks will enjoy all the benefits of operating in one of India's SEZs, which operate as duty-free enclaves treated as a foreign territory. Brandix foresees Sri Lanka as the hub for all front-end and product development activities, while exploiting the scale advantages offered by India.

### *India*

India is one of the SAARC countries where overseas investment policy has been substantially liberalised in recent years. Indian companies can invest up to US\$ 100 million (US\$ 150 million SAARC countries, excluding Pakistan and Myanmar and up to Rs 7000 million by way of rupee investments in Nepal and Bhutan) in a year without approval of RBI or GoI provided the overseas investment is not real estate-oriented. Funding of such investments can be out of balances held in Exchange Earners Foreign Currency Account (EEFC) of the Indian Company or 100% of ADR/GDR proceeds or withdrawal of foreign exchange from an authorised dealers in India up to 200% of the net worth of the Indian company.

India's investment in South Asian countries was US\$ 164.53 million during the period 1996–2002, being no more than a little over 2% of its overseas world investment. Nepal was the most important destination of Indian investment followed by Sri Lanka. Since 2002 however Sri Lanka has overtaken Nepal as India's largest investment destination in South Asia (Raihan 2006).

By virtue of its proximity and the Trade Treaty with India, close economic linkages between India and Nepal have manifested themselves, inter-alia, through Indian investment and joint ventures in Nepal. Government of India has established a special 'Nepal Window' to facilitate approvals for Indian investment in Nepal and the limit for 'fast track' approval by Reserve Bank of India for investments in Nepal has been raised in July 2000 to Rs 350 crore (Indian currency). In 2000 there were over 265 approved Indian joint ventures in Nepal of which over 100 are operational, with a cumulative total Indian investment amounting between 36 and 40% of the total FDI in Nepal. In 2004 there were 114 operational Indian joint ventures in Nepal with authorised capital of NR 14.33 billion. Of these, 22

joint ventures had authorised capital of NR 100 million and above. Some illustrations have been given in Table 8.5.

There have not been any specific investments in Pakistan from India. However, of late, some signs of possible investment are visible. Reliance Industries is at an advanced stage of negotiations to acquire the petrochemical business of ICI Pakistan (around US\$ 300 million). ICI Pakistan which comprises 5 Pakistan businesses of polyester, soda ash, chemicals, life sciences and paints is one of the largest quoted companies on

Karachi, Lahore and Islamabad stock exchanges. The \$ 2.2 billion Indian software services major Tata Consultancy Services (TCS) has taken the first steps to set up a base in Pakistan. If it succeeds, TCS will become the first Indian IT company in the market. Dabur India will soon have a foothold on Pakistan soil for it will be setting up a manufacturing joint venture with a Pakistani firm by the end of this year, Ayurvedic products will be the fulcrum of their joint ventures in Pakistan. Some illustrations have been given in Table 8.5.

**Table 8.5 Successful Examples of Intra SAARC FDI and Technical Collaborations: Nepal**

Indian Company	Nepalese Company	Type of Collaboration	Sector
Mahanagar Telephone Nigam Limited (MTNL)	United Telecom Ltd. (UTL)	Joint venture company in collaboration with Telecom Consultants India Limited (TCIL), Videsh Sanchar Nigam Limited (VSNL) and NVPL (Nepal Ventures Pvt. Ltd., a Nepalese Company)	Telecom
Life Insurance Corporation of India (LIC)	Life Insurance Corporation (Nepal)	Joint venture in collaboration with Vishal Group Limited	Life Insurance

**Table 8.6 Successful Examples of Intra SAARC FDI and Technical Collaborations: Pakistan**

Indian Company	Pakistani Company	Type of Collaboration	Sector
Hewitt, India	Arwen Tech	HR skills assessment and strategy for training of call centre personnel	IT
Compare, India	Creative Chaos	Joint venture	IT

**Table 8.7 Successful Examples of Intra SAARC FDI and Technical Collaborations: Sri Lanka**

Indian Company	Sri Lankan Company	Type of Collaboration	Sector
Tata Infotech	John Keells Institute of Information Technology (Pvt) Ltd	Technical collaboration	IT
Aptech Ltd., India	Mackwood Infotec (Pvt) Ltd	Technical collaboration	IT
CEAT India	CEAT-Kelani Associated Holdings Ltd	Joint Venture between RPG Goenka Group, India, and the Associated Motorways Group, Sri Lanka	Tyre manufacturer
Bengal Waterproof Ltd, Calcutta, India	Bensiri Rubber Products (Pvt) Ltd	Wholly owned subsidiary	Rubber
Ishar Group, Indore, India	GTB Colombo Corporation Pvt Ltd	Subsidiary of Ishar Group	Alloy and special steel
Gujarat Ambuja Cement, India	Ceylon Ambuja Cement and Midigama Cement	Wholly owned subsidiaries	Cement
Indian Hotels Co Ltd	Taj Lanka Hotels Ltd	Subsidiary	Hotels
Asian Paints Ltd	Asian Paints Lanka Ltd	Subsidiary	Paints
Nilkamal Plastics, Bombay, India	Nilkamal Easwaran Plastics (Pvt) Ltd	Joint venture between Nilkamal Plastics, Bombay, India and the Easwaran Brothers Group, Sri Lanka	Property development, import and export trading, and manufacturing activities
Gujarat Glass Ltd	Ceylon Glass Company Ltd	Owned by acquisition	Glass
NIIT Ltd, India	Unisoft Institute of Technology (Pvt) Ltd		Joint Venture IT

## ■ IMPACT OF SAFTA ON INWARD FDI INTO SOUTH ASIA

Very few studies exist that estimate the impact of regional trade agreement on FDI inflows and none as yet for South Asia. Banga (2004) estimates the impact of two regional trade agreements, agreement reached among the APEC members, i.e. non-binding investment principles (NBIP) and investment area agreement (AIA) reached by Association of Southeast Asian Nations (ASEAN). The study finds a positive and significant impact of NBIP on inward FDI into these countries though the AIA did not have a significant impact as the in the period of analysis the agreement was relatively new. The fact that SAFTA is still in its infancy makes it difficult to estimate its impact on FDI into the region. Alternatively, the impact of tariffs of each member country vis-à-vis other SAARC countries on inward FDI into the country has been estimated, on the basis of which impact of SAFTA on inward FDI into the region is assessed.

To estimate the impact of SAFTA on inward extra-regional FDI into South Asia, a panel data analysis is undertaken where inward FDI into seven member countries of SAFTA is considered over a period of 1980 to 2006. The impact of intra-regional tariffs and intra-regional trade on inward FDI flows is estimated after controlling for other determinants of FDI. The methodology used and results are as follows.

### Methodology and Data

Inward FDI into member countries of SAFTA will be attracted by some economic fundamentals of the country like domestic market, availability of skills, labour costs, etc. Drawing on the vast existing literature on the economic fundamentals that have been considered as determinants of inward FDI, we control for the market variable (i.e. potential market size), cost variables (i.e. cost of labour in terms of efficiency wages) and human capital (i.e. literacy rate) in the economy. Studies have found market variables and quality of human capital to have a positive impact while cost variables are expected to be negatively related to FDI inflows.

It is argued that higher trade in the region will attract higher extra-regional FDI into the region. To capture the impact of SAFTA we use weighted average of MFN tariffs of each member country of SFATA with respect to other member countries as a group. The variable has been constructed using TRAINS dataset (UNCTAD). The sign of the variable is expected to be

negative. Low regional tariffs between the member countries will attract efficiency-seeking FDI which may then follow product fragmentation within the region or cater to markets of member countries by basing itself in the least-cost location and appropriating the benefits of economies of scale.

To test whether FDI into the region may follow product fragmentation or not we estimate the impact of other trade-related variables on inward FDI. These are exports of each member country of SAFTA to other member countries as a group and imports of each member country of SAFTA from other member countries as a group. If higher share of SAARC in trade of a country attracts higher FDI it indicates that FDI may seek economies of scale and choose to locate in the country with higher access to the SAARC market. However, since the exports and imports may be of finished goods it may not reflect vertically-integrated FDI. We estimate the impact of imports of intermediate goods in a country from other member countries on inward FDI into the country. Positive impact here will indicate that a country which has higher share of imports from SAARC in its total imports will attract vertically-integrated FDI which may choose it as its destination. In other words, the probability of inward FDI may have higher product fragmentation within the region increases. Exports and imports variables have been normalised by taking them as a ratio of GDP of the country as well as ratio of total exports and imports from other member countries.

Along with these trade-related variables trade policy variable has also been used which is number of bilateral investment treaties (BITs) signed by a country. The variable is cumulative in nature. There has been a substantial increase in number of BITs that have been signed and brought to force in the last two decades and particularly in the 1990s. In general, BITs deal exclusively with investments and lay down specific standards of investment protection and transfer of funds. They contain provisions for the settlement of disputes both between the treaty partners and between investors and the host state. BITs also cover a number of other areas, in particular, non-discrimination in the treatment, and in some cases the entry of foreign-controlled enterprises, and other related fields. An important characteristic of BITs is a considerable uniformity in the broad principles underlying the agreements (UNCTAD 1999), coupled with numerous variations in the specific formulations employed. BITs generally recognise the effect of national law on FDI and accept the right of governments to regulate entry

of FDI. By providing protection, BITs are expected to promote FDI.

Based on the above discussions, to estimate the impact of SAFTA on inward FDI into the region and into the member countries the equation estimated is as follows:

$$\begin{aligned} \text{Inward FDI}_{it} = & \alpha + \beta_1 \text{Growth of domestic market}_{it} \\ & + \beta_2 \text{Skill availability}_{it} + \beta_3 \text{Labour} \\ & \text{Cost}_{it} + \beta_4 \text{Tariffs vis-à-vis other} \\ & \text{SAFTA Members}_{it} + \beta_5 \text{Exports to} \\ & \text{other SAFTA Members}_{it} + \beta_6 \\ & \text{Imports from other SAFTA Mem-} \\ & \text{bers}_{it} + \beta_7 \text{Degree of Openness}_{it} + \beta_8 \\ & \text{Number of BITs signed}_{it} + \beta_9 \text{Import} \\ & \text{of intermediate goods from} \\ & \text{SAARC}_{it} + \beta_{10} \text{Export of interme-} \\ & \text{diate goods from SAARC}_{it} + \varepsilon. \end{aligned}$$

The data sources, definitions and expected signs of the variables are presented in Table 8.8.

### Empirical Results

The results are presented in Table 8.9 in columns 1–3. An attempt is made to control the economic fundamentals of the host country. To avoid the problem

of simultaneity between the explanatory variables and dependent variable (i.e. log FDI), economic fundamentals are lagged by one year. Second, the impact of inter-regional tariffs and bilateral investment agreements on inward FDI is analysed by using a panel data for seven member countries of SAFTA for the period 1980–2006. Listwise deletion is undertaken in the case of missing data. All results presented are corrected for autocorrelation and heteroscedasticity.

The results show that the economic fundamentals of a SAFTA member country have a significant impact on inward FDI. Domestic market size, low cost of labour and availability of skills attract FDI from outside the region. Higher trade openness attracts higher FDI. Tariffs with respect to other SAFTA member countries has a negative impact which indicates that lowering of tariffs following SAFTA will attract FDI from outside the region into the region (Table 8.9, column 1) The coefficient indicates that the impact will be significant, i.e. 30% of the rise in inward FDI may be because of lowering of inter-regional tariffs. This indicates that SAFTA may encourage FDI inflows into the member countries and consequently into the region as a whole. The theoretical reason for this is, as discussed above, regional integration offers many advantages to the inward FDI. It lowers the risk of investments, provides

Table 8.8 Variables Used, Data Sources, Definitions and Expected Signs

Variables	Definition	Expected Sign	Sources of Data
Potential domestic market (Growth of domestic firms)	Log of real gross domestic product	+	WDI 2007
Literacy rates (Skill availability)	Log of secondary enrolment ratio	+	WDI, 2005
Efficiency wages (Labour cost)	Log of labour cost/Labour productivity	–	UNIDO
Degree of openness	Log of ratio of sum of exports and imports/GDP	+	COMTRADE
Tariffs vis-à-vis other SAFTA countries	Log of weighted average of tariffs vis-à-vis other SAFTA countries	–	TRAINS
Imports from other SAFTA member countries as a proportion of GDP	Log of imports from other SAFTA member countries as a proportion of GDP	–	COMTRADE
Exports to other SAFTA member countries as a proportion of GDP	Log of exports from other SAFTA member countries as a proportion of GDP	+	COMTRADE
Exports to other SAFTA Member countries as a ratio of total exports	Log of exports to other SAFTA Member countries as a ratio of total exports	+	COMTRADE
Imports from other SAFTA member countries as a ratio of total imports	Log of imports from other SAFTA member countries as a ratio of total imports	+	COMTRADE
Import of intermediate goods from SAARC as a ratio of GDP	Import of intermediate goods from SAARC as a ratio of GDP	–	COMTRADE
Export of intermediate goods from SAARC as a ratio of GDP	Export of intermediate goods from SAARC as a ratio of GDP	+	COMTRADE
Number of BITs signed	Number of Bilateral Investment Treaties signed by a country in year <i>t</i> (accumulated over the years)		

**Table 8.9 Impact of Tariffs within SAARC on Inward FDI**

Variables	Dependent Variable: Log of FDI		
	(1)	(2)	(3)
Market growth	0.20*** (2.42)	0.39*** (4.58)	0.45*** (4.86)
Literacy rate	0.179** (2.47)	0.11 (1.39)	0.15* (1.71)
BITS	0.69*** (5.61)	0.60*** (4.62)	0.56*** (3.82)
Efficiency wages	-0.50*** (-3.43)	-0.45*** (-2.87)	-0.51*** (-2.99)
Openness	0.14*** (2.38)	0.37** (2.14)	-
Weighted average of tariffs vis-à-vis other SAFTA member countries	-0.30* (-1.79)	-	-
Total exports to SAARC as a ratio of GDP	-	-	0.30** (1.94)
Total imports from SAARC as a ratio of GDP	-	-	0.39*** (2.52)
Total exports to SAARC as a ratio of total exports	-	-0.09 (-0.76)	-
Total imports of intermediate goods from SAARC as a ratio of total imports	-	0.20** (2.15)	-
Constant	24.7 (1.00)	101.7 (0.76)	20.5*** (94.52)
Observations	133	182	182
Hausman statistic	2.84prob value: 0.82	2.38prob value: 0.12	2.28prob value: 0.89

Note: \* significant at 1%; \*\* significant at 5%; and \*\*\* significant at 10%.

access to larger market and provides the opportunity to reap economies of scale by locating in the least cost country and supplying to other member countries and it may also lead to product fragmentation, i.e. vertical FDI.

To assess whether SAFTA will encourage vertical FDI or not, the impact of share of SAFTA member countries in imports of intermediate goods on inward FDI is examined. The results presented in Table 8.9 (column 2) show that the imports of intermediate goods in the host country have a significant impact on inward FDI. In other words, higher the probability of importing intermediate goods into the host country more attractive will be the destination for inward FDI. SAFTA may therefore encourage vertically-integrated FDI. However, share of SAFTA member countries in total exports of the destination country does not have any significant impact indicating that inward FDI may not necessarily be attracted to countries with higher exports to SAARC as a proportion of total exports. But, results presented in column 3 of Table 8.9 shows that total exports to SAARC as a ratio of GDP of a country may in have positive impact on inward FDI. SAFTA may

therefore encourage vertically integrated FDI which may boost exports of the destination country.

Apart from the trade-related variables the results show that Bilateral Investment Treaties (BITs) signed by the host country has a significant impact on inward FDI flows. This indicates that the extent to which the operations of FDI are facilitated in the host country may impact the decisions of foreign investors.

## ■ CONCLUSION

The results of the chapter show that SAFTA may not only lead to higher intra-regional trade but may also induce higher inflow of foreign direct investments into the region. The increasing linkages between trade and FDI may enforce higher FDI to flow into the region. Higher imports of intermediate goods into a country and higher exports from the country are found to significantly attract inward FDI which suggests that FDI into the region may be both market seeking as well as efficiency seeking. SAFTA may therefore encourage vertically integrated FDI into the region.

# 9 ■ Quantification of Benefits from Transport and Trade Facilitation in South Asia<sup>1</sup>

## ■ INTRODUCTION

The increase in trade across the world since the past several decades was driven by several very diverse factors which countries consciously pursued, including the reduction in legal trade barriers and defining of international standards for products, manufacturing and services, among others. Countries pursued trade liberalisation measures since they were convinced that the positive benefits from opening up trade and tariff reduction for the country as a whole outweighed the negative effects on the protected domestic producers and loss of revenue for the government. Trade was further facilitated but falling transportation costs over time which allowed firms to base manufacturing facilities in countries which were able to offer them the optimum low-cost mix of technology, labour, and capital at basic minimum standards.

In the context of regional trading blocs, these benefits from trade sometimes need to be quantified and demonstrated to all trading partners in order to induce them to participate in the liberalisation process. However, benefits from improved transport and trade facilitation measures bring obvious win-win outcomes for all trading partners, subject to certain conditions. High trade costs such as transportation charges, documentation requirements, and clearance delays at

the borders have a discouraging impact on trade and production similar to trade restrictions such as tariffs and quotas. A country's ability to deliver goods and services in a timely manner at low cost is the key to its export competitiveness. It also promotes imports and foreign direct investment which encourages innovations in technology. Trade and transport facilitation measures targeted at improved trade logistics through simplification of customs procedures and enhanced connectivity bring direct benefits to business, which includes the faster clearance and release of goods, costs cutting and reduced delays, increased transparency and integrity, and enhanced competitiveness.<sup>2</sup> The benefits in the form of savings of time and reduced costs to the trading partners help the economy to grow fast. Further, since inefficient trading procedures act as NTBs to trade, improved trade and transport facilitation reduces the scope for illegal trade and corruption. Trade facilitation measures also provide participating countries safeguards against sometimes conflicting national measures imposed by individual countries.

Given the various issues of trade and transport facilitation in South Asia, this chapter quantifies gains from cooperation identified regional projects using BCA.<sup>3</sup> Although regional in nature, the benefits are computed for one country which is undertaking the project on its territory in order to provide a flavour of

<sup>1</sup> Useful comments and inputs have been provided by Prabir De at the Research and Information System for Developing Countries (RIS), New Delhi, T. Keshawrani and K.L. Thukral at the Asian Institute of Transport Development, New Delhi, and Saikat Sinha Roy at Jadavpur University. Bhishma Rout's assistance in procuring data and documents is much appreciated.

<sup>2</sup> <http://www.dti.gov.uk/europeandtrade/key-trade-issues/trade-facilitation/page22745.html>

<sup>3</sup> BCA involves the aggregation of the present value of the time-streams of all benefits and costs expected generated by the proposed project (James, 2005). The three steps involved for the BCA are as follows: compile costs of the project; calculate all possible monetary benefits of the project; and calculate present value of net benefits from the project. The time-stream of total costs is depicted as  $C_1, C_2, \dots, C_n$ , and total benefits as  $B_1, B_2, \dots, B_n$  over an 'n' year time period. The stream of net benefits  $(B_1 - C_1), (B_2 - C_2), \dots, (B_n - C_n)$ , where all values of  $C_t$  are 0 after costs are incurred. The present value (NPV) of is the sum of discounted net benefits, where the discounted net benefit for any year  $t$  is obtained by dividing each net benefit value (e.g.  $B_2 - C_2$ ) by  $(1 + r)^t$  where  $r$  is the social 'discount' rate.  $NPV = \sum (Bt - Ct)/(1+r)^t$ .

the extent of benefits that can accrue. The benefits if computed for the subregion will multiply manifold. Future analysis may be undertaken to examine options for implementation of cross-border projects. Of the four projects, two were identified by the South Asia Subregional Economic Cooperation (SASEC) transport and tourism working groups<sup>4</sup>:

- Upgrading of the Kolkata-Petrapole/Benapole corridor and customs facilities
- Development of Bagdogra airport as a gateway and hub
- Railway improvement between Lahore and Wagah/Attari
- Colombo port expansion.

The positive impact of all projects is intuitive and indisputable, and the BCA helps in demonstrating the extent of gains in one country alone. As compared to national projects, these projects have the added benefit of high trade and tourism potential. The discussion on BCA for the projects in different scenarios brings out that the projects are immensely beneficial and extension of infrastructure facilities could be considered by the South Asian countries jointly.

## ■ OVERVIEW OF CURRENT BARRIERS TO TRADE IN SAARC

Lowering of border tariffs was integral to South Asia's trade policy liberalisation since the 1990s. However, despite high rates of GDP and export growth, the countries still confront hurdles in the form of infrastructure bottlenecks, poor governance, serious constraints in land and labour markets, and inadequate financial markets. Das (2007) summarises that 'some of the most conspicuous economic constraints have been created by power shortage and inland road and rail transport constraints, archaic labour laws, and inefficient trade infrastructure, particularly customs procedures and regulations.' Despite the lowering of tariffs, restrictive trade and transport facilitation have hampered intra-regional trade.

### Non-tariff Barriers to Trade

SAARC countries have several *ad hoc* trade restrictions

and NTBs on imports and exports. It is seen that NTBs faced by SAARC countries accelerated in the 1990s as tariff measures went down. The NTBs most often imposed relate to sanitary and phytosanitary measures (SPS) and technical barriers to trade (TBT), quotas, anti-dumping measures, license requirements, and countervailing measures. Documentation procedures and SAPTA certification have been strong forms of NTBs amongst SAARC countries. The computerisation of trade transactions (cargo declaration, licensing, and duty payments) opens up need for standards (e.g. ASYCUDA) and compatibility across regional systems. Albuero (2004) highlights that though there is scope for regional cooperation in addressing NTBs, there is little scope for *resolving* the barriers which is a matter for negotiations amongst the governments.

**Table 9.1 Percentage Share of NTBs to all NTBs Faced by SAARC Countries**

Non-Tariff Barrier	Share (%)
SPS, TBT, and Other Related Measures	86.3
Tariff Quota	9.8
Anti-Dumping Measures	7.4
License Requirement	5.3
Countervailing Measures	1.2

*Note:* Percentage shares exceed 100% since number of cases varies.

*Source:* Bhattacharya and Mukhopadhyay 2002 (Table A-10 Part B).

### Governance Issues

The World Bank's *Doing Business* portal provides ranks and objective measures of business regulations and their enforcement across 178 countries of the world. Efficient customs, good transport network, and fewer documentation requirements promote exports and imports and therefore growth and employment.

The World Economic Forum's *Global Competitiveness Report 2007–08*, provides detailed rankings for five of the SAARC countries – Bangladesh, India, Nepal, and Pakistan, and Sri Lanka. Lack of infrastructure and government bureaucracy are listed as India and Pakistan's main problems for doing business, while in Nepal it is political instability and in Bangladesh, corruption.

<sup>4</sup> The various SASEC working groups commissioned studies carried out by a group of sector experts, in consultation with the concerned governments. Each SASEC report makes an analysis of the situation at the ground level and narrows down on projects and programs that could be jointly adopted by the countries. They mainly list a menu of options which were later discussed at the working group meetings. Identified projects are in ADB (2005) and Padeco (2005). Discussions were held within INRM, after reviewing various SASEC sector reports.

Table 9.2 Doing Business in South Asia

	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
	<b>Rank</b>							
2007	172	139	148	142	100	150	81	94
2008	174	112	149	79	110	151	94	60
	<b>Documents for Exports (number)</b>							
2006	7	7	8	10	8	9	8	7
2008	12	7	8	8	8	9	9	8
	<b>Time for Exports (days)</b>							
2006	66	35	38	36	21	43	33	25
2008	67	28	38	18	21	43	24	21
	<b>Cost to export (\$ per container)</b>							
2006	2500	902	1150	864	1200	1600	996	797
2008	2500	844	1150	820	1200	1600	515	810
	<b>Documents for Imports (number)</b>							
2006	10	13	11	15	9	10	12	12
2008	11	9	11	15	9	10	8	6
	<b>Time for Imports (days)</b>							
2006	97	57	38	43	20	35	39	27
2008	71	32	38	21	20	35	19	21
	<b>Cost to import \$ per container)</b>							
2006	2100	1287	2080	1244	1200	1725	1005	789
2008	2100	1148	2080	910	1200	1725	1336	844

Source: World Bank, 2008, Doing Business website

### Infrastructure Constraints

The lack of physical, industrial, and communication infrastructure in the region has also contributed to restricted trade amongst countries. Kabir (2007) summarises the key issues. Air and maritime ports are ranked as less competitive in South Asia as compared to East Asia. While it takes two hours to clear a vessel in Singapore and Laem Chabang, Thailand, it takes 2–3 days in Chittagong. At Delhi airport, average cargo dwell time is 2.5 days. There are some estimates that have been made to compute the magnitude of NTBs in the form of connectivity and approaches infrastructure. World Bank (2003) estimate saving in terms of transport cost from road to rail along the Kolkata-Kathmandu corridor at 22–33% of road cost. UNESCAP (2003) estimates transit charges at 0.45% of CIF value for private cargo. UNESCAP (2007) finds that inter-South Asia disparity in infrastructure facilities has been rising over the years. Further, progress in information technology is as important as development of physical infrastructure and is imperative for customs and standards harmonisation between countries of the region. South Asian countries have been relatively successful in

strengthening IT infrastructure at some prominent border crossings in recent years (UNESCAP 2007)

### ■ INFORMAL TRADE IN SAARC

NTBs and other ‘behind the border’ constraints such as problems with connectivity across contiguous countries; poor border conditions, approaches, and facilities; and excessive documentation requirements and clearance procedures thwart the positive effects of tariff liberalisation. The need to file detailed and multiple documents are associated with corruption in customs. Delays and frequent demands for bribes encourages traders avoid customs altogether and smuggle goods across the border. This consequently defeats the purpose of border control on trade, which is to levy taxes and ensure high quality goods.

Informal trade figures between SAARC countries are surprisingly high. Historical roots of economic relationships have kept trade flows between these countries despite tariffs and NTBs. The vast and porous borders have allowed for much informal trade throughout the history of the region. Close ethnic ties and common culture and language have played an

important role in facilitating informal trade at the border. However, while informal trade may have initially been confined within short distances and neighbourhood communities, it has expanded and enveloped the entire region.

Taneja (2004 and 2005) has intensively worked on informal trade in the region and has analysed the magnitude and features of informal trade between countries. The main finding is that total informal trade in South Asia is US \$1.5 billion, which is 72% of formal trade (for the years for which data are available). Some survey results even put the magnitude of informal trade at more than 100% of official trade, as in the case of Bangladesh exports to India (Bakht and Sen 2002).

### India's Geographic Position

India is the central actor in South Asia's informal trade as it is the only country that shares borders with almost all the countries and the other countries do not share borders with each other except India. India is also a dominant and key player in the region due to its size, geographic location, and economic performance. India's recent high growth can now be shared by the countries of the subregion. The analysis herein therefore takes on an Indo-centric approach to demonstrate the gains from transport and trade facilitation.

**Table 9.3 India's Informal and Formal Trade with South Asian countries (US \$ million)**

	Trade Balance		Total Trade	
	Informal	Formal	Informal	Formal
Bangladesh (1992-93)	285.0	341.2	313.0	356.9
Bhutan (1993-94)	30.1	4.0	32.6	10.0
Nepal (2000-01)	-48.0	-114.0	408.0	396.0
Pakistan (2004-05)	503.8	416.6	524.6	602.0
<b>Sri Lanka (2000-01)</b>	<b>163.7</b>	<b>595.</b>	<b>207.3</b>	<b>685.2</b>

Source: Taneja, 2005.

Some of the features of India's trade with its neighboring countries in the region are as follows (Taneja, 2005):

- Although the north-east region of India would benefit more from trade with Bangladesh, due to its proximity, Taneja finds this is merely 4% of

Indo-Bangladesh trade while the bulk of the trade is accounted for by West Bengal, probably due to cultural and linguistic similarities. Trade has been very concentrated and localised over land routes. Both official and unofficial trade surplus is with India. Although tariffs have come down substantially in the 1990s, the two countries have the highest NTB coverage in the region for primary and manufactured goods (66 and 52% respectively). There have been stringent over invoicing of both export and import between India and Bangladesh. The major official and unofficial trade items have been found complementary and non-competitive to each other.<sup>5</sup> Detailed commodity-based surveys show that a significant share of household consumption of goods in Bangladesh comes from informal imports (Bakht and Sen 2002).<sup>6</sup>

- India's informal trade with Bhutan is three times as much as its formal trade. Bhutan's trade deficit has increased from a low of 4.3% of GDP in 1996 to 16.7% in 2000, and 22.6% in 2001. The 2001 trade deficit was \$81.7 million, 56% of which was with India. The 1995 Agreement between India and Bhutan allows for free trade between the countries and unhindered transit facilities to Bhutan's trade with third countries.<sup>7</sup> Hence, the high informal trade figures are surprising.
- India's informal trade with Nepal is almost as large as its formal trade. It is observed that in the case of Nepal, a large part of informal imports to India comprise third country goods rather than a similar composition of commodities that occurs with formal trade. India shares a very porous border with Nepal and goods are carried across mainly by motorised and non-motorised transport over land. However, ambiguities in definition of rules of origin and consequent harassment by customs officials have driven traders to informal trade.
- India's informal trade with Pakistan is estimated at 87% of formal trade. Informal trade takes place through five major routes (Dubai-Bandar Abbas-Herat-Kabul-Jalalabad-Bara, Dubai-Bandar Abbas-Herat-Kandahar-Wesh-Chaman, Dubai-Bandar Abbas-Herat-Kandahar-Wesh-Noshki-Quetta, Sind cross-border, and India-Dubai-Karachi) and six

<sup>5</sup> <http://www.capexil.com/article/June-22nd-98.html>

<sup>6</sup> Household surveys comparing consumption with production and imports show a gap attributed to informal imports. For example 15% of cereal consumption come from informal trade. The ratio ranges from 61% for vegetables to 19% for rice. All of these were for the period 1995.

<sup>7</sup> <http://www.nationsencyclopedia.com/Asia-and-Oceania/Bhutan-FOREIGN-TRADE.html> (U.S. Library of Congress)

minor routes (Delhi-Amritsar-Lahore, India-Singapore-Karachi, India-Hong-Kong-Karachi, Mumbai-Karachi (boats, launches), Mumbai-Kabul-Bara, Karachi-Chamman-Afghanistan, and Karachi-Peshawar-Afghanistan). Mukherjee (2001) indicates that unofficial exports through both routes comprise machinery, cement, tyres, tea, medicines, videotapes, alcoholic beverages, chemical products, steel utensils, etc. The barriers to trade are in the form of bank requirements, application of measures related to standards necessary to protect human, animal or plant life or health, to protect environment and to ensure quality of goods, and poor connectivity.

- India-Sri Lanka in 1991 stood at \$186 million while unofficial trade estimates were \$264 million. While India had an official trade surplus, unofficial trade was more or less in balance. Informal trade between the countries has substantially fallen due to the FTA and ease of trade between the countries. One reason for persisting informal trade is there are high domestic taxes on imports though tariffs have come down.

Taneja (2005) finds that the main feature of informal trade in the region is that the commodity basket is not divergent from the formal trade patterns (except for Nepal). Further, informal trade is also seen to occur in commodities for which levels of tariff have substantially declined. There are high levels of informal trade between India and Nepal and India and Bhutan despite there being almost zero-tariffs between these countries. This points strongly towards the notion that institutional factors are the main barrier to trade.

### Institutional Barriers

Other than procedures, ADB (2007) identifies the major constraints at the South Asia borders as the following:

*Lack of Border Infrastructure and Traffic Planning:* Most of the border crossings between the South Asia countries are not designed to handle the volumes of traffic that currently passes through them, which results in severe traffic congestion and delays in handling the shipments.

*Land Ports at the Border:* Lands are required to be transferred into different vehicles in most cases at the borders. The land ports comprise open storage and closed godowns within the customs controlled area. Due to increased trade, the storage dwell times has been

increasing the port storage is grossly inadequate. For example, at the Petrapole-Benapole border, it invariably takes longer to unload vehicles into the land port than the physical clearance time.

*Trader Practices:* Importers often do not submit required clearance documents to customs. Since much time is needed to collect the vast amount of supporting documents, importers use the godowns as storage as they make for the required financial and documentation arrangements as storage charges are relatively low. Hence the storage is being used for purposes it was not designed for.

*Lack of Cross-Border Transport Agreements:* Due to lack of through-transport movement, there are transport inefficiencies at the interface. The situation is exacerbated due to trader and transport practices.

## ■ THE KOLKATA-PETRAPOLE/BENAPOLE CORRIDOR

Indian exports to Bangladesh are growing at 21% per year with the current annual value at US\$1,102 million. Trade in the opposite direction is weaker with just US\$84 million worth of goods being moved from Bangladesh to India. Figure 9.1 indicates the trends in Indo-Bangladesh trade. The balance of trade has significantly been in favor of India. On an average, 280–300 trucks per day carry Indian exports to Bangladesh, comprising rice, fertilizers, raw materials for chemical and apparel industries, and manufactured goods including tyres and iron and steel articles, passing through congested towns such as Barasat, Habra, and Bongaon. However, only 40–50 trucks handle imports from Bangladesh to India, which is jute products, beetlenut, and hilsa fish.

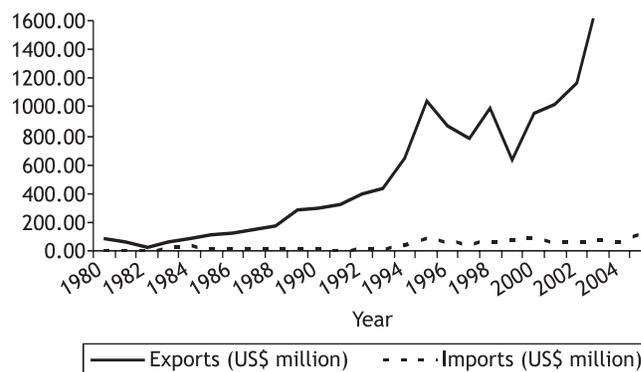


Fig 9.1 Indo-Bangladesh Imports and Exports, 1980–2004

The total length of the Kolkata-Dhaka corridor through Petrapole/Benapole and Jessor is 350 km. Petrapole is about 95 km from Kolkata, which is the final transshipment area for commodities across the country that are carried over to Bangladesh. Even on poor roads which are typical of the subregion, the distance can be covered by a truck in about 10 hours if there are no barriers or drastic choke points. The distance may be covered in 2 days, if one includes the time for inspections on both sides of the border, but in actuality, the average times for the Kolkata-Dhaka trip is 5–7 days. There are bottlenecks all along the corridor due to high congestion and encroachments on the road, and delays at the cross border point of Petrapole/Benapole.<sup>8</sup>

The infrastructure is poor on both sides. On the Bangladesh side, there are delays in inspection of trucks and processing the documentation, the storage facilities are poor, and crossing the Padma river is problematic. The Indian side has graver constraints, the main problems being:

- Kolkata-Petrapole road is extremely narrow, particularly the 60 km stretch from Barasat to Petrapole. The area is densely populated with markets and trees along the road.
- The Naobhanga Bridge, 3 km from Petrapole, is narrow and only one 15–18 tonnes truck can pass at a time. Higher capacity shipments need to be reshipped in smaller trucks at Bongaon.
- There is no bonded warehousing facility. Bangladesh imports are transhipped into the inadequate, ill maintained and water-logged no-man’s land area in front of customs office.
- Customs operations are adversely affected by the erratic power supply.
- There is only a single gate both for passengers and cargo traffic and there is lack of basic infrastructure and facilities for truckers and passengers such as toilets, medical services, drinking water, fire stations, etc. There are no bus links from Petrapole to Kolkata and available taxi service is expensive.
- Cross-border inspections and documentation and unsynchronised work hours are cumbersome.
- There is no containerisation of cargo.

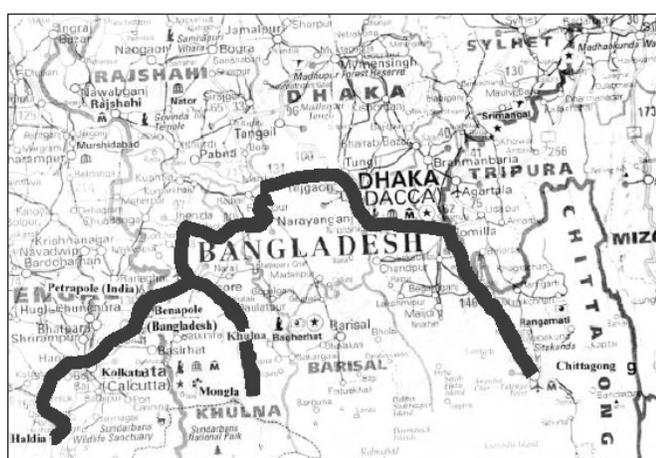


Fig 9.2 Corridor 5A: Kolkata-Petrapole/Benapole-Jessore-Dhaka (to Mongla and Chittagong)

Das and Pohit (2005) show that while the average time loss for exports from India at other borders is 21 hours, it is 99 hours (or four days) at Petrapole. The maximum loss occurs in parking, customs clearances, and crossing the border which is 78 hours for each shipment. Unloading at Benapole takes an additional 9 hours. This results in auxiliary time loss of about 10% of shipment value. The total costs for Kolkata-Petrapole route is on average Rs 2543 in comparison of Rs 1752 for other national highways in India for the same 95 km distance (or Rs 27 per km for this stretch as against to Rs 18 for other national highways). Furthermore, Pohit and Taneja (2003) indicated that

Table 9.4 Transaction Time and Cost for India’s Overland Exports to Bangladesh

	Subramanian and Arnold (2001)	Das and Pohit (2006)	De and Ghosh (2006)
	Survey year: 1998	Survey year: 2002	Survey year: 2005
Transaction costs (% of shipment value)	–	10.38	16.80
Border crossing delays (days)	2.5	3.63	3.92
Types of documents required at border (No)	29	–	17
Copies of documents required at border (No)	118	–	67

<sup>8</sup> Padeco (2005). Land borders are the most utilised routes for trade between the countries in the subregion. There are five recognised road-based Indo-Bangladesh land-border routes – Petrapole, Dawki, Mahdipur, Hilli, and Changrabandha. The Petrapole–Benapole route, including ferry crossing to greater Dhaka, has the heaviest movement in terms of value, accounting for about 70% of India’s export to Bangladesh (ADB 2000).

the main reason for informal trade (for lower value goods) is to avoid high transactions costs. The inadequate transportation systems between the two countries have led to high transportation costs with respect to port congestion, excessive documentation, slow movement of goods, etc.

### The Potential

It is estimated that the removal of all tariffs would enhance intra-regional trade by a factor of 1.6, or 5% increase in trade for every 1% reduction in tariff (Mehta and Bhattacharya 2000). India has persistently had an export surplus with Bangladesh and this surplus has been increasing over time. However, we can expect an increase in Bangladesh imports with the opening of the Indian market due to the lifting of quantitative restrictions on tradable in SAARC. Since SAFTA has been adopted, SAARC countries are expected to further reduce tariffs on a sectoral basis. With an increasing pressure on an already weak infrastructure, the entire system may collapse if appropriate remedial measures are not taken with regard to the movement of goods between the two countries.

Padeco (2005) computes that goods worth about US\$1,650 million are presently moved across the six SASEC corridors and that transport cost savings of about US\$25 million may be annually realisable. Reductions in transport costs have similar benefits to reductions in tariffs as there is a general stimulus trade, estimated at 5% for every 1% reduction in cost. The reduction in the costs to end-users of goods moved along the corridor is estimated at an average of 1.5% average which will stimulate trade and lead to an estimated 1% addition to regional GDP. The total first year direct benefits for the proposed measures are calculated as about US\$25 million, with over 75% of this sum being accrued from the Kolkata-Petrapole-Benapole-Dhaka corridor. On this corridor, large volumes of traffic are combined with large potential benefits. The distribution of benefits will be between international shipping companies which may gain about 6% of the total benefits; truck operators who may gain about 41% of the initial total benefits from a combination of savings in vehicle time through reduced delays; reduced speed/facilitation payments; and reductions

cargo loadings; Bangladesh Railways and the Indian IWTC, who may gain 5% of total benefits from reductions in operating costs; and importers, consumers of imports and producers of exports who may gain 48% of total benefits, largely from reduced cargo detention times.

These latter benefits are most likely to filter to the poorest sections of the community. It is estimated that Bangladesh, will gain about 63% of total benefits, this mainly due to savings at the Bangladesh/Indian borders, which will mainly benefit Bangladeshi consumers, producers and Bangladeshi truck operators. India will gain about 21% of total benefits and the proportion of these savings that are likely to be absorbed by the Indian trucking industry. Accordingly, GDP in Bangladesh may grow by 1.6%. Subregional parts of India, mainly Bihar and West Bengal, may grow by 0.4% growth which is lower than that for the region as a whole, because of the very large population in the subregion and the country's share of benefits is incommensurate with the population affected.

The socio-economic impact on the rural population living along a transport corridor needs to be considered and quantified. This includes impacts on agricultural activities, non-agricultural activities, distance to markets, and access to education, health facilities, and to political participation. These translate into measurable benefits (time savings, improved connectivity and access to markets), reflected as:

- National benefits manifested as increased trade between countries, reduced vehicular operating costs, and times savings
- Local benefits such as increased local employment due to better job opportunities, improved health due to smoother traffic flows and less congestion, better access to education due to improved connectivity.<sup>9</sup>

### The Project

For this analysis, we consider a specific section of the corridor which will help in immensely easing the heavy current as well as future traffic flows. NH34 and SH1 have already been considered under ADB's West Bengal Corridor Development Project (ADB 2001a and b). We

<sup>9</sup> AITD (2003) estimates that for a national highway: mobility for work increases 32%; use of the road for various purposes increases 79%; probability of incidence of poverty reduces 17%; rural proportion of non-agricultural workers increases as much as 50%; over all school enrolment increases 40%, and for girls alone 17%; and access to amenities such as electricity, drinking water, and sanitation increases 22%

consider improvements along NH35, which the government is considering and, additionally, improvements at the border points. The remedies suggested are:

- Upgradation of the Barasat-Bangaon national highway (NH35) with two-lane facilities and provision of illumination. It is currently a very poor motorable single lane road of 60 km length. Civil works includes widening and improving road geometry and drainage, environmental and road safety considerations, and provision of graded railway crossings.
- Upgrading the Naobhanga Bridge, 3 km short of Petrapole. The bridge is currently in extremely bad shape. Improvement work will include reconstruction of the bridge along realigned sections
- Building of 5 railway overbridges on the railway crossings en route the export road to Petrapole
- Construction of two gates at the Petrapole border; one each for import and export cargo and making the area two-lane by demolishing trees and small sheds which are creating obstacles
- Creation of truck terminal and warehousing facilities on 16 acres of land at Petrapole procured by CWC and provision of rest-stop facilities
- Building cross-border trade and customs facilities including building, lighting, sheds, parking bays, and other infrastructure need to be constructed. The facility will also require communication and customs systems and administrative systems

Projections have been carried out for the project area and are presented in Table 9.5.

**Table 9.5 Project Cost Estimates**

Kolkata-Bangaon	\$ million
Civil works, equipment, and bridges	90
Land acquisition and resettlement activities	10
Consulting services	2
Design and construction	3
Work at Petrapole	11
Upgradation of warehousing facilities	9
<b>Total</b>	<b>125</b>

The traditional view holds that highways facilitate intercity travel and transport of goods. However, large-scale investment in road infrastructure is an effective and viable policy measure for poverty alleviation. In

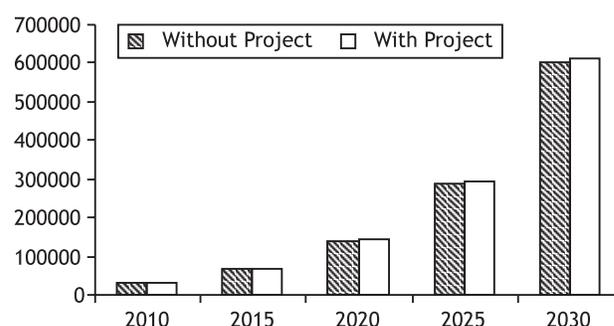
this section, we quantify two types of benefits emerging from the project: increased trade and local employment benefits.

**Increased Trade:** India’s share in the total imports of Bangladesh grew from 3.6% in 1980, to 9.37% in 1995, and in 11.1% in 2000. However, India’s share of imports from Bangladesh remained less than 1% between 1990 and 2000. The rate of growth of India’s exports per annum over the years has been increasing at a very high rate since 2000; the rate of growth of exports per annum has been over 20% and the rate of growth of imports has been 20–40%. More efficient movement of trucks and shipments will result in increased trade. Assuming a 6% growth in GDP over time (pessimistic scenario), we forecast trends in imports and exports for the period 2008–30 (Table 9.6).<sup>10</sup>

**Table 9.6 Indo-Bangladesh Projected Trade Balance (US \$ million)**

Year	Exports	Imports	Trade balance
2008	2,596.06	199.70	2,396.36
2010	3,482.70	269.29	3,213.41
2015	7,259.69	199.32	7,202.92
2020	13,661.85	568.60	6,691.09
2025	15,132.84	1,200.60	13,932.23
2030	65,754.41	5,352.83	60,401.57

We make a conservative estimate regarding the with-project scenario for our analysis. We assume that benefits from growth in trade due to the project will accrue after the project is completed, i.e. only after five years. We assume a conservative scenario whereby with the project there is only further 2% increase in exports and 4% increase in imports, i.e. imports will grow at a higher rate since we expect with SAFTA, it will be easier for Bangladesh to export to India. Thus, there is an



**Fig 9.3 Trade Balance with and without Project Scenarios**

<sup>10</sup> For the function  $\log \text{GDP} = a + b \log X$ , we obtain  $b = 2.76$  with  $R = 0.96$ ;  $SE = 1.33$ ;  $t\text{-stat} = 16.76$  for  $\log \text{GDP} = a + b \log M$ , we obtain  $b = 1.74$  with  $R = 0.76$ ;  $SE = 2.55$ ;  $t\text{-stat} = 5.52$  which we use to make forecasts over a 25 year period.

improvement in Bangladesh's trade balance. The increase in trade is the difference in the trade balance in with- and without project scenarios.

**Access to Education, Markets, and Infrastructure:** Several quantifiable benefits emerge for the local population with better connectivity. These will not be large as compared to the figures of improved trade but they can be compared to the resettlement costs to see long-term local benefits emerging from the project. The corridor under consideration is in proximity to SH1, and has features similar to this and SH10.<sup>11</sup> The categories of affected persons include project affected households and communities, both vulnerable and non-vulnerable; small business enterprises (SBE), such as tea shops, temporary markets, or mechanics; and informal dwellers or squatters, who are illegal or unauthorised occupants. While there will be costs of relocating these persons and structures, there are increased opportunities for them as well. In order to compute incremental benefits from better access to education, markets and infrastructure facilities, we compute a valuation for time savings in Table 9.7. Assuming each person saves 2 hours a day and can be gainfully employed in this time, we attach a monetary valuation to the time savings for 2000 households. This is valued at the current wage rate at Rs 10 per hour.

**Table 9.7 Estimated Time Savings from the Project**

	Unit
Current time savings per household per day	120 minutes
Total time savings per household annum	92 days
Number of beneficiary households in the area	2000
Wage rate at Rs 10 per hour, savings per household	Rs 7,300
Benefits from Time Saved	Rs 14,600,000
Benefits from Time Saved	\$339,535

### Employment Benefits

Normal road projects have a high labour component and wage bills are approximately 30% even for large national highway projects. Hence, we can make a conservative assumption that 20% of projects costs is the wage bill, which is a direct benefit for the people of the region. Indirect employment benefits will come from increased employment opportunities in the region due to better connectivity and facilities. We assume that

employment benefits accrue only during the time of project implementation.

**Total Benefits:** A summation of national benefits from increased trade and local benefits from increased employment and education and market opportunities yields total benefits from the project. The trends of additional benefits with the project over time are in Table 9.8.

**Table 9.8 Total Benefits from the Project (US \$)**

Year	National Net Exports	Employment Benefits	Time Savings	Net Benefits
1		2,500,000		-10,000,000
5		2,500,000		-10,000,000
10	78,918,155		339,535	79,257,690
15	164,112,799		339,535	164,452,334
20	341,265,215		339,535	341,604,750
25	709,619,187		339,535	709,958,722

### Benefits Costs Analysis

The detailed result of a benefits costs analysis, should the government undertake such a project on its own, is conducted as the base scenario. We take a 27 year scenario with \$125 million as project costs incurred over the five years at 10% in the first year, 20% in the second, 30% in the third and fourth year, and 10% in the last year. 20% of costs are the wage bill. Trade and time-savings benefits are assumed to accrue only after the end of the project. We take \$1 million as maintenance costs in two phases. The main results from the exercise are summarised in Table 9.9.

**Table 9.9 Results from Benefit-Cost Simulations**

	Economic Rate of Return (%)	Net Present Value (NPV) (\$)
<i>Base Calculation</i>	37.73	638,788,238
Benefits lagged by 1 year	24.36	441,535,923
Benefits lagged by 2 years	22.70	350,285,175
<i>Costs up by 10%</i>	35.78	629,890,479
Benefits lagged by 1 year	23.23	424,693,737
Benefits lagged by 2 years	21.66	334,294,177
<i>Benefits down by 10%</i>	35.99	567,933,080
Benefits lagged by 1 year	23.22	382,254,281
Benefits lagged by 2 years	21.64	300,794,717

The base calculations have been computed with the conservative assumption that the project will lead to

<sup>11</sup> ADB (2001b) estimates 1834 persons are affected along SH1 and SH10 in West Bengal (including bypass) as, categorised according to ownership of structures. Retail service shops along the roads are 35% while food kiosks are 29%. Over 60% of the small businesses are owner-operated.

2% increase in exports and 4% increased in imports from projected levels and that the benefits will accrue only after the project is fully completed. The NPV at this base case is \$638 million and the EIRR is 37.73%. Both the NPV and EIRR for different scenarios indicate that the project is economically viable and they are not overly sensitive to decreased benefits or increased costs.

## ■ BAGDOGRA AS A GATEWAY AND HUB

ADB's Tourism Development Plan (2005) cites strong support from tourism stakeholders in northeast India, particularly in Sikkim, for establishing Bagdogra in Siliguri district, West Bengal, as an international airport. The TDP recommends a planning study to assess potential tourism benefits. A preliminary analysis is provided here. Development of Bagdogra airport will open vast tourism potential in Bhutan, Sikkim and the northeastern states of India, eastern Nepal, and northern Bangladesh. Bagdogra will provide an alternative and additional gateway to Kathmandu for mountain tourism. New and innovative packages can be developed over time. We consider here the principal economic impacts of tourism, geographical distribution, direct and indirect financial and economic benefits and costs associated with tourism, and the impact on economic welfare in the northeast region of India (excluding West Bengal).

India's tourists mainly come from North America, Western Europe, and South Asia, which respectively accounted for 19%, 31%, and 24.5% of arrivals in 2003. Bangladesh alone accounted for 455,000 tourist arrivals in 2002, or 17% of the total. New Delhi is the main port of entry for foreign tourists into the country. Kolkata accounted for 3.7% of total arrivals in 2003 but for 5.5% of the South Asia arrivals. The number is likely to be much higher when overland cross-border traffic is included. Foreign arrivals to the northeast states are low, averaging only about 19,000 annually over the last 5 years. Sikkim has been successful in attracting high-yield domestic market segments as well as trekkers, youth training groups, and adventure enthusiasts.

Despite a wide range of tourist attractions, the eastern Himalayan region has been unable to achieve the full potential of benefits from tourism. At the subregional level, Bangladesh's has poor tourism image abroad and Bhutan's high-end tourism policy has not helped the region. The TDP summarises the main issues as: air access and connectivity constraints; security and safety concerns; weak tourism infrastructure, including



Fig 9.4 Bagdogra Airport

road, rail, air, electricity, water, sanitation, and telecommunications; poor standard of their tourist services, particularly health and hygiene facilities, attitudes toward hospitality, and the dearth of tourist information and wayside amenities for road travel; and complex requirements for inner line and protected area permits (PAP) for Arunachal Pradesh, Mizoram, and Nagaland in India's North East, and trek permits and various other restrictions on internal travel. Multitude of PAP regulations relating to tourism, environment, forest, ecology, and wildlife exist, many promulgated before independence. Tourism operators report that the complexity of the legislation is a constraint to development. Only Assam currently has one recognised tourist transport operator. There are no Ministry of Tourism recognised operators in these categories for any of the other northeastern states or Sikkim. Indian tourism includes an enormous unorganised sector that supplies vital services to visitors without the use of trained personnel.

## The Potential

The rugged, mountainous region of India comprises mostly poor rural farmers and there is vast potential to develop its tourism attractions. The rich, natural flora and fauna allows for the development of ecotourism such as wildlife and jungle tourism; nature and mountain trekking; and leisure traffic trips planned around orchid and pineapple orchards. Village and tribal experiences can be planned around the rich art and culture traditions. Dance forms of the northeast are varied and well-known. The themes may be religious, social, agricultural or recreational. Traditional handicraft skills have been handed down over generations and are integral to the daily lives and routines of the people of the region. The range of crafts

in the region includes cane and bamboo products, textile weaving, woodcarving, carpet making, jewelry, hand-made pottery, brass cutting, silver works, articles made with goat hair, boar tusks, and beads.

Proper infrastructure development will assist the region in business and trade. Tea is a major revenue generator and plays a very important role in improving the economy of the region. Assam and Tripura are the traditional tea growing areas in this region. Assam accounts for almost 53% of the all India production of tea and 20% is annually exported. As tea is a labour-intensive crop, the plantation industry provides gainful employment to a large section of the population directly and indirectly across the country through manufacturing and marketing. The region can produce very high quality, organic teas as tea is planted in virgin areas. There is great opportunity for export of good quality tea from the region in the long run.

Improved connectivity will also open up a wide range of agribusiness and trade possibilities for the region. The region has comparative advantage in several horticultural products and the opening of an airport will allow the products produced here to enter the vast domestic as well as global market, especially in South East Asia. Products include orchids, flower bulbs, foliage, medicinal plants, citrus fruits, hot cherry peppers, cardamom, ginger, turmeric, organic vegetables, and tropical fruits.

A large segment of the northeastern states have international borders. Trade along and across the borders has been significant for the economy of the region as a whole. The Border Trade Agreement between India and Myanmar that came into effect in 1995 provides for border trade initially through two points – at Moreh in Manipur and at Champhai in Mizoram. Mutually identified points are to be subsequently considered. There is no formal point of

trade with the People's Republic of China. Improved connectivity to the region will open opportunities for trade with these neighbouring areas as well. Although to begin with the impact may not be significant for the national economy, over time connection to the southeast and east Asia region and the People's Republic of China will bring considerable benefits. Increased connectivity will allow for increased business opportunities, more business travel, and increased employment opportunities in the region for the unemployed youth and the landless labourers which will minimise social unrest in the rural areas.<sup>12</sup>

### The Project

Bagdogra is a civilian airport, approximately 18 km from Siliguri in northern West Bengal. The proposed project is upgradation of the Bagdogra airport to an international airport which allows for short-haul flights for both passengers and cargo and needs to provide for the following:

- Basic international airport facilities including paved runways that are as maintenance-free as possible; runway strip at least 90 meters wide; passenger terminal buildings and basic security; stock-proof boundary fencing; water supply and sewerage facilities; and maintenance equipment for facilities and structures
- Operational facilities including control towers; automatic weather observation systems; precision approach path indicators; other visual aids to identify runways when visibility is poor; and generators

We work out the preliminary cost estimates in Table 9.10 based on airports authority of India (AAI) estimates for domestic airports as well as some estimates for international airports, which have features similar to that of Bagdogra.<sup>13</sup> Costs of \$150 million are taken

<sup>12</sup> Sanjib Baruah, 'The Problem', *Manipur Online*, 23 November 2005, writes that the region's difficulties as a result of the loss of connectivity and market access following 1947 partition are well known but there is also an older story of colonial geopolitics that cut the region off from its neighbourhood across the eastern and northern borders. 19th century British colonial decisions to draw lines between the hills and the plains, to put barriers on trade between Bhutan and Assam, and to treat Myanmar as a buffer against French Indo-China and the People's Republic of China severed the region from its traditional trade routes – the southern trails of the Silk Road. While colonial rulers built railways and roads mostly to take tea, coal, oil and other resources out of Assam, the disruption of old trade routes remained colonialism's most enduring negative legacy. After a century and half the opportunity has now arisen to undo the effects of colonial geopolitics. While economics dominate discussions of what the Look East policy could do for the region there are potential non-economic dividends as well. Transnational ties could speak to Northeast India's current political troubles. The opportunities that economic integration with its transnational neighbours could open up for Northeast India are enormous. Sanjib Baruah, 'The Problem', *Manipur Online*, 23 November 2005.

<sup>13</sup> The airports authority of India (AAI) announced that it would seek funds from capital markets to help meet the estimated Rs 40,000 crore, or \$8.7 billion, cost of modernising about 30 non-metro airports across the country. AAI also allocated an additional \$2.2 million to its \$8.1 million construction project at the Surat Airport (approximately Rs 22 crore). The work includes an upgradation of the runway and a new terminal building. International airport estimates for Bamyán, Afghanistan and Bowers Field, Washington, have been taken into consideration for this analysis.

**Table 9.10 Project Cost Estimates for Bagdogra**

Item	US\$ million
A. Base Cost	
1. Rehabilitation of Airport	
(a) Airside Civil Works	
Runway construction and overlay	24.00
Shoulder pavement	4.40
(b) Landside Civil Works	
Apron construction	3.20
Construction of Hangar	8.50
Customs facilities	52.00
New Terminal construction	25.00
Auto parking area	2.90
(c) Other Capital Investment	
Airport roadways and signages	1.00
Security and wildlife perimeters fence	1.00
(d) Equipment	
Navigation Aids	3.50
Maintenance Equipment	5.50
2. Human Resource Development	5.00
3. Post-construction Operations Assistance	1.00
4. Project Management and Monitoring	1.00
5. Administrative Support	1.00
6. Contingencies	
(a) Physicals	9.00
(b) Price	2.00
<b>Total</b>	<b>150.0000</b>

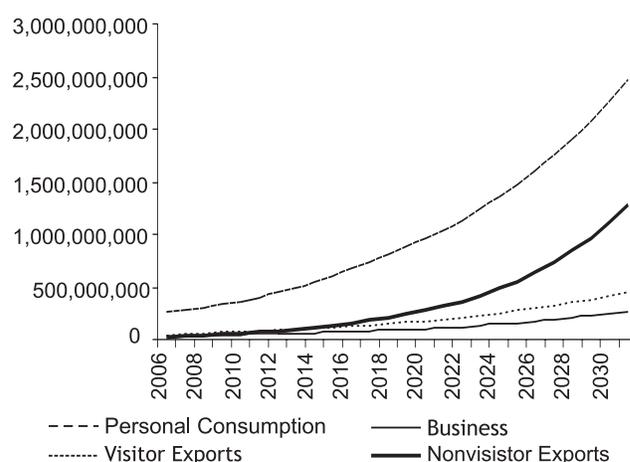
to include building of a new terminal with international standards and customs facilities.

Tourism is an extremely important sector for the economy. It is a labour-intensive sector that helps generate employment, which is particularly valid in the context of the ‘jobless growth’ phenomenon affecting several developing countries where rapid growth of GDP has not led to significant growth of employment. Tourism in all forms makes substantial contributions to national income, foreign exchange earnings, employment, and government revenues. Nature tourism is particularly important in the context of sustainable development. The currently used standard methodology for tourism statistics was developed by the World Tourism Organisation in 1990 to enable more meaningful measurement, utilisation, and understanding of data by countries, and to allow for better cross-country comparisons.<sup>14</sup> We consider the trends in travel and tourism demand and compute:

- Direct benefits, including expenditure on personal travel and tourism; expenditure on business travel; expenditure on visitor exports; and employment benefits from the project; and

- Indirect benefits, including expenditure on non-visitor exports.

Growth trends based on WTTC data are presented in Table 9.10 and this is used to project trends over the life of the project and presented in Figure 9.5.



**Fig 9.5 Trends in Tourism Categories for Northeast Region of India**

**Personal Consumption:** This includes all personal spending by the economy’s residents on travel and tourism services, including lodging, transportation, entertainment, meals, financial services, and goods. The India trends and trends for the northeastern states is as follows without the project. Increase in personal consumption has been at over 10% per annum. Based on WTTC forecast for the coming 10 years, it is estimated that even without project, this category will grow at 9% over the coming 25 years.

**Business Consumption:** Also known as intermediate consumption, this includes expenses of government and industry for employee business purposes, including transport, accommodation, and meals. Trends show a growth of 9%.

**Visitor Exports:** Visitor exports include expense made by international visitors on good and services in the resident economy. Here again the growth trends have been over 10% and we take 9% growth rate for our analysis without the project.

**Employment Benefits:** The employment associated with travel and tourism demand is the broadest measure of the sector’s contribution to a domestic economy.

<sup>14</sup> WTTC’s conceptual framework is in accordance with the UN-approved standards. Annex 1 summarises world and South Asian data for these categories and projections.

Airlines, hotels, car rentals, companies, as well as manufacturing, construction, etc., are establishments that grow and contribute towards economic activity. However, we do not compute this into benefits calculation as this is already accounted for in the expenses on personal and business tourists, both domestic and foreign, on goods and services and would cause double-counting. Tourism has expanded greatly in the past two decades and is reportedly the world's largest industry and provider of jobs, although measurement is extremely difficult and accurate statistics are scarce (WTTC 2003). It is estimated that international tourism generated about 10% of global GDP in 1994, accounted for over 10% of all consumer spending, created more than 12 million new jobs and provided more than \$650 billion in tax revenues to governments. The magnitude of these figures explains why tourism is, or should be, a priority concern of governments worldwide. For the project, we consider 20% of project costs as wage bill which is a direct benefit to people in the region.

**Non-visitor Exports:** Non-visitor exports are indirect benefits from Tourism which include expenses on consumer goods such as clothing, electronic items, and petrol, which are exported for ultimate sale to visitors and capital goods such as aircrafts and cruise ships exported for use by the travel and tourism, providers. The growth trends for this category are very high at over 18%. We assume that this will grow at 15% over the coming years without the project.

**Table 9.11 Growth of Travel and Tourism in Northeastern States (US \$ million)**

Year	Personal Travel	Business Travel	Visitor Exports	Non-visitor Exports
2006E	280.71	36.71	52.68	33.14
2007E	302.69	38.64	59.88	39.77
2008E	330.24	41.29	66.36	47.54
2009E	365.08	44.67	72.72	56.82
2010E	404.71	48.44	79.68	67.92
2011E	448.69	52.52	87.36	81.18
2012E	497.48	56.95	95.76	97.02
2013E	551.55	61.77	105.00	114.10
2014E	611.51	67.02	115.08	134.13
2015E	677.97	72.74	126.12	157.83

Source: Computed based on WTTC 2005

**Total Benefits:** A summation of total direct and indirect benefits will give us a figure for total tourism benefits. We do not for our analysis consider benefits from increased exports of goods already in the export market

such as tea and handicrafts or potential exports of agricultural commodities. Past trends indicate a 10% growth per annum for each category except for non-visitor exports which have grown at over 18%. We now make a conservative assumption that with the project, that there is a further growth of 5% overall in the economy of the region for each of the categories. We then take the projected project benefits as the difference in benefits from without the project and with the project. Thus the trends in additional benefits from each of these categories is presented in Table 9.12.

**Table 9.12 Total benefits from the project (US \$)**

Year	Increase in Personal Consumption	Increase in Business Expenditure	Increase in Visitor Exports	Increase in Non-visitor Exports
1	13,256,700	1,717,926	2,256,000	1,375,782
5	18,254,040	2,233,260	3,636,000	2,841,150
10	30,575,340	3,351,078	5,754,000	6,706,680
15	47,850,584	5,133,713	8,901,434	13,802,703
20	67,545,004	7,246,655	12,565,100	24,141,013
25	103,926,362	11,149,878	19,332,964	48,556,200

### Benefits Costs Analysis

The direct costs of the project are the costs of investing in upgradation of the existing airport to international standards to allow for a small number of international flights, perhaps initially from the subregion and southeast and east Asia. We perform the BCA as though the government undertakes such a project on its own. We take a 25 year scenario with \$150 million as project costs incurred over the five years at 10% in the first year, 20% in the second, 30% in the third and fourth year, and 10% in the last year. 20% of costs are the wage bill, and the benefits are assumed to accrue only after the end of the project. We take \$1 million as maintenance costs in two phases after 10 years. This is over and above the regular costs for maintenance which

**Table 9.13 Results from Benefit-Cost Simulations**

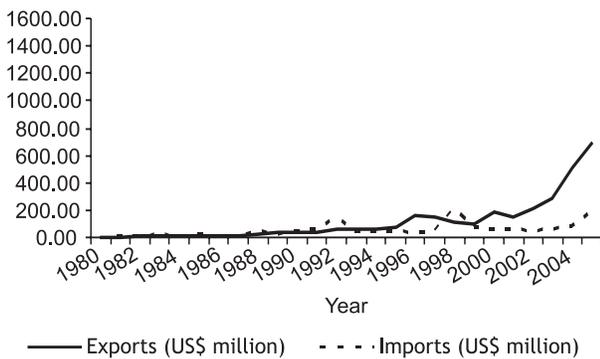
	Economic Rate of Return (%)	Net Present Value (NPV) (\$)
<i>Base Calculation</i>	19.05	87,237,232
Benefits lagged by 1 year	17.35	82,091,574
Benefits lagged by 2 years	15.48	53,482,992
<i>Costs up by 10%</i>	17.99	78,721,352
Benefits lagged by 1 year	17.93	128,713,344
Benefits lagged by 2 years	14.55	41,642,351
<i>Benefits down by 10%</i>	17.88	69,955,064
Benefits lagged by 1 year	17.82	114,564,718
Benefits lagged by 2 years	14.44	36,200,825

are expected to be met with revenues raised by the airport by ways of entry fees, parking charges, etc. The main results from the exercise are in Table 9.13.

The base calculations are computed using conservative assumptions. The costs for upgradation have been taken as much higher than estimated for other similar projects in India and abroad. We have assumed the project benefits increase by 5% and that the benefits accrue only after the project is fully completed. The Net Present Value (NPV) at this base case is \$87 million and the Economic Internal Rate of Return (EIRR) is 19%. Both the NPV and EIRR for different scenarios (Tables B10 and B11) indicate that the project is economically viable and they are not overly sensitive to decreased benefits or increased costs.

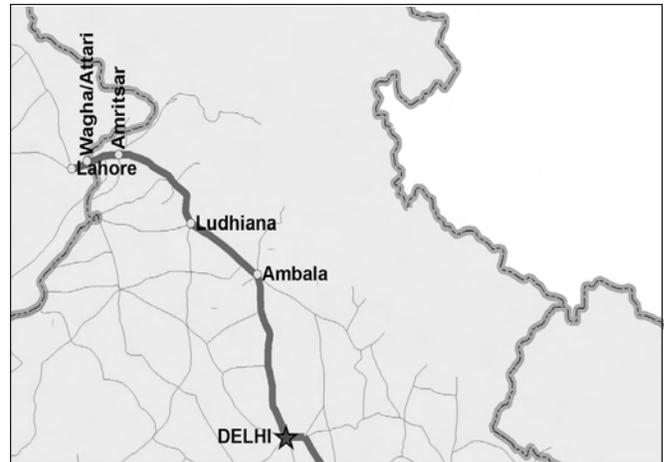
**RAILWAY IMPROVEMENT PROJECT FROM LAHORE TO WAGAH**

Trade relations between India and Pakistan have been governed by political considerations. Taneja (2007) has made a detailed analysis of Indo-Pakistani trade. Although still very low, the trade has grown significantly since 2001 when India's export were US \$144.01 million to 2006 when India's exports are \$ 689.23 million. The trade balance is in India's favor and has grown six times in this period.



**Fig 9.6 Indo-Pakistan Imports and Exports, 1980-2006**

Taneja (2007) summarises that trade between the countries takes place by all modes of transport – air, rail, sea, and road. The most feasible and cost-effective way of moving goods between the two countries is over land but land transport is extremely inadequate. The only operational road route is through the Wagah border. Although India permits export and import through several other points in Amritsar, Ferozepur, and Jodhpur districts (notified under Customs Act,



**Fig 9.7 Lahore-Amritsar Rail Corridor through Wagah-Attari**

1994), Pakistan allows trade from India only through Wagah-Attari by rail and road. Goods from Kolkata are shipped to Karachi via Singapore. Only a limited number of items are allowed to be traded through the road route. Since 2005, Pakistan allows import of a few vegetables and livestock from India and allows the export only of cement to India by road. The road route between India and Pakistan has several bottlenecks which include single gate for goods and passengers; time restrictions; and number of trucks that could go across each day. Recent amendments of the road protocol allow Indian and Pakistani trucks to cross over to the border and unload, similar to the protocol between India and Bangladesh.

The restrictions on movements of goods by rail are more severe. Pakistan does not allow the import of cotton by the rail route through Attari since as per Plant Quarantine Rules, 1967, Pakistan, cotton may be imported only through Karachi port. The numerous textile mills located around Lahore have to import cotton through Mumbai and Karachi. Similarly India has restriction on movements of certain goods – molasses and cotton yarn – via rail. The two countries also do not allow transit facilities to each other. Pakistan allows goods from Afghanistan to be transported to India over land but does not allow Indian goods to transit onward to Afghanistan. India also does not allow Pakistan transit facilities through its territory to Bangladesh and Nepal. The inland ports' idea which received much thrust from Government of India's Ministry of Commerce and Ministry of External Affairs, was objected to by the Ministry of Home Affairs on the ground of security concerns. However, the ICP notion to develop border trade is being pursued.<sup>15</sup>

<sup>15</sup> *Times of India*, 4 Dec. 2006, 'New border points set to open up for trade' by Indrani Bagchi.

Taneja (2007) highlights the bottlenecks for rail transportation. Currently goods move by rail by the goods wagon or by parcel wagons that are attached to the passenger train *Samjhauta Express* and rakes are allowed to ply from some cities in Madhya Pradesh. The features of this movement are as follows:

- Goods transported by Samjhauta Express parcel wagons move at fixed timings on a biweekly basis.
- The same number of parcel wagons (10) move on every trip, whether loaded or unloaded.
- There is no fixed timing for a goods train but the trains are not allowed move across the border after 5:00 pm as security concerns are cited.
- The number of rakes/wagons that can ply from Attari to Amritsar are determined usually on a monthly basis.
- Under a reciprocal arrangement between the two countries, the wagon balance has to be cleared every 10 days between the two countries.
- There is a scarcity of wagons since demand exceeds supply. For each month from December 2006 to March 2007, 20 rakes per month were permitted while the demand was estimated at 1,000 rakes per month. The scarcity leads to high transaction cost and bribes to the tune of US\$ 2.5 per tonne in India. Pakistani traders pay a corresponding bribe of US\$ 1.5 per tonne.
- Goods are oftentimes stranded for as long as 20 days and sometimes the allotment of wagons takes two months.
- Since wagon balancing takes place only thrice a month, there is a scarcity of wagons till such time that there is a zero balance. From the sixth day onwards, railway authorities try to restrict the number of wagons to be moved across the border.
- The Indian crew and engine does not move into the Pakistani territory and vice-versa. Only the wagons are allowed to move from one country to another with the respective country's engine and crew.
- The handling capacity at Lahore is limited to 20 rakes. Thus increase in rail wagons/rakes from India needs simultaneous increase in handling capacity at Lahore.
- Wagons currently used are antiquated.
- There is no provision for movement of containerised rail cargo from Amritsar and all containerised cargo has to be moved by sea.
- Lack of space for customs house agents, poor condition of sheds, obsolete weighing and X-ray (only one) machines, and lack of regular communication between rail and customs officials are additional problems.

Exporters in Kolkata interested in exporting over land are unable to book rail wagons and are, therefore, forced to send shipments from/to Karachi through transshipment at Singapore. From Karachi the goods are transported by the land route to Lahore which hugely increases transportation costs.

### The Potential

Although recent trends show number of people crossing the borders over land have decreased, the duty collected by customs authorities has gone up from Rs 295,000 in 2002–03 to Rs 1.04 million in 2005–06 and Rs 2.6 million in 2006–07. Commercial trade between both sides dealing in vegetables, meat, fruits, livestock, and other products has reached Rs 600 million. In the period January-October 2007, 715 trucks loaded with

**Table 9.14 Route-wise Transactions Costs (TC) per Container**

Costs in USD	Delhi-Attari, Rail	Delhi-Attari, Road/Rail	Delhi-Mum- Karachi, Rail/Sea	Mumbai- Karachi Sea	Mum-Dubai- Karachi, Sea	Mum-Karachi, Switch Bill of Lading
Rail/Road	325	338	460			
Sea			550	550	750-950	550
Transport costs	325	338	1010	550	750-950	550
Bribe for clearances	21	32	48	26	26	26
Other bribes	45	45				200
Total Bribes	66	77	48	26	26	226
Total TC	391	415	1058	576	776-976	776
Transport time(day)	1	1	1.5	6	4	6
Delay (days)	12	12	7	7	8	10
<b>Total time (days)</b>	<b>13</b>	<b>13</b>	<b>8.5</b>	<b>13</b>	<b>12</b>	<b>16</b>

Source: Taneja, 2007

tomatoes and other vegetables had gone from India to Pakistan; the trade of tomatoes alone in this period was worth Rs 143 million.<sup>16</sup> Direct trade among the countries is expected to go up significantly with the allowing of trucks to cross the international border.<sup>17</sup>

Railways are the most economical and fuel-efficient mode of transportation and there is significant potential for containerised cargo movement. A bilateral agreement with several components including streamlined documentation procedures, operationalisation of third country traffic and transit, removal of wagon-type restrictions is required to realise the full potential of trade via railways but the project is restricted to infrastructure improvements as a first step.

Taneja (2007) estimates TC imposed on importers and exporters for not being able to avail of the direct rail link to transport goods. The costs are estimated as money costs, which includes bribes to customs officials, police, border authorities, and others for the procedural clearances. Transport costs for various rail, truck, air and sea routes between the countries was surveyed. It is found that Mumbai-Dubai-Karachi and Delhi-Mumbai-Karachi routes are most efficient in terms of transaction costs per container-kilometre (Table 9.14). However, even if one considers total bribes, costs per container are lowest by the direct rail route which cannot be utilised as it is not always available. Actual transport time is also lowest on this route but delays are due to time taken in obtaining clearances and procurement of wagons.

Taneja's survey of traders reveals almost every exportable item is exported to Pakistan through third countries and that cross-border informal trade occurs though bus and rail passengers.

## The Project

The most significant rail corridor connecting India and Pakistan is the corridor from Lahore connecting to the Indian Railways network by broad gauge. The link from Lahore is 28 km to the Indian border through Wagah/Attari. The corridor from Attari is connected to Kolkata through Amritsar. The Attari-Amritsar section of 23 km is single line and not electrified. The Delhi-Kolkata corridor is capable of handling very high volumes of both passenger and freight traffics. However, inadequate handling capacity at Lahore and insufficient infrastructure facilities at the rail cargo

station in Lahore add to transaction costs. Lack of EDI facilities at both sides of the land border slows down the movement of consignments.

For this analysis, we consider physical barriers on the Pakistan side which require being addressed (SAARC 2007). The project components are:

- Rehabilitation of the 28-km section between Wagah and Lahore, from single-lined and non-electrified to electrified section, and that of associated structures.
- Provision of air-brakes locomotive and freight wagons on Pakistan railways.
- Computerisation at the border.

The project investment costs are summarised in Table 9.15.

**Table 9.15 Project Cost Estimates**

Kolkata-Bangaon	\$ million
Civil works	52.9
Equipment	2.8
Land acquisition, resettlement, and social mitigation	3.8
Upgradation of warehousing facilities	7.9
Restructuring costs	0.7
Contingencies	1.5
<b>Total</b>	<b>73.0</b>

Besides boosting trade, the benefits from improved railway infrastructure is immense which includes cost and time savings to traders. There is also reduced fuel consumption since railway traffic is more fuel-efficient than road traffic, resulting in savings in carbon dioxide emissions. Further there are reduced costs of future road maintenance and reduced incidence of road accidents. Offsetting increases in railways accidents are negligible and not estimated. We quantify two types of benefits for this analysis: increased trade and local employment benefits.

**Increased Trade:** India's exports to Pakistan as a percentage of total exports have been negligible at less than 1%. The import and export growth figures show fluctuations due to the political relations between the countries. However, there has been a rising trend since the late 1990s with the rate of growth of exports being 43% in 2002–03, 82% in 2004–05 and 32% in 2005–06 while import growth for corresponding years has been – 31%, 64%, and 89%. We forecast the trends

<sup>16</sup> 'Peoples movement down, Trade volume up between India-Pakistan', <http://www.thaindian.com/newsportal/india-news/>

<sup>17</sup> Sarin, Jaideep, 'After 60 years, India-Pakistan trade finds a direct link', <http://www.indiaenews.com/business/20070928/72520.htm>

in imports from period 2008–30 without the project assuming a pessimistic 6% GDP growth and assume exports will further go up by 10% with the project since growth of exports to India had been very high in the past 5 years.

**Table 9.16 Pakistan’s Projected Exports to India with and without the Project (US \$ million)**

Year	Exports without Project	Increased Exports Due to Project
2008	241.10	265.21
2010	292.66	321.93
2015	475.12	522.64
2020	771.33	848.47
2025	1252.22	1377.44
2030	2032.90	2236.19

**Employment Benefits:** Normal rail projects have a high labour component and wage bills are approximately 30% even for large projects. Hence, we can make a conservative assumption that 20% of projects costs is the wage bill, which is a direct benefit for the people of the region. Indirect employment benefits will come from increased employment opportunities in the region due to better connectivity and facilities. We assume that employment benefits accrue only during the time of project implementation.

**Time and Costs Savings:** We make a similar assumption as in the case of the Petrapole-Benapole project and assume that a small section of the local population saves 2 hours a day due to reduced congestion and improved access to markets. There is also increased employment benefits in the area. We value this conservatively at \$600,000.

**Total Benefits:** A summation of national benefits from increased exports and local benefits from increased employment and access to goods yields total benefits

**Table 9.17 Total Benefits from the Project (US \$)**

Year	National Net Exports	Employment Benefits	Time Savings	Net Benefits (\$ million)
1		2,000,000		-8,000,000
5		2,000,000		-8,000,000
10	35,525,817		600,000	36,125,817
15	57,674,106		600,000	58,274,106
20	93,630,572		600,000	94,230,572
25	152,003,812		600,000	152,603,812

from the project. The trends in additional benefits with the project over time are summarised in Table 9.17.

### Benefits Costs Analysis

The detailed result of a benefits costs analysis, should the government undertake such a project own its on, is conducted as the base scenario. We take a 27-year scenario with \$73 million as project costs incurred over the five years at \$10 million in the first year, \$17 million in the second, \$20 million in the third, \$17 million in the fourth year, and \$ 10 million in the last year. 20% of costs are the wage bill. Trade and time-savings benefits are assumed to accrue only after the end of the project. We take \$1 million as maintenance costs in two phases. The main results from the exercise are summarised in Table 9.18.

**Table 9.18 Results from Benefit-Cost Simulations**

	Economic Rate of Return (%)	Net Present Value (NPV) (\$)
<i>Base Calculation</i>	32.12	187,176,733
Benefits lagged by 1 year	19.40	105,906,447
Benefits lagged by 2 years	18.08	81,793,884
<i>Costs up by 10%</i>	30.11	180,700,389
Benefits lagged by 1 year	18.23	94,788,398
Benefits lagged by 2 years	17.00	71,305,120
<i>Benefits down by 10%</i>	30.32	163,306,873
Benefits lagged by 1 year	18.23	85,377,524
Benefits lagged by 2 years	16.99	64,176,586

The base calculations have been computed with a conservative assumption that the project will lead to 10% increase in exports to India from projected levels and that the benefits will accrue only after the project is fully completed. The NPV at this base case is \$187 million and the EIRR is 32.12%. Both the NPV and EIRR for different scenarios indicate that the project is economically viable and they are not overly sensitive to decreased benefits or increased costs.

### ■ COLOMBO PORT EXPANSION<sup>18</sup>

Indo-Sri Lanka trade significantly increased after the signing of the bilateral FTA between the two countries. The trade gap dropped by two-thirds within five years of signing the agreement. In 2002, Sri Lanka exported \$167.7 million worth of goods to India, an increase of

<sup>18</sup> This discussion in this section is entirely based on ADB’s project ‘Proposed Loan Colombo Port Expansion Project (Sri Lanka): The Report and Recommendation of the President’, 2007.

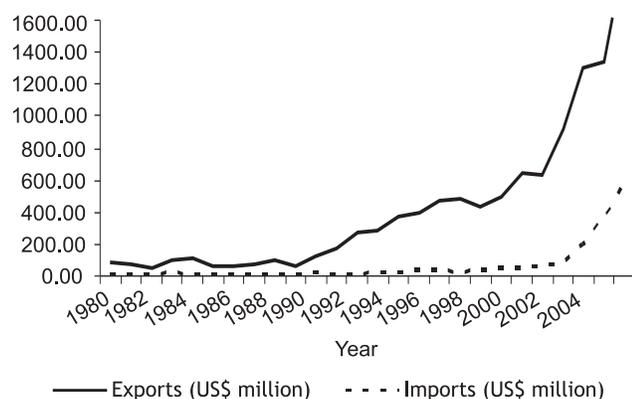


Fig 9.8 Indo-Sri Lanka Imports and Exports, 1980–2006

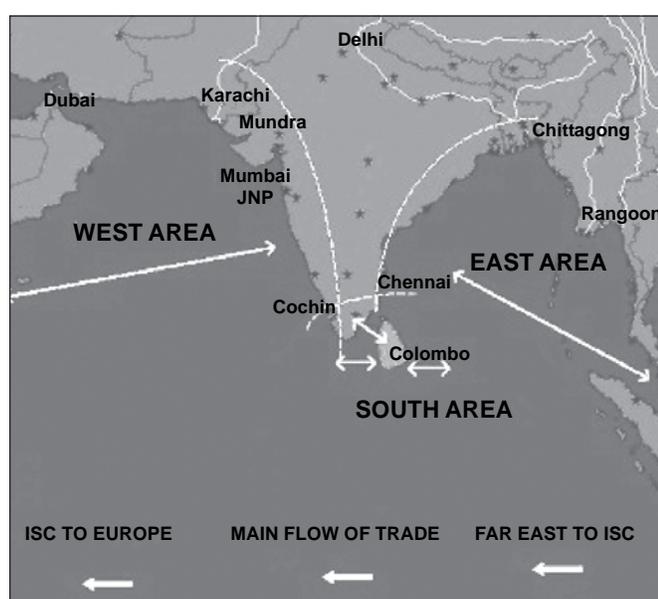


Fig 9.9 Location of Colombo

over 135% on the \$70.8 million recorded in 2001. India, in turn, sent exports worth \$831 million to Sri Lanka, up from \$604 million the year before.<sup>19</sup>

Ports are integral to trade for both countries as 90% of the total trade to and from India and Sri Lanka is carried by the sea route. Taneja et al. (2004) estimate that India has 12 major ports which handle 75% of its total port traffic. The Colombo port is also one of the major hub ports for India. A comparison between the Colombo and Mumbai's Jawaharlal Nehru Port Trust port shows that in 1998 Colombo ranked 24, its ranking fell to 35 in 2005 while JNPT which held the rank of 64 in 1998 improved to 30 in 2005 in terms of container handling.<sup>20</sup> However, in terms of equipment handling Colombo offers better facilities than JNPT. For instance Colombo has 21 quay cranes while JNPT has only 16, and Colombo has 69 other cranes while JNPT has only 47. Even if JNPT develops as a hub port, Taneja's survey shows that traffic from the southern part of India will continue to go through Colombo due to geographical proximity.

The Colombo port handles 95% of Sri Lanka's total international trade though majority of the traffic is for transshipment purposes. Since 1995, transshipment has accounted for around 70% of Colombo's total container traffic and over 74% of this transshipment is traffic to and from the Indian sub-continent, comprising India, Pakistan, and Bangladesh (ADB 2007). As Colombo is located close to the world's main shipping routes it has a locational advantage to develop as a hub port. The growth of Colombo port will allow it to increase its share of transshipment traffic from the South Asian region, primarily India.

Table 9.19 Composition of Container Traffic, 1995–2003

000 TEU	1995	1996	1997	1998	1999	2000	2001	2002	2003
Transshipment	700	979	1,233	1,191	1,152	1,129	1,157	1,147	1,287
Domestic	329	350	416	479	512	552	531	546	589
Re-stows	20	26	38	43	40	50	37	71	83
Total	1,049	1,355	1,687	1,713	1,704	1,731	1,725	1,764	1,959
Growth % pa		29.2	24.5	1.5	-0.5	1.6	-0.3	2.3	11.1
<b>Shares %</b>									
Transshipment	67	72	73	70	68	65	67	65	66
Domestic	31	26	25	28	30	32	31	31	30
Re-stows	2	2	2	3	2	3	2	4	4
<b>Total</b>	<b>100</b>								

Source: SLPA.

<sup>19</sup> 'Sri Lanka's Indian trade doubles', 2003, <http://news.bbc.co.uk/1/hi/business/2848411.stm>

<sup>20</sup> <http://aapa.files.cms-plus.com/Statistics/WORLD%20PORT%20RANKINGS%202005.xls>

## The Potential

The potential for Colombo Port comes not from increased Indo-Sri Lanka trade but from its potential as being a hub for trade from South Asian countries to the rest of the world. The Sri Lanka port authority (SLPA) aims for the Colombo Port to become a significant international player providing market-driven facilities and services to shipping lines. ADB (2007) estimates Colombo saw rapid growth in the early 1990s which averaged 20% per annum until 1998 when the growth stopped and the overall traffic volume remained static at about 1.7 million TEU per year despite India's accelerated GDP growth. It was only in 2003 that growth resumed at 11%. The main reasons for stagnation of container traffic are attributed to increased direct calls JNPT; competition from the new ports of Salalah, Aden, Tanjung Pelepas and Port Klang; high tariff levels at Colombo compared with competing ports, and failure to respond to falling prices; civil strife; low operational efficiency: low productivity, congestion and ship delay at the port.

ADB (2007) forecasts a positive business climate for Colombo Port. The container traffic forecast for container traffic both from domestic and Indian sub-continent (i.e. Bangladesh, India, and Pakistan) sources is shown in Table 9.20. It is noted that the economic growth of Indian subcontinent economies and the resulting growth in their import and export trades is the fundamental determinant of container transshipment volumes originating from these economies and hence Colombo Port's traffic opportunity.

**Table 9.20 Forecast of Traffic at Colombo Port (000' TEU)**

Indian Sub-Continent Container Transshipments				
	Domestic Container Growth Forecast	Forecast	% Trans-shipped via Colombo, Singapore, Salalah, etc.	TEU (000) Trans-shipped
2002	546*	4,739*	45*	2,133*
2005	727	6,658	39	2,597
2010	1,118	11,219	35	3,927
2015	1,643	17,262	33	5,696
2020	2,414	24,211	30	7,263
2030	4,975	47,626	26	12,383
2040	9,786	93,688	16	14,990

Note: \* represents actuals which was used as the base for projections. 2040 forecast assumes unconstrained by port capacity limitations (000 TEU).

Source: ADB (2007)

It is expected that the potential transshipment share of the Indian subcontinent market will decline over time due to increased direct calls. ADB's Colombo South Harbor project represents a landmark in project procurement and inward investment as well as recognising necessary reform. The impacts upon Colombo are expected to be significant, not only to the port users but to the entire community.

The Colombo port also needs to cater to the increase in domestic exports. Overall, Sri Lanka's exports accounted for 28% of GDP and imports for 37% in 2005. Almost all national imports and exports are containerised. Most exports are destined for Europe and the US. However, imports are often materials for use in export industry and they come from the Far East and significantly from the Indian sub-continent.

Hence potential to expand the Colombo port needs to consider the following points (ADB 2007):

- Significant volumes of Bay of Bengal container cargo are transshipping across Singapore or Port Klang for Europe and North America which is probably more expensive and longer than transshipment at Colombo. Colombo needs to investigate ways of supporting and encouraging more frequent and more regular feeder services, notably to Chittagong by offering other special deals.
- Capacity limitations at JNPT are prompting carriers to seek alternatives. Colombo offers a real alternative for European and Far Eastern cargoes and current users of JNPT should be targeted.
- The potential for partnering with a range of small ports, of which Vizag could be a key example, to modify cargo flows for joint benefit requires investigation. This must be done in a way that does not adversely affect other significant port relationships.
- The port is a national asset which should promote contacts with local exporters, importers and development agencies by demonstrating to them how the port is able to assist them. The growth of national cargo base is an important objective and direct foreign investment in local industrial export-oriented business is to be encouraged

## The Project

ADB's Colombo Port Expansion Project aims at the enhancement of operational efficiency at all of Colombo port's container terminals and investment in

port infrastructure which is urgently needed to increase its container-handling capacity and alleviate its depth infrastructure constraints to reverse this trend. It provides for dredging and breakwater construction sufficient to accommodate three terminals, which will be constructed sequentially. It includes the establishment of a new marine operations center, relocation of a submarine oil pipeline, provision of navigational aids, and construction of shore utilities. The project will be developed on a public-private partnership basis. The first two terminals are expected to be operational in 2010 and 2015 respectively and constructed by operators chosen through open competitive bidding under a build-operate-transfer concession agreement. The Project will promote economic growth by improving Sri Lanka's competitiveness in the ports sector by expanding Colombo Port's capacity using PPP to maintain its status as a regional transshipment hub port. The main output is increase in container-handling capacity from 3.3 million TEU in 2006 to 5.7 million TEU by 2010, 8.1 million TEU by 2015 and 10.5 million TEU by 2024. Specific project components include:

- Harbour Infrastructure Works Component to accommodate vessels with an overall length of 400 m, beam of 55 m, and draft of 16 m. It involves the construction of a major new breakwater to the west of the existing harbor and a smaller secondary breakwater.
- Container Terminal Component: It is planned that the first container terminal will have a planned capacity of 2.4 million TEU per annum. The existing harbour is planned to be remodeled and realignment of neighbouring roads and quays is also to be carried out.
- The Project is being developed as a PPP with the public sector implementing the harbor infrastructure works component, while the private sector implements the container terminal component in line with the provisions of the SLPA Act.

The Project will facilitate economic growth by enhancing national competitiveness in international trade via lower costs and faster delivery times. Export container traffic handled by Colombo Port is expected to increase by 9.5% per annum starting in 2011. The additional capacity will enable Colombo Port to increase its ISC transshipment market share from 23% in 2002 to 30% by 2011. Transshipment volumes handled by Colombo Port are expected to increase by

Table 9.21 Project Investment Plan

	\$ million
<b>A. Public Sector Component</b>	
1. Base cost	
(a) Harbor infrastructure works	366.2
(b) Consulting services	14.7
2. Contingencies	43.9
3. Financing charges during implementation	55.2
<i>Subtotal (A)</i>	480.0
<b>B. Private sector component</b>	
1. Terminal construction works	154.0
2. Equipment	147.0
<i>Subtotal (B)</i>	301.0
<b>Total (A + B)</b>	<b>781.0</b>

Source: ADB, 2007

8% per annum starting in 2011. Sri Lanka will thus be able to generate additional income from transshipment. The direct payments generated by transshipment traffic alone are expected to increase the contribution of the ports sector to GDP by an additional 0.1% by 2015, and attract foreign direct investment of approximately \$800 million to the ports sector by 2024.

The main consequence for the economy of the project is not implemented would be the loss of the frequent, fast, direct shipping services used by exporters and importers. Without investment in the project, Colombo Port would lose its transshipment traffic; and if the port no longer operates as a transshipment hub port, it would soon lose its direct calls on trunk-line routes. Local traffic is not high enough to attract direct calls by trunk-line ships. Colombo Port would eventually become a feeder port, served by a combination of feeder ships and mainline services with relatively long transit times for the ports with lower traffic volumes. The consequences for Sri Lanka's current and future exports would be serious. The project will benefit Sri Lankan exporters by enhancing their competitiveness in international markets through lower freight costs and faster delivery times for time-sensitive exports, e.g. textiles, which account for 52% of Sri Lanka's exports. The main costs to the Sri Lankan economy of the reversion to a feeder port would be:

- Additional costs of feeder services to regional hub ports such as Singapore, to connect with trunk route services (at least 20% are estimated to switch to feeders)
- Longer transit times and delays, which are injurious to export markets, especially for textiles, but also for new exports that will emerge

**Table 9.22 Total Benefits from the Project (US \$)**

Year	Avoidance of Feeder Costs	Additional Revenue from Transshipment	Net benefits
1	–	–	79,000,000
5	104,338,000	22,843,000	108,478,000
10	153,306,000	47,188,000	93,126,000
15	225,257,000	74,240,000	123,032,000
20	342,876,000	114,975,000	322,570,000
25	455,655,000	74,342,000	396,827,000

Source: ADB, 2007

- Loss of revenues to Sri Lankan terminals from transshipment; and
- Loss of dues paid to SLPA by container vessels. Lower freight costs are expected to result in annual savings of \$82 million by 2015, and faster delivery times will create annual savings of \$49 million by 2015.

In addition transshipment traffic is expected to generate direct net annual income to terminal operators amounting to \$77 million by 2015. The benefits of the Project are the avoidance of these costs to the economy. The values assigned to the benefits are compared with the total investment cost of \$1.3 billion for the Project to 2034.

### Benefits Costs Analysis

The economic evaluation compares the economic benefits and costs of the project from the viewpoint of the national economy. The economic analysis was based on the scenario that the three terminals are sequentially developed to meet the forecasted demands by taking into account that SLPA provides the basic infrastructure to accommodate the terminals.

**Table 9.23 Results from Benefit-Cost Simulations**

	Economic Rate of Return (%)	Net Present Value (US\$)
Base calculation	17.76	436,655,000
Capital costs up by 10%	16.3	
Total costs up by 10%	15.95	346,757,000
Traffic forecasts down by 10%	16.0	
Avoidance of feeder costs down by 10%	16.19	331,393
Decrease in revenue benefits by 10%	17.36	408,354,000
Total benefits down	15.76	303,091,000

The economic internal rate of return is estimated at 17.8%. These assumptions do not include the value

to be placed on fast, direct shipping services by investors considering alternative countries as locations for setting up new manufacturing or distribution centers. It also does not include loss of international investors, who will include frequent, direct shipping services on their checklist of preconditions for locating in a country. Thus the economic analysis is conservative. Sensitivity and risk analyses indicate that the economic internal rate of return is robust under most conditions. The financial analysis of income and expenditure also gives a robust result of 11.5% for the base case.

### CONCLUSION

It has been demonstrated that the trade and transport facilitation projects under consideration are high benefit projects for the countries undertaking them. Should the government choose to finance the projects on their own from year 1 to year 5, with benefits accruing only after project completion, both projects yield very high benefits with high economic internal rates of return, even in the worst case scenarios. However, the importance of a supportive overall policy framework for the promotion of transport, trade, and tourism cannot be undermined. It is essential for the governments to develop a meaningful strategy. As SAFTA is established, additional steps to support the framework such as facilitating customs procedures at borders points and improved infrastructure are essential in order to reap the benefits from reduced tariffs. The large amount of informal trade in the SAARC region is attributable to the cumbersome procedures at the border and improvements in infrastructure will formalise these figures. But, investments in transportation systems alone are not sufficient and there is a need for policy reform, accompanied by improved procedural and operational efficiency. For the road and rail project considered at the Indo-Bangladesh and the Indo-Pakistan border respectively, positioning appropriate trained customs department personnel and provision of adequate law and order is necessary. Thus, besides physical infrastructure gaps, regulatory and procedural problems need to be looked into, which includes harmonisation of technical standards, customs, documentation and procedures which have so far impeded timely delivery of goods and services. Therefore, a sustained effort to develop an entire package of policies for trade facilitation is required to realise the full trade potential and the effective exploitation of comparative advantage and competitiveness among countries. Similarly, a long term master

plan needs to be developed in consultation with all the state governments and private sector to ensure sustainable tourism development or unplanned construction and overcrowding will considerably reduce the tourism appeal in the region. An independent development agency may be created to draw up an integrated plan using area planners and landscape architects to create infrastructure including roads, power, water and sewage systems, and railway stations.

This exercise has been preliminarily worked out as a BCA to show that the four identified projects are high yield projects for the countries that undertake

them. The projects would also benefit other countries of the region. They can be expanded to subregional projects such that there is political commitment and endorsement from all countries, and coordination of custom reforms and activities to bring better consistency in the legal and regulatory frameworks can be designed for better regional cooperation. An integrated effort will serve national and regional interests at the same time. The total benefits will exhibit manifold increase with marginal increases in costs. Adoption of similar win-win projects will induce confidence in the regional cooperation agenda for all involved countries.



## Part II

# **BENEFITS FROM DEEPENING INTEGRATION: TRADE IN SERVICES**



# 10 ■ Trade in Services and South Asia: An Overview

## ■ INTRODUCTION

The services sector in South Asia has grown substantially in the past decade. In 2006, services contributed 54% of total GDP in South Asia as a whole. In almost all SAARC countries, except for Nepal and Bhutan, services contribute more than 50% to GDP. It is interesting to note that in the context of South Asia, agriculture was initially the predominant sector, and still is in terms of employment, but this region was characterised by relatively early development of the services sector and by poor development of industry (Ahluwalia and Williamson 2003: 3). This occurred despite the stress on industrialisation as the core strategy of development pursued for many years. Though the services sector has grown substantially in South Asia, in terms of its contribution to total trade it still lags behind the other sectors in most of the countries in the region, except for India and the land-locked countries where tourism remains the main form of trade. India, on the other hand, has witnessed a steady growth in proportion of trade in services to trade in merchandise which can be attributed solely to its trade in IT and ITES.

In terms of composition of overall trade in services in South Asia, we find that imports of services were higher than exports of services for the SAARC region till 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; we find that export is highest in computer and information services from India, followed by Sri Lanka and Pakistan. In terms of imports, we find that India is

the only country that has substantial imports of computer and information services. Travel services are found to be 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, we find that 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.<sup>1</sup> 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.

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. Moreover, it has been suggested that members of SAARC are more homogeneous than those of the ASEAN (Panchamukhi 1988, 1993). This indicates that the process of overall integration of the South Asian region should be less troublesome when compared particularly with ASEAN. Historically speaking, the case for inclusion of services as part of the SAFTA has been a strong one. In this context, the 14th SAARC Summit held in New Delhi has been a landmark summit as it underlined the

<sup>1</sup> According to WTO's International Trade Statistics 2007:139, India's exports of financial services were valued at \$1.468 billion and imports at \$1.227 billion.

collective vision of South Asia of an inter-connected region where there would be free flow of peoples, goods, services and ideas (MEA, India 2007).

In view of the importance of the role that services can play in providing momentum to SAFTA, the study undertakes an in-depth analysis of trade potential and restrictions in key services sectors—construction and related services; higher education services; health services; telecommunication services and tourism and travel related services in seven South Asian countries, namely India, Pakistan, Sri Lanka, Bangladesh, Nepal, the Maldives, and Bhutan. Six out of seven countries are already part of the multilateral trading system where they have made commitments to liberalise these sectors. Moreover, they are contemplating to further liberalise these sectors during the ongoing services negotiations. Bhutan, the only one of the seven countries from the region, not yet part of the WTO, is also actively involved in accession negotiation and has submitted its services offer to undertake commitments in various services sectors.

In this regard, while the chapter argues that all seven countries should make liberal commitments under GATS, they should be willing to undertake more liberal commitments at the regional level in order to reap the full benefits of liberalisation. There could be two specific reasons why these countries should be undertaking wider and deeper commitments than they would do under the GATS. First, as the group is small—having just seven players, as compared to the entire WTO membership there is higher probability of early harvest thereby benefiting from the liberalisation. Second, the real or perceived risk of opening up of the services sector would be drastically reduced at a regional level as compared with that at a multilateral level. Further, this provides an opportunity to the countries to engage in calibrated liberalisation.

Theoretically speaking, given the asymmetrical growth of services and services trade between South Asian countries it would seem that India might gain most from a regional agreement. However, the study argues that it is the smaller countries who should be gaining most from a negotiated agreement. Although India is already the dominant player at the regional level, in order to negotiate an agreement, smaller countries would need to identify their areas of comparative advantage (this is based on the assumption that as the market size would be far smaller and they would be knowing the characteristics of the market better than that of the entire world's market that will help them in nuancing their demand.) and accordingly seek better

market access for their services in bigger countries. Likewise, in the areas of import interest they can seek concessions and would eventually gain by the reduction in import price. For example, in exports they can ensure meaningful market access for movement of their workers to countries like India and Pakistan. Similarly, they seek concessional fees for their students who come to India to study. They can also ask for concessional fees for South Asian medical patients when they come for medical treatment to India. Facilities like visa on arrival or no visa requirement for a South Asian will also be a great help. Above all, this forum will enable them to better articulate the areas of their special interest which is otherwise relatively cumbersome at a multilateral level. Finally, as elsewhere, here too the LDC member countries may benefit from the possible provisions of special and differential treatment.

Further, it is found that South Asian countries have a competitive edge in different categories of services. In transport services, Pakistan and Sri Lanka have competitive advantage while India has a competitive advantage in construction services, computer and information services and other commercial services. Maldives and Nepal are found to be more competitive in travel services while Bangladesh has a higher competitive edge in financial services (Banga 2008). Overall, South Asia's trade interests in the services sector are driven by its factor endowments, with export interests in the area of labour-intensive and manpower-based services and import interests in the area of capital and technology intensive services (Chanda 2005). All the South Asian countries have strong interest in exporting labour-intensive services, at all levels of skills. The gains would be huge in areas where the services trade is highly restricted, such as cross-border movement of labour. Overall, it appears that construction, education, tourism and health services are of special significance both from export as well as import interests.

## ■ OVERVIEW OF SERVICES: COUNTRY-LEVEL ANALYSIS

### India

The importance of South Asia in services trade seems to be largely owing to India's phenomenal success. In fact, in recent years the changes in the world economy brought about by the remarkable growth in the services sector have been nothing less than spectacular in the case of India. It has enormously shifted the composition of India's GDP in favour of services. The share of the services sector in India's GDP has risen rapidly from a

mere 38% in 1980 to around 62% in 2006 (RBI Bulletin 2007). What is special about India is that its services sector has made a unique and unusual contribution to the country's growth. Unusually for an emerging economy with low per capita incomes, its services sector has leap-frogged the manufacturing sector and become one of the economy's main drivers.

Others also suggest that the sectoral composition of output in India has come to resemble that of a middle-income country, even though its per capita income remains that of a low-income country (Gordon and Gupta 2003). And the main driver of the Indian economy is the services sector, which contributed two-thirds of average real GDP growth for the period 2002-07 (RBI Bulletin 2007). In India, services account for around two-thirds of the total FDI inflows. In 2006-07, information technology, financial and non-financial services and telecommunications alone accounted for half of FDI received by India (Ministry of Commerce & Industry 2007). However, it is a matter of concern that while this sector is contributing over 60% to India's GDP, it provides employment to only a little over-third of the employed labour force (Report to the National Commission on Farmers 2004). In order to generate more employment India should pay adequate attention to services like tourism and construction which have immense potential to provide employment to people at various skill levels.

Slowly but steadily India has become a very active negotiating country on services. On the face of it, it looked as if India had a clear advantage only in Mode 4 and later in computer and related services. However, as the negotiations have progressed India has found various other services and other modes too of some critical importance. In just over a decade India has jumped from being the 34th largest services exporting country in 1995 to the 10th largest one in 2006. During the same period its services exports grew eleven times in value terms with exports reaching almost \$74 billion in 2006 (WTO 2007).

India is the only South Asian country that has submitted its revised offer during the ongoing services negotiations at WTO. Broadly speaking, the Indian revised offer covers almost all services sectors such as business, communication, construction, distribution, education, environmental financial, health, tourism and transport services. India has also offered commitments in the five identified services sectors – construction, education, tourism, telecommunications – as part of communication services and health services, making it the most liberal country at the regional level. While in

education, tourism, telecommunication and health services, India has clear export interests; in construction it may have some import interests as well. Although a liberal trade regime in India is in its own interest, it has very positive implications for all other SAFTA member countries because all are likely to benefit from it. Particularly, India's Mode 4 commitments are noteworthy in this regard, which offer an opportunity to all other South Asian countries to export skilled labour to India.

### Pakistan

Like India, the importance of the services sector to Pakistan's economy has substantially increased over the last three and a half decades whereby the share of services in GDP has gone up from 45% in 1969-70 to almost 58% in 2005-06 (Burki and Hussain 2007). The fastest growing services sectors in Pakistan are finance and insurance; wholesale and retail trade and transport and communications. Nevertheless, the available statistics indicate that Pakistan being a small global services provider, its imports are growing faster than its exports. While in 2005 and 2006 Pakistan exported services worth only \$2.043 billion and \$2.246 billion, respectively, at the same time it imported services of relatively huge value of \$7.208 billion and \$8.089 billion, respectively (WTO 2007). Another interesting feature of the Pakistani services sector is that even though the share of services sector in the GDP has increased overtime, the services share in employment has not increased. This shows that poverty alleviation potential of services sector growth. This may be explained by the fact that growth has mostly occurred in knowledge-based sub-sectors. In this regard, a relatively higher growth in employment-generating services sectors such as tourism and construction services could play a significant role.

Unilateral liberalisation of the services sector appears to be the hallmark of Pakistan's policy. Significant progress has already been made towards liberalisation of key infrastructural or backbone sectors. These reforms provide a window of opportunity to Pakistan to gain concessions from its negotiating partners by locking-in at its current level of commitments in multilateral negotiations. Pakistan has received several requests from its trading partners in the Doha Round of negotiations for improved market access and national treatment of service providers. Among others these requests relate to construction and related engineering services; architectural, engineering, and integrated engineering services. Likewise, Pakistan has also tabled

requests on improved conditions for temporary movement of natural persons for purposes of supplying services and cross-border supply of services, among others.

Apart from India Pakistan is another country from the region that has offered commitments in all three sectors – construction, education and tourism. In construction and education services Pakistan has strong import interests and thus offers an opportunity to other SAFTA member countries to supply these services. In tourism services the country has both export as well as import interests. Overall it appears that lack of adequate capital and skilled manpower is hampering the expansion of supply capacity of the country in these services. Pakistan has undertaken some reforms to liberalise its FDI regime in the services sector which has shown good results in attracting FDI. Pakistan being the second largest market in the region is of great value to other south Asian countries. In addition, Pakistan also needs to explore opportunity in order to export services in the region.

### Sri Lanka

The services sector has emerged as the most important contributor to the output of the economy and employment in Sri Lanka, accounting for over 55% of GDP and 44% of total employment. Key services sectors contributing to the economy are tourism, telecommunications, banking, insurance, shipping and air transport (CUTS 2007). Considerable liberalisation has taken place over the last two decades on a unilateral basis than under the auspices of the GATS framework. Sri Lanka has made commitments in only three services sectors under the GATS in tourism and travel services, financial services and telecommunication services.

In the ongoing GATS negotiations at the WTO, Sri Lanka has so far not made any substantial improvement in its existing commitments perhaps due to the limited number and low quality of market opening offers it has received. Sri Lanka has submitted its request list to various countries mainly in professional services, computer-related services, health related and social services, transport services and services auxiliary to all modes of transport. Sri Lanka's primary focus in GATS negotiations like many other developing countries is to negotiate commitments in Mode 4. In return, Sri Lanka has also made an initial offer in telecommunications, financial services and tourism on the basis of existing level of liberalisation. Sri Lanka appears to have taken the position that if it makes any new or improved offers for further liberalisation of services, this will

be done on the basis of the prevailing level of liberalisation.

As it took very limited commitments during the Uruguay Round, overall, Sri Lanka's services trade regime seen from the GATS angle paints a very restrictive and conservative picture. It has huge interest in the liberalisation of services like construction and education. However, unless it offers meaningful commitments it may not be able to obtain market access in the desired sectors. At a regional level Sri Lanka is a significant market and some of its services are of high standard. As an island country it has a relatively developed maritime transport system and it can play an important role in services trade at the regional level. Its desire to negotiate an agreement with India on services only substantiates the point that its services have reached a certain level where it can have some arrangement with India. At the same time, this indicates that while Sri Lanka may not be willing to undertake liberal commitments at a multilateral level it may do so at the regional level. The level of its engagement with India in services trade further reinforces the point as Sri Lanka is already an important trading partner in tourism, construction and education services. Sri Lanka is also engaged in services trade with other South Asian countries.

### Bangladesh

The services sector has become the largest contributor to the GDP in Bangladesh. Currently its share in GDP stands at 57.50%. Wholesale and retail trade constituted 14.12%, transport, storage and communication contributed 10.01%, real estate, renting and other business activities accounted for 8.14%, community, personal and social services accounted for 7.52% (Bangladesh's TPR 2006). However, its share in the country's total employment was only 34.75% in 2004–05. Workers' remittances contribute significantly to the economic development of the country by reducing unemployment and augmenting foreign exchange reserves and income. In 2004–05, the remittances from expatriate Bangladeshi workers as percent of GDP and commodity export stood at about 6.43% and 44.47% respectively.

Although services account for more than half of Bangladesh's GDP, inefficiencies and shortages in essential services hamper economic growth (Bangladesh's TPR 2006). Trade in services only amounts to 5–7% of the country's total trade in goods. The trade deficit for commercial services is between

20–40% (Raihan and Mahmood 2004:6). Growth rates for trade in services fluctuated between 2000 and 2003. Between 1994 and 2003, services sector growth in Bangladesh exceeded overall GDP growth (*Ibid*: 5).

Nevertheless, Bangladesh maintains one of the most liberal FDI regimes in South Asia, with no limits on foreign equity participation (Bangladesh's TPR 2006). Possibly due to 'a better enabling investment environment' and reduction of investment expenditure (cost), annual FDI inflows into Bangladesh grew almost nine-fold during 2002–04, increasing from \$52 million to \$460 million and outflows were \$3 million and \$4 million.

Since the beginning of the 1990s, Bangladesh has adopted a number of policies to facilitate the expansion of the private sector and increase the inflow of foreign investment (UNCTAD-ICC 2000). The private sector is recognised as the engine of growth. Foreign companies are welcome. As already noted, the country offers perhaps the most liberal FDI regime in South Asia, with no prior approval requirements or limits on equity participation or restrictions on the repatriation of profits and income.

UNCTAD-ICC also suggest that while discussing the investment climate in Bangladesh one of the weaknesses of the Bangladeshi economy is that it has low levels of skills and training in the workplace implying that foreign investors have an opportunity to invest in education and training (UNCTAD-ICC 2000). Similarly, it has been suggested that inadequate infrastructure provides immense investment particularly in the construction industry. This indicates that Bangladesh has strong import interest in both education and construction services and liberal commitments in these services would help the country meet the requirements of the economy.

In Bangladesh, computer and related services, telecommunications, distribution services, life insurance and maritime transport services generally enjoy a positive balance of trade. Conversely, the following sub-sectors have shown a negative trade balance since 1999: rental and leasing services without operators; construction and related engineering services; education services; health-related and social services; tourism and travel-related services; news agency services; research and development services; and air transport services. Bangladesh's import of tourism and travel-related services surpassed exports by \$32.33 million. At \$25.83 million, the deficit in the education sector is also comparatively high. Overall, the level of trade in commercial services in Bangladesh remains low.

In the context of the ongoing services negotiations at the WTO, Bangladesh has not yet submitted its initial offer and the Uruguay Round commitments it has undertaken are limited to tourism. In fact, during the Uruguay Round, Bangladesh had undertaken commitments in just one sub-sector covering five star hotels and lodging services under tourism sector. Later in 1998, it also undertook commitment in telecommunications. However, as the paper argues, Bangladesh has strong import and to some extent exports interest in construction and education services and accordingly, it ought to undertake commitments in these services. Alongside, it needs to make wider and deeper commitments in tourism services as well.

### Nepal

Nepal acceded to the WTO in 2004. As a result of the accession negotiations it has undertaken relatively liberal commitments in a number of service sectors. From GATS point of view, Nepal offers perhaps the most liberal services regime in South Asia. This assumes greater significance considering the fact that Nepal is an LDC. Nepal has undertaken commitments in all the services sectors being discussed here. Nepal however suffers from a variety of problems that commonly beset poor countries at an early stage of industrialisation (UNCTAD-ICC 2003). Skills and productivity in the workforce are at a low level. Infrastructure is insufficient and poorly maintained. There are also policy areas that need attention. One example is the labour law, which is widely seen in the business community as excessively restrictive.

Services account for barely 39% of Nepal's GDP which is only slightly higher than that of Bhutan's GDP. The tourism and travel related service sector appears to be the area of its strength in services as the country has spectacular natural and cultural assets. Thus, while in tourism Nepal has strong export interest, in construction and education services it has import interests. Being a landlocked poor country any attempt to upgrade the state of its infrastructure will have economy-wide positive implications. Hence, attracting investment in the construction sector will be highly beneficial. Similarly, as the paper argues, in view of low skill level of the labour force, Nepal has to invest huge sums of capital to revamp its education commensurate to the requirements of its economy.

In recent years Nepal has been moving towards creating a more hospitable environment for foreign investors (WIR 2004). In 1992, the government introduced a new policy on FDI and instituted a 'one-

window' system to facilitate and encourage it (UNCTAD-ICC 2003). There is also a consensus that the country welcomes investors and that its regime is liberal by South Asian standards.

Nepal is already very well involved in trade in services with some of the South Asian countries. India is obviously the most important trading partner and also the largest investor in Nepal. Nepal receives a large number of Indian tourists every year, whereas thousands of patients and students from Nepal come to India for medical treatment and education respectively. A regional agreement will bring Nepal closer to other South Asian countries particularly Bhutan and Bangladesh due to their geographical proximity. Like other countries in the region, Mode 4 is of special significance to Nepal and it would like to ensure better market access for its surplus labour force. In this regard, the regional agreement would be a great facilitator of movement of natural persons. Nepal may also gain by exports via Mode 1 as it is developing its capability in the area of IT. Mode 2 is already a proven area of interest particularly given its advantage in tourism. However, Nepal has huge import interest in Mode 3 in all three service sectors, viz., construction, tourism and education services.

### The Maldives

The Maldives has recorded remarkable economic growth over the past two decades, especially compared with the rest of the South Asian countries. It reached an impressive per capita income of \$2,680 in 2006 from \$771 in 1984 and sustained a significant annual GDP growth of 7.9% in the past 15 years until 2004. The country has attracted a fairly high level of FDI. However, due to a combination of factors including Tsunami, for the first time in its history, the country recorded a negative growth rate of 4.1% in 2005. But once again the growth rate has bounced back and registered a whopping 18.7% rate of growth in 2006 (Maldives Data Profile, World Bank 2007).

According to the World Bank study, ironically, although the Maldives lacks the resource endowments, the scale of economies, and the geographical diversity enjoyed by its South Asian neighbours, it has surpassed all of them to achieve the highest per capita GDP levels in the region (The World Bank 2006). However, the study adds that the Maldives belongs to a special category of countries called "Small Island economies," which are dependent primarily on tourism and therefore on a narrow product or service range.

Services constitute by far most of the Maldivian GDP (82%), as tourism is the economy's mainstay (33% of GDP) (Maldives' TPR 2002). The Maldives' economic growth has been largely based on tourism development since the early 1970s. The legal and regulatory environment for FDI in the Maldives is relatively simple, liberal and generous (Maldives' TPR 2002). The main legal instrument on FDI is the Law on Foreign Investment, which requires an agreement to be entered into between the investor and the government. Areas to negotiate include, the sector of operation, the royalty payable to the government, location and duration of investment and operation, jurisdiction, dispute settlement, investment guarantee, compensation, and incentives, including land rent (and lease period where applicable) and import duty concessions.

The Law broadly provides for 100% foreign ownership, in addition to foreign – local joint venture, and investment guarantee. The investor is permitted to repatriate capital and profits. Employment of non-Maldivians is allowed in cases when competent locals for the post in question are not available. Incentives in the form of waivers on import duty on machinery, capital goods and construction materials are available.

Despite a relatively open regime and efforts to attract FDI, inflows remain low. FDI grew, on average, by between 10% and 20% annually from 1986 to 2000 (Maldives' TPR 2002). This growth was from a small base, with annual FDI inflows averaging \$5 million during 1985 to 1995, and \$12 million from 1997 to 2000. FDI stock was \$3 million in 1985, \$118 million in 2000 and \$131 million in 2001. Much of this investment was in tourism. The stock of inward FDI, excluding tourism as of March 2000 comprised about 50 projects with a total investment of around \$65 million. A few of these projects may have some bearing on construction services but there does not appear to be any investment in education services.

In spite of having a relatively liberal trade regime, it can be suggested that the Maldives has among the fewest commitments in services under GATS. Its commitments undertaken during the Uruguay Round are limited to just one service sector – business services. (In services such as tourism, construction, and education it has strong interests. In tourism it has proven advantage and it should seek regional support to further build on its growth and sustain it in the long run. However, in education and construction services it has an import interest and it should aim to gain from regional integration. Particularly in education, other South Asian countries could be of great help in respect

of improving the quality of education. It could be suggested that the Maldives ought to undertake commitments in construction, education and tourism services. Although population wise the Maldives is the smallest country in South Asia, its market may not be ignored in view of the highest per capita income it has in the region and the country is an import-dependent one. There is already services trade taking place between the Maldives and other South Asian countries, particularly with India, Bangladesh and Sri Lanka. For export of labour from these countries the Maldives provides an attractive market. Indian hotel companies have several hotels and resorts in Maldives.

### Bhutan

Bhutan is currently negotiating accession to the WTO. It became an observer in 1999 and has now entered the advanced stage of accession negotiations. It expects to become a full-fledged member of the WTO in 2008. By all measures Bhutan is a small country and its economy overwhelmingly relies on India. From the studies Bhutan has assigned to various research organisations it appears that financial services, telecommunications, energy, and tourism services are considered important (Rinchen 2004).

Like many small economies, Bhutan is a highly open and trade-dependent economy, with trade comprising 65% of its GDP (UNESCAP 2003). Bhutan has also opened the economy to foreign investments. Under the present circumstances, it is not mandatory for a business firm to comply with FDI requirements (Tobgay 2007). However, in the sectors opened under WTO, all foreign players would be required to enter through the FDI channel and contribute to the nation as a national legal entity.

Although there are several structural limitations and external sector vulnerabilities, the government has followed prudent policies to ensure a sound macro-economic environment. Bhutan pursues a conservative fiscal policy (UNESCAP 2003). Domestic revenues have to cover recurrent expenditures, and capital expenditure is largely determined by the availability of external assistance. Various efforts are underway to increase exports that can earn convertible currency given the limited diversification of trade. For example, the government has waived corporate income tax on income earned in convertible currency for manufacturing units, information technology industries or services and agriculture produce.

In December 2002, the government approved the

Foreign Direct Investment Policy (FDIP) with a view to fostering private sector development, generating employment, enabling the transfer of capital, technology and skills, and enhancing convertible currency earnings (Ibid: 197). In the case of Bhutan, FDI is understood to be investments made in convertible currencies only. Prior to this policy, limited foreign investment was allowed in the banking, tourism and industrial sectors on a case-by-case basis.

The FDIP sets out the broad parameters for foreign investors by delineating areas and size of investments, skills transfer requirements for import of capital goods must be met out of foreign equity; (b) repatriation of profits and dividends must be balanced by net foreign exchange earnings; and (c) repayment of foreign currency loans will be permitted subject to prior approval of the loans by the Government. With a minimum requirement of \$0.5 million, the services sectors open for FDI include: tourism including hotels, roads and bridges, housing, and education services. However, foreign investors can hold up to 70% equity (UNESCAP 2003:197).

ESCAP argues that while the adoption of FDI policy is significant, it is still deemed conservative (UNESCAP 2003). Bhutan's main services sectors comprise construction, transport, telecommunications, tourism and hotels, and the retail trade. The high growth rates in the transport and construction sectors are related to the construction of large hydropower plants in the country. Publicly funded infrastructure works including the construction and repair of roads and housing complexes dominate the construction sector.

Tourism is perhaps the only services sector that may be of interest to foreign firms in the near future. The entry of foreign suppliers could have a positive catalytic impact on the private sector in Bhutan. For example, foreign banks will be able to provide Bhutanese entrepreneurs with better services and more sophisticated financial products. However, it is unlikely that foreign suppliers will rush to Bhutan's small services market, given the limited demand for services and the high cost of delivery of services (UNESCAP 2003).

Due to the shortage of skilled domestic labour, over 50,000 Indian nationals are employed in Bhutan in the construction sector. The government, on the other hand, has adopted strict limits on the number of immigrant labourers allowed as a result of political obligation. However, the lack of consistency in government policies related to labour, taxation and licensing is also perceived as a constraint by the private sector (UNESCAP 2003).

As part of its accession negotiations Bhutan seems to have submitted liberal services offer in the WTO and if Nepal is any reference point then it is sure that Bhutan would be finally making wider and deeper commitments in services. As of now it appears it has covered a number of services sectors in its offer. Like Nepal and the Maldives, while Bhutan has export interest in tourism it has strong import interest in education and construction services.

### Least Developed Countries

As four out of seven South Asian countries are LDCs, any study ought to take into account their special position. It is interesting that the significance of the services sector is growing in all South Asian LDCs. The Maldives' services sector largely due to its booming tourism has sustained a relatively high rate of growth. Similarly, Bangladesh, Bhutan and Nepal have also shown better growth in services and have a liberal trade regime in place. However, it is a matter of concern that apart from Nepal and Bhutan – recently acceded and acceding countries respectively – the commitments made by the remaining LDCs in South Asia, i.e. Bangladesh and the Maldives are far below the prevailing level of liberalisation in their countries.

It should however be appreciated that with the process of the negotiations on services continuing, identifying the sectors and modes of supply that will bring the greatest degree of benefits is of critical interest to LDCs. At the regional level it is important that developing countries should not seek the same level of market access commitments from LDCs as they should be doing among themselves. At the same time the developing countries should open their Mode 4 regime at all skill levels and also allow cross-border supply of services via Mode 1 so that LDCs could gain from regional liberalisation. Overall, it appears that Modes 1 and 4 are of special significance to the LDCs and it should be imperative on the part of all South Asian countries to arrive at a consensus with an aim to liberalising these two modes.

### ■ MUTUAL RECOGNITION AGREEMENTS

Unlike goods, which are primarily regulated by border measures, services are regulated by domestic regulation as services are largely produced and consumed inside the economy. This particular feature of services makes the issue of regulation relatively complicated. Taking into account this aspect of domestic regulation the

GATS has made some provisions. Thus while Article VI specifies rules for domestic regulation, there is another article – Article VII which provides rules for recognition of qualification. Recognition is an important issue for all services being studied. However, it is the construction and related engineering services sector that is heavily dependent on recognition of qualifications of service providers. Education services can also gain from the recognition of qualification. Movement of teachers, experts and trainers could be hugely facilitated if the sector develops MRAs in the region. Likewise, qualifications of tourism professionals can also be recognised. In order to deal with the problem of lack of recognition of qualifications it would be beneficial if South Asian countries could arrive at a decision to have agreements on mutual recognition of qualifications, credentials and other requirements for the supply of services. It is interesting in this regard that since almost all countries of the region follow the same Commonwealth pattern of education, they have better chances to rapidly conclude such agreements. India has shown the way by having made the beginning in this direction in its agreement with Singapore – CECA.

Recognition of qualifications is not the only limitation that is hampering trade in these services at the regional level. There are many other limitations such as issuance of visa to service providers, differential taxation policy and not so conducive FDI regime. The visa issue is being discussed in the WTO and India's proposal on services negotiations has in fact discussed this issue in greater detail (India 2000). However, this issue is closely linked to the recognition of qualifications since visa issuing authorities could be given clear criteria for the service providers they wish to allow. The Indian proposal calls for a separate visa category for service providers aimed at curtailing the discretionary power of visa issuing authorities and thereby facilitating the movement of professionals. At the regional level though there have been some positive movements in regard to issuance of visa, a lot remains to be achieved so that service suppliers encounter fewer hurdles and spend less amount of time in obtaining visa.

As regards other issues such as taxation policy and FDI regime, consistent efforts being made in opening of their economies have helped them, to some extent, streamline the procedures.

### ■ SOUTH ASIA AND SERVICES NEGOTIATIONS

During the Uruguay Round WTO member countries did not make wider and deeper commitments to open

their services markets, instead their commitments fell far short of the prevailing level of liberalisation. This was true for both developed as well as developing countries though developing countries made lower level of commitments and in fewer services sectors. South Asia was not an exception to this trend. Hence during the Uruguay Round and spill-over negotiations on financial and telecommunication services India made commitments in only 36 out of 161 sub sectors. Similarly, Pakistan, Sri Lanka, Bangladesh, and the Maldives made commitments in only a few sectors while Nepal and Bhutan were not part of the multilateral trading system.

The ongoing round of negotiations – the Doha Round – is certainly different, particularly for the developing countries because apart from import interests in services they now have export interests in some of the services sectors as well. Nevertheless, the number of such countries which have a proven comparative advantage in services trade and are willing to undertake commitments in more and more sectors is not too many. This scenario is best reflected in the case of South Asia. Out of the seven countries only India and to a limited extent Pakistan have shown their willingness to lock-in their autonomous liberalisation undertaken in services. Sri Lanka, which made commitments in just three sectors during the Uruguay Round and thereafter and has submitted initial offer, has not shown any willingness to undertake additional commitments. Likewise, neither Bangladesh nor Maldives has offered to improve their original commitments. In fact, Nepal seems to be the only South Asian country that undertook relatively high level of commitments in a large number of services sectors during its accession negotiation (70 out of 161 sub sectors nearly double of what India committed during and after the Uruguay Round). Like Nepal, Bhutan is also likely to undertake liberal commitments in a number of services sectors during its accession negotiation.

The study argues that given the faster growth in services in almost all South Asian countries, they have an opportunity to come closer to reap the benefits of liberalisation in the sector. Education and health being part of social infrastructure and construction and telecommunication being part of basic infrastructure are fundamental to their overall growth. In light of this, it seems imperative that these sectors are given their due importance. While the state of development in these sectors is certainly at different stages in different countries, what is interesting is that there is some amount of complementarity among these countries warranting

rapid integration in services. The Maldives has a lot to offer in tourism as its services are of world class. Nepal, Sri Lanka, and Bhutan have a clear advantage in tourism and can always attract a huge number of tourists from the region. Pakistan has quite a few academic institutions from which other South Asian countries can gain. India has some advantages in construction, health and education services from which other countries can gain. At the regional level, it is surprisingly true that a lot of formal and informal movement of service providers is already taking place. Maldives is clearly a case in this regard as it receives thousands of workers from India, Sri Lanka and Bangladesh particularly to work in the tourism sector. Likewise, thousands of Indian nationals are working in Bhutan. If workers from Bangladesh and Nepal come to India seeking work, along with them also come students and patients who pay for the services they receive.

In view of these complementarities, the study strongly argues that SAFTA member countries urgently need to expand the scope of SAFTA by including at least these identified five services sectors. As the study is limited to five sectors, similar complementarities have to be found in other services sectors in order to recommend for their inclusion. Moreover, these countries ought to make wider and deeper commitments than they would be doing under the GATS if they want to gain more from the regional integration.

The subsequent chapters discuss individual services sectors and sub-sectors – construction and related engineering services, tourism and travel related services, higher education services, telecommunication services and health services, respectively. The discussion in these chapters begins with the analysis of original commitments (initial, and revised offers). An attempt is made to identify the restrictions on trade in these services in each of the member countries. With respect to the construction services sector, due to its close links with professional services such as engineering and integrated engineering services architectural and urban and landscape services, the chapter discusses the restrictions in these services as well to show the state of liberalisation in the full range of services which affect the transaction of construction services. Similarly, the chapter on tourism, wherever feasible, also discusses the liberalisation undertaken under the GATS regime in the area of air transport which is so closely linked to international tourism. Finally, an attempt is made to identify the sub-sectors where there is a possibility of MRAs to facilitate trade.

# 11 ■ Construction and Related Engineering Services<sup>1</sup>

## ■ INTRODUCTION

With its close links to public works the construction and related engineering services sector has always been considered as a strategically important industry for creating employment and sustaining growth. For developing countries the sector carries particular importance because of its link to the development of basic infrastructure, training of local personnel, transfer of technologies, and improved access to information channels. Further, the EC suggests that for developing countries, liberal market access commitments in this sector will attract foreign investments (EC 2000).

Though this sector and some other services such as architectural and integrated engineering are distinct, they are closely interrelated sectors. It is recognised that the supply of construction and related engineering services involves services provided by professional engineers and that the two categories of services overlap each other. Brazil also expresses similar views that there is an evident interrelation between the supply of construction services and the supply of architectural, engineering, integrated engineering and urban planning and landscape architectural services, even though these latter are placed separately in the W/120, under the grouping of professional services (Brazil 2001). In fact, Brazil adds, construction firms often provide all of these services in an integrated manner as they are used throughout the development of an investment project, including the stages of pre-investment (e.g. feasibility studies), project execution (e.g. architectural and structural design), and project implementation (e.g. the physical construction *per se*). Because strong linkages exist between construction services and engineering, architectural and integrated engineering services, Brazil

argues, the overall impact of liberalisation in construction services is expected to also depend on the extent of liberalisation in engineering and integrated engineering services. Therefore, while discussing the commitments in construction services, it would be appropriate to include the commitments undertaken in these professional services as well.

## Description of the Sector<sup>2</sup>

This sector is classified in the document ‘Services Sectoral Classification List’ in MTN.GNS/W/120 as ‘3. Construction and Related Engineering Services (CPC 511–518)’. The activities covered under this heading are the following:

1. *General construction work for buildings (CPC 512)*: This item includes construction work (including new work, additions, alterations and renovation work) for all types of buildings, residential or non-residential, whether privately or publicly owned.
2. *General construction work for civil engineering (CPC 513)*: This item covers construction work for structures other than buildings such as highways and streets, railways and airfield runways, bridges and tunnels, waterways and harbours, dams, pipelines, communication and power lines, mining and manufacturing plants, and stadia and sports grounds.
3. *Installation and assembly work (CPC 514, 516)*: This item includes such activities as the assembly and erection of prefabricated constructions, installation work for heating and air conditioning, water plumbing, gas fitting, electrical wiring, fire

<sup>1</sup> The chapter is based on the report authored by Shailendra Kumar.

<sup>2</sup> This is based on a Background Note by the Secretariat on Construction and Related Engineering Services, WTO, Document No. S/C/W/38, 8 June 1998.

alarm construction, insulation, fencing and lift construction.

4. *Building completion and finishing work (CPC 517)*: This item covers special trade construction work for the completion and finishing of buildings such as glazing, plastering, painting, floor and wall tiling, carpeting, carpentry, interior fitting and decoration, ornamentation fitting.
5. *Other (CPC 511, 515, 518)*: This item includes pre-erection work at construction sites, as well as special trade construction work such as foundation work, water-well drilling, roofing, concrete work, steel bending and erection, and masonry work. It also covers renting services related to equipment for construction or demolition of buildings or civil engineering works, with operator.

### General Restrictions in the Sector

In the WTO the construction and related engineering services sector is a relatively liberal sector as a total of 69 members (the EC being one) had undertaken commitments in the sector by 2000. However, the scope of commitments widely differs and most of those who have commitments in this sector cover general construction work for civil engineering. Construction services are primarily supplied through the establishment of service suppliers at or near the site of the work by local or regional operators. Hence Mode 3 is of special significance. Though Mode 1 is relatively less important, with advanced communications systems, blueprints and designs can be transmitted electronically, and possibly many other jobs required for the sector. Like Mode 3, Mode 4 is quite important for the transaction of construction services. In fact, the international supply of construction services involves large movements of workers at all levels of skill.

According to the EC, the construction sector is subject to many different aspects of domestic regulation. They include controls on land use, building permits and inspection, registration of proprietors, contractors and professionals, regulation of fees and remunerations, environmental regulations, etc. (EC 2000). Such measures are applied not only at the national level, but also very frequently at the sub-federal or local government level. Standards may be fixed by the governments or by standard-setting bodies or private sector associations. Some technical standards and specifications may be applied only to foreign suppliers. Even if the same measures are applied to all suppliers, domestic or foreign, they may be found to be more onerous to foreign suppliers.

Restrictions on the establishment and operation of a commercial presence by foreign firms, such as limitations on foreign investment including those on foreign ownership (for example, only minority ownership allowed for foreigners) or on the types of legal entity allowed (such as a local incorporation requirement, or a prohibition on establishing branches) can constitute obstacles to market access (WTO 1998). The formation of a joint operation or a joint venture company with local suppliers or subcontractors is often an economic necessity, but requirements to do so would create a burden on the foreign supplier's ability to make its own decisions based on business conditions. Other market access limitations would include economic needs tests for commercial presence and limits on the contract amount accessible to foreign firms. Sometimes, market access is allowed to foreign suppliers only when resources and materials are not available locally.

With its extensive use of skilled and unskilled labour, the construction sector is strongly affected by limitations on the movement of natural persons. Nationality and residency requirements or other staffing requirements for persons employed by foreign firms could constitute limitations on market access and national treatment.

Subsidies and tax incentives are provided in many countries to promote construction work or to encourage growth of the construction sector. If they are granted only to local suppliers, they may be inconsistent with a member's national treatment obligations. There can also be preferences provided to local contractors in bidding, or requirements to transfer technology. Restrictions on the ownership of land by foreigners are normally applied to all sectors, but may have a strong effect on the construction industry, since property developers will not be able to own apartments and houses under construction until completion.

### Characterising SAFTA Countries' Commitments: Initial/Revised Offers

#### *India*

India's proposed commitments, as incorporated in its revised offer, in this sector cover all five sub-sectors and almost all modes of supply which seem to be a substantial improvement over its initial offer and Uruguay Round commitments. India has thus offered to undertake commitments in: general construction work for building (CPC 512), general construction work for civil engineering (CPC 513), installation and assembly work (CPC 514 + 516), building completion

and finishing work (CPC 517), and other (CPC 511 + 515 + 518). During the Uruguay Round however India undertook commitments in only one out of the five sub-sectors, namely construction work for civil engineering. Even this sub-sector was not fully covered. The commitments were limited to Mode 3.

Apart from expanding the scope of commitments by covering all sub-sectors, the revised offer has also expanded its modal coverage and has proposed full commitments in Modes 1 and 2. In the Market Access column, under Mode 3 the foreign equity ceiling of 51% has been removed thereby making this mode free from any foreign equity cap. This should also be considered a major improvement. However, the establishment would still be only through incorporation and a new regulation has been added that commercial presence is subject to the condition that in the case of foreign investors having prior collaboration in this sector in India, FIPB approval would be required. Although Mode 4 remains unbound and refers to the horizontal section, there is significant improvement under this Mode too since the horizontal section allows delivery of engineering, integrated engineering, architectural, and landscape services through contractual services suppliers (CSS) – employees of juridical persons and/or independent professionals (IPs). The coverage of India's commitments is thus broader and deeper and offers a lot of opportunity to other developing countries for delivery of construction and related engineering services. India's Mode 4 horizontal commitments for independent professionals are particularly path breaking and would be of immense economic value to all other South Asian countries.

In the National Treatment column, Modes 1, 2 and 3 are without any restrictions, implying that services rendered via these modes would be accorded national treatment. This is good for foreign service providers as there would be no discrimination between the domestic and foreign players. However, as in the Market Access column, Mode 4 is unbound in National Treatment column and refers to the horizontal section.

In the professional services that are considered relevant to the delivery of construction services India had previously committed only one sub-sector, i.e. engineering services for which Modes 1 and 2 in the Market Access and National Treatment columns were unbound and Mode 3 was subject to the foreign equity ceiling of 51% and the establishment only through incorporation. However, in its revised offer India has proposed to undertake fresh commitments in architectural, urban planning and landscape services and

integrated engineering services. In all these professional services Modes 1 and 2 in the Market Access and National Treatment columns have no restrictions at all. However, under Mode 3 and particularly for architectural, urban planning and landscape architectural services apart from the condition that the establishment would be only through incorporation as partnership firm constituted by architects and subject to the condition that in the case of foreign investors having prior collaboration in these services in India, FIPB approval would be required. Finally, Mode 4 is unbound and refers to the horizontal section. Likewise for engineering and integrated engineering services also there are requirements under Mode 3 that the establishment would be only through incorporation and subject to the condition that in the case of foreign investors having prior collaboration in these services in India then FIPB approval would be required. As usual, Mode 4 is unbound except as in the horizontal section.

There are a few points worth mentioning here. The first is that though India has removed the foreign equity ceiling of 51%, this is now subject to the condition that in the case of foreign investors having prior collaboration in this sector in India, FIPB approval would be required. On the face of it, it does not appear a major restriction, as the FIPB is just another route through which FDI enters though not automatic. But the moot question is why a company which has already invested should be asked to pass through a non-automatic route whereas a fresh investor would have signal free entry. As the stipulation suggests the same investor who as a fresher did not face any barriers now would have to undergo a screening procedure of the FIPB. Foreign investors will certainly consider it as a barrier and India may have to rethink over it. This is also technically problematic. According to GATS, as a member country can only improve its existing commitments, it is not expected to inscribe any additional barriers of whatsoever nature and this might be treated as a new barrier. Though in certain circumstances a member can add restrictions, this can be done under other provisions of GATS.

The second point is that though India has offered a relatively liberal market access environment under Mode 4 for the supply of engineering, integrated engineering, architectural and landscape services, the level of services allowed is still relatively high and unless the skill level is brought down other South Asian countries may not fully exploit the Indian market. A large number of Indian workers such as carpenter, electrician, fixer/fabricator, foreman, mason, mechanic-AC,

painter, plumber, technician, welder, supervisor, surveyor, fitter, and labourers/helper go abroad to supply their services (ESCAP 3003). Likewise Pakistan, Bangladesh, Sri Lanka, and Nepal are also sending construction workers to different parts of the world, the Middle East being the most popular destination in this regard. The categories of workers mentioned above are mainly involved in the construction sector. This sector is in fact unique in the sense that it requires services at all possible levels of skills and even unskilled. From this point of view the sector is considered crucial with respect to providing employment opportunities to poor countries.

**Other Restrictions:** India is becoming an increasingly important player in international trade in construction services. In 2005, India's exports of construction services were valued at \$828 million and imports at \$774 million (WTO 2007). Interestingly, in Asia, after Japan and the People's Republic of China, India was the third leading construction services exporting country in 2005. However, what is more relevant is that with imports of \$774 million of construction services India offers an attractive market to other South Asian countries.

Though the construction sector has been witnessing a growth rate of 7–8% for the past several years and there are quite a few big Indian companies operating in the country, from a global perspective this sector is still small and fragmented. Most Indian construction companies specialise in specific industries and are not in a position to undertake large turnkey projects (Taneja et al. 2004). Almost 90% of the construction companies are engaged in the domestic market with only a few of them engaged in exports, concentrated mainly in South Asian and Middle East markets. The construction services exports include project management, engineering and architectural consultancy, design engineering and maintenance services. Entry into foreign markets through competitive bidding remains limited. In recent years, some of the large Indian construction companies have started entering foreign markets through a consortium.

While the sector does not appear to be highly regulated, it has been constrained by cumbersome land registration procedures, regulation on land ceiling, complex tenancy laws, rent control, stringent regulations on hiring of contract labour and poor enforcement of building codes and byelaws (Kumar 2005). The cumbersome procedures of land registration

have, to some extent, been simplified and stamp duties reduced and some progressive measures have also been taken with respect to urban land ceiling in many states. However, the major problem is that there are regulations at various levels and India being a large country there is no uniformity in the regulations.

The sector as covered in India's revised offer allows 100% FDI. In the South Asian context India's offer of commitments in construction and related engineering services clearly stands out as one of the most liberal. India, however, needs to allow construction workers if not for the entire WTO membership then for its South Asian trading partners as part of SAFTA so that India could offer other SAARC member countries more meaningful market access for their Mode 4 exports.

It would be equally interesting to find out what India expects from other countries in the sector. In this regard, its request to New Zealand may be indicative of its overall request in the construction and related professional services sectors. From India's request to New Zealand it is clear that the Indian construction industry is very much interested in the delivery of construction services via Mode 3 and has sought full commitments from New Zealand in all sub-sectors of the construction sector.<sup>3</sup> Similarly, India has also made such requests in engineering and integrated engineering services. In these services India has sought full commitments under Modes 2 and 3 and under Mode 4 it has asked for full commitment particularly for professionals like civil engineer, electrical engineer, chemical engineer, electronics and telecommunications engineer, mining engineer, metallurgical and related professionals, cartographers and surveyors, etc. India has also asked New Zealand to recognise the qualifications of Indian engineering and related professionals.

In light of this, India would expect market access from other SAARC countries for its construction and related professional services. Given India's relative strength in the sector, it would like other South Asian countries to allow import of construction services via all modes. However, Modes 1, 3, and 4 would be of particular interest to India.

The two groups of major professional services – engineering and architectural services – are important for construction services. While architects are regulated by the council of architecture (COA), there is no law governing the profession of engineering in India. Though efforts are on to have a statutory body for the

<sup>3</sup> India's request List to New Zealand, [commerce.nic.in/wto\\_sub/services/newzealand.pdf](http://commerce.nic.in/wto_sub/services/newzealand.pdf), last visited on 1 November 2007.

engineering profession as well, India may allow existing engineers associations to negotiate with their counterparts in other SAFTA countries to develop MRAs that will ensure hassle free movements of engineers in the region. As regards architectural services since the regulatory body exists there should be less problem in negotiating MRAs.

### *Pakistan*

During the Uruguay Round like India, Pakistan had also undertaken very limited commitments in the construction and related engineering services sector. Its commitments covered only one sub-sector, i.e. construction work for civil engineering and that too only for bridges, elevated highways, tunnels and subways leaving aside many other segments of this sub sector. Further, its commitments under Modes 1 and 2 were unbound albeit for the lack of technical feasibility. Mode 3 commitments had been subject to partnership and/or joint venture with Pakistani engineers or engineering companies. However, in the initial offer the scope of commitments has been expanded marginally by including some more segments such as waterways, harbours, dams and other waterworks from the same sub sector- construction work for civil engineering. Moreover, Modes 1 and 2 have now been fully committed though there is almost no change in the status of Modes 3 and 4. As regards horizontal commitments, which apply to this sub sector as well, it is stipulated that except in the case of representative offices, commitments under Mode 3 are subject to incorporation in Pakistan with maximum foreign equity participation of 60%. In this regard, Burki and Hussain (2007) explain that transfer of technology appears to be the motivation behind this limitation. However, this could be considered as a major restriction on Mode 3.

Further, all expenses of representative offices shall be met by remittances abroad. Such offices shall restrict their activities to the undertaking of liaison work or of representing the interest of the parent company abroad. Under Mode 4 while the entry of intra-corporate transferees (ICTs) – managers, executives, and specialists – was already allowed during the Uruguay Round, now four new categories of natural persons – business visitors, professionals, independent professionals, and persons having other skills – have been added. Out of these four new categories of natural persons, the categories of independent professional and persons possessing other skills – are relevant to the construction sector. The category of independent professionals is akin to that of the Indian category and

offers meaningful market access particularly to the export of professional services by developing countries to Pakistan. The category of persons possessing other skills has specifically been mentioned for construction engineering services though this is limited to imparting training in Pakistan.

As the construction services sector also bank on the smooth supply of related professional services, we need to look at the state of commitments in these services. In this regard, it is noted that while in engineering and integrated engineering services Pakistan had undertaken commitments; during the current round it has proposed fresh commitments in architectural services. However, the level of liberalisation as reflected in the initial offer does not seem to be encouraging because Mode 1 remains unbound in all three services and for integrated engineering services even Mode 2 is unbound. Since architectural and engineering designs can be conveniently supplied through trans-border data flows (Mode 1), countries having relative comparative advantage are likely to benefit from liberalisation commitments under Mode 1. In light of this, it has very rightly been suggested that Pakistan has a pool of experienced and qualified professional engineers and architects, which is a source of comparative advantage to Pakistan (Burki and Hussain 2007). Therefore, liberalisation commitments under Mode 1 would be in Pakistan's export interest.

Burki and Hussain further suggest that Pakistan may also want to further rationalise its commitments under Mode 3 to enhance benefits from Mode 1, because arguably Pakistan may be able to export more through Mode 1 by attracting more foreign firms or joint ventures in architectural, engineering and related engineering services.

Under Mode 3 there are quite a few restrictions in engineering and integrated engineering services – foreign shareholding of maximum of 51% in engineering consultancy companies is allowed. This however, is not applicable to those companies that are registered with the securities and exchange commission of Pakistan. In addition, the Mode 3 commitment is subject to partnership and/or joint venture with Pakistani engineers or engineering companies. As already noted, this restriction has been existing since the Uruguay Round and the only modification suggested in the initial offer is that this restriction also does not apply to those companies which are registered with the securities and exchange commission of Pakistan. In architectural services while Mode 2 is without any restrictions, Mode 3 has three limitations –

foreign equity ceiling of 51%; services shall be supplied by a natural person or by a registered firm having local partners in majority or in case of a company, 70% holding of Pakistani nationals; and economic needs test (ENT) based on inquiry to gauge if direct or indirect government subsidy is being provided.

Burki and Hussain (2007) suggest that Pakistan maintaining market access restrictions on Mode 3 seem to have been designed to protect small players from foreign competition and to avoid displacement of domestic construction workers since foreign players would have comparative advantage in using more mechanised constructions with highly skilled workforce. However, they argue that shielding all local players (both small and large) from foreign competition by giving them a blanket cover may not be justified.

Out of the three professional services inscribed in the Pakistani initial offer that are closely interconnected with the construction sector architectural services appear to be the most restrictive. The commitments proposed in the National Treatment column also carry many limitations – while Mode 1 has been kept unbound, Mode 3 is subject to fulfillment of all requirements and conditions applicable only to foreign investors/juridical entities and Mode 4 is unbound except as indicated in the horizontal section where though there are no limitations. Besides, all four modes – 1, 2, 3, and 4 – are unbound for subsidies. The overall picture that emerges from the above is not very bright and Pakistan needs to further improve its initial offer.

The construction and related engineering services sector represents the fundamental activity in Pakistan that permeates all economic sectors and thus constitutes the single largest sector. It is thus not surprising that Pakistan has received the request from a number of WTO members to liberalise the sector. Burki and Hussain suggest that the request substantially covers subsectors from CPC 511 to CPC 518 (Burki and Hussain 2007). It specifically demands the elimination of any limitation (market access and national treatment) in Modes 1, 2 and 3. The request, however, does not cover movement of natural persons (Mode 4) limitations in the construction sector. Moreover, the request also deals with removal of some national treatment limitations pertaining to discriminatory registration and licensing procedures meant for foreign firms.

Similarly, Pakistan has received a collective request to liberalise the architectural, engineering and integrated engineering services. The coverage of this request and the subsectors are: CPC 8671: Architectural services; CPC 8672: Engineering services; and CPC

8673: Integrated engineering services. In Mode 4 the request is for commitment in all categories with a special emphasis on contract service suppliers. Finally there is a request for removal of limitations regarding economic needs tests (ENTs) (across all modes).

**Other Restrictions:** According to the State Bank of Pakistan, in 2006–07, the construction industry in Pakistan grew by 17.2% (State Bank of Pakistan 2007). This was not only higher than the 7.0% target, but was also the second highest growth recorded by this sub-sector since 1975–76. The resurgence is mainly attributed to higher development expenditures by the government, increased FDI in the construction sector and, record worker's remittances. The sustained growth in the construction sector is important from its strong backward linkages with a number of industries and employment generation. In addition, construction also generates a range of employment opportunities from unskilled workers to architects. Although the construction sector has only a 2.3% share in Pakistan's GDP, its share of the employed labor force was disproportionately large at 6.1% in 2006–07. In 2004–05, the sector accounted for about three percent of the total FDI inflows into Pakistan.

In 2006–07, exports of construction services by Pakistan were valued at merely \$16 million whereas imports were at \$143 million (Burki and Hussain 2007:18). This shows that though Pakistan has some capability of exporting construction services, it is indeed an important importer in the region. A recent study on Pakistan includes construction and related engineering services suggests that this sector is a potential import as well as export interest to Pakistan (Burki and Hussain 2007). Growth in this sector is critical for growth in national income and employment in the country. Hence its mainstreaming would help achieve national development goals. However, they argue that majority of constructors are small players who have weak financial positions, outdated labour-intensive technology and poor organisational structures and vision for growth and development. They are highly vulnerable to foreign competition. Most constructors have comparative advantage in small commercial buildings, small bridges and roads. It has been suggested that only a few sophisticated firms specialise in large earthwork and large construction work for civil engineering. While modernisation of this sector with entry of foreign firms may enhance efficiency and service quality in this sector, but the likely injury to small players would be a major challenge for the negotiators.

Some large sophisticated firms are also present in the construction sector that compete internationally due to specialisation and cost effectiveness, especially in the Middle East. The comparative advantage of these firms mostly lies in cheap skilled and unskilled labour, and experienced engineers who have previously worked for multinational companies in Pakistan or abroad. Two most significant factors that are linked with the success of these companies are (a) acceptability of engineering qualifications of engineers educated in Pakistan and (b) unrestrained flow of temporary movement of natural persons. If Pakistan is to gain from the ongoing negotiations in the Doha Round then its stand in the construction sector should be built around these factors. Since Pakistan's comparative advantage lies in cheap labour and its pool of experienced professionals, Pakistan may not be able to effectively compete on foreign turf in the absence of Mode 4 clause while service providers from requesting Members are likely to gain from this clause.

### *State of Liberalisation*

Market access for commercial presence is fairly open to bid for government contracts. In this regard, several Chinese public or private sector companies, Turkish companies and Korean companies have from time-to-time operated in construction or civil engineering works (Burki and Hussain 2007: 26). Entrance of foreign construction and engineering firms has enhanced competition in their bid for mega projects. Moreover, various foreign companies of the Middle East or South East Asia origin are also involved in developing real estate projects in association with some Pakistani companies due to joint venture restrictions.

Ironically, the study suggests that the policies relating to construction services come from various line ministries, departments and regulatory bodies. For example, the Ministry of Works is mandated to oversee most construction and engineering related legislation and to initiate policies after interministerial consultations. However, the Pakistan Engineering Council (PEC) is the regulatory body established by the Act of Parliament of Pakistan in 1976, which regulates engineering education, gives certification to professional engineers and advises government on all engineering and construction related issues. Moreover, all construction and engineering related firms are required to be licensed by PEC to operate in the country. PEC registers constructors and operators into three categories namely, C1, C2 and C3, which are based on the minimum paid-up capital requirement indicating a

firm's sound financial and technical capacity. From more than 24,000 constructors and 88 operators registered with PEC, only close to 600 qualify to the C1 category (largest contractors/operators) on the basis of a benchmark of Rs.20 million average annual value of work undertaken during the past three years. The foreign engineering consultancy service providers are also subject to the regulations of PEC.

The Pakistan council of architects and town planners (PCATP) is another governing body established by the government to regulate the profession of architecture, which not only sets standard of conduct for its own members, but also advises government on architectural issues facing the industry. Even though there are no solely owned foreign architectural firms in Pakistan, JGC-Descon is a joint venture company of Descon Engineering with a leading Japanese company geared up to produce engineering and architectural designs for the global market. Foreign architectural firms seeking market access into Pakistan are subject to the condition of registration with PCATP.

At another level, the construction and architectural services are subject to the by-laws of local governments. Hence each city district development authority has its own independent regulatory body to regulate construction plans and designs in their jurisdiction. But, there is no consistency in rules and regulations across cities due to lack of coordination between the federal and local governments. In addition to the above, the national highway authority is mandated to regulate construction of highways and elevated highways all over the country. Further, the Pakistan housing authority in the ministry of works formulates policies for the development of housing industry.

In sum, the study suggests that construction work processes are generally too primitive and they need to change as soon as possible. Current regulations governing construction, engineering and architectural engineering services have several tiers. These regulations are highly diversified and their implementation is mostly lax in nature. Pakistan needs to revamp its multi-tiered regulatory framework in construction, engineering and architectural sectors before this sector is ready to cope with the risks of liberalisation.

Pakistan's regime is typical of those countries that have a federal structure. Although many of the limitations emanating from this kind of system may take a lot of time and energy to remove such limitations, what could be immediately done is to take wider and deeper commitments in construction and all related professional services. In this regard, particularly

important is to remove restrictions under Modes 3 and 4. Under Mode 3 there are some companies from the region already involved in providing construction services in collaboration with local partners. Further liberalisation in commercial presence will increase the possibility of trade in construction services at regional level. Similarly, Mode 4 needs to be made quite open by allowing entry of even low and semi-skilled workers from the region. Pakistan being the second largest market in South Asia all other countries would look at it for seeking market access for their workers. Finally there is no reason why there should be any restrictions on Mode 1. This is the mode in which India, Sri Lanka, Bangladesh and Nepal would be interested in the Pakistani market. At the same time Pakistan would be equally interested in this mode. Therefore, it would be in Pakistan's interest if it removed all restrictions from this mode.

### *Sri Lanka*

Sri Lanka undertook very limited commitments and in a few services sectors during the Uruguay Round. In fact, its sector specific commitments cover only three sectors, namely, tourism and travel related services, financial services, and telecommunications services. However, its horizontal commitments under Mode 3 indicate that foreign investors may invest in Sri Lanka in any sector other than the following: moneylending; pawn brokering; retail trade with a capital of less than \$1 million; businesses providing personal services other than for export of tourism; and coastal fishing. This implies that foreign investors have not been prevented from investing in the Sri Lankan construction and related engineering services sector. This has further been clarified by the provision inscribed in horizontal commitments that foreign investment of up to 40% of equity in a company proposing to carry on a business activity listed below will be automatically approved by the BOISL and foreign investment in excess of 40% (and up to 100%) will be approved by the BOISL on a case-by-case basis in consultation with the relevant state agencies. The relevant sectors are the following: construction and residential buildings; mass transportation; telecommunications; mass communications; education; professional services; freight-forwarding; travel agencies; shipping agencies. This situation will be reviewed every two years with the aim of further simplification.

Further, a provision has been made that if a foreign investor incorporates a company in Sri Lanka under the Companies Act and buys land in the name of the

company, there will be no liability otherwise if a foreign individual buys land then s/he will be liable to pay a tax at 100% of the purchase price. There is one more provision in the horizontal section suggesting that in the relevant sectors when a joint venture partner is a public sector enterprise, while granting access, preference will be given to foreign service suppliers/entities, which offer the best terms for transfer of technology.

As regards Mode 4, the horizontal section stipulates that movement of natural persons is subject to Sri Lankan laws on immigration, consumer laws, and other relevant laws and regulations. Thus foreigners, who intend to work or to conduct business in Sri Lanka, shall have to obtain the relevant work permits in addition to complying with the immigration requirements.

In light of the above provisions, it is clear that foreign investors can invest in the construction and related engineering services sector subject to the limitations inscribed in the schedule. However, this poses several problems. Lack of sectoral commitments in the sector implies that Sri Lanka has not given the due importance the sector deserves. The construction sector in Sri Lanka accounts for 7% of GDP and posted strong growth rates in 2005–06, largely due to tsunami reconstruction projects (US Department of State 2007). Also, it can only be assumed that there are no commitments in Modes 1 and 2. Particularly, Mode 1 is a fairly significant mode for delivery of various services in the construction sector. Similarly, there are no sector specific commitments under Mode 4 and those, which are inscribed in the horizontal section, do not make things easier as all immigration rules and regulations apply. Same view can be expressed regarding the commitments on professional services. Thus one can only assume that all professional services can be supplied but only through Mode 3. Overall, what appears from the Sri Lankan schedule is that the commitments in the sector are not only restrictive but also ambiguous.

Although Sri Lanka has submitted its initial offer as part of the requirement of the ongoing round of services negotiations, its offer has not been made public. However, as already noted in the previous chapter, Sri Lanka has not included the construction services sector in its initial offer. In consequence, the sector remains one of the most restrictive under the GATS regime. Sri Lanka being an important market in the region, non-Sri Lankan South Asian service providers may be affected by not having a liberal regime in that country.

**Other Restrictions<sup>4</sup>:** In Sri Lanka, there is a need for development of infrastructure, particularly in the construction of highways, bridges, railways, roads and buildings. Sri Lanka has given priority to the development of infrastructure by encouraging private participation, both domestic and foreign, through attractive fiscal and tax concessions such as full tax holiday, concessionary tax and import duty exemption on capital goods. It is interesting to note that several Indian companies have entered the Sri Lankan market and are engaged in building and civil construction. The most important investors in residential construction are the Ansals and SMS Property Developers. Both have wholly owned subsidiaries in Sri Lanka. The reasons cited for choosing Sri Lanka are geographical proximity, initiatives taken by the Sri Lankan government in attracting Indian investment and demand for housing. However, the Indian construction companies have faced many barriers. For instance, a number of clearances have to be obtained from multiple agencies. Moreover, the government has failed to provide infrastructure and other ancillary services required for residential complexes. Lack of information on the housing market has made it difficult for the Indian investors to gauge the demand for housing. However, perhaps the most limiting factor has been the lack of adequate housing finance. In the case of civil construction activity, there is a lack of transparency in the bidding process and cumbersome safety and environmental regulation poses added problems. Investors have also pointed out that they prefer to have a strategic local partner because of lack of information on the Sri Lankan market. Difficulties in import of equipment for construction purposes are also to be a barrier.

As in construction services there are quite a few restrictions in engineering and architectural services in Sri Lanka. Although it is not legally binding for an engineer to register with the institute of engineers of Sri Lanka (ISEL), there are a few government bodies such as Colombo municipal council and the urban development authority that require an engineer to be registered with IESL. Requirements for architects to serve in Sri Lanka are laid out by the institute of architects of Sri Lanka (IASL), which is governed by the IASL law and is based on international union of architects (UIA) in Paris. Sri Lankan and other foreign

nationals are allowed to practice in Sri Lanka provided their degree is recognised in UIA and that they clear the examination conducted by the IASL. Several foreign architects work in Sri Lanka, but the requirements to practice are often violated. Foreign architects, including Indian architects, either go through the BOI agreed investments or go for a short term to provide services on a visitor's visa.

From South Asia it appears Sri Lanka has received requests from India to make full commitments under the Market Access column in architectural and urban planning and landscape architectural services in Modes 3 and 4. Under the National Treatment column, India has requested Sri Lanka to remove nationality/citizenship requirements, if any. India has also requested Sri Lanka to make additional commitment on MRAs for qualification and licensing requirements to practice (use of professional title).

It could be suggested that Sri Lanka may undertake wider and deeper commitments in the sector covering all the subsectors and in all related professional services. It should also undertake commitments in all modes. If not under the GATS regime then under the regional arrangement it must do so. Sri Lanka is an important market at the regional level, being a country with relatively high per capita income of \$1300 in 2006, which is only next to the Maldives in the region.<sup>5</sup>

### *Bangladesh*

In the construction and related engineering services sector, Bangladesh neither undertook any commitments during the Uruguay Round nor proposed to do during the ongoing Doha Round. However, Singapore, the EU, Japan, Norway and the United States have requested Bangladesh to open its construction and related engineering services, and professional and business services (Raihan and Mahmood 2004: 41-42).

The construction and related engineering services sector accounts for 8.63% of the Bangladesh's GDP. This sector also accounts for three percent of overall employment in Bangladesh (World Bank 2007) The sector has been identified as one of the services sectors of major interest to Bangladesh in which it has been suggested that it should offer market access commitments (Raihan and Mahmood 2004). However, the study also suggests that Bangladesh should follow

<sup>4</sup> The discussion in this section is largely based on Taneja, Nisha, Mukherjee, Arpita, Jayanetti, Sanath, and Jayawadhana, Tilani (2004). *Indo-Sri Lanka Trade in Services: FTA II and Beyond*, Indian Council for Research on International Economic Relations (ICRIER), India and Institute of Policy Studies (IPS), Sri Lanka, November 2004.

<sup>5</sup> Sri Lanka Data Profile, The World Bank, <http://devdata.worldbank.org/external/CPProfile.asp?PTYPE=CP&CCODE=LKA>, last visited on 31 October 2007.

a cautious approach with respect to import of construction and related engineering services.

Although Bangladesh took very limited commitments in a few services such as tourism, financial and telecommunications services during the Uruguay Round and spillover negotiations, it ought to undertake commitments in many other services if it is to sustain a relatively high rate of economic growth. Bangladesh being an LDC seems to have taken the stand thus far that LDCs should not be asked to undertake commitments in the sectors it does not wish to. However, the study strongly argues that LDCs should stop insisting that they do not need to open any sectors. Many sectors would benefit through an open policy regime and a predictable competitive environment. Others also suggest that inadequate infrastructure in Bangladesh provides immense investment opportunity particularly in the construction industry (UNCTAD-ICC 2000).

As technology transfer plays a significant role in the development of this sector and it has high stakes for domestic service providers, as well as substantial imports, Raihan and Mahmood suggest that liberalisation of this sector should be balanced. As of now there are no major restrictions in the sector. FDI is allowed and even labour movement is permitted though subject to existing laws. Bangladeshi construction workers go abroad to work on construction sites and it gains substantial amount of foreign exchange as workers remittances. Their foreign work experience would be an advantage while working in South Asia. But for that to happen Bangladesh needs to undertake commitments in the sector. Bangladesh should undertake wider and deeper commitments in the sector and in all modes. Although it may find it difficult to make such liberal commitments under the GATS regime, it must do so as part of SAFTA. By so doing in fact, Bangladesh would gain more by liberalising its services sector as it will have access to bigger markets in the region.

### *Nepal*

Nepal is one of the few LDCs, which have recently acceded to the WTO. As part of its accession negotiations it was asked to undertake relatively liberal commitments in as many services sectors as it could. As a consequence, what we have today is undoubtedly one of the most liberal schedules of commitments in services undertaken by any South Asian country.

In the construction and related services sector Nepal has undertaken commitments in two out of five sub-sectors – general construction work for civil engineering (CPC 513) and other (CPC 511+515+518). Unlike

Pakistan which has proposed commitments in some segments of the only one subsector of the construction sector at four-digit level classification, these two subsectors as committed by Nepal are at three-digit level implying that its commitments fully cover the two subsectors. Further, Nepal has inscribed no restrictions of whatsoever nature in Modes 1 and 2 and Mode 3 stipulates that the entry is subject to incorporation in Nepal with a maximum foreign equity capital of 51% though Mode 4 is unbound and refers to the horizontal section. Specifically for the subsector – general construction work for civil engineering (CPC 513) the commitment states that foreign equity participation will be increased to 80% after five years from the date of accession which will come into effect in April 2009. In the National Treatment column in both subsectors Modes 1, 2, and 3 are without any sectoral limitations and Mode 4 remains unbound referring to the horizontal section.

As regards the horizontal commitments which apply to the construction sector, under Mode 4 entry of three kinds of natural persons is allowed – services sales persons, persons responsible for setting up a commercial presence and ICTs. Unlike India and Pakistan, Nepal has not made any provisions for professionals or independent professionals. Under the National Treatment column also there are some limitations. Under Mode 1 national treatment has not been accorded with respect to foreign exchange provided to foreigners (excluding those categories of persons covered by Nepal's schedule) to pay for any cross-border services. Under Mode 3 a foreign investor reinvesting earnings is required to obtain the permission of the Department of Industry, all foreign investments except for financial services require approval by the Department of Industry, and incentives and subsidies are available only to enterprises wholly owned by Nepalese nationals. Under Mode 4 national treatment is accorded to only those categories of natural persons referred to in the market access column. Moreover, it has been made clear that the selling and buying real estate is the constitutional right of every Nepalese citizen. The civil code prohibits anyone from selling, mortgaging, gifting or endowing or disposing any real property to a foreign individual.

Apart from the limitations inscribed under Market Access and National Treatment columns Nepal has also undertaken some additional commitments. The first commitment stipulates that an environmental impact is required and approval of an investment will not normally be withheld except for failure to meet

environmental standards. The second commitment provides that a foreign investor making an investment in foreign currency shall be entitled to repatriate the following amount outside Nepal:

- The amount received by the sale, in whole or part, of the investors share of equity;
- The amount received as profit or dividend as a result of an equity investment;
- The amount received as the payment of the principal of and interest on any foreign loan; and
- The amount received under an agreement to transfer technology approved by the Department of Industries or the Department of Cottage and Small Industries.

From the commitments Nepal has undertaken it appears that its commitments are closer to the prevailing regime. The construction and related engineering services sector is an important sector in Nepal and plays a crucial role with respect to adding to the growth and employment. Exact figures on employment provided by the construction industry in Nepal are not available. However, it is estimated that for three quarters of those who are economically active, the main place of work is the agriculture sector and for almost half (47%) of those who work in agriculture are considered to be underemployed, construction offers a viable option. Being a landlocked country any infrastructure bottleneck has a relatively heavy effect of pricing. In order to upgrade its infrastructure it needs to have a liberal regime. Nepal has a strong import interest in the sector and also has some export interest particularly with a view to exporting construction workers to other South Asian countries. It may also have some export interest under Mode 1. However, it should remove barriers to Mode 4 and make wider commitments in the sector for other countries from the region. Nepal lacks skilled labour and the other SAFTA countries can fill this gap which will raise the skill level and bring best practices in the country.

### *The Maldives*

Although the Maldives submitted its schedule of commitments on services in 1995, its commitments cover accounting, auditing and book-keeping services under professional services and computer and related services. Hence it has undertaken no commitments in the construction and related engineering services sector.

It is estimated that the construction industry is the fourth largest industry in the Maldives (MCPI 2006). However, the recent past has seen this industry going

through a lot of dynamic changes. These changes reflect the aspirations of the private sector to promote the construction industry as a properly regulated industry, and the government's efforts to promote and regulate the growth of the construction industry. The private sector, with the support of the construction ministry, has come together in a joint effort to create the Maldives association of construction industry (MACI), aimed towards creating a structured industry. In order to increase private sector participation in promoting the construction industry, MCPI suggests setting up a construction industry development board to look after the industry. As regards professional associations, it recommends the government to work to help set up, increase role and involvement of professional associations in promoting the industry, including financial assistance to such recognised associations such as Architects' Association of Maldives and Association of Engineers. MCPI also suggests the government to prepare and implement regulations lacking in the construction industry which should include building code, building control regulations, building designers registration, building practitioners registration, contractors registration and categorisation, procurement guidelines, health and safety regulations, arbitration guidelines, Acts of parliament, and construction industry policy paper.

The construction industry in the Maldives has grown, primarily due to tourism. It is made up of many small firms who act independently and do not have common working conditions and practices. It is unique in the sense that practically all building materials have to be imported in bulk, broken down into lots, and shipped from the port to the islands (The World Bank 2006). There is little storage space available and construction is hostage to importation. The construction costs have become exorbitant in the past few years. There do not appear to be construction-industry indices against which to benchmark. Nor do construction/building inspection and control seem to be exercised sufficiently. The following measures are recommended by the World Bank to address these issues: (i) development of indices of construction, such as costs per square metre or per room; (ii) better supervision of construction, possibly using specialized firms.

Access to land has emerged as one of the biggest obstacles to business growth in the Maldives. The majority of business operations are being carried out in rented/leased out land and buildings. Given the traditional allocation of land by government at request, there is no proper land market in the Maldives. How-

ever, a market is emerging in an area nearby the Male capital island. The World Bank suggests that the government needs to become a facilitator/regulator instead of land provider. The absence of a vibrant private land market aggravates the access-to-finance issue, especially since banks still focus on collateral based lending rather than cash flows. In this regard, the World Bank suggests that the government should promote the establishment of modern movable assets registry in order to encourage using such assets as collateral.

One of the major challenges for the government is how to attract investments within the structure of an increasingly competitive market economy while protecting the vulnerable groups. This is endorsed by the government's Vision 2020. Land and housing markets are an integral component of a dynamic market economy, which was recognised in the sixth National Development Plan. This will require, as the World Bank suggests, a paradigm shift in the role of the government from being a direct provider to being a facilitator and a regulator by allowing the development of housing markets in the private sector and local communities (The World Bank 2006). Presently, no comprehensive regulatory framework for housing and urban management exists in the Maldives.

The Maldives is an import dependent country and it requires modern construction services to support its thriving tourism sector and other needs of the country. WTO commitments in this sector help the country in better articulate its import requirements. This will also bring in transparency and predictability in the system from which both the Maldives as an importing country and others as exporting countries would benefit. Also since its trade regime seems to be relatively liberal, there is no reason why the Maldives should not undertake wider and deeper commitments in this sector given its very strong import interest. At least under the SAFTA it must do so. This will help the country immensely by accessing cheaper services from the region and may lead to enhancement of the skill levels of the labour force.

### *Bhutan*

Although as part of its accession negotiations Bhutan has already submitted its offer in services, the same has not been made available for the use of public. However, there is evidence suggesting that Bhutan has made relatively liberal commitments in services. It should be a repeat of Nepal's story. Thus it is expected that Bhutan might have undertaken commitments in the construction and related engineering services sector.

According to the restricted document available with

WTO members, Bhutan has offered to undertake commitments for warehouses and industrial buildings (CPC 51230) under the sub-sector – general construction work for buildings. It has also proposed to make commitments for highways (except elevated highways, streets, roads, railways and airfield runways (CPC 51310); bridges, elevated highways, tunnels and subways (CPC 51320); long distance pipelines, communication and power lines (cables) (CPC 51340); local pipelines and cables, ancillary works (CPC 51350); and construction, mining and manufacturing (CPC 51360). Thus in two sub sectors of the construction sector Bhutan has taken broad commitments and coverage wise it is by no means less than that of Pakistan. Further, in the Market Access column, under Modes 1 and 2 there are no restrictions inscribed. Under Mode 3 the limitations include services to be provided through incorporation where the foreign investor equity shall be limited to a maximum of 49% and jobs below \$11 million to be reserved for the domestic industry. Mode 4 remains unbound and refers to the horizontal section. In the National Treatment column, Modes 1, 2, and 3 have got no restrictions and the status of Mode 4 is same as in the Market Access column.

In its horizontal section, Bhutan has inscribed certain limitations in the Market Access column under Mode 3 that in order to establish a new commercial presence in Bhutan the minimum size of foreign investment shall be \$0.5 million, foreign investor's equity holding limited to 70%, and the business must also be incorporated in Bhutan. The investment shall be governed by sector specific policies and procedures as established in the sectors included in this schedule. Also Mode 3 is unbound for measures regulating publicly funded services including with respect to national treatment. In the National Treatment column there are some limitations, which include foreign investors required to foster transfer of technology, introduction of management skills and provide training and employ Bhutanese nationals at all levels in the enterprise. Moreover, the shares held by foreign nationals and foreign juridical persons in locally incorporated companies are not transferable without prior permission by the Government of Bhutan.

The share of construction sector in the Bhutan's GDP has increased from 7.9% in 1980 to 12.1% in 2001 (UNESCAP 2003:191). However, this has been largely attributable to the construction of hydropower projects. In Bhutan the regulatory body is the construction development board (CDB) – an interagency of the Royal Government of Bhutan – that regulates the

construction industry in the country.<sup>6</sup> The CDB is responsible for registration, classification and monitoring of consultants, contractors, and their performance. There is nothing in its rules and regulations which could suggest the presence of any discriminatory provisions. Since the country heavily depends on other countries' assistance in the area of construction particularly on India there does not seem to be any explicit discriminatory provisions.

Current development theories contend that infrastructure together with integration into the world economy is essential for economic development (UNESCAP 2003). Small countries such as Bhutan face considerable challenges, as the cost of infrastructure provision is very high, and successful integration is constrained by several structural and locational problems associated with smallness and remoteness. The high costs of infrastructure provision makes small countries heavily dependent on external assistance for capital investments.

Bhutan should undertake liberal commitments in the sector that will help it improve its infrastructure. This will have very positive implications for tourism services. It should also make its Mode 4 regime liberal so that other South Asian countries can gain market access for their professionals and workers. This will improve the overall quality of labour in the country and may lead to skill enhancement in the local labour.

### Other Regulations Affecting Trade in Construction Services

#### *Recognition*

As already noted, Article VII of GATS specifies that for the fulfillment of its standards, licensing or certification of service suppliers, a member may recognise the education and experience obtained or licenses or certification granted in a country. This article thus urges members to recognise the educational or other qualifications of service suppliers of other countries. Recognition related issues are of crucial significance to developing countries including South Asian ones as lack of such recognition of professional qualifications can act as a formidable barrier to providing services especially via movement of natural persons. As per the provision of this article, members have an obligation to notify the Council for Trade in Services (CTS) of existing recognition agreements as well as new ones that are negotiated. However, it appears that not all such agreements are notified. It can therefore be argued

that adequate opportunity is not being provided to other members to indicate their interests in participating in these negotiations. In view of the ineffectiveness of notification obligations one would tend to consider this article as any other best endeavour clause (Kumar 2005). Further, the problem is that there is no provision for mandated review or negotiation on this article to make desired improvement.

Perhaps the most important domestic policy issue to be addressed relates to the *recognition of qualifications*. Lack of recognition of qualifications often constitutes a major barrier to entry by South Asian service suppliers, who are largely outside existing recognition initiatives and thus at a disadvantage in various services where licensing and certification requirements apply to entry (Chanda 2005). However, India has made an historical attempt by having taken some steps in this direction in its agreement with Singapore- CECA. The CECA has a list of professionals and both parties are expected to recognise their qualifications. In the context of South Asia it is suggested that a similar exercise should be carried out. However, here apart from professionals, the list must also include less skilled and semi-skilled workers.

*At the South Asian level developing MRAs with a view to recognising qualifications of engineers, architects, town planners, and all other skilled or semi-skilled workers* will be immensely beneficial to the South Asian countries in facilitating trade in construction services. Having the precedence of India-Singapore agreement and an agreement in the pipeline with Sri Lanka, developing MRAs in the sector may not be that daunting. One bilateral agreement will enable the region to apply it to all other countries. The most important point is that since Mode 4 is the most restricted mode at the regional level the gains will also be most from liberalising it and MRAs would play an instrumental role in facilitating the presence of natural persons. However, since the issue of MRAs is complex it deserves more detailed discussion and accordingly, this has been discussed in the Chapter 5.

**Classification issue:** In view of related professional services being placed under the business services sector under W/120 classification, Cuba argues that members should hold discussions within the purview of the existing interrelationship between the construction and related engineering services sector and the professional services sector with regard to architectural services, engineering services, integrated engineering services and

<sup>6</sup> About the CDB, <http://www.cdb.gov.bt/aboutcdb.htm>, last visited on 24 October 2007.

urban planning and landscape architectural services, to examine possible definitions which would enable services related to this sector to be more comprehensive and focused. Therefore, the two sectors namely, construction and related engineering services sector and professional services as listed under the business services sector such as engineering, and architectural, urban planning should be put together for the purpose of undertaking commitments as these sectors are closely interlinked. In the South Asian context it could be suggested that while undertaking commitments in construction services, SAFTA member countries should also cover the related professional services.

### ■ CONCLUSION

Under the GATS regime the construction and

related engineering services sector appears to be most liberal in India among South Asian countries. Nepal, Pakistan, and Sri Lanka are the other countries from the region that have undertaken or offered to undertake commitments in the sector. Bangladesh and the Maldives have no commitments in the sector. However, Bhutan is said to have offered liberal market access commitments in the sector. As already suggested, all SAFTA member countries should undertake wider and deeper commitments in the sector in order to gain from the liberalisation. Mode 4 regime should be made fully liberal so that all could gain. Finally, all countries must work hard to negotiate MRAs and make earnest efforts to have a conducive visa regime for smooth movement of service providers in the sector.

# 12 ■ Tourism and Travel Related Services<sup>1</sup>

## ■ INTRODUCTION

Tourism and travel-related services sector is regarded as the world's largest industry and one of the fastest growing, accounting for over one-third of the value of total world-wide services trade. According to WTTC, travel and tourism can bring prosperity to host communities, creating jobs in deprived or rural areas, where there are often few viable alternatives (WTTC 2003–04). It employs a relatively high proportion of women, minority groups and those with a low skills level, and encourages entrepreneurship with few barriers to setting up in business.

The most striking feature of South Asian tourism is its one of the lowest share in total international tourist arrivals. In 2006, South Asia received merely 8.9 million foreign tourists, which was barely 1.1% of the total world tourist arrivals (World Tourism Organisation 2007). In fact, in the Asia and the Pacific region South Asia receives the least number of foreign tourists (Table 12.1). However, one positive sign is that in 2006 the growth rate of arrivals has been the highest at 11.7% in South Asia from all regions in Asia and the Pacific. Similarly, in terms of international tourism receipts, the share of South Asia in the world in 2006 was 1.6% (Table 12.2) and the growth rate was the highest – almost 14% – in the region. Another positive sign was that the receipts per arrivals were the second highest after Oceania. Nevertheless, all this is happening at a fairly low base and South Asia has to take a number of drastic measures if it is to attract a sizeable number of tourists commensurate to its potential. This is also a region consisting of countries like the Maldives, Nepal and Bhutan whose economies, to a large extent, are dependent on tourism.

According to the World Tourism Organisation (WTO), from the South Asian region India is the only

country that figures in the list of the top 50 countries in terms of international tourist arrivals by country of destination and ranked 42nd with 4.4 million tourist arrivals in 2006. Similarly, in terms of international tourism receipts too India is the only country from this region that figures in the list of top 50 countries of the world and India did much better in terms of receipts by earning \$8.9 billion and ranked 21st in 2006. This seems to be chiefly because the number of days spent by an average tourist is relatively high for India suggesting the country has enormous tourism potential. In regard to outbound tourism also India does fairly well as its tourists spent \$7.4 billion in 2006 and the country ranked 23rd among the top 50 countries of the world spending the highest amount of money on tourism. It is indeed interesting to see that Pakistan is the only other country from South Asia that has made to the club of top 50 countries in terms of international tourism expenditure implying that it is an important tourism market in the world. From South Asian point of view India and Pakistan offer large markets and even if other countries could grab a small pie of it, it could change the landscape of tourism in other countries.

According to the WTTC (2005), on an absolute scale, India is one of those countries where the travel and tourism demand is expected to grow the most between 2006 and 2015. India is expected to grow its demand to about \$57 billion and should be ahead of Canada and behind eight countries in the list of top 10 countries expecting the highest tourism demand. Moreover, on an employment scale, India is expected to perform better than the absolute scale as by the year 2015 it is likely to generate almost two million new jobs thereby becoming the fifth largest country in terms of job creation. Interestingly, in the list of top 10 countries expected to generate the maximum number of jobs in the tourism sector there is one more country

<sup>1</sup> The chapter is based on the report authored by Shailendra Kumar.

from South Asia – Pakistan – which is likely to create a little over one million jobs. In the WTTC study of 2003, Bangladesh too figured as one of the 10 countries that were likely to generate maximum number of travel and tourism jobs. However, it does not find its place in the studies of later years whereas India and Pakistan have consistently maintained their positions.

On a relative scale India with an annualised growth rate of 8.6% ranks third in the list of top ten countries of the world expected to grow their travel and tourism demand fastest between 2006 and 2015 (WTTC 2006). Even when the WTTC took the projection until 2017 instead of 2015 there was not much change in the India's position and the results show that the People's Republic of China, Montenegro and India are at the top of the list, with demand in the respective countries growing each year at a rate of 9.1%, 8.6% and 7.9% (WTTC 2007). These countries have consistently ranked in the top three positions over the past four years, consolidating their growth year on year. Their strong foothold in terms of performance is underscored by a sustained expansion in their travel and tourism industries as a

result of focused strategic development and targeted investment.

From the calculation of RCA of four South Asian countries – Bangladesh, India, Pakistan and Sri Lanka – it is evident that while the average RCA for these countries is 0.7 (which is low by international standard and an RCA less than one reveals the absence of comparative advantage), that of Sri Lanka is 0.8, which is the highest RCA followed by India and Bangladesh (Table 12.3). However, Pakistan has the lowest RCA of 0.2.

In the South Asian region while the tourism and travel related services sector play a dominant role in the economies of the Maldives, Nepal, Sri Lanka, and Bhutan, it remains important for India, Pakistan and Bangladesh. Out of seven South Asian countries Bangladesh receives the least number of foreign tourist arrivals after Bhutan (Table 12.4). However, if one looks at the growth in tourist arrivals during 1990–2004 then Pakistan has seen the lowest growth. The Maldives stands out as the country having registered the highest growth in tourist arrivals in the region during 1990–2004. However, from 2000 to 2004 it is Sri Lanka that has had the highest growth in tourist arrivals. India

**Table 12.1 International Tourist Arrivals**

Asia and the Pacific	Absolute (million)		Change %			% Share of World
	2005	2006	04/03	05/04	06/05	2006
North-East Asia	87.6	94.1	28.6	10.3	7.4	11.2
South-East Asia	49.3	53.9	30.6	4.9	9.3	6.4
Oceania	10.5	10.5	12.1	3.7	0.6	1.3
South Asia	8.0	8.9	18.5	4.7	11.7	1.1

Source: Based on the figures in *UNWTO World Tourism Barometer*, Volume 5 No. 2, June 2007

**Table 12.2 International Tourism Receipts**

Asia and the Pacific	Change Local Currencies, Constant Prices (%)			\$ billion		Receipts per Arrivals	% Share of World
	2003-04	2004-05	2005-06	2005	2006	2006	2006
North-east Asia	33.4	8.0	11.6	65.4	75.0	800	10.2
South-East Asia	26.1	-0.7	9.7	33.8	40.7	760	5.5
Oceania	7.6	0.9	1.7	25.6	26.3	2,490	3.6
South Asia	20.1	4.3	13.9	9.6	11.5	1,290	1.6

Source: Based on the figures as given in *UNWTO World Tourism Barometer*, Volume 5 No. 2, June 2007

**Table 12.3 (RCA) in Travel Services for South Asia**

Region/Country	1980	1990	1998	1999	2000	Average 1998–2000
South Asia	1.7	0.9	0.8	0.7	0.6	0.7
Bangladesh	0.3	0.2	0.7	0.6	0.6	0.6
India	2.0	1.0	0.9	0.7	0.6	0.7
Pakistan	1.0	0.4	0.2	0.9	0.2	0.2
Sri Lanka	1.6	0.9	0.9	0.8	0.8	0.8

Source: South Asia Yearbook of Trade and Development 2005, CENTAD, p. 116

Table 12.4 International Tourist Arrivals by Country of Destination

	International Tourist Arrivals (1000)						Market Share in the Region (%)			Change (%)		Average Annual Growth (%)	
	1990	1995	2000	2002	2003	2004	1990	2000	2004	03/02	04/03	90-00	00-04
Asia and the Pacific Region	56138	82747	111372	126075	114237	145491	100	100	100	-9.6	28.6	8.3	8.0
South Asia	3150	4233	6086	5833	6426	7613	5.6	5.5	5.2	10.2	18.5	6.8	5.8
Bangladesh	115	156	199	207	245	271	0.2	0.2	0.2	18.0	10.9	5.6	5.8
Bhutan	2	5	8	6	6	9	0.0	0.0	0.0	11.8	47.7	14	5.0
India	1707	2124	2649	1384	2726	3457	3.0	2.4	2.4	14.3	26.8	4.5	6.9
Maldives	195	315	467	485	564	617	0.3	0.4	0.4	16.3	9.4	9.1	7.2
Nepal	255	363	464	275	338	385	0.5	0.4	0.3	22.9	13.9	6.2	-4.6
Pakistan	424	378	557	498	501	648	0.8	0.5	0.4	0.6	29.4	2.8	3.9
Sri Lanka	298	403	400	393	501	566	0.5	0.4	0.4	27.3	13.1	3.0	9.1

Source: Based on the figures as given in *Tourism Market Trends*, Annex, World Tourism Organization, 2005.

has witnessed a consistent increase in tourist arrivals during 1990–2004. While from 1990–2004 the growth rate was 4.5%, from 2000–04 it increased to 6.7%. Overall, it is clear that barring Nepal every country in the region has been registering positive growth.

## ■ CLASSIFICATION OF THE SECTOR

In the WTO the tourism and travel-related service sector has been the most committed sector and most member countries seem to have inscribed the least number of restrictions in the sector. The South Asian countries are also not an exception to this general trend. Hence in South Asia all existing WTO member countries, barring Maldives, have undertaken commitments in tourism and travel services.

The tourism and travel related services sector comprises the following sub sectors:

- Hotels and restaurants (including catering) (CPC 641–43)
- Travel agencies and tour operators services (CPC 7471)
- Tourist guides services (CPC 7472)
- Other

According to the WTO, under the Provisional Central Product Classification itself, CPC 641 (Hotel and other lodging services) is divided into CPC 6411 (Hotel lodging services), CPC 6412 (Motel lodging services) and CPC 6419 (Other lodging services), the last of which is further separated to include holiday camp services, youth hostels, etc. CPC 642 (Food serving services) is divided into full restaurant services (CPC 6421), self-service facilities (CPC 6422), catering

services (CPC 6423) and other (CPC 6429). The CPC 643 classification (Beverage serving services for consumption on the premises) is composed of services without entertainment (CPC 6431) and those with entertainment (CPC 6432). Travel agencies and tour operators services (CPC 7471) and Tourist guides services (CPC 7472) are not further subdivided. International tourism is defined by the World Tourism Organisation as occurring when a traveller crosses an international border. GATSS' definition of tourism in general, as reflected in W/120, leaves out many services activities, such as computer reservation systems, transport, hotel construction, and car rentals, which are regarded by the WTO as key tourism-related industries.

Although most of the WTO members have taken commitments in the sector, the level of market access and national treatment provided within members' schedules and commitments by four modes of supply vary widely for the tourism sector as a whole (Kumar 2005). The percentage of schedules containing no restrictions on market access is obviously highest for Mode 2, followed by lower levels for Modes 1 and 3 with minimal levels for Mode 4. Regarding national treatment the pattern is similar. The number of commitments made also varies widely by subsector. Hotels and restaurants show the greater number, followed in order by travel agencies and tour operators services, tourism guides services and other.

Despite the tourism sector being relatively liberal, various barriers still exist both in the member countries, which receive, and those, which generate tourists. In regard to Mode 1 the limitations include requirement of establishments in the country and the requirement of residency. The absence of bindings due to a perceived lack of feasibility could also be termed as a major

limitation. However, the development of Internet and e-commerce has brought this into question, as these tools are increasingly used to make online bookings, enquiries and marketing. An ENT is frequently required for opening new bars or restaurants; citizenship requirements are sometimes imposed for liquor licenses and tourist guide licenses. Mode 3 is restricted to fixed equity limits and Mode 4 is usually unbound implying that foreign service providers are not allowed entry into the host markets.

Liberalisation of tourism services is highly dependent on commitments made in other related sectors in particular transport services and others such as financial services (insurance, foreign exchange transactions), software services (computer reservation systems, billing, payments, etc.), distribution services and various business services (Kumar 2005). Thus while tourism services have witnessed more extensive coverage and more liberal offers than other services sectors, given their strong complementarity with other services, restrictions in these related services also influence the actual extent of liberalization in tourism services.

South Asia being one of the poorest regions in the world it has special interest in tourism and travel services in view of this sector's capacity to provide employment at all skill levels. Tourism is not really a sector but rather an agglomeration of crosscutting sectors, one of its appealing factors being its linkage to other sectors and activities.

## ■ CHARACTERISING SAFTA COUNTRIES' COMMITMENTS/INITIAL/REVISED OFFERS

### India

Out of the four subsectors of the tourism and travel-related services sector India has offered to undertake commitments in three subsectors, namely hotels and other lodging services (CPC Ex. 641); travel agencies and tour operators services (CPC 7471); and tourist guides services (CPC 7472).

Though India's commitments cover a wide range of tourism services, still there are some services such as full restaurant services, self-service facilities, catering services, beverage serving services, etc., that have not been committed. However, its coverage in travel agencies and tour operators' services and tourist guides services is full.

In its sectoral commitments in the Market Access column India has put no restriction under Modes 1 and 2 for hotels and other lodging services and travel

agencies and tour operators services. Under Mode 3 the entry is only through incorporation and subject to the condition that in the case of foreign investors having prior collaboration in these services in India, FIPB approval would be required. Mode 4 is unbound except as in the horizontal section. In the National Treatment column Modes 1, 2, and 3 are without any restrictions whereas Mode 4 refers to the horizontal section. For tourist guides services while Mode 1 is unbound albeit due to lack of technical feasibility and Mode 2 are without any restrictions, Mode 3 has the same restrictions as in the case of other tourism subsectors. However, Mode 3 is subject to additional restriction that there is a ceiling of 500 tourist guides conversant in Chinese, Spanish, Portuguese, French and Japanese. Mode 4 commitment for tourist guides services is indeed quite liberal as it mentions that there are no restrictions for the tourist guides conversant in Chinese, Spanish, Portuguese, French and Japanese languages though subject to a total ceiling of 500. For other tourist guides Mode 4 is unbound except as in the horizontal section. In the National Treatment column while Mode 1 is unbound on account of technical infeasibility, Modes 2 and 3 are without any restrictions, Mode 4 is unbound and refers to the horizontal section. In the horizontal section, India has taken very meaningful market access commitments for the entry of contractual services suppliers and independent professionals in hotels and restaurant, travel agencies and tour operators services. The only requirement these service providers have is that apart from following usual visa formalities they must have proof of contract and they have to possess requisite educational and professional qualifications relevant to the service to be provided including work experience.

In the National Treatment column there are some general limitations on Mode 3 such as in case of collaboration with public sector enterprises as joint venture partners, preference in access will be given to Foreign Service suppliers which offer the best terms for transfer of technology. Taxation laws for domestic and Foreign Service suppliers shall apply as per the provision of the Income Tax Act, 1961. Finally, subsidies, where granted, shall be available only to domestic service suppliers.

From South Asia, Sri Lanka has made a request on India to offer full commitments under Market Access and National Treatment columns in Modes 1, 2, and 3 in hotel, restaurant and catering services (Taneja et al. 2004). As already noted, while India has not offered any commitments in restaurant and catering services,

in hotel services it has offered almost the same commitments as requested by Sri Lanka. Sri Lanka has special interest in restaurant and catering services as there are some small Sri Lankan motels in India (Chennai) which mainly cater to Sri Lankan tourists, pilgrims, patients, businesspersons, etc. It has been suggested that there is significant scope for Sri Lankans to invest in motels in India in renowned hospitals in the Southern region and in Buddhist circuits such as Bodhgaya.

Tourism is an important services industry in India. In recent years India has taken a number of initiatives to attract foreign tourists. Global and private agencies have been entrusted with the task of selling India to international visitors. The Ministry of Tourism has also made efforts notable among them being the 'Incredible India' spirituality campaign that won the PATA Gold Award. It has also been suggested that there has been a marked improvement in the Government of India's approach to tourism (WTTC 2003–04).

In the South Asian region unlike Sri Lanka, India does not provide visa-on-arrival. However, outbound travel from Sri Lanka to India has been facilitated since India has offered visa-free travel to groups travelling on pilgrimage (ESCAP 2005). During 2001–03 Sri Lanka was the third largest country in terms of sending tourists to India.

### *Summary of Restrictions in the Indian Tourism Sector*

- No commitments in restaurant and catering services
- In all three committed subsectors under Mode 3 FDI only though incorporation and in the case of foreign investors having prior collaboration in these two subsectors, FIPB approval is required
- No sectoral Mode 4 commitments in hotel and lodging and travel agencies and tour operators services
- No commitments under Mode 1 in tourist guides services
- Unlike Sri Lanka, India does not offer visa-on-arrival to tourists from SAARC countries though it offers visa-free travel to groups traveling on pilgrimage from Sri Lanka.

### **Pakistan**

During the Uruguay Round Pakistan undertook commitments in two of the four subsectors of the tourism and travel related services sector – hotels and restaurants (including catering) (CPC 614–643) and travel agencies and tour operator services (CPC 7471).

In these two sub-sectors Pakistan has proposed some improvements in its initial offer (for details see table B in chapter 6). While India's commitments – as proposed in its revised offer – are wider covering three sub-sectors of the tourism sector, Pakistan's commitments in the sub-sector – hotels and restaurants (including catering) cover more services than that of India because India has left restaurants (including catering) services.

Pakistan's sectoral commitments in tourism services are relatively liberal, as it has not put any limitations in Modes 1, 2, and 3 in the Market Access as well as National Treatment columns in both the subsectors that have been committed. However, Mode 4 in all cases is unbound and refers to the horizontal section where this mode is partially open for movement of natural persons. Though tourism companies will directly benefit from the easy entry provisions for the categories of employees like ICTs (managers, executives, specialists), they will also benefit from the liberal entry conditions given for business visitors (business persons and service sales persons). Further, as the entry of professionals and independent professionals is allowed they will facilitate supply of tourism services though entry of independent professionals seems to be limited to imparting training. However, the entry of persons having other skills seems to be the most important provision under Mode 4 because it specifically mentions about the delivery of tourism services albeit limited to imparting training.

From the analysis of the Pakistani commitments in tourism services it is clear that though Modes 1, 2, and 3 have been made fully liberal Mode 4 remains relatively restrictive. This is important because all other countries from the South Asian region would be looking at Pakistan as a major market. In this regard, Pakistan should take more liberal commitments to allow various categories of persons working in the tourism industry. In addition, Pakistan should either remove (the condition of labour market test as given in its commitments for persons having other skills or it should make the criteria of the test fairly transparent. Pakistan and other South Asian countries both would gain from a liberal Mode 4 regime in Pakistan.

In addition, Pakistan ought to include travel agencies and tour operators services (CPC 7471) in its commitments. This sub-sector seems to be quite important for other SAARC countries which are potential providers of these services. This will also help Pakistan in mobilising adequate resources to provide standard services in this sub-sector.

The tourism industry has been relatively small compared with other industries, but its role in the

economy is noteworthy (ESCAP 2005:2). Tourism declined for three years as Pakistan faced negative travel advisories in some source countries after 11 September 2001. By 2004, the number of arrivals had recovered and there were 648,000 visitors, an increase of 29.4% over 2003. The number of tourist arrivals further increased in 2005 and 2006 to 798,300 and 898,400, respectively (State Bank of Pakistan 2007A). Foreign exchange earnings were valued at \$185.6 million in 2004, an annual increase of 36.9% which also saw an upward trend with Pakistan receiving \$260 million in 2006. Tourism receipts accounted for about 0.2% of gross national product (GNP) in 2003–04 and it has remained so even in 2006. About 500,000 people were directly employed in tourism and about 1.5 million indirectly employed. The government of Pakistan has invested in tourism infrastructure in remote areas, which has attracted additional private sector investment. Incentives and concessions have been available to local and foreign investors for tourism infrastructure projects (ESCAP 2005:10). The Ministry of Tourism can issue a certificate for projects in the hotel sector, since tourism has been categorised under the national investment policy. The priority in Pakistan has been to prepare more people to be trainers in order to produce trained staff to meet market demands (ESCAP 2005:2). There are four tourism training institutes in Pakistan, besides the hotels offering in-house training. However, tourism training institutes have failed to achieve desired results because of lack of funds and trained staff (*Daily Times*, 4 February 2005).

Thus, it has been suggested that Pakistan has tourism potential but has not been able to get its due share in world tourism market because of the lack of infrastructure and skilled professionals in its tourism industry (Ibid). Pakistan clearly has strong import interest in tourism services and it should welcome foreign companies in order to improve the level of its tourism products. A regional agreement will immensely help provide the necessary capital and skilled professionals. It can surely gain from the experience of India, Maldives and Sri Lanka. For Pakistan while India has been one of the top five tourist generating countries, South Asia has been one of the top three foreign tourist generating markets along with Europe and America (State Bank of Pakistan 2007). Further integration with the region will help generate huge tourism business in Pakistan.

#### ***Summary of Restrictions in the Pakistan Tourism Sector***

- No commitments in tourist guides services

- Foreign equity ceiling of 60% in the horizontal section
- No sectoral Mode 4 commitments
- No sectoral commitments for entry of professionals as the horizontal commitment is subject to sector specific commitment
- Entry of independent professionals limited to imparting training
- Entry of persons having other skills is limited to imparting training and subject to labour market test
- Unlike Sri Lanka, Pakistan does not seem to offer visa-on-arrival to tourists from SAARC countries

#### **Bangladesh**

Like India and Pakistan, Bangladesh also undertook commitments in tourism services in the Uruguay Round. However, it has not proposed to improve its commitments during the ongoing services negotiations. Bangladesh has taken commitments in only one of the four sub-sectors of tourism services – five star hotels and lodging services (CPC 641) (for details see table D in Chapter 6). Even in the committed sub-sector the coverage is not full as it excludes hotels other than five star and restaurants (including catering). It has rightly been suggested that Bangladesh's commitments are very narrow in coverage (Chanda 2005). Further, Modes 1 and 2 are unbound in both Market Access and National Treatment columns. Under Mode 3 in the Market Access column commercial presence requires that foreign service providers incorporate or establish the business locally in accordance with the relevant provisions of Bangladeshi laws, rules and regulations. There is no fixed ratio of equity between local and foreign investors and foreign equity to the extent of 100% is allowed. Under Mode 4 the commitment suggests that the entry and residence of foreign natural persons are subject to Bangladesh's immigration and labour laws, regulations, guidelines and procedures. There is no restriction in issuing work permits to foreign nationals in Bangladesh. However, the employment of foreign natural persons for the implementation of the foreign investment shall be agreed upon by the government and such personnel shall be employed in higher management and specialised jobs only. Thus the provisions on Mode 4 indicate that it is largely the ICT category of persons that have been covered implying that the Mode 4 commitment is of little value to other South Asian countries. Modes 3 and 4 in the National Treatment column are without any limitations.

In the WTO context tourism is only one of the three services sectors – the other two being financial and telecommunications – wherein Bangladesh has undertaken commitments. The commitments made earlier in tourism have a very positive implication as Bangladesh has gained experience and should thus be willing to take wider and deeper commitments in the sector in the current round. Others also suggest that Bangladesh had initial commitments in this sector during the conclusion of the Uruguay Round negotiations and it is quite obvious from such commitments that it has developed some understanding of the opportunities and risks involved in this sector (Raihan and Mahmood 2004). This will certainly help Bangladesh in drafting improved commitments.

In Bangladesh, the tourism and travel related sector ranks low in GDP share. It has been estimated that tourism contributed about 0.3% to GDP while the hotel and restaurant subsectors accounted for only 0.67% of services sector output in 2002–03 (ESCAP 2005:3). Direct employment in tourism was estimated to be just over 100,000 people and indirect employment could be over 200,000 people. Tourism has been considered important for poverty alleviation and Bangladesh strives for the optimal use of tourism resources to benefit local communities.

The Bangladesh Parjatan Corporation, the national tourism organisation, has been responsible for developing tourist facilities nationwide (ESCAP 2005). At the same time, the private sector has developed tourism businesses. The government has encouraged foreign investment in tourism, either as a joint venture or with 100% foreign ownership. A set of 10 incentives was designed to encourage local and foreign investment. In Bangladesh, the National Hotel and Tourism Training Institute has been developing human resources in the tourism industry. A two-year diploma course in hotel management began in 2002, and national certificate courses on hotel and tourism-related subjects have been conducted regularly.

Bangladesh has supported the Action Plan on Tourism of 1991 as a member of the SAARC Technical Committee on Tourism, which identified tourism as one of six important sectors with scope for multilateral and bilateral cooperation. In 2004, members of the Bay of Bengal Initiative for Multisectoral Technical and Economic Cooperation (BIMSTEC)<sup>2</sup> recognised that

strategies such as joint marketing and exchange of visits and information could enhance interregional tourism. Members also agreed to facilitate business travel, exchange programmes and tourism by introducing a BIMSTEC business travel card/visa. Bangladesh is a member of South Asia subregional economic cooperation.

Bangladesh needs to improve upon its commitments in the sector during the ongoing services negotiations. Bangladesh should expand the coverage of its commitments by including other sub-sectors – travel agencies and tour operators services and tourist guides services. In the sub-sector in which Bangladesh has already undertaken commitments it should also include hotels other than five star and restaurant and catering services. Moreover, as Bangladesh has not made any commitments under Modes 1 and 2 in the committed sub-sector, it should take full commitments in these modes. The opening of the tourism sector will increase the volume of domestic tourism, as well as the level of investment (Raihan and Mahmood 2004). Currently, Bangladesh is a net importer of tourism services through Mode 2 despite having enormous resources for the development of its tourism sector.

Bangladesh is an important tourism market for India. It sends a large number of people to India for various purposes including tourism. For instance, in 1998 about 303,000 Bangladeshis visited India and the number rose to 333,000 in 1999 (Rahman 2000). It has been estimated that about 40,000 Bangladeshis visit India annually primarily for the purpose of medical treatment (*Ibid*). Those who visit India for health reasons are also relevant to tourism in view of health tourism. Similarly, Sri Lanka has started direct flight service between Dhaka and Colombo in order to facilitate the movement of tourists between the two countries. There is trade taking place between Bangladesh and Bhutan via India which is also likely to facilitate tourists' movement between these two countries. Though it is interesting to note that India has been operating hotels in the Maldives, Sri Lanka and Bhutan, there is no information regarding any reputed Indian hotels operating in Bangladesh.

Bangladesh being the third largest market in the region has a lot of potential to attract investments and skilled professionals which will help its tourism industry to grow at a rapid pace. In view of this it ought to undertake wider and deeper commitments in all sub-

<sup>2</sup> The BIMSTEC is an international organisation involving a group of countries in South Asia and South East Asia. The member nations of this group are: Bangladesh, India, Myanmar, Sri Lanka, Thailand, Bhutan and Nepal.

sectors of the tourism sector. Due to historical, cultural and religious connections, Bangladesh will gain immensely from the regional integration.

### *Summary of Restrictions in the Bangladesh Tourism Sector*

- No commitments under Modes 1 and 2 in both the Market Access and National Treatment columns in the committed sub sector- five star hotels and lodging services
- No commitments in hotels other than five star
- No commitments in restaurant and catering services
- No commitments in travel agencies and tour operators
- No commitments in tourist guides services
- Mode 4 commitments almost limited to ICTs

### **Sri Lanka**

Sri Lanka undertook commitments in two of the four sub-sectors of tourism and travel related services, namely hotel and lodging services and travel agencies and tour operators services. For hotel and lodging services Modes 1 and 2 are unbound in the Market Access column. However, under Mode 3 there are no limitations other than those inscribed in the horizontal section which does not seem to cover this sub-sector for allowing foreign investment. Likewise, though there are no explicit limitations under Mode 4, this is subject to all relevant provisions of labour, immigration and customs laws. In the National Treatment column while Modes 1 and 2 are unbound for hotels and lodging services, there are no restrictions at all under Modes 3 and 4. However, as market access under modes 3 and 4 is highly restrictive, a liberal national treatment may not make any substantial difference.

In travel agencies and tour operators services while Mode 1 has no limitations in the Market Access column, Mode 2 is unbound and the nature of commitments under Modes 3 and 4 are exactly the same as in the case of hotel and lodging services. But there is one major difference – FDI for travel agencies is allowed as per the commitments made in the horizontal section. Thus foreign investment of up to 40% of equity in a company proposing to carry on a business activity in travel agencies services will be automatically approved, whereas foreign investment in excess of 40% (and up to 100%) will be approved on a case-by-case basis. There are some other provisions in the horizontal sec-

tion which may also apply to those foreign companies that invest in travel agencies services like they will be treated equally as any company owned by Sri Lankan nationals if they happen to incorporate their companies in Sri Lanka. In the case of joint venture when a partner is a public sector enterprise then while granting access preference will be given to foreign service suppliers which offer the best terms for transfer of technology. Similarly, national treatment accorded to travel agencies and tour operators services is better than that accorded to hotels and lodging services because Modes 1, 3, and 4 have no limitations and only Mode 2 remains unbound.

Although Sri Lanka has submitted its initial offer during the current Doha Round of negotiations, it has not yet made its offer public. However, it is learnt that Sri Lanka has further liberalised the sector and removed all Mode 3 restrictions (Taneja et al. 2004). It has also opened Mode 4 to the extent indicated in its horizontal schedule. However, it is not certain whether changes have been made in the horizontal section.

In tourism and travel-related services, though the commitments allow for foreign commercial presence in hotels and tour operators services, they are subject to scheduled horizontal measures on approvals, taxes, and foreign equity caps. Overall, they are not very meaningful as the coverage of sub-sectors is limited and there are numerous horizontal measures affecting investment (Chanda 2005). Apart from making liberal commitments in the committed sub-sectors, Sri Lanka should also undertake commitments in tourist guides services as this sub-sector would be of some interest to other South Asian countries in view of geographical proximity and cultural affinity. Moreover, it should also make sectoral commitments under Mode 4. This will also be beneficial for other South Asian countries. Although Sri Lanka has made request on India seeking full commitments in both Market Access and National Treatment columns under Modes 1, 2, and 3 in hotel, restaurant and catering services, it has made similar commitments in the sub-sector.

Tourism is one of Sri Lanka's five highest foreign exchange earners after remittances, textiles, tea and gemstones.<sup>3</sup> Sri Lanka has made a concerted effort to draw tourists into the country by shifting its focus from Western Europe to countries in Asia (Taneja et al. 2004). In line with its objectives, the Sri Lankan airlines has upgraded its infrastructure and management and expended its network to get an increasing pie of the

<sup>3</sup> [www.tamilnet.com/art.html?catid=13&artid=23355](http://www.tamilnet.com/art.html?catid=13&artid=23355), last visited on 16 November 2007.

international traffic. The growth of traffic is also sustained by the growth of tourism industry in Sri Lanka. Sri Lanka has also introduced visa-on-arrival, which is now applicable to 73 countries including all SAARC countries. Sri Lanka has actively promoted cooperation related to tourism development within SAARC (ESCAP 2005). Since 2003, Sri Lanka has chaired the official working group on tourism. It has served as the lead country on tourism within BIMSTEC. Agreements were reached to implement several tourism projects when Sri Lanka hosted BIMSTEC meetings in 1999 and 2000. Sri Lanka facilitates travel within the South Asian region since the government initiated an open-sky policy (ESCAP 2005). For several years, the national carrier has been expanding operations to connect almost every country in the South Asian region. It has a liberal regime that allows foreign investors to invest in hotels with 100% equity. Sri Lanka has a hotel school that accommodates 1,000 students for tourism training at all levels (ESCAP 2005).

As a result, the number of tourist inflow increased from 0.3 million in 2001 to 0.5 million in 2003. However, during the next three years there has not been any substantial increase in the number of tourist arrivals as in 2006 only 560,000 tourists arrived which was just 2% more than the number in 2005 though tourism receipts grew at 17% to \$410 million.<sup>4</sup> Tourism in Sri Lanka created more than 175,000 direct and indirect jobs in 2003 (ESCAP 2005). In recent years, the country has become an important tourist destination. From the South Asian region, India is the most important market. In 2002, India was Sri Lanka's largest tourist generating market and in 2003 with a share of 18% of the total number of tourists arriving in Sri Lanka, it was at second place, next only to the United Kingdom (Taneja et al. 2004). Likewise, Sri Lanka is an important market for India. Taneja et al also suggest that Indian hotels are setting up operations in Sri Lanka. For instance, the Taj group has three hotels in Sri Lanka. Indian travel agency Sita Travels has a wholly owned subsidiary in Sri Lanka. Sri Lanka offers incentives such as a five-year tax holiday, import duty exemption on capital goods and concessionary taxes for investment in hotels or travel agencies. Apart from big hotels, medium-sized hotels have also shown an interest in entering the Sri Lankan market. In their study Taneja et al. suggest that these hotels have pointed out that lack of information has deterred them from making an entry in Sri Lanka (*Ibid*: 20). They have also pointed out that small size hotels face a problem in recognition of standards. Some

Indian restaurant/fast food chains such as Amravati and Barista have already established their presence in Sri Lanka. They have however pointed out that acquiring real estate in the desired location and ENT are two major problems affecting their operation and expansion plan in Sri Lanka.

#### *Summary of Restrictions in the Sri Lankan Tourism Sector*

- No commitments in tourist guides services
- No commitments in restaurant (including catering) services
- Modes 1 and 2 unbound in hotel and lodging services
- Mode 2 unbound in travel agencies and tour operators services
- No sectoral commitments under Mode 4
- Lack of information deterring small size hotels from making an entry
- Small size hotels face a problem in recognition of standards
- Acquiring real estate in the desired location is a problem for small hotels
- Small size hotels also face the problem of ENT.

#### **Nepal**

Nepal took commitments in tourism and restaurants hotels, lodging services (CPC 6411) (star hotels only); graded restaurants (CPC 6421–23); and travel agencies and tour operators services (CPC 7471) during its accession negotiations. The relatively high level of Nepal's commitments indicates that the tourism sector is of prime importance. For all committed services Nepal has inscribed no limitations in Modes 1 and 2 in the Market Access and Modes 1, 2 and 3 in the National Treatment column. Under Mode 3 for market access the commitments provide that FDI is allowed. But FDI is allowed only through incorporation in Nepal with a foreign equity cap of 51% for travel agencies and tour operators services and 80% for hotels, lodging services and graded restaurants. The only mode being unbound in both columns is Mode 4 referring to the horizontal section, which however does not provide any access to those categories of persons who are relevant to tourism services since persons covered are limited to ICTs, service sales persons and persons responsible for setting up a commercial presence.

In the horizontal section there is a provision under Mode 1 in the National Treatment column stating that

<sup>4</sup> *Ibid*.

national treatment will not be accorded with respect to foreign exchange provided to foreigners to pay for any cross-border services. Thus for the tourism services provided by foreigners via Mode 1 while paying foreign exchange national treatment is not guaranteed. This implies that there could be discrimination between national and foreigners while payment is made in foreign exchange for services rendered through Mode 1. However, those categories of persons have been excluded who are covered by Nepal's commitments. Incidentally, there are only a few categories of persons who are covered by the schedule of commitments.

Under Mode 3 in the National Treatment column a foreign investor reinvesting earnings is required to obtain the permission of the department of industry. Further, all foreign investments except for financial services require approval by the department of industry. Besides, incentives and subsidies are available only to enterprises wholly owned by Nepalese nationals.

The tourism sector is largely dependent on various other sectors. In this regard, the most important sector is air transport without which the existence of today's tourism would be extremely difficult. However, the air transport is only partially covered by GATS. According to Paragraph 3 of the Annex on Air Transport Services, only three services related to air transport – aircraft repair and maintenance services; the selling and marketing of air transport services; and computer reservation system (CRS) services are covered by GATS and services related to traffic rights which are the main activities in air transport remain outside GATS. The partial coverage of the sector does not really favour developing countries as the sector is dominated by innumerable bilateral agreements dictated generally by advanced countries. Generally speaking, for developing countries a multilateral agreement is preferable to a bilateral one since their concerns could be better addressed when there are a large number of parties involved rather than the bilaterals where a strong party can always thrust its will over the weak counterpart.

In this regard, the review of air transport services is an important exercise in the WTO. Nevertheless, a few peripheral services covered by the GATS – which are actually support services to air transport – have not been liberally committed by member countries. Thus it is not surprising that barring Nepal no other South Asian WTO member country has made any commitments in services related to air transport. Nepal's commitments relate to maintenance and repair of aircraft (CPC 8868) and there are no restrictions in Modes 1 and 2. Under Mode 3 the commercial presence

is allowed through incorporation in Nepal and with a maximum foreign equity capital of 51%. However, foreign equity cap will be increased to 80% after five years from the date of accession. In the National Treatment column, Modes 1, 2, and 3 are without any restrictions. Mode 4 is unbound under both Market Access and National Treatment columns and refers to the horizontal section where there is nothing specific for this sector.

Tourism accounts for about one-third of Nepal's services receipts. SAARC countries offer a very healthy market to Nepal tourism – India being the biggest market for Nepal in the region. However, Nepal tourism has witnessed little growth during 1995–2005. Thus, number of tourist arrivals has been almost stagnant during the past eleven years.

Tourism plays a very important role in the economy of Nepal. Employing some 600,000 people, it is the second largest sector of employment after agriculture (UNCTAD-ICC 2004). It is also a prominent foreign-exchange earner, contributing 21% of the total value of merchandise exports, 10% of total foreign exchange earnings and 3% of the country's GDP. The economic importance of tourism in Nepal has been due to economic linkages, foreign exchange earnings, employment and improved socio-economic conditions in remote rural areas (ESCAP 2005). As tourism in Nepal has hitherto been concentrated in the Kathmandu valley, Pokhara and Chitwan, it has been suggested that new areas can be developed in other parts of the country by setting up resorts that can be destinations on their own, such as the national parks and wild-life reserves (UNCTAD-ICC 2004). The Nepal Tourism Board has been providing small-scale skill development training covering most areas of the tourism industry for local stakeholders to strengthen their capacity (ESCAP 2005). The government has established the Nepal Academy of Tourism and Hotel Management and there are four private sector training institutes in Kathmandu and two in Pokhara.

The major tourist-originating market for Nepal has traditionally been India, which account for nearly 20% of the total arrivals. This is a foundation that can be built on, for Indian tourists are among the highest spenders in Nepal and they are especially likely to visit in the summer months when non-Indian arrivals decline. The latest development in this area is the status granted to Nepal by the People's Republic of China as one of the outbound destinations for Chinese tourists.

According to the UNCTAD-ICC study, Tourism is an area with enormous potential. There are spectacular

natural assets such as Mount Everest – the top of the world – and seven other peaks of 8,000 meters and higher. There is also a rich cultural heritage and a great diversity of ethnic groups with distinctive traditions: Lumbini is the birthplace of the Buddha, while Bhaktapur is a perfectly preserved medieval town full of Hindu temples. Thus far the focus of investors has been mainly on the Kathmandu valley, with a few exceptions. Most of the potential for development lies outside the valley. Investors will also want to consider the potential for more specialised tourism, for example health tourism, adventure tourism, and convention and sports tourism. Nepal's neutral status in the region might offer a real advantage here.

The study further suggests that training schools for the hospitality industry, amusement parks, golf courses, cable-car complexes and resorts in non-traditional destinations such as the mid-western, far-western and eastern development regions are among the opportunities for foreign investment. The emergence of the People's Republic of China as a source of tourists has opened up opportunities for specialty restaurants as well. Similarly, an opportunity exists for setting up the international airport planned for outside the Kathmandu valley. The possible site is a place near Lumbini.

In view of the importance of the tourism sector in Nepal it could be suggested that it should expand the coverage of its commitments by including tourist guides services. The opening up of this sub-sector would enable Nepal accessing standard companies having better guides and conversant in various foreign languages. This will augur well for the growth of the tourism sector in Nepal. In addition, Nepal should rethink over its commitment to have foreign equity ceiling. In fact removal of this ceiling is likely to result in the increased inflows of FDI as foreign companies do not have the necessity to look for local partners. Finally, it should make its Mode 4 regime a bit more liberal which is currently open for limited categories of persons largely involved in the supply of services via Mode 3.

### *Summary of Restrictions in the Tourism Sector of Nepal*

- In hotel and restaurant services commitment limited to star hotels and graded restaurants
- Under Mode 3 maximum foreign equity ceiling of 80% for hotel, lodging and graded restaurant services
- Under Mode 3 maximum foreign equity ceiling of 51% for travel agencies and tour operators services
- No sectoral Mode 4 commitments in both the committed sub-sectors
- Mode 4 horizontal commitments almost limited to ICTs
- As per the horizontal commitments under Mode 1 no national treatment with respect to foreign exchange provided to foreigners to pay for any cross-border services
- No commitments in tourist guides services.

### **The Maldives**

The Maldives had neither undertaken any commitments in the Uruguay Round nor has it offered any commitments during the ongoing services negotiations in the tourism and travel related services sector. This is surprising as it is a country whose economy, to a large extent, depends on tourism. Though it suffers from capacity constraints with regard to negotiating in the WTO and identifying sectors/sub sectors and drafting the schedule of commitments in services as it does not have a representative office in Geneva to interact with the WTO on a regular basis, this is also true that the Maldives will gain hugely from undertaking commitments because that is the only way to ensure that it gets desired market access from its trading partners for its exports. This will also help the country in articulating its import interests.

The Maldives has been very successful in developing its tourism industry and enjoys an enviable image in the market place. The Maldivians' entrepreneurial flair and the liberal investment climate seem to have resulted in 30 years of continuous growth (The World Bank 2006). In 2004, the country hosted 618,000 tourists, a record number – double its population. Its hotel occupancy (more than 80%), average length of stay (more than 8 days), and daily expenditures (approaching \$200/day) are all high by international standards. Over the last decade or so the Maldives has replaced the West Indies as the upper class British destination of choice and now the rich Japanese have joined them.

Tourism in the Maldives grew at a rate of 11.6% between 1972 and 2005. This is a rate well above regional or global growth rate. Although the contribution to GDP is estimated at 33%, the highest in the region, it is commonly believed that much of the activity in the islands – as much as 70% – is linked to tourism. The tourism sector in the Maldives covers six sub-sectors: guest houses, safari vessels, tour operators, travel agents, resorts and hotels. The majority of business enterprises in the Maldives are private limited liability companies and, in the case of tourism, that figure is about 81%, and the majority is owned by the Maldivians. In tourism

the share of foreign ownership was about 13%.

Tourism has substantial links to other sectors of the economy, such as construction, transportation, distribution, and telecommunications (Maldives' TPR 2002). New tourism legislation was introduced in 1999 (Maldives Tourism Act No. 2/99). The government leases islands to investors for resort development; land cannot be sold for tourist activities. The new legislation increased the maximum lease period from 21 to 25 years on investments below \$10 million and retained the period of 35 years for larger amounts, but introduced a 50-year lease period under certain conditions. The company must be Maldivian registered and owned; have at least 50% of its shares publicly held, with no more than 1% held by a single shareholder (or 5% for an investment company); and have listed as its main purpose development and operation of tourist resorts in its Memorandum of Association.

All non-Maldivian citizens (unless holding a resident permit) staying in registered tourist resorts, hotels, guesthouses, and tourist-accommodating vessels pay the bed tax (Maldives' TPR 2002:50). Since it is a flat rate, the *ad valorem* incidence of the levy, which depends upon the room rate, falls more heavily on the cheapest resorts.

**Restrictions and challenges:** The World Bank (2006) suggests that issues are emerging on the horizon and it is time for the growth strategy to be reviewed. It is a long haul destination, more than ten hours from originating markets with only one major airport, which is likely to be a severe constraint to market expansion.

- Maldives has long relied on a public sector role limited to creating the environment for sound investment in tourism and managing the leasing process, with private sector companies bidding on individual islands. The decision to increase the speed of issuing new resort leases represents a fundamental change in Maldives' policy of expanding the sector gradually. A number of current operators are known to be very concerned at this change in policy. As part of the proposed expansion, the government has decided to create a public enterprise that would hold leases at low, preferential rates in a number of islands, and sell these to new operators. It would also sell some shares to the Maldivians on the stock market. The concept is still evolving, but advantages it would have for the country are not clear.
- According to an enterprise survey conducted in

three major sectors – tourism, transport-logistics, and manufacturing – covering 148 enterprises seeking answer to the question – what are the most severe obstacles in the Maldives' investment climate? – revealed that the first four major obstacles to all three sectors are (i) access to finance, (ii) the cost of finance; (iii) access to land; and (iv) skilled labour (World Bank 2006: ix). Interestingly, entrepreneurs in the tourism sector identified the relative significance of the lack of skilled labour as the third highest constraint on investment decisions. This clearly shows that the lack of skilled labour is one of the major obstacles to the tourism sector. Only 9% of employees in tourism in the Maldives have acquired a degree or higher-level qualifications.

- *Access to land* has also been identified as a major obstacle. Given the traditional allocation of land by government at request, there is no proper land market in the Maldives. However, with the commencement of a development project at a place adjacent to the Male Capital Island, there is an emerging land market. The World Bank suggests that there is also a need for a paradigm shift for the government from being a provider to a facilitator and a regulator. The absence of a vibrant private land market aggravates the access-to-finance issue, especially since banks are still focused on collateral based lending rather than cash flows. In this regard, the World Bank suggests that the government should promote the establishment of a modern movable assets registry to encourage using such assets as collateral.

Being a small island country, Maldives is overwhelmingly dependent on other countries for the supply of goods and services and as a result it has a relatively liberal trade regime. Foreign investors own hotels, resorts, restaurants, etc. There are quite a few hotels in the Maldives owned by Indian companies (The Indian Hotel Company 2007). The Taj Group of hotels is the most familiar Indian brand. The Maldives is also dependent on the foreign labour force particularly from India, Sri Lanka and Bangladesh.

Efforts are being made to increase the availability of domestic credit for tourism, for example, by establishing a state leasing company and allowing leased resort islands to be mortgaged to finance tourism development (Maldives' TPR 2002). The authorities are aiming to increase employment of Maldivians by strengthening training. The faculty of hospitality and

tourism studies was established at the Institute of Higher Education to develop trainees for the tourism industry.

According to the World Bank, Maldivian workers follow extensive training programmes, since there is a perception that quality of service is important. The industry is addressing quality in several ways. First, the faculty of hospitality and tourism studies in the Maldives College of Higher Education, in partnership with the Birmingham College of Food, Tourism and Creative Studies, is working hard to improve training for the industry. In turn, the EdExcel Foundation in the United Kingdom approves standards.

The World Bank further adds that the resort chains in the Maldives are also sponsoring training in the country as well as overseas. The companies consider human resource development critical. There is a high level of training, with more than half of the staff having received training on the job. External training is particularly high and, indeed, many firms do send their employees overseas for training (often to Singapore). Unskilled employees, however, receive less training and this is probably where more emphasis should be given. The tourism industry relies heavily on foreign labour; some 45% of workers are expatriates.

In order to overcome the obstacle relating to the shortage of skilled labour the Maldives should undertake commitments under Mode 4 both in tourism and education services. While foreign-skilled labour in the tourism industry can help sustain the high growth rate, in the long run it should develop its education system in such a way that it produces sufficient skilled labour for its tourism industry. Thus liberalisation of these two sectors – tourism and education – for the movement of various categories of persons seems crucial for the Maldivian economy. In tourism education there is an urgent need to develop collaborative arrangements between the Maldives and other South Asian countries for providing education and training to tourism professionals. Moreover, at a lower skill level, workers employed in the Maldivian tourism industry need training which could also be provided by South Asian countries. Thus it could be suggested that the Maldives should undertake commitments in all sub-sectors of the tourism sector. This will help in meeting its demand and also enable it to sustain the high growth rate. As it currently lacks the required capacity to deal with WTO negotiations, it may find it easier to be engaged in regional negotiations that will also help it multilateralise its regional commitments if it so desired in due course of time.

### *Summary of Restrictions in the Maldivian Tourism Sector*

- No commitments in the tourism sector- neither sectoral nor horizontal
- Access to finance
- High cost of finance
- Access to land
- Shortage of skilled labour
- All non-Maldivian citizens (unless holding a resident permit) staying in registered tourist resorts, hotels, guesthouses, and tourist-accommodating vessels pay the bed tax may be considered a non-tariff barrier. In addition, it is a flat rate, the *ad valorem* incidence of the levy, which depends upon the room rate, falls more heavily on the cheapest resorts.

### **Bhutan**

In its offer on services as part of accession negotiations Bhutan has proposed to undertake commitments in only one of the four sub-sectors of tourism – hotel and restaurant services. Thus its proposed commitments cover hotels and restaurants (excluding nightclubs) (CPC 641), food serving services (CPC 642), and beverage serving services for consumption on the premises (CPC 643). In the committed sub-sector under Market Access column, Bhutan has no restrictions under Modes 1 and 2 and under Mode 3 establishment would be limited to hotels with maximum capacity of 50 rooms in urban areas and a maximum capacity of 15 rooms in rural areas. Mode 4 is unbound and refers to the horizontal section. In the National Treatment column Modes 1, 2, and 3 are without any restrictions and Mode 4 is unbound except as in the horizontal section.

In the horizontal section under Mode 3 Bhutan has allowed FDI with minimum size of foreign investment of \$0.5 million and foreign equity limited to 70%. Also the business has to be incorporated in Bhutan. In the National Treatment column foreign investors are required to foster transfer of technology, introduction of management skills and provide training and employ Bhutanese nationals at all levels in the enterprise. In addition, the shares held by foreign nationals and juridical persons in locally incorporated companies are not transferable without permission by the government of Bhutan.

From the analysis of the Bhutanese offer in services it appears that its commitments are limited to just one sub-sector of the tourism sector. In the committed sub-

sector too there are quite a few restrictions under Mode 3 and Mode 4 is unbound. Overall, the picture emerges that the tourism sector in Bhutan is restrictive.

According to ESCAP, Bhutan enjoys an exceptional comparative advantage in the tourism sector due to its unique culture and pristine natural environment (ESCAP 2003). The tourism sector is the single largest source of convertible currency earnings, with significant backward linkages in the economy and potential for employment generation. The sector was liberalised in 1999 and currently there are about 300 tour operators. However, it is unbalanced with more than 50% of the market share dominated by the top six travel agencies. Currently, this sector provides direct employment to 500 regular employees and over 2,000 temporary workers. Number of tourist arrivals has grown at a rapid rate of over 25% per annum during 2003–06 and in 2006 about 18,000 tourists visited Bhutan which was three times higher than that in 2002. Average length of stay of eight nights is also high by international standards and total tourism receipts in 2006 were about \$24 million three times higher than that in 2002.

Following a ‘high value, low volume’ tourism policy, the government administers tariffs in the tourism sector ranging from \$165 in the low season to \$200 in the high season per person per day. This tariff is inclusive of food, lodging, transport and guide services. The tour companies must pay 35% of the daily tariff to the government as royalty fees. The convertible currency receipts of the tour operators are channeled through the royal monetary authority, which retains the convertible currency and pays the (ngultrum – the Bhutanese currency) equivalent to the tour operator.

Foreign investments in the tourism sector are limited to the hotel or resort construction sector, as tour operators’ licenses are restricted to Bhutanese nationals only. ESCAP suggests that foreign investment in this sector will help to improve the quality of services in the hospitality industry as well as allow investments in hotels of higher standards. Partnerships with foreign companies will also boost the marketing efforts of the local companies in the foreign countries.

However, under GATS, the tourism sector liberalisation also includes the opening of distribution marketing and sales of tourism-related services. With liberalisation, Bhutan’s large tour companies could effectively monopolise the industry through partnerships with major international companies that control tourism-rated sectors including hotels, airline reservation, information systems, thereby reducing the market share of the small tour companies.

Other countries could challenge the administered tariff system as being a non-tariff barrier. The onus will be on the government to prove that such a tariff is a necessary safeguard measure consistent with WTO membership. Furthermore, as foreign companies will want to repatriate profits earned in convertible currencies, Bhutan cannot restrict the profit repatriation of such currencies. The cultural and environmental policies of Bhutan could be also be undermined if the large foreign companies and their influential local counterparts, if any, place pressure on the government to open more areas for mass tourism (ESCAP 2003).

Against this backdrop, it could be suggested that undertaking wider and deeper commitments at the WTO level would be a bit problematic for a tiny country like Bhutan. However, the SAFTA provides Bhutan with a better forum where it can liberalise as much as it could.

#### *Summary of Restrictions in Bhutan’s Tourism*

- Commitments limited to only one sub-sector of the tourism sector
- Foreign equity ceiling of 70% and minimum amount being \$0.5 million
- Tour operators licences restricted only to Bhutanese nationals
- Movement of foreign workers highly restrictive
- Administrative tariff system could be challenged as being a non-tariff barrier.

#### ■ CONCLUSION AND SUGGESTIONS

Discussion in this chapter suggests that the tourism is an important sector particularly in view the spillover effects this sector has on various other sectors of the economy. If properly nurtured, the sector can provide immense employment opportunities to the South Asian region. However, since the region fares quite badly in regard to receiving foreign tourists, the South Asian countries must take some drastic measures so that the tourism industry grows at a rapid pace. Regional integration in this regard could provide a big fillip to the growth of the sector. Tourism largely depends on the performance of other sector and it is a very sensitive business as if get affected by even a small incident. Though all issues cannot be addressed by regional integration, there are quite a few barriers that can be removed provided the region as a whole makes concerted efforts.

Like in construction services, there is a reasonable scope to develop MRAs in tourism services for the free movement of teachers/trainers and tourism professionals in all seven SAFTA member countries. These countries can work out equivalence of qualifications and negotiate MRAs in the sector. As per the available information, all SAFTA Asian countries (barring perhaps Bhutan) have hotel/hospitality management institutes both in public and private sectors. In this regard, the initiatives taken by the ASEAN would be a good example to follow. ASEAN activities to strengthen human resources development include the following approaches to cooperation: develop minimum common competency standards for ASEAN tourism professionals; develop an intra-ASEAN curriculum exchange programme with cross-training and cross-certification; prepare the ASEAN tourism training and education network directory (ESCAP 2005:15).

Besides MRAs, efforts should be made to create a common tourism area in the South Asian region. Once again the ASEAN example can be of some help. ASEAN has undertaken a number of activities in support of regional cooperation among its 10 member countries (ESCAP 2005). ASEAN cooperation in tourism infrastructure development and investment has included publishing the *ASEAN Tourism Investment Guide* and providing relevant investment information on the ASEANWEB. Recent ASEAN cooperative activities to facilitate regional travel include publishing *Wonders of Southeast Asia – An Official Guide to Thematic Tour Packaging*; implementing the Visit ASEAN Campaign; publishing the *ASEAN Map* with general information on major tourism destinations; and drafting the framework agreement on visa exemption for Nationals of ASEAN Member States.

In this direction SAARC has also taken a few steps. According to the SAARC Information Centre, the technical committee (TC) 10 was established in 1991 to promote cooperation in the field of tourism in the region. At its first meeting held in Colombo in October 1991, the Committee decided on an action plan on tourism to promote cooperation in the areas such as training programmes, exchange of information, joint promotion, joint venture investment, intra-regional tourism, etc. It also reviewed progress on the SAARC Scheme for Promotion of Organised Tourism. Under TC10, member countries have exchanged information on training facilities existing in the region and a number of slots for providing training in the field of tourism and hotel management were offered. TC10 has decided

to produce joint tourism brochure. Emphasis is also being placed on the importance of early launching of the SAARC scheme for promotion of organised tourism.

As part of SAARC initiatives, efforts are being made to reduce barriers to regional tourism trade. As already noted, there are inbound and outbound flows of tourists taking place among South Asian countries. India is one of the largest markets for Nepal and Sri Lanka. Similarly, Sri Lanka, Nepal, Bangladesh and Bhutan are markets for India. In 2003, India and Sri Lanka signed a Memorandum of Understanding (MoU) to develop tourism for mutual benefits of two countries. However, instead of signing bilateral agreements, which is a very time consuming exercise and instead all countries should try to sign a common agreement is they are to reap the benefit from tourism trade.

Tourism offers enormous opportunity to gain at regional level. India has hotels in Sri Lanka, Nepal, Bhutan and the Maldives and likewise, Sri Lanka has motels operating in India. However, there a number of barriers to the supply of tourism services. Under Mode 1 since India, Pakistan, Sri Lanka, Bangladesh and Nepal have some capability in information technology – though at varying level – warranting all countries to have no restrictions at all under this mode. Similarly, there is no reason why any country from this region should have any restriction under Mode 3. Even if they have any difficulty they should make this mode barrier free for SAFTA countries when they expand the scope of SAFTA by including services. Mode 3 is also important from the point of view *quid pro quo* as LDCs can gain Mode 4 access by offering market access under Mode 3. A common feature emerging from the region is that there is a dearth of quality tourism professionals in almost all South Asian countries.

The South Asian region is far away from important tourist generating rich countries. This places the region in a disadvantageous position. In order to overcome this advantage all economies of the region needs to integrate to gain from one-another's markets. Regional integration will increase the size of markets and will have multiplier effects on various other sectors. As Sri Lanka has been doing, all South Asian countries ought to offer the facility of visa-on-arrival for tourists from the region. In fact, South Asia will gain most if every willing person from the region is allowed to enter in all other countries by just having a valid passport. Some concessions to the tourists from the region will also go a long way in creating better business in tourism.

# 13 ■ Higher Education Services<sup>1</sup>

## ■ INTRODUCTION

While the Services Sectoral Classification List (W/120) contains five categories of education services under the broad education sector – primary, secondary, higher, adult and other education services, the discussion in this chapter would be restricted to the last three education services. This is largely because basic education provided by the government is usually considered to fall within the domain of services supplied in the exercise of governmental authority (supplied neither on a commercial basis nor in competition). Unlike basic and to a limited extent secondary education, it is the commercial aspect of the latter three services that dominate them and it is these services that are the area of interest.

International trade in higher education services has experienced significant growth. This is demonstrated by the increasing number of students going abroad for study, exchanges and linkages among faculties and researchers, increased marketing of curricula and academic programmes, the establishment of ‘branch campuses’, and development of international mechanisms for educational cooperation between academic institutions in different countries (WTO 1998). Higher education, adult education, and training services are expanding rapidly, particularly through the use of the internet (United States 2000). Though trade in education services is of increasing international significance, the sector remains one of the least committed under the GATS (Australia 2001). In this regard, South Asia is also not an exception to this worldwide trend as only Sri Lanka undertook very limited commitments in education services during the Uruguay Round. However, during the current Doha round the scenario has changed and now India and Pakistan – the two largest markets in the region have offered to undertake commitments in the sector. Besides, during its accession negotiations Nepal undertook commitments in education services. Bhutan is also likely to undertake

commitments in this sector. Thus Bangladesh and the Maldives are the only two countries from the region that have not so far shown any willingness to open their education services under the GATS. However, these two markets are open and are involved in international trade in education services.

From the commitments so far made under GATS it is evident that majority of the countries that have made commitments in education services are also exporters of education and most of them happen to be advanced countries. However, the benefits and risks associated with increased trade are clear and do not undermine the developing countries’ efforts to develop and enhance their domestic higher education system (Knight 2002).

According to the WTO, given that the bulk of trade in the sector takes place through consumption abroad (Mode 2), measures restricting the mobility of students may warrant particular attention (WTO 1998). Direct restrictions generally take the form of immigration requirements and foreign currency controls and indirect barriers may include in particular difficulties faced by students in translating degrees obtained abroad into national equivalent. In this regard, it has been suggested that the development of agreements concerning standards for professional training, licensing and accreditation might significantly benefit trade in this mode, as foreign degrees become portable.

With respect to establishing commercial presence (Mode 3), potential barriers include the inability to obtain national licences (e.g. to be recognised as a degree/certificate granting educational institution), measures limiting direct investment by foreign education providers (e.g. equity ceilings), nationality requirements, needs tests, restrictions on recruiting foreign teachers, and the existence of government monopolies and high subsidisation of local institutions. With regard to the presence of natural persons, barriers include immigration requirements, nationality conditions, needs tests, and recognition of credentials.

<sup>1</sup> The chapter is based on the report authored by Shailendra Kumar.

Many of the restrictions mentioned above are also relevant to South Asia. However, what is interesting in the context of South Asia is that in view of the historical, cultural and colonial connections, the differences across the region are far less stark than that in the entire WTO membership. Hence, South Asian countries can open their education sector among themselves and they can make vast gains by so doing. Education creates social infrastructure on which all other developments depend. The rise of India as a major international player in IT has been to a large extent attributed to some world class educational institutions which India could develop relatively early before and after its independence. In fact, the positive externalities of higher education cannot be gauged by simple economic tools. In the case of India it could be stated that the government set up hundreds of engineering colleges in order to prepare a workforce to handle the manufacturing sector. However, lack of a large-scale manufacturing sector forced this workforce to look for alternatives and incidentally, IT provided them with that opportunity and with the support of huge number of qualified unemployed engineers the Indian IT industry could become one the most successful stories in the world.

Across the region the higher education sector manifests interesting similarities. All South Asian countries lack adequate resources to provide their population with quality higher education. In view of their other more pressing priorities like poverty reduction programmes, health care and basic education, in the short or medium term they may not be able to allocate adequate resources in order to offer quality higher education to all those who are willing to join higher education as usually happens in advanced countries. In light of this, pooling of regional resources will be a great help.

This chapter analyses the commitments made and initial or revised offers submitted by the South Asian countries under the GATS regime which is one indicator of the level of liberalisation they have achieved in the education sector. Besides, the chapter also discusses other restrictions and efforts to liberalise the sector. The main aim of the chapter is to explore further possibility of liberalisation to see that if there could be some level of equivalence in the education systems of these countries. As there is an increasing trend in the trade in education services at the regional level, this needs to be strengthened to reap the benefits of collective liberalisation.

## ■ CHARACTERISING SAFTA COUNTRIES' COMMITMENTS/INITIAL/REVISED OFFER

### India

India had not undertaken any commitments in education services during the Uruguay Round. Nor did it offer any commitments during its initial offer. However, its revised offer includes higher education (CPC 923) for which commitments have been made (for details see table A in chapter 6). In the Market Access column under Mode 1 the entry of cross-border education services is subject to the condition that service providers would follow the same regulations as applicable to domestic providers in the country of origin. This condition is expected to ensure the quality of service and would also be regulated according to the laws of the country of origin. Mode 2 is without any restrictions. This signals that Indian students going abroad for education purpose will have no barriers. Commercial presence however is subject to the condition that fees to be charged can be fixed by an appropriate authority and that such fee do not lead to charging capitation fees or to profiteering. Further, in the case of foreign investors having prior collaboration in this sector in India, FIPB approval would be required. Though this restriction has already been discussed in the context of construction services, it is hard to understand the rationale behind this measure. In the case of education this can be understood as that if the same person is opening another engineering college when he already had one in collaboration with someone, for the second college his application will route through FIPB. If the idea is to check the anticompetitive behaviour, India has a full-fledged competition commission of India (CCI) and that can take care of this aspect. Mode 4 is unbound and refers to the horizontal section.

In the National Treatment column Modes 1, 2, and 3 are without any restrictions and Mode 4 is unbound except as in the horizontal section. Thus national treatment has been accorded to foreign services supplied through Modes 1, 2, and 3.

Although India's horizontal commitments under Mode 4 are relatively liberal, the categories of persons mentioned in those commitments do not include education services. Particularly in the South Asian context this assumes greater significance as the trading partners especially Pakistan, Sri Lanka and Bangladesh would be looking at India as a very important next door market for Mode 4. Since these countries may

not mobilise adequate resources for commercial presence they would be more interested in Mode 4.

India should also undertake commitments in adult and other education services. Various kinds of training and other informal educational programmes come under these two categories. India has already shown its ability with regard to exporting IT education, management, and medical training. Some of other South Asian countries may also like to export informal education and thus they would want India to undertake commitments in these two subsectors.

According to the study done by Powar (2007) on education, India has the third largest higher education system in the world comprising about 330 university-level institutions, about 16,000 colleges (including 4,500 professional institutions), over 9.5 million students and approximately 350,000 teachers. Though the government is the principal contributor of higher education in the country, Powar suggests, the private sector is increasingly making a significant contribution to professional education at the degree level. Another study by Agarwal (2007) highlights that in terms of enrolment in higher education India is third largest system in the world – after the People’s Republic of China and the United States. With 18,500 institutions, the country has the distinction of having the highest number of institutions for higher education in the world – almost four times that in the US and Europe and more than seven times the number of institutions in the People’s Republic of China.

The study further suggests that though the quality of education imparted by different higher education institutions in India is admittedly variable, there are quite a few institutions that provide education of quality that is comparable with that offered at the best international institutions. The Indian Institutes of Technology (IITs), the Indian Institutes of Management (IIMs), the Indian Institute of Science (IISc), quite a few central and state universities, and a few privately managed ‘deemed universities’ are examples. There exists in India a parallel, non-formal stream of education in the form of training institutions that provide skill-oriented programmes while encouraging its students to register at the same time in bachelor degree programmes in the conventional universities. NIIT is a prime example. The non-formal institutions have differing programmes. The best-known institution, NIIT, has two ‘domains’. Domain A is an adaptation of the university structure. Domain B is for those who do not aspire for a degree and includes short-term, skill-oriented courses whose value is determined by the market.

Rapid growth in the globally integrated Indian economy has led to a huge demand for skilled human resource, but the lack of quality and relevance in higher education is causing an obstacle to filling the gap. India is facing up to 25% shortage of skilled candidates in the area of engineering and this problem has surged to 45% level across sectors (Agarwal 2006). In view of this, it has been suggested that foreign universities should come to India to form joint ventures with the universities here and a one year benchmark should be set for this task. In this regard, Pangariya strongly argues that entry of private universities, so common around the world including Bangladesh and the People’s Republic of China, must be introduced (Pangariya 2007). He further argues that the government has no resources to expand higher education at a pace consistent with demand. Nor is it in a position to create many IITs and IIMs like institutions with public resources.

International providers are entering the Indian education market in an increasing number. From the advertisements on academic programmes offered by foreign providers during 2000–04, it is clear that there has been an increase in the number of advertisers from 144 in 2000 to 319 in 2004; in the number of providers recruiting students for their home campuses from 117 to 204; and in the number of providers offering programmes in India, under Mode 3, from 27 to 144 (Powar 2007). However, Powar suggests, nearly a third of foreign providers were not universities, and an equal percentage of their Indian collaborators were not a part of the formal higher education.

The study by Powar emphasises the importance of distance education. Distance education programmes exemplify education supplied through Mode 1. These programmes take two forms – conventional distance education using print and audio-visual material and e-learning through the internet. Conventional distance education is highly developed in the Asian countries and is available at low cost. India has eleven open universities and 102 centres of distance education in dual mode universities. They provide education at about 40% of the cost of education through the formal mode. Some Indian universities have recently started offering degree programmes, through the distance mode, in countries having a large Indian diaspora. The Indira Gandhi national open university (IGNOU) is the prime example.

Cross-border supply through the internet (virtual education) has immense potential, especially in disciplines like management and trade that have strong international components. Some well known training institutes based in India offer, globally, further

education programmes, in professional areas like computer application (software development). NIIT offers programmes in 44 countries where it also has study centres. However, Powar suggests, Indian and other South Asian countries may find the need to regulate cross-border supply of education, using electronic transmission, by framing appropriate legislation or through other measures, including the non-recognition of degrees awarded through the e-mode, and denial of permission for joint ventures.

Magnitude of education trade via Mode 2, and its potential, is clear from the fact about 83,333 Indian students were enrolled in 2006–07 year in the United States alone and India remained the leading country of origin for the sixth successive year for students coming to the United States.<sup>2</sup> The total of Indian students coming to the US in 2006–07 was up by 9.6% from the previous year, when the number was 76,503, and India dominated with 14.4% of the total of 582,984 international students enrolled in American colleges and universities in the US in 2006–07, which also increased by 3% over the previous academic year. The United Kingdom, Germany, France, Australia, Canada, etc. are the other countries where Indian students study in a large number.

Although the number of foreign students coming to India is small given the size of the country, the number of foreign students especially from neighboring countries like Bangladesh, Nepal, and Sri Lanka studying in India is not that small. In 1999, according to one estimate, about 53,000 Bangladeshi students were studying in India, with about 14,000 Bangladeshi students coming to India every year (Rahman 2000:53). Similarly, in 2003, 1600 Sri Lankan students came to India for study (Taneja et al. 2004). Nevertheless, India needs to intensify its promotional activities and the University Grants Commission (UGC) is attempting to do so through its committee for the promotion of Indian higher education abroad (Powar 2007). The private deemed-to-be-universities are also undertaking marketing activities to attract international students to their professional programmes. In Sri Lanka, for the first time in May 2004, an Indian Educational Exhibition was organised by Colombo Exhibition Centre in which more than 25 colleges and higher educational institutions participated (Taneja 2004).

The study by Taneja et al. on Indo-Sri Lanka bilateral trade in services found that Sri Lankan students have several problems (2004). Students' visas are not

given for all courses to be pursued in India. The Indian high commission does not grant visas for courses that are conducted privately and are not recognised in India. Another problem cited by the Sri Lankan students is that they are not granted visas for the duration of the course in India. They are given a one-year visa through the Indian high commission in Sri Lanka which comes under the purview of the Ministry of External Affairs in India. An extension of the visa can be obtained through the Ministry of Home Affairs (MHA). Students find the procedures laid out by the MHA extremely cumbersome and often there is a delay in processing. A major problem relates to lack of information on the courses and disciplines offered to foreign students, quotas for foreign students, etc. Most students rely on the Sri Lankan diaspora to get relevant information. Sri Lankans have better access on educational opportunities in countries such as the United Kingdom and Australia due to the promotional and marketing efforts undertaken by these countries.

According to Powar, trade in educational services via Mode 3 takes different forms:

- Grant of franchise to local academic institutions or business organisations, which provide the physical infrastructure and administer the programmes. The foreign institutions provide the intellectual property, including curricula and teaching-learning materials, conduct the examinations and award the degrees. The local partner has no say in academic matters.
- Twinning programmes leading to joint degrees or dual degrees. Also articulation arrangements under which students undertake the major part of their studies in local institutions and then complete the programme on the campuses of the foreign providers. Academic responsibility is shared. The credits earned in the host country are transferred to the provider institution, which awards the degree or diploma.
- Establishment of local centre or campus by the foreign providers in which there is formal (face-to-face) teaching according to academic curricula developed in the home country, but using local faculty (Powar 2007:5–6).

The franchise model is the most common. During the last three to five years an increasing number of western universities have entered into twinning

<sup>2</sup> <http://www.rediff.com/money/2007/nov/12stud.htm>, last visited on 17 November 2007.

arrangements of the articulation model. The instances of providers starting off-campus centres/campuses are very few. The articulation model provides an example of transition from total import to cooperative ventures. The programmes offered by the foreign providers have found ready acceptance in India. However, considering the total student population the enrollment in the academic programmes offered by the foreign universities is insignificant. Powar suggests that since the early 1990s there has been a steady increase in the number of foreign providers in the developing countries of Asia (Powar 2007). However, Powar argues, by and large, the best universities are not represented. Many of the providers are not even accredited as universities in their own countries. A recent development is the steep increase in the number of articulation arrangements, as many as 61 such agreements were recorded. Significantly, the Indian partners are private institutions, some like the Manipal academy of higher education, having a reputation of being providers of quality education.

Some reputed private university-level institutions (deemed universities) in India have ventured abroad and set up campuses in countries having a significant Indian diaspora. Examples are the Birla institute of technology and science in Dubai, Birla institute of technology, Ranchi in Oman and the Manipal academy of higher education and Medical Group in Nepal and Malaysia. By all accounts these ventures are successful.

Movement of teachers and scholars from the developed world to the Asian countries is at a low level (Mode 4). This is because scholars from developed countries are not willing to go to developing countries for extended periods. However, an appreciable number of Asians take up teaching or research assignments in the developed countries. Although the chances of there being an appreciable increase in teacher mobility, for extended periods of services have been considered as remote, at regional level there is a need for movement of teachers and it should be facilitated as much as possible.

The study by Powar suggests that the all India council for technical education (AICTE), which oversees engineering and management education in India, has issued regulations to control the entry and operation of foreign universities/institutions for imparting technical education. The AICTE regulations require the foreign provider to either establish operation on its own or have collaborative arrangements with a recognised Indian academic institution. The foreign institution should be accredited in its home country and should give an undertaking that the degree/diploma will be

recognised in the home country. The Indian partner has to be an Indian university or an affiliated institution, preferably accredited by the national board of accreditation of AICTE. The nomenclature of the degree offered in India has to be the same, as that exists in the home country. However, Powar argues, it is not clear as to what would be the interpretation if the nomenclature were not in accordance with the nomenclature approved by the university grants commission. It will be the responsibility of the concerned foreign university/institution to provide for, and ensure that, all facilities are available. The fees charged, and the intake of students, will be prescribed by the AICTE. There are other conditions that aim at protecting the interests of Indian students and provide for overall control of operations by AICTE.

The AICTE regulations are omnibus in nature and are applicable to foreign universities intending both to enter into collaborative arrangements with Indian academic institutions, and to establish their own campus. However, Powar argues that it is doubtful if these could be applied, with equal effectiveness, to the different modes of operations like agreements leading to joint or dual degrees, articulation programmes, franchise arrangements or direct operation through (off-shore) centres/campuses. It would, perhaps, be better to have separate regulations for different situations.

The national policy on education 1986 recognised the need to monitor and promote the quality of education through a process of assessment and accreditation. Accordingly, four major accreditation agencies were set up. These are;

- The national assessment and accreditation council (NAAC) under the UGC, which undertakes evaluation of all types of higher education institutions.
- The national board of accreditation (NBA) under the AICTE, which undertakes programme evaluation in the disciplines of engineering and technology, management and pharmacy.
- The accreditation board (AB) of the Indian council for agricultural research (ICAR), which monitors the compliance with norms and standards set for agricultural education in India.
- The distance education council (DEC) under the IGNOU, which evaluates and accredits institutions offering distance education programmes.

The UGC, the AICTE and other statutory Councils like the National council for teacher education, medical council of India, council of architecture, and bar council

of India, have prescribed minimum standards as regards infrastructure, faculty, duration of programme and eligibility criteria, and all institutions are expected to strictly comply with them.

In sharp contrast to Powar, Pangariya talks of deregulation. He suggests that apart from university level, even at the college level, where the private sector is currently permitted to operate, there is a need for deregulation (Pangariya 2007). The process of entry should be relatively simple and transparent. The limits on the number of students these colleges can currently admit should be abolished. Under the current rules, private engineering colleges usually lack the freedom to choose their own students or charge fees beyond a tiny fraction of those admitted.

Regarding the UGC, Pangariya strongly argues that it should loosen its stranglehold and it should give greater autonomy to universities and colleges. In this respect, India's own experience has been consistent with that of the rest of the world: institutions such as the IIT and IIM. These highest-quality institutions in India have been outside the UGC ambit. He also suggests giving greater play to unitary (rather than affiliating) universities. Like the IIT and IIM, such institutions will be better able to maintain uniform and high-quality standards.

Universities in India are entitled to determine equivalence of degrees and diploma as deemed fit. However, by a resolution of the Association of Indian Universities (AIU), passed in 1993, universities have generally agreed to grant equivalence on a reciprocal basis provided the eligibility conditions for admission, duration of programmes and course contents are similar. The AIU has been authorised by the government of India to grant equivalence to foreign degrees with the degrees awarded by Indian universities.

In India, the FDI regime is liberal as 100% foreign equity is allowed in education. However, the biggest problem is regulating the education being provided by

Indian private suppliers and foreign providers. Education under the Indian constitution is on the concurrent list with the central and state governments exercising joint responsibilities. However, experience suggests that this has not contributed to bringing in some sort of uniformity at all India level (Kumar 2005). There are wide differences and gaps in syllabi, duration of courses, etc. Lack of uniformity in education across the country makes the regulatory task all the more challenging. Then there is an array of regulatory bodies and in some cases at various levels (see Agarwal 2006). In the given regulatory scenario, a single institution may have to be regulated by more than one regulatory body. Regulatory bodies urgently need to be revamped so that they work hard to ensure quality in all institutions. Traditionally, the governments at various levels have been the main provider of education at tertiary level and regulation has been relatively easy. However, with the entry of private players and foreign providers the same regulatory bodies find it difficult to handle things particularly in a time bound manner.

If different types of education providers are to succeed then the regulatory bodies have to adopt more professional like approach as TRAI or IRDA are doing in the areas of telecommunications and insurance, respectively. Further, the CCI should also be active to take care of the interests of students and ensure fair competition in the country.

From the discussion it is clear that though India has taken a major move by offering to undertake commitments in education services, in order to realise its full potential it ought to expand the coverage of its commitments and hence include adult education as well as other education services. In regard to regulation of the sector there appears an urgent need to revamp the existing regulatory system so that it takes decision as quickly as possible and ensures regular monitoring of private and foreign education.<sup>3</sup> In India, there is a huge demand for higher education and the supply is meagre.

<sup>3</sup> There are various instances when the AICTE has taken years to give permission. *Hindustan Times* (30 November 2007:10), a national daily, reports that a North Delhi-based technical education institution had sought permission for a tie-up with a foreign university. Three years and after several trips to the AICTE the application is still pending. In another instance, it took ten months for an application, by a Rajasthan-based management institute seeking allocation of extra seats, to be reviewed by the AICTE. The delay in the processing of applications is contrary to the AICTE guidelines which state, "applications should be processed within a month". The daily suggests that the instances are not an exception but have, over the years, become a trend when it comes to the "corrupt practices" of the AICTE. Every year, AICTE officials conduct inspections-paying for their stay and offering gifts or taking their family for site seeing goes without saying. Even then, some of them make unreasonable demands and if these are not met, the institute is served a show cause notice on flimsy grounds. The Amity University – one of the largest private universities in India – had contested several of such show cause notices and verdicts in many cases have been in its favour. On the other hand, the daily quotes a survey conducted by the Mumbai University which found that 42 engineering colleges affiliated to the AICTE did not meet the prescribed standards. It is because, the daily explains, what is stated in the guidelines is never implemented. These guidelines often help officials in corrupting the entire system, compromising with the quality of education they are expected to promote.

Therefore, entry of more and more players particularly in technical education would certainly be a great help to the country and many of the students who go abroad may prefer to study in India. This will have an import substitution effect in education. In addition, this will create employment opportunities for various categories of people.

As part of the ongoing services negotiations the United States submitted a proposal on education services which calls for inclusion of training services and educational testing services in the education sector for the purpose of undertaking commitments (United States 2000). Training services are particularly related to higher education, adult education, and other education services, whereas testing services are generally related to all types of education. The proposal explains that educational testing services are a fundamental and essential part of the learning process, used to evaluate the student as well as the course material. These services include designing and administering tests, as well as evaluating test results. Although currently education exporting countries like the United States, the United Kingdom, Australia, Canada and New Zealand may be interested in such services, in the future even India would be interested as it may become an important education providing country.

However, apart from regulatory problem it is the recognition of degrees that is a key challenge in the Indian educational system. The bodies responsible for the recognition of qualifications should work towards having some kind of equivalence at the South Asia level. As the education system is not very divergent from one another's in this region, it is not going to be that tough as it would have been for doing the same at multilateral level.

## Pakistan

Like India, Pakistan had also not undertaken any commitments in education services during the Uruguay Round. However, Pakistan's initial offer includes education services and perhaps, it has proposed one of the most liberal schedules of commitments in the sector in South Asia. Its proposed commitments thus cover all three subsectors of higher education – higher education services (CPC 923), adult education (CPC 924) and other education services (CPC 929) (for details see table B in chapter 6). Coverage wise, Pakistan's commitments in the sector are close to that of Nepal and far wider than that of India. In the Market Access column Pakistan has offered full commitments under

Modes 1, 2, and 3 in all three subsectors. However, Mode 4 is unbound and refers to the horizontal section where however Pakistan has made significant commitments. While entry of the categories of service providers such as ICTs, businesspersons and service sales persons is allowed and the education sector may also benefit from it, professionals, independent professionals and persons having other skills can also engage in supplying education services. But entry of the latter two categories of persons is limited to imparting training. Although under Mode 3 the sectoral commitments in all three subsectors are without any limitations, the horizontal section specifies that commercial presence is subject to incorporation in Pakistan with maximum foreign equity participation of 60%. It is interesting to note that India's revised offer does not have any foreign equity cap in education services, Sri Lanka already allows foreign equity up to 100% in education, and Nepal will soon have its equity cap extended to 80%. Viewed from this perspective Pakistan's commitments under Mode 3 appear relatively restrictive.

In the National Treatment column, Modes 1, 2, and 3 are without any restrictions and Mode 4 is unbound except as in the horizontal section where Pakistan has neither inscribed any commitments nor restrictions. However, in regard to subsidies national treatment will not be accorded under all modes.

Education in Pakistan is divided into five levels: primary, middle, high, and university programmes leading to graduate (undergraduate), and advanced (postgraduate) degrees (The World Bank 2006 A). The World Bank suggests that decades of neglect have drawn universities in Pakistan – and more generally the higher education subsector to a level, which are incompatible with the ambitions of the country to develop as a modern society and a competitive economy (Ibid: Executive Summary). As it stands now the subsector does not compare well with its counterparts in the region.

Spending on education in Pakistan as a share of national output has fallen in recent years. According to ICG (2004), Pakistan is one of just twelve countries in the world that spend less than 2% of GDP on education. Raising public expenditure on education to at least 4% of GDP, as recommended by UNESCO seems to be one of the challenges Pakistan is confronted with. Compared to other countries in the region, Pakistan is lagging, both in terms of economic development and in terms of the performance of the higher education sub sector (World Bank 2006:5). Pakistan would have to overcome the severe resource

constraints to meet the country's educational needs. In order to meet the challenge the Pakistan government's education sector reform (ESR) plan relies heavily on the participation of the private sector and the international donor community to fill this gap (ICG 2004: 26).

In 2002, the higher education commission (HEC) was created which developed a medium term development framework (MTDF), which has provided a vision for the reformation of the sector. It has pointed out the twin challenges of access and excellence by focusing mainly on teaching staff, which is the weakest link in the chain. It points out that the most important factor for this poor quality is the acute shortage of qualified university faculty linked both to low initial credentials and to limited opportunity for skill upgrade. A variety of initiatives have been financed in the area of faculty development including both short term and long-term initiatives and indigenous and foreign programs.

All academic institutions are the responsibility of the provincial governments. The federal government mostly assists in curriculum development, accreditation and some financing of research. However the authority over higher education is divided. The federal government controls the federal universities. It also provides funding for provincial universities which are under the control of provincial governments.

The private sector already is active in higher education (World Bank 2006). Private rates of returns to higher education stand substantially higher in Pakistan than in neighbouring countries (World Bank 2006). There is potential for an even larger contribution by private higher education institutes (HEIs) to broaden access, improve quality, and enhance relevance, while alleviating some of the burden on public institutions. In addition, the public sector and private institutions would mutually benefit from reinforcing their partnership: they would respond better to the growing demand, and would make the entire higher education subsector more responsive to market expectations. To reap these benefits, the World Bank suggests, several regulatory and financial steps must be taken to even the playing field, and assure that the quality of services supersedes institutional borders.

Stimulated by burgeoning demand that the public sector is unable to meet, private sector institutions currently serve almost one-fourth of HEI enrollments (World Bank 2006). Private institutions are particularly active in the areas of business administration, computer science, and IT-areas where employer demand is high. Improving the regulatory environment for the private higher education sector should be a priority. To

illustrate this, the World Bank explains, the minimum land and endowment requirements currently imposed to private HEIs to establish a campus are unnecessarily tight and could be loosened without risk to the quality of teaching.

According to the World Bank study, mode wise demand of education suggests that Pakistan has import interest in education through all modes. The online delivery of programmes has potential where Pakistani residents wish to enhance their skills, but are not able to undertake long-term study out of the country. Hospitality is one area where distance education is a preferred option. Similarly, though there are approximately 74 colleges and universities based in the major cities of Pakistan, the demand for places exceeds their availability. While the private sector has had some impact in soaking up the excess demand for places, there are a significant number of people for whom studying abroad is the preferred option. Approximately 10,000 Pakistani students travel overseas for further studies every year. In response to increased trade competition and need for a high performing workforce, the government of Pakistan is strongly emphasising vocational training. Australia's vocational education and training (VET) system delivers training that is practical and career-oriented could service some of this demand. Private institutions are seeking affiliations with universities abroad to ensure they offer information and training that is of international standard. The World Bank suggests that foreign institutions both public and private can operate in Pakistan (The World Bank 2006). The government encourages collaboration between foreign institutions and local providers. Different types of collaboration came with different regulatory requirements related to infrastructure, accreditation and inspection depend on the nature of the collaboration and the quality of the foreign institution. Top ranked foreign institutions such as the London school of economics are allowed to run degree programmes with local partners with only minimal regulation. Currently eight foreign universities/institutions have been approved to run collaborative degree programmes in Pakistan (not including programmes from 'top ranked' universities). There is no exact information as to what extent Pakistan needs education via Mode 4 that is through the movement of teachers, researchers, experts, etc. But there is enormous demand for teachers in Pakistan.

Overall, it could be suggested that Pakistan should allow 100% foreign equity in education services. The Pakistani education system would, in fact, immensely

benefit from a liberal FDI regime under the GATS given the vast gap between the demand for and supply of higher education. In addition, Pakistan ought to undertake sectoral commitments for the entry of teachers/researchers and other experts under Mode 4. Pakistan offers an important market for education in South Asia. Thousands of students leave Pakistan every year for study in foreign countries and hence a huge amount of foreign exchange is spent on the import of education by Pakistan. A lot of such amount could be saved if Pakistan encourages foreign institutions to open their branches in the country. Pakistan is also a market for import of education through Mode 1. Distance education is one example in this regard. Education via internet could be many times cheaper than the conventional mode and students are free from a number of associated problems such as hostel, library, etc. Mode 4 is another window through which Pakistan could gain immensely.

### *Summary of Restrictions in the Sector*

- Foreign equity cap of 60% for commercial presence
- No sectoral Mode 4 commitments
- No national treatment with regard to subsidies
- The minimum land and endowment requirements imposed to private educational institutions to establish a campus
- Multiplicity of educational systems.

### **Nepal**

Like Pakistan, Nepal has also undertaken commitments in all three sub-sectors of education services – higher education (CPC 923), adult education (CPC 924), and other education (CPC 929) – for which usually commitments are sought in the sector. Nepal has not inscribed any limitations under Modes 1 and 2 in the Market Access column and under Mode 3 access is subject to incorporation in Nepal with a maximum foreign equity ceiling of 51%. However, foreign equity participation will be increased to 80% after five years from the date of accession of Nepal and since Nepal would be completing five years of its accession in April 2009 the ceiling of 51% would by then become a past restriction. Unlike other modes, Mode 4 is unbound and refers to the horizontal section where there does not seem to be any commitments for education services. Therefore, this mode, at best, is closed for the movement of teachers and other related professionals who can provide education services. In the National Treatment column while there are no limitations under Modes 1 and 2, under Mode 3 national treatment has been

accorded to foreign education providers and Mode 4 is once again unbound except as in the horizontal section where too this mode remains unbound.

In the horizontal section under Mode 3 in the Market Access column there is a provision stating that the conditions of ownership, operation and juridical form and scope of activity as set out in a license or other form of approval authorising the operation and supply of services by an existing foreign service supplier will not be made more restrictive than they existed as on the date of Nepal's accession to WTO. This is a sort of assurance to those companies that were providing services prior to Nepal's accession and the rules and regulations applied to them owing to Nepal joining WTO will not be more restrictive. Thus the rules and regulations, in a way, will be grandfathered and the interests of the concerned companies will be protected.

The Mode 4 provisions as given in the horizontal section do not specifically apply to education services because the categories of persons allowed to enter Nepal to deliver services are service sales persons, persons responsible for setting up a commercial presence and ICTs. These categories of persons are primarily meant to cater to the needs of commercial presence.

Under Mode 1 in the horizontal section, national treatment has not been accorded with respect to foreign exchange provided to foreigners to pay for any cross-border services. This may be considered a substantial barrier to the transaction of educational services via this mode. Unlike Mode 1, Mode 2 is without any limitations. However, there are quite a few limitations on Mode 3. The first is that a foreign investor reinvesting earnings is required to obtain the permission of the Department of Industry. The second limitation being that all foreign investments except financial services require approval of the Department of Industry. Finally, incentives and subsidies are available only to enterprises wholly owned by Nepalese nationals. Mode 4 is unbound except for measures concerning the categories of natural persons referred to in the Market Access column which incidentally do not cover education services.

In the education sector the gross enrollment ratio at the tertiary was only 9.7% in 2006 implying that Nepal requires substantial amount of investment in order to provide education to a larger number of students at this level (Summary Education Profile: Nepal, World Bank). Nepal is a labour-surplus country and exports unskilled, semi-skilled and highly skilled (e.g. engineers) labour to various labour-importing countries (UNCTAD-ICC 2003). This is so despite the

low literacy level – 42% among those over 15 years. The Institute of Engineering under the State-funded Tribhuvan University is recognised as a centre of excellence by the Asian Institute of Technology (AIT) in Bangkok. In addition to university courses, various skill-development courses are run by a number of private and public institutions under the council for technical education and vocational training (CTEVT) in different fields. There is, however, a serious problem of brain drain, as highly qualified people do not find enough opportunities in a small and sluggish economy. This seems to be largely because of the mismatch in the kind of requirement of qualified people and what the education system produces because the most common concern of potential foreign investors in the Nepali information technology (IT) and telecom sector has been the lack of skilled manpower (UNCTAD-ICC 2003:52).

The surprising reality is that about 4,000 IT workers are trained every year in Kathmandu alone. This number is attributed to the presence of training institutes which include such brands as Informatics, NIIT, STG, SSI, Pentasoft and APTECH, operating through branches or franchises. The Government's Employment Promotion Council has also started a programme in cooperation with the private sector to train 8,500 semi-skilled and skilled, and 500 highly-skilled, IT workers. In addition, four universities in Nepal offer bachelor's degree courses in IT. Their total annual intake of students is above 3,000 persons (UNCTAD-ICC 2003). Two universities are also running master's degree courses in IT. The Institute of Engineering under Tribhuvan University offers a two-year MSc in Information and Communication Engineering and has an annual intake of 20 students, while Kathmandu University has two such courses: MSc in Communication Engineering (20 students per year) and ME in information technology (20 students per year). In addition, the faculty of sciences of Tribhuvan University offers an MSc in Computer Science and IT and has an annual intake of 20 students. The IT worker is available at low cost.

Overall it could be suggested that Nepal should further remove restrictions in the sector at least at the regional level. It has strong import interest in education and South Asian countries could be significant providers of education services. For import of education all modes are relevant in the case of Nepal. While via Mode 1 Nepal can have access to affordable education, via

Mode 2 it can send students to South Asian countries. Likewise, opening of the educational institutions will have far reaching implications on Nepal's educational and economic progress. Indian educational institutions are already successfully operating in Nepal, the prime example being a medical college run by the Manipal University in Pokhara since 1994. The Manipal college of medical sciences (MCOMS) claims being ranked as the best college in Nepal.<sup>4</sup> Apart from Nepalese students there are students from India and many third countries who are studying in this college. Finally, via Mode 4 Nepal will be able to attract better qualified teachers from the region.

### *Summary of Restriction in the Sector*

- Foreign equity ceiling of 51% and after April 2009 of 80%
- No sectoral Mode 4 commitments
- Horizontal Mode 4 commitments limited to ICTs
- No national treatment with respect to foreign exchange provided to foreigners to pay for any cross-border services.
- A foreign investor reinvesting earnings is required to obtain the permission of the Department of Industry
- All foreign investments except financial services require approval of the Department of Industry
- Incentives and subsidies are available only to enterprises wholly owned by Nepalese nationals.

### **Sri Lanka**

Sri Lanka has not undertaken any sectoral commitments in education services. However, its commitments under Mode 3 in the horizontal section do cover education services which provide that foreign investment of up to 40% of equity in a company providing education services will be automatically approved by BOISL and foreign investment in excess of 40% (and up to 100%) will be approved by the BOISL on a case-by-case basis in consultation with the relevant State Agencies. Allowing 100% FDI in education services that too during the Uruguay Round assumes special significance as it was a rare kind of liberalisation particularly for a South Asian country.

Nevertheless, as the commitments are in the horizontal section they raise a number of questions. Whether the Sri Lankan commitments apply to all five sub-sectors of the education sector as given in the

<sup>4</sup> <http://www.manipal.edu/mcoms/aboutus/overview.htm>

W/120? This is not clear since the horizontal commitments do not refer to any CPC number giving rise to serious ambiguity regarding the coverage of the sector. Since FDI is allowed in education, that commercial presence is permitted. However, nothing can be said about other modes. In fact, no commitments made under other modes imply that Modes 1, 2, and 4 are unbound. Hence in the absence of detailed commitments in the sector nothing can be made out of the Sri Lankan schedule of commitments. Although Sri Lanka provides a promising market for other South Asian countries, lack of commitments may prevent them from supplying education services. In this regard, commitments under all modes would be relevant.

According to the World Bank, Sri Lanka devotes the lowest share of the public budget to education of all South Asian countries (World Bank 2005). The Bank suggests that private sector investment and participation in the Sri Lankan education should increase. Further, it suggests that relaxing legal obstacles and introducing strategic initiatives to counter the adverse political economy environment to private sector participation in education could produce several benefits. First, it would increase the overall volume of resources invested in the education sector. Second, since the students attending private institutions are likely to be drawn from upper income families, it would release more public resources, on a per student basis, for students from poorer families. Third, it would stimulate economic activity in a sector where investment has been artificially restricted and contribute to higher growth. Fourth, it would provide alternative mode of service delivery, with considerable power and responsibility at the level of individual education institutions. These private education institutions would be compelled to offer high quality services to remain viable in an economic context where they are in competition with free public education institutions. However, experience does not always support the World Bank viewpoint and what is, in fact, needed is a strong and efficient regulatory system that can ensure private institutions to offer quality education.

Since the establishment of private universities has been an extremely contentious issue, the World Bank suggests that it is highly unlikely that private universities can be established in Sri Lanka in the medium term (World Bank 2005). Others also suggest that a major impediment in the existing university system is that there has been a lack of reforms that would facilitate the growth of accredited private institutions (Taneja et al. 2004). However, the World Bank suggests, the

government of Sri Lanka has responded to the opposition to private universities by encouraging the private sector to participate in non-contentious areas. These have mainly been the establishment of private degree awarding institutions, usually linked to foreign universities, and investment in tertiary level programmes such as professional and technical courses (World Bank 2005). Taneja et al. suggest that the private sector is mainly engaged in the provision of professional education particularly in the areas of accountancy, management and information technology (Taneja et al. 2004). Although there are provisions in the existing Universities Act to recognise degree courses conducted by private institutions, the process is still not clear (*Ibid*). Some private institutions conduct courses leading to degrees in collaboration with foreign universities. The Bank argues that Sri Lanka needs to explore options to expand private participation in tertiary level non-university education in professional and technical fields where the demand for labour, both within and outside the country, is strong (World Bank 2005).

Taneja et al. have done a detailed study on the Sri Lankan education system (Taneja et al. 2004). They suggest that in Sri Lanka, government is the main provider of primary education, with only one percent of the schools owned and run privately and it is the sole operator of accredited universities in the country. Due to limited opportunities available at the universities, they suggest, there exists an excess demand for university education. For instance, in 2003, only 14% of eligible students were granted admission to national universities. Due to a dearth of opportunities for higher education, a large number of Sri Lankan students who can afford foreign university education leave Sri Lanka annually. The preferred destinations to obtain degrees in higher education are the US, the UK, and Australia. Although India is not a preferred destination, several students opt for it because of lower costs, geographical proximity and cultural affinity.

They further inform that the number of students coming to India increased from 1000 in 2002 to 1600 in 2003. Most of the students come to Bangalore, Chennai, Trichy, Madurai and Delhi. Students come to India to study professional degree courses such as engineering, medicine, management and communication. In addition, a large number of students pursue undergraduate and postgraduate degree courses in various disciplines. Most of the institutions have quota for foreign students ranging between 5% and 30% of the total seats. However, there is no special quota for Sri Lankan students. The fee charged from foreign

students is much higher than what is charged from local students. However, IITs offer a 50% fee waiver to students from SAARC countries.

Taneja et al. argue that the practices of the Sri Lanka medical council (SLMC) sometimes impose rigid conditions on Sri Lankan doctors qualified abroad. In cases where the SLMC does not recognise the foreign degree, they suggest, the Sri Lankan doctor qualified abroad has to give detailed information on the curriculum, duration, qualification of the faculty, etc. In addition, s/he has to clear an examination conducted by the medical council after which s/he is allowed provisional membership. Full membership is granted after a year of internship. In fact, they inform that Apollo in Sri Lanka found it more difficult to employ Sri Lankan doctors qualified in India than Indian doctors. On the other hand, Sri Lankan doctors passing out from any of the six recognised medical colleges in Sri Lanka are eligible for provisional membership on completion of their MBBS.

The study of Taneja et al. suggests that several Sri Lankan students come to India to obtain a medical degree from medical institutions such as Kasturba Medical College, Manipal, college of dental sciences and all India institute of medical sciences (AIIMS). While the former two are private medical institutions, the latter is run and owned by the government. The private medical institutions reserve a quota of 50% for foreign students (majority of them being Sri Lankans) while at AIIMS there are limited seats for foreign students. Foreign students at the private medical institutes pay a much higher fee than local students (several times of local fees for MBBS) whereas at AIIMS the fee charged is the same for local and foreign students. The main problem faced by Sri Lankan medical students is that the Indian degree is not recognised by the SLMC unless they clear an examination in Sri Lanka after they obtain their degree from India.

Taneja et al's study has found that the qualifications obtained from India are not always recognised in the Sri Lankan job market. While some Sri Lankan students with Indian degrees have pointed out that they do not feel disadvantaged vis-à-vis local students, others have pointed out that some professional Indian degrees are not recognised in Sri Lanka. For instance, students with medical and accountancy degrees from India have to take an examination in Sri Lanka before they can practice. For engineers, Sri Lanka specifies organisations and companies for which membership with the Institute of Engineers is mandatory. Foreign engineers can acquire membership to the Institute of Engineers

provided they clear the local examinations. However, where such membership is not required, foreign engineers can practice without membership.

Taneja et al. also suggest that several Sri Lankans come to India for training in various disciplines. India has been extending training facilities to Sri Lanka in various professional courses under ITEC and TCS of Colombo plan (annually 70 under ITEC and 50 under Colombo plan). The major courses under these schemes are financial management, auditing and accounting, rural banking, insurance, plantation management, teacher training, textiles engineering and railways.

The SLMC and the Indian Medical Association can work out mutual recognition agreements so that medical degrees from both countries should be recognised. A similar exercise could be done for dentists. However, what is urgently required is that Sri Lanka must undertake liberal commitments in the higher education sector. Sri Lanka being an important market in the region, all other South Asian countries would be interested in it.

### *Summary of Restrictions in the Sector*

- No sectoral commitments
- A number of restrictions under Mode 3
- Foreign degrees not being recognised
- Ambiguous rules at university level for private/foreign participation.

### **Bangladesh**

Bangladesh has thus far not undertaken any commitments in education services in the WTO nor has it offered to do so during the ongoing services negotiations. However, Bangladesh has opened up the education sector and foreign investment is allowed. In fact, trade in education services is already taking place via all four modes in Bangladesh. As there is an enormous gap between the demand and supply of education, the country needs to supplement its efforts by seeking foreign investment. Raihan and Mahmood who have done a detailed study on various services sectors of Bangladesh suggest that in Bangladesh education is one of the basic services where market failure is common and the role of government is essential to ensure education for all (2004: 11). This particular service sector has always been a target for increased investment, both from the public and private sectors, due to the growing demand for education and education related services.

Trade in education services takes place only in the tertiary sector, except for an education programme in

Afghanistan run by BRAC (Raihan and Mahmood 2004). The trade takes place in all modes. In Mode 1, Bangladeshi students participate in various certificate exams, like TOEFL, GMAT, GRE, etc., to qualify for pursuing higher studies abroad, particularly in the US, Canada and the UK. Students of computer science and ICT courses also participate in various professional examinations, like MCSE and MCP.

As elsewhere, import and export of educational services take place essentially through Mode 2 and the country is a net importer of education services. Major destinations for tertiary education abroad are: the US, the UK, Canada, Australia, Japan, India and Singapore. Generally, students going abroad for higher studies stay there under permanent immigration schemes (Raihan and Mahmood 2004). The total number of students going to major destinations per year is estimated at 25,000, of which 40% go to India, and more than 2,000 to Australia.

In terms of exports through Mode 2, Bangladesh attracts students from Nepal, Bhutan, India and some African countries. Though the total number of students is unknown, most foreign students come to Bangladesh to study medicine, languages or science disciplines.

Bangladesh started to import education services through Mode 3 after the government allowed the establishment of private universities and off-shore campuses for foreign private universities. In 2003, the total number of private universities and off-shore campuses of many foreign universities was 52. In most cases, private universities substituted for the import of educational services. While half of the private universities do not have campuses of their own, all have credit transfer facilities with universities abroad (Raihan and Mahmood 2004). More than half have foreign affiliation status. The countries, with which the universities have affiliations, or exchange, joint and off-shore programmes, are Australia, the US, the UK, Malaysia, Japan, New Zealand, Canada and Singapore.

Although there are serious concerns regarding the quality of most private universities, the boom in these establishments is proof that there is a demand for adult education services to complement the education available at public universities. As a whole, private universities are under-funded. Since 1992 the total investment in private universities was \$34.45 million. Twenty-nine foreign teachers visited Bangladesh to provide education services through private universities. One positive impact of these establishments is that many holders of foreign PhDs have returned to Bangladesh to teach. In 2003, the total number of teachers with a PhD degree

was 362, and 284 students transferred their study credits to foreign universities.

In terms of export, many Bangladeshi teachers also provide education services at foreign universities on either short- or long-term basis, although precise data on the numbers is not available. As a whole, the study suggests, the tertiary education sector is very vibrant and there is potential for further growth in the areas of adult education and training services through all Modes.

The country's higher educational facilities include 11 public and 16 private universities, 4 engineering colleges, 13 public and 9 private medical colleges, and 20 polytechnic institutes (UNCTAD-ICC 2000). Every year almost 45,000 students graduate from various technical colleges and institutes, and the number of students graduating from professional institutes is around 82,000. (Raihan and Mahmood (2004).

Although the education sector in Bangladesh has experienced progressive development over the last few decades, it is clear that this particular service sector looks forward to further investment in order to fill the increased demand for quality education. The government's future vision and current education policy also support the view that any kind of investment geared towards developing the education sector would be well appreciated. Raihan and Mahmood (2004:14–15) provide the following brief description of the areas where foreign service providers can look for investment opportunities:

- *Tertiary Level Education:* This particular level has experienced massive growth in recent years in terms of the establishment of new private universities, the opening of campuses for foreign universities and institutes, and the transfer of students and foreign teaching professionals. The increased demand for tertiary level education, coupled with growing competition in public universities, has opened a window of opportunity for foreign service providers to invest in this area.
- *Training of Professionals:* Since the movement of natural persons has emerged as one of the most lucrative export sectors in recent years, there is an increased demand for skills training to enable workers to access more value-adding professions. However, the lack of experts and training centres have emerged as constraints in this regard. Foreign service providers, therefore, have opportunities to seize opportunities in this area.
- *Technical Education:* Bangladesh has responded to

the global growth of information technology. The government has already formulated an ICT policy, which addresses the need for increased private participation to drive growth in this sector. So far, a good number of foreign training centres have opened branches in various cities; some of them initiated jointly with Bangladeshi entrepreneurs. However, the wide gap between the supply and demand for services, as well as the limited number of quality training centres, reflect the breadth of opportunity for development in this area. Besides computer-related skills training, there is also increased demand for training in graphic design, interior decoration, machine operation, packaging development, global trade issues, etc.

At the tertiary level, UGC is responsible for regulating private and public universities, and thus serves as the intermediary between the government and autonomous educational institutes (Raihan and Mahmood 2004).

According to the study, the constraints facing the education system in Bangladesh can be categorised under three broad headings, i.e. (1) access and equity; (2) quality of education, and (3) governance and management of education. Similar to other South Asian and LDCs, the growth potential in the education sector in Bangladesh is severely hampered by institutional and regulatory constraints and inadequate resources.

The education services are among those social services sectors that have been identified on account of their import interests (Raihan and Mahmood 2004). The GDP share for education services in Bangladesh is only 2.36%. They argue that liberalisation of this sector is likely to attract foreign investment which will facilitate its further growth and will play an import substitution role in the long run (Ibid.). The opening of off-shore campuses of foreign universities and the growth of private universities with foreign affiliation creates some sort of import substitution effect. Also, given the low revenue/GDP ratio, the government is largely dependent on external sources for financing its development budget. External aid finances more than 50% of government development expenditure on education.

The above analysis of the education sector would strongly suggest that there are good reasons for Bangladesh to undertake commitments in this sector during the current round of services negotiations. In fact, Bangladesh ought to undertake commitments in higher education (CPC 923), adult education (CPC 924), and other education (CPC 929) and in all modes.

It is interesting regarding Bangladeshi education that it has already developed a very close relationship with India, Nepal and Bhutan in the region. The WTO commitments will further boost this relationship and Bangladesh may also develop some niche market in the region for export of education. India is clearly in an advantageous position and can supply education to Bangladesh through all modes. The available literature suggests that recognition of foreign qualifications perhaps does not seem to be an explicit problem in Bangladesh. This should be an additional reason why service providers from the region should invest in the sector in Bangladesh.

### The Maldives

Like Bangladesh, the Maldives too has not yet undertaken any commitments in the education sector nor has it proposed any commitments during the ongoing round of negotiations. However, shortage of skilled labour, skills mismatch in the labour force and the high proportion of foreign labour have been highlighted as major obstacles to the economic growth of the Maldives. Although educational attainment in the Maldives has improved over the past several years, other elements for a strong human capital base are missing (World Bank 2006). In 2004, the graduate output was 862, representing certificate, diploma, degree, and foundation study programmes. Despite certain improvements, the lack of local skilled labour continues to be a major problem in the Maldives. Moreover, the quality of education has not kept pace with enrollment. This has led to a dysfunctional labour market that creates high reliance on migrant labour from neighbouring countries. Since there is no statutory minimum wage, cheap labour in the region, especially from India, Sri Lanka, and Bangladesh, further depresses the market. The domestic labour force stood at about 87,442. The labour force participation rate is 47.7%. The local labour force is supplemented by the employment of a significant expatriate labour force. In 2004, 38,413 expatriates were employed in the Maldives, up from 33,765 at the end of 2003. The World Bank suggests that there is no easy and immediate solution to this emerging problem, given the Maldives' proximity to a large, cheap labour market in India, Sri Lanka, and Bangladesh. Categories in which expatriate labour has been employed mostly include teachers, medical personnel and other professional categories, as well as semi-skilled and unskilled workers such as domestic helpers and construction

workers (Maldives' TPR 2002). From the perspective of the industrialists, it is a positive development, but from a long-term economic and social perspective, it poses a major threat that needs to be addressed without affecting industry performance (The World Bank 2006).

In view of the lack of educational opportunities at higher level and also due to the over dependence on expatriate labour force it could be suggested that the Maldives should undertake liberal commitments in the three education services – higher, adult and other education services and under all modes. The Maldives has strong import interest in education services. As in Bangladesh, in the Maldives also there does not seem to be any explicit problem with recognition of foreign degrees. In view of the Maldives having the highest per capita income in the region, it offers an attractive market for other South Asian countries. In this regard, India and Sri Lanka seem to be better placed to provide education services to the Maldives due to their geographical proximity and better education facilities. As India already has some educational institutions in Nepal and the Manipal University is planning to start its branch in Sri Lanka, given the demand for higher education, Indian institutions may like to be present in the Maldives. Modes 1 and 2 also appear to be important for supply of education to the Maldives by other South Asian countries. However, currently the demand for qualified teachers is very high in the Maldives and other South Asian countries can fill this gap.

There is a general trend in the Maldives that for higher education students go abroad particularly to the Western advanced countries. With the support of other South Asian countries the Maldives can gain immensely by having access to relatively cheap education via Mode 2 and by allowing commercial presence its students can instead study in the country thereby saving a lot of foreign exchange. Due to predominance of the tourism sector in the Maldivian economy, its main emphasis is on tourism related education which could also be provided by other South Asian countries.

## Bhutan

Bhutan, an acceding WTO member country, has submitted its services offer to the WTO which includes education services. Bhutan's proposed commitments in education services cover higher secondary education services (CPC 9222) and post secondary technical and

vocational education services (CPC 9231). CPC 9222 has been defined as general school education services at the second level, second stage.<sup>5</sup> Such education services consist of general education programmes covering a wide variety of subjects involving more specialisation than at the first stage. The programmes aim to qualify pupils for university entrance of higher technical or vocational education without any special subject prerequisite. Similarly, post-secondary technical and vocational education services have been defined as services consisting of a great variety of subject-matter programmes.<sup>6</sup> They emphasise teaching of practical skills, but also involve substantial theoretical background instruction.

From the definitions of the two education services in which Bhutan has proposed to make commitments it appears that Bhutan has proposed very wise and practicable commitments as they suit the limited requirements of the small country. Moreover, at higher level and particularly for technical education large Foreign Service providers may not find the Bhutanese market big enough to invest a large amount of capital.

While in the Market Access column, Modes 1 and 2 have no restrictions, under Mode 3 services can be provided jointly with local educationists. In addition, foreign investor equity would be limited to a maximum of 51% and except for education services funded from state resources. Mode 4 is unbound except as in the horizontal section. In the National Treatment column Modes 1, 2, and 3 are unbound and Mode 4 is unbound except as in the horizontal section.

In the horizontal section, the restrictions are limited to Mode 3. In the Market Access column the first limitation specifies that in order to establish a new commercial presence in Bhutan, minimum size of foreign investment would be \$0.5 million and foreign investor's equity holding limited to 70% and business must also be incorporated in Bhutan. Further, the investment shall be governed by sector specific policies and procedures as established in the sectors included in this schedule. Mode 3 is unbound for measures regulating publicly funded services including with respect to national treatment. In the National Treatment column also there are some limitations. Foreign investors are required to foster transfer of technology, introduction of management skills and provide training and employ Bhutanese national at all levels in the enterprise. Finally, the shares held by foreign nationals and juridical

<sup>5</sup> United Nations Statistics Division, Department of Economic and Social Affairs, the United Nations, <http://unstats.un.org/unsd/cr/registry/regcs.asp?Cl=16&Lg=1&Co=92220>, last visited on 12 November 2007.

<sup>6</sup> Education Services: Background Note by the Secretariat, WTO, S/C/W/49, 23 September 1998.

persons in locally incorporated companies are not transferable without prior permission by the government of Bhutan.

Although for a country of Bhutan's size undertaking commitments in education should be appreciated, these commitments have to be critically analysed from the point of view of a foreign services provider. In view of this, the Bhutanese commitments do not seem to be liberal. The first and foremost problem with these commitments is that there are too many restrictions in the sectoral as well as horizontal commitments. In fact, question could be asked why would any foreign investor decide to invest in Bhutan when there are so many barriers. These barriers are also equally relevant in the case of South Asia and it is interesting to note that India and to a limited extent Bangladesh are already involved in providing education services to the Bhutanese students. In fact, South Asian countries could be major investors in Bhutan's education services. Bhutan should remove some of the Mode 3 restrictions particularly mentioned in the horizontal section. Similarly, it is hard to understand why Bhutan has inscribed unbound under Modes 1, 2 and 3 in its sectoral commitments in the National Treatment column. Mode 1 would be of much interest to the other South Asian countries and hence Bhutan needs to take full commitment in the National Treatment column of its sectoral commitments.

### *Summary of Restrictions in the Sector*

- No commitments under Mode 1
- A number of restrictions under Mode 3 such as foreign equity cap of 51%, services can be provided jointly with local educationists, etc.
- No commitments under Mode 4.

## ■ CONCLUSION AND SUGGESTIONS

From South Asia India, Pakistan, Nepal, Sri Lanka, and Bhutan have so far either undertaken commitments or have offered to do so in education services as part of the ongoing services negotiations. However, Bangladesh and the Maldives are the two South Asian countries which have not shown any willingness to bind-in their autonomous liberalisation undertaken in the sector. While there is a study suggesting that Bangladesh has strong import interests in education services and hence should undertake commitments, there does not seem to be any such study on the Maldives suggesting about its possible move under the GATS. The World Bank and others have strongly

argued that the Maldives lacks skilled labour force and only a handful of its students have the opportunity of studying at higher education level. There is also evidence that Maldivian students going abroad is a trend for seeking higher education. There are plausible reasons for the Maldives to make commitments under the GATS.

At the South Asian level there is a dearth of educational institutions providing higher education particularly in management, engineering, medical and other technical education. The excess of demand is manifested in the region-wide trend of students going abroad especially to Western countries for education. A liberal Mode 3 regime in these countries would certainly play the role of import substitution by providing far cheaper education as compared to what the Western institutions provide.

Similarly, lack of qualified teachers at higher education level affecting the quality of education seems to be a regional characteristic. It could be suggested that apart from allowing teachers to move freely across the region, training teachers at regular intervals in better institutions will help tackle the problem. Not surprisingly teacher training is one of the areas selected by SAARC to work on.

There is already trade in education taking place in South Asia and India is clearly the leading exporter of education at the regional level. Several thousand students from Bangladesh, Nepal and Sri Lanka come to India every year for education. Under the SAARC arrangement India is providing some concessions to the students from this region studying in select governmental institutions. In the possible regional agreement some mechanism could be developed to give concessions to South Asian students studying even in private institutes too. This will make the South Asian education more attractive for students.

There is immense scope for delivery of education via Mode 1. As already discussed, this can take many forms. However, distance education and education particularly via internet are of great significance to the region. In fact, this has special developmental perspective as education via this route is found to be several times less expensive than through conventional mode.

It has been suggested that quality and accreditation are at the heart of this debate (Knight 2002). The importance of frameworks for licensing, accreditation, qualification recognition and quality assurance are important for all countries whether they are importing and exporting education services. Developing countries have expressed concern about their capacity to have

such frameworks in place in light of the push towards trade liberalisation and increased cross border delivery of education. The development of a regulatory framework to deal with the diversity of providers and new cross-border delivery modes becomes more critical as international trade increases. In some countries, this will likely mean a broader approach to policy which involves licensing, regulating, monitoring, both private (profit and non-profit) and foreign providers in order to ensure that national policy objectives are met and public interests protected. It has further been suggested that more work is necessary to determine how domestic/national regulatory frameworks are compatible with, or part of a larger international framework and how they relate to trade agreement rules.

Knight also raises an interesting point that GATS is facilitating the mobility of professionals to meet the high demand for skilled workers (Knight 2002). This impacts many of the service sectors and has particular implications for the mobility of teachers and scholars in the higher education sector. In many countries, Knight argues, the increasing shortage of teachers is resulting in active recruitment campaigns across borders. Knight further adds that since many teachers and researchers want to move to countries with more favourable working conditions and salaries, there is a real concern that the most developed countries will benefit from this mobility of education workers.

However, it could be argued that the solution perhaps lies in allowing private players to enter the area of education and not in closing the system to outside players. Pangariya rightly suggests that only private universities that can charge hefty fees and attract private sponsors from home and abroad will be able to afford salaries necessary to retain top-class scholars and teachers and create facilities required to promote excellence in research (Pangariya 2007). Bangladesh encourages private universities and the result has been that they have recruited teachers from expatriate Bangladeshis living in countries like the US and the UK (interview at the BRAC University, Dhaka, Bangladesh). Thus what seems to be of paramount importance is the presence of an efficient regulatory authority that will ensure quality in education.

In the South Asian context it is important that regulatory bodies such as the UGC and the AICTE begin discussing with their counterparts in other countries of the region to explore the possibility of having some uniformity in curricula in particularly technical education which could lead to equivalence of qualifications and finally to recognition. Although when thousands of students from Bangladesh, Nepal, and Sri Lanka are already studying in India implying that there is some acceptability of the degrees obtained in India, this has to be given a formal legal cover.

# 14 ■ Health and Related Services<sup>1</sup>

## ■ INTRODUCTION

The chapter attempts to assess the extent of liberalisation and the regulatory requirements for delivery of Health services in each of the SAARC countries, i.e. Bangladesh, Bhutan, Maldives, Nepal, Pakistan, Sri Lanka and India. The specific health services that are studied are 'Medical and Dental services', listed under the 'Business Services' section, and 'Hospital Services' listed under the 'Health related and Social Services' section of the WTO Secretariat's Services Classification list, commonly referred to as the W-120 Services Classification list.<sup>2</sup> The other kind of health services covered under the W-120 List are services provided by nurses, midwives, physiotherapists and para-medical personnel. These are also addressed in this chapter.

This chapter is divided into four broad sections:

- The first section provides an overview of the commitments under GATS that have been made by the SAARC countries. The purpose of this overview is to present the aspects that need further improvement from the perspective of further liberalisation under the SAARC framework.
- The second discusses the domestic regulatory requirements that either facilitate or restrict trade in health services. The purpose of this segment of discussion is to flag areas for improvement that are necessary in the SAARC discussions on trade in health services. The discussion on domestic regulations also highlights areas where autonomous liberalisation are at a higher level than GATS commitments, and could be areas where SAARC negotiations could push for firm commitments.
- The third analyses the impact of the regulatory

requirements on the Modes of delivery healthcare services in the SAARC countries.

- Based on the analysis above, the last section highlights the focus areas for discussions under the SAARC negotiations on health services.

At the outset, the main modes of service delivery and a brief outline on the constraints and opportunities for the same in the SAARC region, are provided below:

### *Mode 1*

Cross-border delivery of health services through telemedicine can enable healthcare providers in one SAARC country to provide services to a consumer in another SAARC country. While telemedicine is slowly taking roots within countries like India, the practice of telemedicine is being attempted by a few hospitals within India, such as Apollo.<sup>3</sup> The government of India has also undertaken initiatives such as the on 'Development of Telemedicine Technology', for delivery of services within India.<sup>4</sup> The government of India is also reportedly considering guidelines for standardising delivery of telemedicine services.<sup>5</sup> This is however yet to be formalised. Cross-border services within the SAARC region have however been confined to limited instances of teleradiology and telepathology services from India to Nepal and Bangladesh.<sup>6</sup> With the growth of information technology, however, there is potential for growth of Mode 1 as a mode of supply among SAARC countries. This will depend to a large extent on the mutual recognition of doctors qualified in any SAARC country by all the other SAARC countries. This aspect, therefore, needs to be taken up as a potential area for opening up in the SAARC negotiations.

<sup>1</sup> The chapter is based on the report authored by R.V. Anuradha.

<sup>2</sup> WTO Secretariat, *Services Sectoral Classification List*, MTN.GNS/W/120, 10 July 1991 <http://channels.apollolife.com/telemedicine/info/index.htm>

<sup>3</sup> <http://www.spsood.com/telemedicineinindia.htm>

<sup>4</sup> <http://www.mit.gov.in/telemedicine/Report%20of%20TWG%20on%20Telemed%20Standardisation.pdf>

<sup>6</sup> *Ibid.*

### Mode 2

Trade in health services via consumption abroad is typified by medical tourism especially in India. Consumers from many of the SAARC countries travel to India for specialised healthcare. There are no direct regulatory impediments for this mode of supply. However, there are factors such as lack of portability of insurance that could act as constraints. This mode has futuristic potential for growth, and commitments for facilitating access needs to be taken up in the SAARC negotiations.

### Mode 3

Commercial presence in health services through FDIs in hospitals and healthcare centres is an area in which there are practically no regulatory constraints in the SAARC countries. This has not resulted in any significant flow of investments within the SAARC region. Operational constraints in this regard need to be ironed out.

### Mode 4

Trade via movement of health service providers among countries of the SAARC region is an aspect that needs to be addressed as a fundamental component of services liberalisation in the SAARC negotiations. Most of the movement by healthcare professionals (doctors, dentists, nurses and paramedics) from India and Sri Lanka, primarily, have been to wealthier destinations in the UK, USA, Canada, Australia and the Middle-East (Hamilton and Yau 2004, Buchan and Sochlaski 2004 and Adikioli 2006). Countries in South Asia are also said to have a high degree of internal migration, from rural and backward areas, to cities (Adikioli 2006). Interestingly, however, any movement between lesser developed SAARC countries to more developed ones (e.g. Bangladesh to India), has not been mapped as yet. As with Mode 1, Mode 4 will depend to a large extent on the mutual recognition of doctors qualified in any SAARC country by all the other SAARC countries.

## ■ COMMITMENTS IN HEALTH AND MEDICAL AND DENTAL SERVICES UNDER GATS

The nature of GATS commitments by SAARC countries predominantly focus on Modes 3 and 4. Only Nepal

has made commitments in Mode 1. All others have left this as unbound. Pakistan in fact states that Mode 1 is left out of its schedule because it is technically 'not feasible'. Commitments on Mode 2 have been made only by Nepal and Pakistan. Despite lack of significant GATS commitments, mode 2 service delivery in the form of services to patients from other SAARC countries has been prevalent especially in India. Both Mode 1 (especially telemedicine) and Mode 2 (in the form of medical tourism) have significant potential for future growth, and this will be discussed separately in this chapter. Appendix Table A14.1 presents a summary of commitments by SAFTA member countries in health and related services. The extent of commitments under GATS by each of the SAFTA member country is as follows:

### Bangladesh<sup>7</sup>

Bangladesh has not undertaken any commitments on Health and Medical services under the GATS as yet. However, as will be discussed later in this chapter, its domestic regulatory regime in fact allows for foreign participation in the delivery of health services.

### Bhutan

As mentioned before, Bhutan is not a member of the WTO as yet, hence it does not have any GATS-related commitments. As will be discussed later in this chapter, FDI is allowed for hospitals subject to Government approval.

### India<sup>8</sup>

India's GATS schedule specifies the following for Hospital Services.

*Mode 1:* No commitments have been undertaken.

*Mode 2:* No commitments have been undertaken.

*Mode 3:* Under Mode 3, India has committed to allow for foreign equity participation up to 51% in the setting up of hospitals in India. It also mandates incorporation of the entity in India for such commercial presence.

*Mode 4:* No commitments have been undertaken. No

<sup>7</sup> See, GATS/SC/8, 15 April 1994, available at [www.wto.org](http://www.wto.org)

<sup>8</sup> See, GATS/SC/42, 15 April 1994, available at [www.wto.org](http://www.wto.org)

commitments have also been undertaken with regard to temporary movement of medical professionals engaged in medical or dental services. Commitments have however been undertaken in respect of ‘specialists’ who are employed in a juridical person having commercial presence in India.

As will be seen in the discussions later in this chapter, the domestic regulatory framework in India allows for 100% FDI for hospitals. The regulatory framework also allows for limited entry of foreign qualified doctors and dentists.

### The Maldives<sup>9</sup>

Maldives has not undertaken any commitments on Health and Medical services under the GATS as yet. However, as will be discussed later in this chapter, the domestic regulatory regime in fact allows for foreign participation in the delivery of health services, and also allows for limited entry of foreign qualified doctors and dentists.

### Nepal<sup>10</sup>

Nepal’s schedule of commitments under GATS specifies that with regard to Hospital services it has no restrictions with regard to delivery of services under Modes 1 and 2.

*Mode 3:* With regard to Mode 3, it mandates incorporation in Nepal and allows for maximum foreign equity capital of 51%.

*Mode 4:* Under Mode 4, the schedule specifies that foreign medical experts can work in Nepal with the permission of the Nepal medical council for a maximum duration of one year. Additionally, the horizontal section states that ‘specialists’ employed in a juridical person having commercial presence, will be given access for an initial period of 3 years, which may be extended to 7 and a maximum of 10 years. Other categories of natural persons who will be provided entry are ‘service salespersons’ and persons responsible for setting up commercial presence.

As discussed later in this chapter, the regulatory framework allows for 100% FDI for hospitals in Nepal.

### Pakistan<sup>11</sup>

With regard to both Hospital and Medical and Dental Services, Pakistan’s GATS schedule specifies as follows:

*Mode 1:* Mode 1 is unbound because of what Pakistan perceives is “*lack of technical feasibility*” in cross-border supply of such services.

*Mode 2:* There are no restrictions on Mode 2.

*Mode 3:* Under Mode 3, incorporation is necessary and foreign participation up to 51% is allowed. Mode 3 is further subject to Pakistan Medical and Dental Council regulations.

*Mode 4:* No commitments have been undertaken with regard to Mode 4 for the Health sector. The horizontal section states that specialists who are employed by a juridical person having commercial presence, will be provided access. The quota for such specialists is 50% of the requirement of the juridical person. The time period for the access however is not specified.

As discussed in the subsequent section, the framework for FDI in Pakistan allows for 100% FDI for hospitals. Movement of foreign doctors also seems to be possible under the regulations.

### Sri Lanka<sup>12</sup>

Sri Lanka has not undertaken any specific commitments under the Health or Medical/ Dental services sub-headings. However, from its horizontal commitments, the following commitments can be inferred:

*Mode 3:* Foreign investment of up to 40% of equity in a company proposing to carry on Medical and Dental services is allowed under the automatic route. Any investments above this limit require approval from the relevant investment authority in Sri Lanka.

*Mode 4:* The horizontal section of the schedule specifies that movement of natural persons is subject to Sri Lankan laws on immigration, consumer laws, and other relevant laws and regulations, and that aliens seeking to work will need to acquire a work permit. Categories

<sup>9</sup> See, GATS/SC/101, 30 August 1995, available at [www.wto.org](http://www.wto.org)

<sup>10</sup> See, GATS/SC/139, 30 August 2004, available at [www.wto.org](http://www.wto.org)

<sup>11</sup> See, GATS/SC/67, 15 April 1994, available at [www.wto.org](http://www.wto.org)

<sup>12</sup> See, GATS/SC/79, 15 April 1994, available at [www.wto.org](http://www.wto.org)

of natural persons in terms of business visitors or ICTs are not specified.

The domestic regulatory framework as discussed here, seems to allow for 100% FDI for hospitals. Temporary registration for foreign qualified doctors and dentists also seems to be possible under the framework.

## ■ DOMESTIC REGULATORY REQUIREMENTS FOR MEDICAL AND DENTAL SERVICES

### Overview

Most of the domestic regulatory requirements in the SAARC countries are focused on:

- Regulations regarding FDI in Hospitals and/or health centres in the country. These regulations have a direct impact on the commercial presence under Mode 3.
- Regulations regarding qualifications required for registration as a doctor or dentist with the relevant statutory authority. Regulations affecting recognition of nurses, midwives and paramedics will also be studied, to the extent these have been available. These regulations have direct relevance in respect of movement of natural persons under Mode 4. These regulations could also have implications for any potential delivery of health care services through cross-border services, i.e. Mode 1, such as telemedicine.

There are no regulatory requirements that prohibit Mode 2, i.e. movement of patients across borders to avail of healthcare services in another country. This aspect is prevalent in the SAARC region mainly in the context of movement of patients from neighbouring countries to India. However, issues such as lack of portability of health insurance coverage act as constraints, and limit Mode 2 primarily to the wealthy cross-section of the population. The issue of Mode 2 and factors for facilitating this will be discussed separately.

The following sections on each SAARC member outlines the regulatory requirements in each country with respect to FDI in health services, and domestic regulations in respect of qualification and registration of doctors, dentists and nurses in that country.

## Bangladesh

### *FDI-related Requirements*

Foreign investment in Bangladesh is regulated by the Foreign Private Investment (Promotion and Protection) Act, 1980 and The Investment Board Act 1989.<sup>13</sup> Board of Investment created under the Investment Board Act of 1989.<sup>14</sup>

There are no restrictions under the laws for FDI in the hospital sector. Consequently, 100% FDI in hospitals is allowed in Bangladesh. A foreign investor is advised to register its venture with the Board of Investment to enable it to avail of the support provided by the BOI to foreign investment, including ascertaining the state level/municipal clearances and licenses that may be needed in relation to the venture.

### *Domestic Regulations Regarding Qualification and Licensing Criteria for Medical Practitioners, Dentists and Nurses*

*Regulatory Authority:* The Bangladesh medical and dental council (BM&DC) established under the Bangladesh Medical and Dental Council Act, 1980 is the regulatory body for medical and dental services. The Bangladesh nursing council under the Bangladesh Nursing Council Ordinance of 1983 is the regulatory authority for nursing services. Registration with the relevant councils is a mandatory pre-requisite for practice of the medical, dental and nursing professions in Bangladesh.

*Recognition of Foreign Qualifications:* The list of 'recognised colleges' as published by the BM&DC includes only colleges in Bangladesh.<sup>15</sup> The powers and functions of the BM&DC however includes the power to recognise medical and dental qualification granted by institutes outside Bangladesh, and enter into a scheme of reciprocity with foreign medical and dental councils for recognition of medical and dental qualifications.<sup>16</sup>

The Bangladesh Nursing Ordinance also includes on the power to recognise qualifications awarded in other countries. However a list of such colleges outside of Bangladesh that are recognised, was not available.

*Reciprocal Arrangements:* As will be discussed in the

<sup>13</sup> *Bangladesh Investment Handbook*, 2007 [http://www.boi.gov.bd/invest\\_book\\_2007.html](http://www.boi.gov.bd/invest_book_2007.html)

<sup>14</sup> [http://www.boi.gov.bd/invest\\_book\\_2007.html](http://www.boi.gov.bd/invest_book_2007.html)

<sup>15</sup> See [http://www.bmdc.org.bd/recg\\_med\\_dcol.php](http://www.bmdc.org.bd/recg_med_dcol.php)

<sup>16</sup> <http://www.bmdc.org.bd/>

section below on India, India and Bangladesh have entered into a scheme of reciprocity by virtue of which medical degrees offered by various medical colleges in Bangladesh are recognised in India. Since the principle for this recognition is reciprocity, there would be several Indian colleges whose degrees are recognised in Bangladesh. Copies of the same could however not be obtained.

*Temporary registration of Foreign Doctors and Dentists:* The BM&DC also provides for temporary registration of foreign doctors and dentists who are required to submit a standardised form to the Council. Such temporary registration typically seems to be awarded for a six-month period.<sup>17</sup> The following are the key requirements that need to be provided for such temporary registration<sup>18</sup>:

- Original medical degrees certificate/copy duly endorsed/attested by high commission embassy or mission of the country of the candidate in Bangladesh.
- Registration certificate of practice of the candidate's country, original or attested as in (a).
- Work permit from the government.

## Bhutan

### *FDI-related Requirements*

FDI in Bhutan is governed by the FDI Rules and Regulations, 2005 read with the Foreign Direct Investment Policy, 2002. Under this framework, approval of the ministry of trade and industry of the royal government of Bhutan is required for all foreign collaborations/joint ventures.

The FDI Rules and Regulations, 2005 in Schedule II provide the list of services that are open to foreign direct investment.<sup>19</sup> Health/hospitals is not in the list of services open to FDI. Consequently, only joint ventures or collaborations in the hospital/health sector will be permitted with prior approval from the Ministry of Trade and Industry, Royal Government of Bhutan.

Under the said policy and regulations, all FDI in Bhutan needs to be registered with the Ministry of trade and industry. FDI registration (FDIR) certificate is typically issued by the ministry of trade & industry within two working weeks of submission of a completed application form. The certificate states conditions that must be fulfilled by investors. The nature of such conditions however could not be ascertained.

### *Domestic Regulations Regarding Qualification and Licensing Criteria for Medical Practitioners and Dentists and Nurses*

*Regulatory Authority:* The Bhutan Medical and Health Council established under the Medical and Health Council Act of the Kingdom of Bhutan, 2002,<sup>20</sup> is the regulatory authority responsible for regulating doctors and dentists in Bhutan. Registration with the Council is mandatory for the practice of the profession of medicine, dentistry and nursing in Bhutan.

*Recognition of Foreign Qualifications and Reciprocal Arrangements:* The Bhutan Medical and Health Council Act provides that the Council may recognise degrees awarded by medical institutions both within and outside Bhutan.<sup>21</sup> Additionally, the council also has the authority to enter into arrangements for reciprocity with medical councils of other countries.<sup>22</sup>

The WHO's assessment of Bhutan states that developing medical doctors is still very difficult as Bhutan has to depend on the neighbouring countries for medical education.<sup>23</sup> Bhutan reportedly does not have any medical college, and therefore candidates are sent to Bangladesh, India, Myanmar, and Sri Lanka for their MBBS courses.<sup>24</sup> While lists of recognised courses was not available, it can be inferred with reasonable certainty that degrees awarded in Bangladesh, Sri Lanka and India are recognised by Bhutan.

## India

### *FDI-related Requirements*

Foreign Investment in India is regulated by the

<sup>17</sup> [http://www.bmdc.org.bd/docs/forms/temp\\_reg\\_frqn\\_doc.pdf](http://www.bmdc.org.bd/docs/forms/temp_reg_frqn_doc.pdf)

<sup>18</sup> *Ibid.*

<sup>19</sup> <http://www.mti.gov.bt/industry/Final%20approved%20FDI%20Policy-.doc>

<sup>20</sup> Bhutan National Health System Profile at pg 10 available at [http://www.searo.who.int/LinkFiles/Bhutan\\_CHP.pdf](http://www.searo.who.int/LinkFiles/Bhutan_CHP.pdf): The website address of Ministry of Health is <http://www.health.gov.bt>

<sup>21</sup> The schedule relating to such foreign degrees, however, is not available in the Ministry of Health's website

<sup>22</sup> Chapter 4, Medical and Dental Council Act, 2002

<sup>23</sup> [http://www.searo.who.int/EN/Section313/Section1517\\_10767.htm](http://www.searo.who.int/EN/Section313/Section1517_10767.htm)

<sup>24</sup> *Ibid.*

Government of India acting through the Secretariat for Industrial Assistance and the Department of Industrial Policy and Promotion.<sup>25</sup> The Reserve Bank of India under the Foreign Exchange Management Act, 1999, regulates the flow of foreign exchange into and from India.

Investment in specific sectors requires prior government approval, while a number of sectors are open to foreign direct investment under the automatic route. Under the automatic route no prior approval of the Government or Reserve Bank of India is needed to undertake an investment into the Indian venture. The investors are required to only notify the regional office of the RBI within 30 days of making the investment.

Hundred per cent FDI under automatic route is allowed in hospital sector in India.<sup>26</sup>

### ***Domestic Regulations Regarding Qualification and Licensing Criteria for Medical Practitioners and Dentists and Nurses***

**Regulatory Authorities:** The Medical Council of India established under the Indian Medical Council Act, 1956, is the regulatory authority for medical practitioners in India. Only persons holding degrees and qualifications recognised by the Medical Council of India and registered with the Council can practice the profession of medicine in India.

The Dental Council of India established under the Dentist Act, 1948, is the regulatory authority for dentists in India. Only persons holding degrees and qualifications recognised by the dental council of India and registered with the Council can practice the profession of dentistry in India.

### ***Recognition of Foreign Qualifications and Reciprocal Arrangements***

**Medical Practitioners:** Section 12 of the Indian Medical Council Act provides that medical qualifications granted by medical institutions outside India which are specified in Schedule II to the act, shall be recognised as medical qualifications for the purposes of the Act. Degrees from specified medical colleges and universities in Bangladesh, Nepal, Pakistan and Sri Lanka, have

been listed in Schedule II to the Indian Medical Council Act. These are listed below:

SAARC Countries	Degrees Specified in Schedule II
Bangladesh	MBBS from Chittagong University Dhaka University Rajshahi University
Nepal	MBBS from Tribhuvan University B.P. Koirala Institute of Health Sciences, Dharan Manipal College of Medical Sciences, Pokhara, Kathmandu University
Pakistan	LMS, MB, MBBS, MD and MS from Punjab University LMS from Punjab State Medical Faculty
Sri Lanka	LMS from Ceylon Medical College

- Certain other degrees from other universities in Bangladesh, Nepal, Pakistan and Sri Lanka are also recognised provided the applicant is an Indian citizen.<sup>27</sup>
- In order to notify a foreign college in Schedule II to the Indian Medical Council Act, the Medical Council of India needs to enter into negotiations with the relevant authority of the foreign country and set up a scheme of reciprocity for recognition of medical qualifications.<sup>28</sup> This provides the potential basis for negotiations with other SAARC countries for recognition of qualifications.
- The medical council of India also recognises medical practitioners having medical degrees granted by medical institutions in countries with which India does not have a reciprocal agreement, if the following conditions are satisfied<sup>29</sup>:
  - Such persons are enrolled as medical practitioners in accordance with the law regulating the registration of medical practitioners for the time being in force in their country;
  - Such persons can work with an institution in India *for the purposes of teaching, research or charitable work*; and
  - The duration of such persons medical practice in India shall be limited to the period specified in this behalf by the Central Government by general or special order.

<sup>25</sup> [www.dipp.nic.in](http://www.dipp.nic.in)

<sup>26</sup> Press Note No.2 (2006) Series, DIPP

<sup>27</sup> Section 13(3), Medical Council Act read with Part II of Schedule III, which includes degrees such as MBBS(Dakha), MBBS(Karachi), and MBBS(Ceylon)

<sup>28</sup> Section 12(2), Indian Medical Council Act.

<sup>29</sup> Section 14(1), Indian Medical Council Act [http://www.fdiworldental.org/resources/assets/facts\\_and\\_figures/2000/INDIA.PDF](http://www.fdiworldental.org/resources/assets/facts_and_figures/2000/INDIA.PDF) for further details

*Dentists:* Under the Dental Council of India Act, the Dental Council of India may enter into negotiations with the relevant authority of the foreign country and set up a scheme of reciprocity for recognition of dental qualifications. The Council reportedly has reciprocal agreements with UK, Australia and New Zealand.<sup>30</sup> Agreements on a reciprocal basis with SAARC countries are also a possibility under this provision.

The Dental Council of India Act also envisages temporary registration of foreign qualified doctors who are engaged in teaching or research in India.<sup>31</sup>

Degrees obtained by Indian citizens from certain foreign countries are also specified as recognised degrees by virtue of which such person can register as a dentist with the dental council. However a foreign dentist holding a similar degree cannot register. For a foreign degree to be recognised, therefore, an arrangement of reciprocity with such country is a pre-requisite.

*Nursing:* The Indian Nursing Act provides for three categories of nursing professionals based on qualifications and training: Nursing, Midwives and Auxiliary Nurse Midwives. Only nurses registered with the Indian Nursing Council can practice the profession in India. The Nursing Council has the power to recognise qualifications from other countries. However, it is not clear whether nursing degrees from other SAARC countries are recognised in India. India reportedly has arrangements recognising degrees from the USA and Canada.<sup>32</sup>

### The Maldives<sup>33</sup>

#### *FDI-related Requirements*

Foreign investment in the Maldives is governed by Law 25/79. The law provides the framework for an agreement between the government and a foreign investor. This law was reportedly passed in 1972, and the government is in the process of amending and replacing it with an updated law. The law does not specify any sector specific limits to foreign direct investment. It

simply provides for the procedure for a foreign investor to enter into an agreement with the government of Maldives to invest into the country. In practice, for most sectors, with the exception of retain and education, the Government allows for 100% foreign investment.

The basic stages for investment into the health sector would involve the following<sup>34</sup>:

- An application regarding the proposed investment needs to be made to the Foreign Investment Services Bureau (FISB), which is part of the Ministry of Trade, Industries and Labour
- The FISB's Evaluation Committee reviews the proposal primarily from the point of view of infrastructure availability and consumer needs. There are no sector-specific guidelines for this; the approach adopted is a case-by-case approach.
- 100% FDI is normally allowed in the event the proposed investment is worth US\$ 1 million or above. For investments lesser than US\$ 1 million, joint ventures with a local partner are recommended.
- A decision is typically reached by the FISB within 3–4 weeks of the proposal being made.
- Once investment is authorised for setting up of a hospital or a health centre, registration of the same with the Ministry of Health is also necessary.

#### *Domestic regulations regarding qualification and licensing criteria for medical practitioners and dentists and nurses*

Rules, regulations and guidelines enacted by the ministry of health govern the qualification and licensing criteria for medical practitioners, dentists, nurses and paramedics.<sup>35</sup> The government of Maldives typically advertises internationally for skilled medical practitioners, and it has been estimated that approximately 75% of medical practitioners in the Maldives, including doctors, dentists, other specialists, nurses and paramedics are of foreign origin.<sup>36</sup> It has also been estimated that the proportion of Indians among the foreign doctors in the Maldives, is close to 70%.<sup>37</sup>

<sup>30</sup> Section 34, Dental Council of India Act, 1948

<sup>31</sup> *Ibid.*

<sup>32</sup> See, <http://www.anmc.org.au/international/index.php>

<sup>33</sup> Information in this section on Maldives has been obtained from a review of Law 25/79 on Foreign Investments, and discussions with Mr. Ahmad Shahid, First Secretary (Economic and Commercial), High Commission of Maldives, New Delhi.

<sup>34</sup> *Ibid.*

<sup>35</sup> Copies of regulations could not be obtained. This section however summarises the overview provided by Mr. Ahmad Shahid, First Secretary (Economic and Commercial), High Commission of Maldives, New Delhi.

<sup>36</sup> Discussions with Mr. Ahmad Shahid, First Secretary (Economic and Commercial), High Commission of Maldives, New Delhi.

<sup>37</sup> *Ibid.*

The process of recruitment of foreign doctors is as follows<sup>38</sup>:

- The government advertises in international newspapers
- Shortlisted applicants have to undergo several rounds of interview, and a close scrutiny of their qualifications and references.
- The national accreditation board of Maldives accredits several universities and the degrees awarded by the same. If the applicant is from an accredited university, his/her application is processed faster. If not, a committee from the Ministry of Health is required to closely investigate the credentials of the university, the course outline, and the nature of exams offered by such university.
- After an applicant is approved by the ministry of health, she is required to apply for a 'work permit' to the ministry of labour. A work permit is typically awarded for one year duration, and is renewable. It is estimated that some foreign doctors have stayed on to provide medical services in Maldives for 15 to 20 years.

## Nepal

### *FDI-related Requirements*

The government of Nepal has formulated a Foreign Direct Investment Policy, under which 100% FDI is allowed in the health/hospital sector.<sup>39</sup> Pursuant to the Foreign Investment and Technology Transfer Act, 1992 the approval and permission of the Department of Industry under Government of Nepal is required for all FDI in Nepal. In order to obtain the permission, the foreign investor should first submit an application to the Department. Approvals are granted on a case-by-case basis.

### *Domestic Regulations Regarding Qualification and Licensing Criteria for Medical Practitioners and Dentists and Nurses*

*Regulatory Authority:* The Nepal medical council established under the Nepal Medical Council Act, is the regulatory body responsible for regulating medical and dental practice in Nepal. The Nepal nursing council

established under the Nursing Council Act is responsible for the professions of nursing. Only persons with qualifications recognised by the relevant councils will be allowed to register with the councils for the practice of the professions of medicine, dentistry and nursing in Nepal.

*Recognition of Foreign Degrees and Reciprocal Arrangements:* The Council recognises medical and dental degrees awarded by specified institutions in India, Bangladesh, Pakistan and Sri Lanka. Accordingly, six (6) Bangladesh universities, over hundred (100) Indian universities, nine (9) Pakistan universities, and one (1) Sri Lankan university, offering both degrees in medicine and dentistry, have been notified in the Nepal Medical Council's list of recognised institutions.<sup>40</sup> These include both medical and dental colleges and institutions.

*Requirements for Registration of Foreign Doctors and Dentists:* Foreign medical practitioners seeking to practice in the country are required to register themselves with the Nepal Medical Council. The criteria prescribed by the Council include the following key aspects<sup>41</sup>:

- A filled application in the format of NMC for practice of medicine in a medical college or hospital for stipulated period.
- A photocopy of visa and passport attested by an NMC member or any permanently registered doctor authorised for the same.
- A good standing certificate from the council of the country which domicile country of the applicant.
- A recommendation letter for registration with NMC from chief of medical college or hospital.
- A letter of recommendation from HMG clearly stating the period and reason for appointment in that particular medical college or hospital.
- Copies of the relevant medical degrees
- Certificate of registration in other medical council if any.

It is not clear whether the above requirements are in respect of only the foreign institutional degrees that are recognised by the Nepal medical council. The exact period for which temporary registration can be granted is also not clear. As specified in Nepal's Schedule of

<sup>38</sup> *Ibid.*

<sup>39</sup> <http://www.catmando.com/gov/industry/fipd>

<sup>40</sup> <http://www.nmc.org.np/document/institutional.pdf>

<sup>41</sup> <http://www.nmc.org.np/registration/foreign.php>

commitments under the GATS, as discussed in Part 1 of this report, the Nepal medical council typically provides temporary registration for foreign doctors a maximum period of one year.

*Recognition of Foreign Qualified Nurses:* The Nepal Nursing Council has the power to recognise qualifications from other countries. It reportedly does not as yet have any arrangements for reciprocity with any other Nursing Councils.<sup>42</sup>

## Pakistan

### *FDI-related Requirements*

The foreign investment framework in Pakistan is governed by Foreign Private Investment (Promotion and Protection) Act 1976 read with the Protection of Economic Reforms Act, 1992 and the Board of Investment Ordinance, 2001. The Board of Investment is the body that regulated foreign direct investment in Pakistan.

Under the foreign investment regulatory framework 'hospitals and medical' services fall under 'social sector' and 100% FDI<sup>43</sup> is allowed subject to minimum investment US\$ 300,000.<sup>44</sup>

### *Domestic Regulations Regarding Qualification and Licensing Criteria for Medical Practitioners and Dentists and Nurses*

*Regulatory Authority:* The Pakistan medical and dental council established under the Pakistan Medical and Dental Council Ordinance, 1962, is the authority responsible for the regulation of the medical and dental profession in Pakistan.<sup>45</sup> The Pakistan nursing council established under the Pakistan Nursing Council Act, 1952, is the authority responsible for registration and licensing of nurses and midwives. Only persons possessing degrees recognised by the relevant councils and registered with such council can practice the profession of medicine, dentistry and nursing in Pakistan.

*Recognition of Foreign Qualifications and Reciprocal Arrangements:* Section 13 of the ordinance relates to the power of the medical and dental council to enter

into negotiations with appropriate authority within or outside Pakistan, for settling a scheme of reciprocity for the recognition of medical and dental qualifications. Section 14 provides that the federal government after consulting the council may accord recognition to a medical qualification granted by medical institution outside Pakistan. Section 16 provides for recognition of additional medical qualification granted by foreign or domestic medical institutions. Section 17 provides for registration of medical licenses and diplomas granted by medical institutions in or outside Pakistan, in accordance with the provisions of the ordinance.

Sections 18 and 19 contemplate recognition of qualifications granted by dental institutions in or outside Pakistan and their certification by the council. Under Section 23, the council maintains a register for registration of medical practitioners possessing qualifications, which are recognised medical qualifications under the ordinance.

The schedule to the ordinance listing the specific foreign degrees recognised, could not be obtained. However, since the Indian Medical Council Act specifies several medical degrees from Pakistan under the principle of reciprocity, it is likely that the Pakistan ordinance too lists degrees from several Indian universities that would be reciprocally recognisable in Pakistan.

With regard to Nursing, a copy of the Pakistan Nursing Council Act could not be obtained. It is therefore not clear whether nursing degrees from other countries are recognised in Pakistan.

## Sri Lanka

### *FDI-related Requirements*

The Controller of Foreign Exchange (under the Exchange Control Act) and the Board of Investment (earlier called the Greater Colombo Economic Commission created under the Greater Colombo Economic Commission Law, 1978), are the regulatory authorities for investment in Sri Lanka. Applications for foreign investment need to be made to the Controller of Foreign Exchange which refers applications to the Board of Investment.

Sri Lanka has three lists of sectors – one prohibiting

<sup>42</sup> <http://www.anmc.org.au/international/index.php>

<sup>43</sup> <http://investinpakistan.org/investment-laws.php>

<sup>44</sup> <http://www.pakboi.gov.pk/sectors.htm>

<sup>45</sup> However, the main functions of the Pakistan Medical and Dental Council are summarised in the judgement of the Pakistan Supreme Court, *Pakistan Medical and Dental Council v. Ziauddin Medical University & Others*, dated December 15, 2006, available at <http://www.pmdc.org.pk/judge.pdf>.

foreign direct investment, the other limiting foreign direct investment and a third list where prior approval of the Government is required for foreign direct investment. The hospital/health sector is not listed in any of the three lists.<sup>46</sup> Consequently, 100% FDI is allowed in the hospital sector in Sri Lanka.

However, in order to get incentives for development of hospitals a foreign investor should obtain approval of Board of Investment and undertake a minimum level of investment.<sup>47</sup> BOI incentives are granted to construct hospitals under the categories of 'Small or Large-scale Infrastructure'. In the case of other categories of investment, incentives will be granted depending on project characteristics.

### *Domestic Regulations Regarding Qualification and Licensing Criteria for Medical Practitioners and Dentists and Nurses*

*Regulatory Authority:* The Sri Lankan Medical Council is the regulatory authority for the medical, and nursing dental professions in Sri Lanka. Persons possessing qualification recognised by the Council are required to undertake a qualifying examination administered by the Council, before being registered for the practice of the medical or dental professions in Sri Lanka.

*Recognition of Foreign Qualifications and Reciprocal Arrangements:* The Council also prescribes the procedure for recognition of foreign medical degrees. The foreign degrees committee of the medical council is the authority responsible for evaluating applications for recognition of foreign medical and dental degrees. A foreign applicant seeking such recognition needs to apply to the committee. If the committee, after evaluation of the relevant documentation, recognises the degree, it may still require members of the medical council to visit the relevant school before according recognition.

If a foreign degree is accepted, the applicant is required to sit for a qualifying examination before registering with the medical council. Although a list of degrees recognised by the council could not be obtained, it is likely that medical degrees from at least India and Nepal are recognised under the principle of reciprocity,

since these countries have recognised degrees awarded by colleges in Sri Lanka. With regard to nursing, however, Sri Lanka reportedly recognised foreign degrees only from New Zealand, Australia, England and some countries in the middle-east.<sup>48</sup>

### ■ **CONSTRAINTS AND OPPORTUNITIES FOR TRADE IN HEALTHCARE SERVICES IN THE SAARC COUNTRIES**

This section assesses the impact of the regulatory constraints discussed above on the delivery of healthcare services under each of the modes of service supply. It also highlights how in certain aspects, presence of several operational level constraints also impacts delivery of service under a particular mode. These are then consolidated as aspects for discussion and negotiation under the SAARC framework for liberalisation of healthcare services. Mode 3 and FDI issues will be discussed first, followed by issues relating to Mode 2, i.e. 'consumption abroad' or medical tourism. Mode 1 on cross-border services and Mode 4 on movement of natural persons across borders to deliver medical services, will be discussed together since the regulatory opportunities and constraints for this aspect are very similar.

#### **Mode 3 Access: Regulations relating to FDI in the SAARC Countries**

UNCTAD's World Investment Report 2007<sup>49</sup> points out that social services such as health and education are among the industries with the lowest level of explicit restrictions on FDI. This is further corroborated in the above analysis. All the SAARC members, with the exception of Bhutan, allow for 100% FDI for setting up of hospitals, subject to certain terms and conditions. In fact this liberalisation is upwards of their GATS commitments discussed above. This is typically the case for most WTO members, partly because countries have been more willing to liberalise unilaterally than multilaterally, for various reasons, including their desire to maintain policy space.<sup>50</sup>

With respect to India there are no major regulatory constraints in the setting up of hospitals,<sup>51</sup> and this

<sup>46</sup> <http://www.boi.lk/BOI2005/content.asp?content=investinc3&SubMenuID=29>

<sup>47</sup> <http://www.boi.lk/BOI2005/content.asp?content=investopp14&SubMenuID=94>

<sup>48</sup> <http://www.anmc.org.au/international/index.php>

<sup>49</sup> UNCTAD, *World Investment Report 2007*, available at [http://www.unctad.org/en/docs/wir2007\\_en.pdf](http://www.unctad.org/en/docs/wir2007_en.pdf)

<sup>50</sup> *Ibid.*

<sup>51</sup> Rupa Chanda, *Foreign Investment in Hospitals in India: Status and Implications*, Study for WHO and the WTO-Cell, Ministry of Health and Family Welfare, 2007, page 14.

holds true for the other SAARC countries also given the liberal FDI regime. This has however not yet translated into flow of investments within the SAARC region for setting up hospitals. There is no factual data on how much cross-border intra-SAARC investments have been made in the health sector, however, there have been news reports regarding both the government and private companies from India setting up hospitals in Sri Lanka and the Maldives. Private investment in health services in the SAARC region is constrained by several other factors, some of which are discussed briefly below.

### *Operational Constraints on Foreign Investment in the Health Sector in SAARC Countries*

There are studies that have generally mapped the investment climate in the SAARC countries. The principal findings from the same are summarised below.

- A World Bank study with regard to ease of doing business in South Asia points out that all South Asian countries rank quite poorly in the World Bank's assessment of ease of doing business.<sup>52</sup> The World Bank report used indicators such as ease of obtaining clearances and permits in relation to land acquisition, labour requirements, taxation requirements, obtaining credit, contract enforcement and trade regulations. The report also notes regional and local variations within the same country, especially countries with federal systems like India. The South Asian rankings among 162 countries of the world are as follows<sup>53</sup>:

Worldwide Ranking	Country
53	Maldives
74	Pakistan
88	Bangladesh
89	Sri Lanka
100	Nepal
134	India

- The World Bank notes that all South Asian countries need to address contract enforcement and labour and trade regulations as a matter of priority in order to facilitate greater investments.

- Attractiveness for foreign investment in the health sector also depends on a web of other inter-related aspects, such as standards in respect of hospitals and health centres, accreditation and registration guidelines, and benchmarks for service delivery.<sup>54</sup> None of these aspects are addressed in the legal framework in any of the SAARC countries. There are also no independent regulatory bodies for maintaining standards and conducting regular audits of hospitals and nursing homes. In India, only a few states have laws relating to regulation of clinical establishments. The government is presently considering a Clinical Establishments (Registration and Regulation) Bill, to register, regulate and set standards for clinical establishments. Such an effort could be considered at the SAARC level as well in order to attract higher investments in health services.

### **Mode 2 Access: Constraints on Service Delivery**

As discussed none of the SAARC countries impose restrictions on entry of foreign patients for availing medical services. Movement of patients across borders, especially from all the SAARC countries to India as a destination of specialised health services in the region, exists.

A study in 2001 estimated that approximately 50,000 patients come from Bangladesh each year seeking treatment in Calcutta and other Indian cities.<sup>55</sup> The study also estimated that in the border areas of Bangladesh and India, there are agents who facilitate the process of obtaining medical services in India, and that several medical institutions in India have made arrangements with Bangladeshi clients, including special counters to deal with Bangladeshi patients, speedy treatment, concessional rates, and contacts between doctors in the two countries.<sup>56</sup> The same study also notes the migration of patients from Sri Lanka, Maldives, Nepal and Bhutan to India.

Despite such statistics, a major limitation which is true of most SAARC countries is the fact that there is a limited 'paying' consumer base who can afford high-end health services. Accessibility to health care both within a country, and access through Mode 2

<sup>52</sup> World Bank, *Doing Business in South Asia*, 2007

<sup>53</sup> World Bank, *Doing Business in South Asia*, 2007, Table 1.1

<sup>54</sup> Rupa Chanda, *Foreign Investment in Hospitals in India: Status and Implications*, Study for WHO and the WTO-Cell, Ministry of Health and Family Welfare, 2007, page 35.

<sup>55</sup> Rupa Chanda, *Trade in Health Services*, Working Paper No.70, ICRIER, November 2001, available at [www.icrier.org/pdf/WP-RUPA.pdf](http://www.icrier.org/pdf/WP-RUPA.pdf).

<sup>56</sup> *Ibid.*

(consumption abroad), is also limited because of lack of penetration of health insurance covers, and lack of portability of insurance coverage.<sup>57</sup> Another potential limitation is the issue of recognition of foreign medical degrees by an insurance service provider of a patient from another country.

#### Modes 1 and 4: Constraints on Service Delivery

Mode 1, i.e. the delivery of healthcare services from the territory of one country to the service consumer in another country, is a relatively undeveloped mode of supply. As noted in the introductory section of this chapter, while telemedicine is developing within countries like India, cross-border trade has been confined to limited export of telediagnostic and telepathology services from India to Nepal and Bangladesh.<sup>58</sup> Nevertheless it has significant potential especially with the emergence of information technology as a viable tool for such delivery.

Mode 4 dealing with temporary movement of medical professionals across borders for both educational purposes and temporary employment is an aspect which occurs to some extent in the SAARC region. On this issue, however, there has been no comprehensive research as yet that estimates in numbers or economic terms the movement of healthcare professionals in the SAARC countries.

Both Modes 1 and 4 hinge on the issue of 'recognition' of the medical professional providing the service in the country of the consumer availing of the service. The opportunities and constraints for both these modes of service delivery are therefore similar, and depend primarily on the regulatory environment for such recognition. This has already been discussed earlier and will be summarised here.

A formal structure of recognition of medical professionals qualified to practice in one SAARC country to provide services to consumers in another SAARC country either through Mode 1 or 4 is a necessary precursor for development of these modes of supply.

#### *Regulatory Requirements on Recognition of Qualifications and Licensing in the SAARC Region*

With regard to regulations governing the practice of

medicine and dentistry in the SAARC countries, the following general trends can be discerned. The similarities in trends could provide a good basis to initiate dialogue on mutual recognition agreements (MRAs) for the health sector.

- The practice of the professions of medicine, dental and nursing and auxiliary services is regulated by regulatory bodies constituted under law. The laws in practically all the SAARC countries have been modeled on the Indian statutes, hence they are similar in structure and provide scope for reciprocal arrangements in terms of recognising qualifications of other countries on a reciprocal basis.
- The law in each SAARC country mandates that only persons having the required qualifications from a university/ college recognised by the council, can register with the council. Such registration is mandatory for the practice the profession of medicine/dentistry/nursing, as the case may be.
- Inherent in the prescription of the degrees is prescribed internship and work experience, pursuant to which a degree is granted. These requirements are similar in all the countries. Sri Lanka is the only country where the relevant medical council prescribes an examination which needs to be undertaken prior to grant of the degree.
- Degrees awarded by foreign universities and colleges can be notified by the relevant medical/dental/nursing council as recognised for the purposes of registration. The procedure for notification of foreign degrees can be done both unilaterally by the relevant council; or as a result of a reciprocal arrangement between two councils.
- If a degree from a foreign university is not notified as being recognised by a council, there are no special test requirements that are provided for the registration of the concerned applicant.
- The Indian Medical Council Act has notified medical degrees from Bangladesh, Nepal, Pakistan and Sri Lanka under the reciprocal arrangement provision of the statute. This, by implication means that each of these countries also recognises degrees from notified universities and colleges in India.<sup>59</sup>
- With regard to dentistry, Nepal seems to recognise some Indian colleges on dentistry.

<sup>57</sup> Rupa Chanda, 'Trade in Health Services', Working Paper No.70, ICRIER, November 2001, available at [www.icrier.org/pdf/WP-RUPA.pdf](http://www.icrier.org/pdf/WP-RUPA.pdf)

<sup>58</sup> *Ibid.*

<sup>59</sup> The lists of foreign medical colleges recognised by India and Nepal were available. Both specify colleges from all SAARC jurisdictions, except Bhutan; but the reason for this is because Bhutan reportedly does not have a medical college: See Part 2.2 on Bhutan.

- However with regard to nursing and dental, there is no information on whether other SAARC countries have recognised degrees from each other.
- There are no explicit requirements for citizenship or residency to register with the relevant authorities for practicing the profession of medicine or dentistry in the relevant SAARC member.

## ■ CONCLUSIONS AND RECOMMENDATIONS

### Overview

The inclusion of services within the SAFTA framework presents several challenges and opportunities for the SAARC countries. Such an inclusion holds potential not just for ensuring greater intra-SAARC trade, but also holds the potential of raising the levels of competitiveness in the South Asian region as a whole. It has been estimated that the availability of services (especially tourism, health, education, and labour) within the SAARC region will help to attract consumers from other parts of the world, and that an advanced services infrastructure within the region will boost the regions' share in global services trade.<sup>60</sup> For facilitating this, several developments to liberalise both within each country, and at the regional level, will be necessary.

With respect to health services, as already discussed, 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. However, there are several other issues pertaining to supply of services under each mode, which need to be addressed as part of the negotiations. These are summarised below.

#### ***Recommendation 1: Investment Related Aspects Affecting Health Services, i.e. Mode 3 Service Delivery***

- *Address upgrading commitments to autonomous levels:* One of the aspects that comes out from the discussions in this chapter is that while none of the SAARC countries have committed Mode 3 in 'hospital services' as an area for complete liberalisation under the GATS framework, each of the

countries has achieved significant autonomous liberalisation in this Mode, and there are practically no regulatory impediments to Mode 3 in the regulatory framework of these countries. Only Maldives and Bhutan require specific government approval for joint ventures in the hospital sector. In all the other countries, 100% FDI is allowed.

As part of the SAARC negotiations, the upgrading of the GATS commitments to the autonomous levels achieved in the member countries, should, therefore, be an aspect for discussion.

- *Address Investment-related operational constraints at national and regional levels:* Operational constraints to investment need to be dealt with at the national level as a matter of legal and institutional reform. While this process needs to be undertaken at both the national and regional levels, investment related provisions investment related provisions under SAFTA could provide certain obligatory provisions offering special protection for foreign investors.
- *Constitution of a working group to address FDI related barriers:* The SAFTA currently does not envisage a chapter on Investment. It however mandates the SAFTA members to consider removing barriers to intra-SAARC investments.<sup>61</sup> Constraints to FDI as identified above could therefore be studied and attempt to be addressed under a joint working group of the SAARC members.

#### ***Recommendation 2: MRAs for Recognition of Medical and Dental Degrees between SAARC Members***

There are a number of similarities in the regulatory frameworks for recognition of qualifications and licensing of professionals in medicine, dentistry and nursing. Reciprocal arrangements for recognition of medical degrees exist among India, Bangladesh, Sri Lanka, Nepal and Pakistan. With respect to Maldives and Bhutan, these countries seem to recognise medical degrees at least from India and Sri Lanka. Internship and other work experience requirements for qualification are also similar in all the countries. There are no constraints in terms of citizenship and residency requirements in the regulatory framework.

<sup>60</sup> See, Shivraj Bhatt, "Services under SAFTA: How to make it work for South Asia?" Nepalnews.com, September 6, 2006, available at [http://www.bilaterals.org/article.php3?id\\_article=5780](http://www.bilaterals.org/article.php3?id_article=5780)

<sup>61</sup> Article 8, Agreement on SAFTA.

To formalise the movement of doctors across SAARC countries, therefore, it may be desirable to have mutual recognition agreements (MRAs) on recognition of qualifications for doctors, dentists and nurses. Such MRAs will have a positive impact in facilitating service delivery through both Modes 1 and 4. At a minimum, such MRAs should address the following aspects:

- Ensure that the relevant medical, dental and nursing councils from each SAARC country recognise medical and dental qualifications provided in other SAARC countries. As a first step, such recognition may be confined to degrees awarded only by specific institutions in each of the countries, and may subsequently be reviewed and expanded to a larger list of institutions
- Recognition of qualifications needs to be accompanied by streamlining the process of application for registration with the relevant councils. An aspect to be explored is whether recognition by a medical, dental or nursing council in any SAARC member can be automatically recognised by the relevant council in another SAARC member. This would mean, for instance, that a doctor qualified and registered with the medical council of India need not go to each SAARC member and complete the registration formalities in such member; but will be automatically recognised in such member by virtue of his/her membership of the medical council of India.
- Such an MRA should also address standards of service delivery.

### ***Recommendation 3: Measures to Encourage Mode 2 in Health Services Delivery***

As discussed in this chapter, there are no regulatory constraints for mode 2 delivery of services. However, factors such as lack of insurance portability limits access for a service consumer. This needs to be addressed at the level of each member state.

- *Ensure portability of insurance coverage and recognition of foreign medical degrees by insurance companies:* This aspect needs to be addressed at the national level in each SAARC member. The agreement between the SAARC members should recognise this as a key factor for development of Mode 2 supply of service. Each member should also undertake to ensure that health insurance service providers within their territories extend the coverage for treatment in any SAARC country.
- *Provide expedited Medical Visas:* ‘Medical visas’ as a separate category is recognised under the Indian regulations pertaining to Immigration and Visas. Expedited mechanisms for consideration and grant of medical visas between all SAARC members needs to be considered.

# 15 ■ Prospects for the Telecommunication Sector under SAFTA<sup>1</sup>

## ■ INTRODUCTION

The dynamism of global telecommunications markets is widely attributed to rapid technological development and an increasingly liberal policy environment. Over the last few years many Asian economies including, SAFTA countries, have begun a process of telecom liberalisation which has resulted in significant expansion of telecom networks in these economies. While the timing of telecom reform and liberalisation differs among SAFTA countries, there are certain commonalities in the reform process. All countries have introduced competition in the provision of telecommunication services that has resulted in dramatic reduction in the pricing of these services. Further, introduction of competition in a sector once considered a natural monopoly has necessitated setting up of an independent regulator.

Another striking similarity among all SAFTA countries (except Bhutan, who is not a member of the WTO) is the nature of the commitments made in telecommunication services under the GATS. The scheduled commitments of these countries in the telecommunications sector have been rather moderate when compared to the commitments made by certain other WTO members and even when compared to the applicable regime in each country.

The Uruguay Round, for the first time, brought services into the multilateral trading system. The GATS, which came into force in January 1995, established rules and disciplines governing trade in services. The Agreement aims at progressive liberalisation of trade in services through successive rounds of negotiations. One of the few sectors in which progress was possible under the Uruguay Round was telecommunication. The slow progress of multilateral liberalisation has prompted several countries – both developed and

developing, to enter into bilateral/regional agreements in order to increase the pace of liberalisation. SAFTA is one such regional block.

Factors such as similar regulatory regimes, trade complementarities, economies of scale in regional services integration and network externalities have encouraged countries to opt for the bilateral/regional routes (Hockman and Braga 1997, Rajan and Sen 2002). A unique feature of the post-Uruguay Round agreements or the ‘New Age FTAs’ is that they not only liberalise trade in goods but also trade in services, investment and trade facilitation among others. Telecommunications, inter-alia, has been a popular services sector on which efforts to liberalise have concentrated. Other sectors are transport, finance, and IT (Mukherjee and Ahuja 2006).

The objective of this chapter is to compare the commitments made by SAFTA countries in the telecom sector and to juxtapose those commitments against the applicable regime. It discusses the recent trends and developments in the telecommunication sectors in the SAFTA countries and identifies areas of further reform. The structure of the paper is as follows: The first section discusses the coverage of telecommunication sector under the GATS. The second section analyses the developments in the telecom sector in the seven countries. The third section evaluates multilateral liberalisation in the sector. The fourth section discusses domestic liberalisation and compares it to the WTO commitments for each country. The last section draws the main conclusions.

## ■ COVERAGE OF THE SECTOR

The telecommunication sector covers a wide range of services. The *Annex on Telecommunications* in the GATS defines ‘telecommunications’ as the transmission

<sup>1</sup> The chapter is based on the report authored by Rajat Kathuria.

and reception of signals by any electromagnetic means. The Annex further defines 'public telecommunications transport service' as any telecommunications transport service required, explicitly or in effect, by a member to be offered to the public generally. Such services may include, *inter alia*, telegraph, telephone, telex, and data transmission typically involving the real-time transmission of customer-supplied information between two or more points without any end-to-end change in the form or content of the customer's information. It also defines 'public telecommunications transport network' as the public telecommunications infrastructure which permits telecommunications between and among defined network termination points.

During the Uruguay Round of WTO negotiations, members drew up a Services Sectoral Classification list (MTN.GNS/W/120) from the United Nations Central Product Classification (UNCPC) for the purpose of negotiations. In the W/120 classification, telecommunication services are covered under communication services.<sup>2</sup> (Table 15.1) compares the W/120 classification with the UNCPC. Under W/120 telecommunication services are subdivided into two broad categories: basic services and value-added services. These are further subdivided into 14 sub-sectors and a category 'others'<sup>3</sup> as shown in Table 15.1.

As shown in Table 15.1 of the Appendix, there are differences in W/120 classification and UNCPC. GATS

**Table 15.1 Classification of Telecommunication Services under W/120**

<b>Basic Telecommunication</b>	Voice telephone service Packet-switched data transmission services Circuit-switched data transmission services Telex services Telegraph services Facsimile services Private leased circuit services
<b>Value-added Services</b>	On-line information and/or on-line data processing (including Transaction processing) On-line information and data base retrieval Electronic data interchange (EDI) E-mail Voice mail Enhanced/value-added facsimile services, incl. Store and forward, store and retrieve Code and protocol conversion
<b>Others</b>	

Source: Compiled from WTO (8th December, 1998) S/C/W/74

<sup>2</sup> Other 'communication services' are postal services, courier services, audio-visual services and others.

<sup>3</sup> The category 'others' covers everything else that is not included in the listed sub-sectors.

<sup>4</sup> CPC is not mentioned.

<sup>5</sup> CPC is not mentioned.

definition does not cover all services included in UNCPC and the latter itself has gone through several amendments over the years. Given the rapid pace of technological development in telecommunications, the classification of services inevitably becomes obsolete as new services are introduced. Moreover, the distinction between several sub-sectors has become blurred with the adoption of new transmission technologies, and the advent of service suppliers who distinguish themselves not by specialisation in particular telecom services, but by the market segment they service. Although the GATS classification is to some extent outdated, the use of W/120 is not mandatory and governments do have their own sets of classifications; most members have used this classification for scheduling commitments in the Uruguay Round and for submitting requests and offers in the Doha Round (Mukherjee and Ahuja 2006).

For example, the United States in its revised offers has made minor modifications to the W/120 classifications. US has introduced another category of services – other communications services, which include services having characteristics of both audio-visual and telecommunications services. These include cable services provided over cable system,<sup>4</sup> one-way satellite transmission of DTH (Direct-to-Home) and DBS television services and of digital audio-visual,<sup>5</sup> programme transmission services (CPC 7524), television broadcast transmission services (CPC 75241), radio broadcast transmission services (CPC 75242) and radio and television combined program making and broadcasting services (CPC 96133). In its revised offer EU on the other hand has used the classification of telecom services as found in the Annex on Telecommunication Services to the GATS. By classifying telecom services as the services of 'transmission and reception of signals by any electromagnetic means' it avoids some of the uncertainty in the existing classification. It is also neutral across different business models, ways of providing services, and technology. While the classification proposed by EU is contemporary and covers *only* economic activities which require telecommunications services for their transport or delivery and not content, members are unlikely to support it, since it introduces an element of risk as to what they may be 'giving up' in their schedules of commitment as a result of the reclassification. To retain control over the character of

the commitments, countries would therefore like to persevere with the existing classification of the GATS, even though it is recognised to be out of date. For example, in the Indo-Singapore CECA (signed on 29 June 2005 and came into force on 1 August 2005), telecommunication services are defined following a positive list approach, like in the GATS.<sup>6</sup>

### ■ RELEVANT PROVISIONS OF GATS AND OTHER RULES AND DISCIPLINES FOR TELECOMMUNICATIONS

The WTO rules and disciplines for telecom comprise the GATS, the Annex on Telecommunications (hereinafter the Annex) and the Schedules of commitments made under the GATS. In addition, the Reference Paper provides the basic thrust of major regulatory disciplines that are relevant to telecom services. The Annex recognises ‘the specificities of the telecommunications service sector and, in particular, its dual role as a distinct sector of economic activity and as the underlying transport means for other economic activities’, i.e. importance of telecommunications as an input for other sectors.

The Annex comprises seven sections, with the core obligations contained in the section on access to and use of ‘public telecommunications transport network and services’ (or PTTNS). These require WTO members to ensure that access to and use of the PTTNS are allowed on reasonable and non-discriminatory terms for the supply of services included in its schedules. This would be true even when no basic telecom service commitments have been made by the government in its schedule, and whether or not such PTTNS is supplied by a monopoly or through competition. Inasmuch as a Commitment in a Member’s schedule on basic telecom services is for the supply of these services, access to and use of PTTNS on reasonable and non-discriminatory terms is a mandatory requirement under the provisions of this Annex. In addition, there is recognition of the need for maintaining security and confidentiality of messages, safeguarding universal service and other public obligations, and protection of the technical integrity of the networks.

Several governments felt that explicit regulatory principles should be drawn up for basic telecom services, particularly in order to guard against anti-competitive behaviour by incumbents. This was based

on the view that the telecom sector normally has a dominant supplier who could alter the market situation to the disadvantage of a newcomer. Further, an

**Table 15.2 WTO Reference Paper: Definitions and Principles**

Definition/Principles	Description
Definitions	The Reference Paper applies rules to ‘major suppliers’ of telecommunications services who have ‘control over essential facilities’ or uses its position to ‘materially affect the terms of participation’.
Competitive Safeguards	Governments must take appropriate measures to prevent suppliers of telecommunications services from using anti-competitive practices such as cross-subsidisation, apply information obtained from competitors in an uncompetitive manner, or denying competitors access to relevant technical information.
Interconnection	Governments must ensure that major suppliers provide interconnection of their networks to other service suppliers at ‘any technically feasible point in the network’. Major suppliers will offer interconnection that is non-discriminatory, timely, and at a rate and quality ‘no less favourable’ than that provided for its own subsidiaries or affiliates.
Universal Service	Governments may set universal service obligations, as long as they are administered in a transparent, non-discriminatory, competitively neutral manner and are not more burdensome as necessary in reaching their policy objectives.
Transparency	Under circumstances where licenses are required, the licensing criteria, timeframe, and terms and conditions are to be made publicly available. Upon the request of the applicant, the reasons for denial of a license will be made known.
Independent Regulators	The regulatory body must be separate and not accountable to any supplier of basic telecommunications services and that its procedures be impartial.
Allocation and Use of Scarce Resources	Government procedures for the allocation and use of scarce resources, such as frequencies and numbers, must be objective, timely, transparent and non-discriminatory.

Source: Compiled from [www.wto.org](http://www.wto.org)

<sup>6</sup> A positive list approach gives countries the flexibility to choose the sectors/sub-sectors and modes within those sectors/sub-sectors for making commitments.

efficiently functioning telecom market requires appropriate linking up ('interconnection') of the established and new suppliers, while guarding against anticompetitive behaviour. A reference paper (RP) (see Appendix 15) was, therefore, prepared which laid down regulatory disciplines that were considered necessary for promoting competition in this sector. Adherence to these principles, however, is voluntary and subject to whether or not WTO Members inscribed them into their schedules as additional commitments.

The reference paper has been described as the touchstone for telecommunications services negotiations (see Table 15.2). It elucidates principles necessary for facilitating and sustaining a competitive telecoms sector, thereby recognising the vital role a competitive telecom sector plays in its own development as well as in growth of other sectors that use telecom services as input in the production process. Liberal telecom regimes such as those in Western Europe and United States have fully subscribed to the principles enshrined in the RP. SAFTA country commitments to the RP, in particular, and under GATS in telecom in general have both been modest. This is surprising since the applicable regime in individual countries in SAFTA is far more liberal than the commitments made under GATS. The revised offers, where available also do not bridge this gap. The reasons are discussed later in this chapter.

### The Schedules of Commitment

Article XX of the GATS provides that WTO members should inscribe their specific commitments in their Schedules. The Schedules of commitments specify both the telecommunication service sector (the sub-sector) in which commitments have been undertaken by a WTO member, and the nature of these commitments with respect to market access and national treatment. These commitments are made separately for each mode of service supply. In certain cases, members have undertaken additional commitments (on licensing and regulatory principles) in their schedule of commitments. While one schedule specifies the conditions and qualifications attached to market access and national treatment by members, another Schedule contains the MFN exemptions specified by countries.

With respect to market access commitments inscribed in the schedule, certain types of limitations (separately for each mode of supply) may be maintained only if, and to the extent, it is specifically mentioned in the Schedule. The types of limitations that may be specified for market access are:

- limitation on the number of suppliers
- limitations on the total value of service transactions or assets
- limitations on the total number of services operations or on the total quantity of service output
- limitation on the total number of natural persons that may be employed
- measures which restrict or require specific types of legal entity or joint venture limitations on the participation of foreign capital.

With respect to national treatment for any specified service, members can specify conditions and qualifications so as not to give full national treatment. The exceptions to national treatment can take the form of different treatment with respect to tax measures, nationality or residency requirements, licensing standards, criteria relating to qualifications, and requirements for obtaining authorisation for providing the service.

Based on an interpretative note issued by the Chairman of the negotiating group on basic telecom, an understanding was developed that unless specified, the scheduled commitments would cover all the relevant dimensions of basic telecom services in terms of:

- local, long distance and international services
- public and non-public services
- supply on a facilities basis or through resale
- technology-neutrality with respect to supply by cable, radio, satellites, stationary and non-stationary means.

As is well known, negotiations are conducted on a request offer approach, ultimately culminating in commitments by individual countries. Based on information available currently, the following members have submitted 69 initial offers:

Albania; Argentina; Australia; Bahrain; Barbados; Brazil; Brunei Darussalam; Bulgaria; Canada; Chile; the People's Republic of China; Taipei, China; Colombia; Costa Rica; Croatia; Cuba; Dominica; Dominican Republic; El Salvador; Egypt; European Communities and its member states; Fiji; Former Yugoslav Republic of Macedonia (FYROM); Gabon; Grenada; Guatemala; Guyana; Honduras; Hong Kong, China; Iceland; India; Indonesia; Israel; Jamaica; Japan; Jordan; Kenya; Korea; Liechtenstein; Macao, China; Malaysia; Mauritius; Mexico; Morocco; New Zealand; Nicaragua; Norway; Oman; Pakistan; Panama; Paraguay; Peru; Philippines; Qatar; Saint Kitts and Nevis; Saint Lucia; Saint Vincent & the Grenadines;

South Africa; Singapore; Sri Lanka; Suriname; Switzerland; Thailand; Trinidad and Tobago; Tunisia; Turkey; United Arab Emirates; United States; Uruguay.

Several initial offers have been derestricted by the member concerned and are publicly available on the WTO website.<sup>7</sup> In addition, some members have made their initial offers, or summaries thereof, publicly available on their internet sites. Since 19 May 2005, the following members have submitted 30 revised offers: Australia; Bahrain; Brazil; Canada; Chile; the People's Republic of China; Taipei, China; Colombia; Egypt; European Communities and its member states; Honduras; Hong Kong, China; Iceland; India; Japan; Korea; Liechtenstein; Macao, China; Malaysia; Mexico; New Zealand; Norway; Peru; Singapore; Suriname; Switzerland; Thailand; Turkey; United States; Uruguay. Several revised offers have been derestricted by the Member concerned and are publicly available on the WTO website.

## ■ LIBERALISATION IN TELECOMMUNICATION SERVICES UNDER THE URUGUAY ROUND

This Section is based on a combination of recent information and the WTO Document of December, 1998. The overall picture is the same with each of these two information sources.

### *Classification of Telecommunications Service Sectors and the Commitments made by Various SAFTA Members*

Section 1 described the classification of telecom services into seventeen categories (mentioned in the first column of Table 15.1 above); fourteen of which are ordered from 'a' to 'n', and three 'other' categories under 'o'. Though these services are classified separately in the list, the ongoing convergence arising due to technological and market development is blurring the distinction among some of these categories. Given convergence, provision of packaged or bundled services by the same operator will increasingly become a norm in the future. Members therefore have adapted the WTO classification in their commitment and offer schedules, due not only to convergence but also on account of their own requirement. For example, in its schedule, Bangladesh distinguishes between telecom services for public and private use and has introduced a category called Gateway Earth Station services. Nonetheless, given the nature of information available,

this section will provide the relevant details based on the seventeen sectoral classifications.

As of January 2000, 93 WTO members had included telecommunications services in their Schedules of Commitments. Basic telecommunications is included in the schedule of commitments of 83 WTO members and value-added services have been committed on by 72 member governments. In addition, 72 members have committed on some or all aspects of the reference paper. Of these, 66 have accepted the reference paper in its entirety or with minor modifications. All industrialised countries have taken commitments on basic telecommunications, most value-added sectors, and the reference paper. Industrialised countries operate an extremely liberal telecom regime and have largely bound the applicable regime in their schedules. On the other hand SAFTA countries (excluding Bhutan, who is not a member), have made limited commitments in telecom. Only Sri Lanka has fully committed to the principles enshrined in the reference paper, while Maldives has made no commitments at all. Even the commitments made by SAFTA countries in telecom are meaningless when compared to the prevalent regime in the respective countries. This is further discussed later.

### *The Nature of Commitments made in the Schedules Including the Types of Limitations on National Treatment and Market Access by SAFTA members*

As stated, SAFTA countries have made partial commitments. Further, such partial commitments were made much more for the mode of supply 'commercial presence', than for other modes of supply. Another noteworthy feature is that the 'incumbent government monopoly' has been accorded preferential treatment, viz., an automatic license or mandated use of facilities owned by it. For 'national treatment', most limitations relate to 'nationality requirement', followed by limitations relating to residency requirement, authorisations requirements, and ownership of property land. The number of limitations for 'market access' are much more than those for national treatment. These relate mainly to limitations on number of suppliers, types of legal entities, and participation of foreign capital.

With regard to accounting rates, there was general appreciation among WTO members that the accounting rate regime in place would not be able to withstand the pressures brought about by competitive markets. It was, therefore decided to secure a shared understand-

<sup>7</sup> [www.wto.org](http://www.wto.org)

ing that Members would not challenge each other's accounting rates under the WTO's dispute settlement regime. Further, it was agreed that the understanding would be reviewed no later than the commencement of the new services negotiations, from 1st January 2000. However, certain countries included exemptions to the MFN rules with respect to their accounting rate systems. 4 of 6 SAFTA members included exemptions in their schedules.

### Country by Country Commitments and Offers and a Comparison with the Applicable Regime

#### *Bangladesh*

Bangladesh is one of the poorest, most densely populated, and LDCs in the world. Its fixed line teledensity (about 1%) remains the lowest in South Asia. The overall situation in the country's telecom sector has been improved to some extent in recent times by a rapidly expanding mobile market. After a number of years of strong growth, mobile penetration reached about 22% at end of July 2007, at par with most of its regional neighbours. However, with almost 99% of homes lacking a telephone and with a four year waiting list for fixed-line services, the country is still struggling with some of the most underdeveloped telecommunications infrastructure in the world. About 80% of the telephone lines are in Bangladesh's four main cities, while 80% of the population lives in some 86,000 rural villages. Fixed lines services are mostly provided by the state-owned Bangladesh telegraph and telephone board (BTTB), while mobile services are provided by six private operators.

It is expected that the government will continue to vigorously pursue the de-regulation process. Expanding the national telecom infrastructure remains a priority. A critical factor is that Bangladesh has some of the most underdeveloped telecommunications infrastructure in the world. The national telecommunications policy, issued in March 1998, offers broad intentions for market liberalisation. The Bangladesh telecommunications regulatory commission (BRTC), established in January 2002, is pushing new initiatives to open up competition in local loop services, rationalise the spectrum policy and establish formal controls over interconnection to stimulate penetration and improve quality of service.

Several significant initiatives have been taken by BRTC as of early 2004. Absence of an effective interconnection regime had been one of the major weak-

nesses of the sector. Service providers were prone to predatory pricing and to refusing access to competitive operators. An estimated 85% of calls originating on mobile networks failed to complete on the public switched telephone network. This forced subscribers to maintain accounts from multiple providers due to the challenges of connecting calls between networks. Over time, GrameenPhone has emerged as the largest mobile provide and dwarfs both fixed line and mobile competitors in number of subscribers.

After years of delay, an interconnection regime has finally been put in place with performance, service quality, network availability or pricing obligations imposed by the Government. Following resolution of the interconnection issue, the fixed line network was thrown open to competition. Four Licenses have been issued in September 2007, but BTTB expectedly remains the dominant operator. The benefits of introducing competition in PSTN will appear in the near future.

Other topics that have been high on the government's list of priorities include VOIP. The gray market for Internet telephony has exploded in recent years. BTRC has announced an international long distance policy (ILDLP) 2007 which invited bids for licenses to operate international gateways and VOIP services. The ILD market is finally gearing up for 'legitimate' competition, which until now was being provided by grey market VOIP providers. Other important initiatives include the restructuring and corporatisation of BTTB, and comprehensive technical assistance for BTTB, BRTC and the Ministry of Post and Telecommunications.

Comparison of the applicable regime described above and the commitments made by Bangladesh in 1997 reveals a significant disparity (see Appendix, Table 15.3). Bangladesh has committed to license only two operators, in addition to the Government operator, to supply domestic long distance and local voice services as well as transmission facilities (leased circuit services). Crucially however, no bypass of government owned operator is permitted. The commitment however, included full competition in voice and data transmission over closed used groups and for internet access services.

**Table 15.3 Key Telecom Indicators for Bangladesh**

Population	144
Fixed lines	1.44
Fixed teledensity	1%
Mobile phones	32.37
Mobile density	22%

<http://www.btrc.gov.bd/circular.htm>

For cellular mobile it committed to four suppliers in addition to the government owned operator. The commitment also included the possibility of review of regulatory principles in the future. International Long Distance, however, remained a government monopoly and no bypass of the network facilities owned by the government has been permitted.

Bangladesh also submitted an MFN exemption list to permit the government or the government-run operator to apply differential measures, such as accounting rates, in bilateral agreements with other operators or countries. Bangladesh has not submitted an offer to the WTO or at least it is not available in the public domain.

The fact that the applicable regime is not bound for Bangladesh, (and for that matter for all SAFTA countries) cannot be for reasons to protect the incumbent supplier and gradually introduce it to competition.<sup>8</sup> The reality on the ground is that competition already exists, and while the commitment does not permit bypass of government owned operator facilities, the applicable regime in Bangladesh is vastly different. An interconnection regime is in place and private long distance operators can carry traffic both within and outside the country. The reason must be therefore be found elsewhere. Binding the applicable regime under GATS rules out the possibility or at least makes it difficult to backtrack on liberalisation. However, entry restrictions in telecom are becoming increasingly difficult to justify given technological progress and the acknowledged benefits of competition. Therefore, the option value of 'backtracking' is also unlikely to provide the answer. The only real possibility is that Bangladesh like other SAFTA countries will look to trade off increased market access in telecom under GATS to secure benefits in sectors of their comparative advantage, such as Mode 4.

### *India*

Prior to the liberalisation of the 1990s, the telecommunication sector in India was under a public monopoly, which was then considered essential due to the public good nature of the services. In the 1990s, Indian government gave up its monopoly and gradually introduced competition to enhance investment, improve productivity and the growth rate. The entry of private and foreign players led to significant expansion in telecommunication network, introduction of new technologies and striking improvement in productivity.

As a consequence, India, today, has one of the largest telecommunication networks in the world. Given the rapid growth of the sector and huge investment potential, the country is an attractive destination for foreign direct investment. On its part, India needs to enhance the growth of telecommunication sector to sustain its global competitiveness in knowledge-based services.

Before the mid-1990s, government was the sole provider of telecommunication services in India and all telecommunication services were provided by the incumbent monopoly – department of telecommunication (DoT). The first step towards deregulation was the announcement of the national telecommunication policy (NTP 1994). Although NTP 94 was a major step towards liberalisation, there were some problems in its implementation, among them being the non existence of an independent regulator (Kathuria 2007).

The inadequacies of NTP 94 led to the formulation of a new, more elaborate policy – NTP 99, which tried to infuse more competition in the sector and also recognised the role of investment in the economy and convergence of IT, media, telecommunication and consumer electronics. It envisaged provision of telecom services to all Indian villages at affordable prices and the provision of high-level services. It led to a shift to a system of one-time entry fee combined with revenue sharing payments from the license fee bid system, while duopoly rights were discontinued in order to allow for unlimited competition. The private sector was allowed to provide domestic long-distance services and, from April 2002, international long distance voice services, with no restriction on the number of participants.

In the past 15 years, telecommunication sector of India witness major changes due to liberalisation and technological changes. Today, there are no restrictions on the entry of new players in basic, national long distance (NLD), international long distance (ILD), internet service provider (ISP) and infrastructure businesses. Four operators are allowed in cellular mobile in each service area. This has led to intense competition and a downward trend in tariffs. Some of the strategies being employed by service providers to compete in the market are bundling, segmentation across subscriber types, customisation, etc. Due to intense competition, many private players found it difficult to remain financially viable. This led to mergers and acquisitions and emergence of few big players. India, now, has one of the largest telecommunication networks in the world and its regulatory regime is at par with international developments.

<sup>8</sup> The classic infant industry type of protection.

India's telecom renaissance has been remarkable. After 44 years of government monopoly, market liberalisation introduced in 1991 has led to a 10-fold increase in the number of phones in just 15 years. India's network is one of the largest in the world and, after the People's Republic of China, second largest among emerging economies. Given the persistent low telephone penetration rate compared to industrialised countries, but high levels of overall economic growth, the telecom sector offers vast potential. The mobile market recently topped 200 mn customers. It is therefore not surprising that India is one of the fastest growing telecom markets with an average annual growth of about 22% for basic telephony and over 100% for cellular and Internet services.

Recognising that the telecom sector is one of the prime-movers of economy, the Government's regulatory and policy initiatives have been directed toward establishing a world-class telecommunications infrastructure. Capital requirements are considerable. India requires investments of at least \$69 bn by 2010. India's telecommunications sector is now among the most deregulated in the world and presents potentially lucrative opportunities for service providers and equipment vendors alike. Companies that have successfully seized the opportunity are Agilent, AT&T Cisco, HP, Hughes Network Systems, Lucent Technologies, MCI Motorola, Qualcomm, Sprint and Tekelec.

**Table 15.4 Key Telecom Indicators for India**

Population*	1110
Fixed lines*	51
Fixed teledensity	5%
Mobile phones*	220
Mobile density	20%

\* million

Source: www.trai.gov.in

Comparison of the applicable regime described above and the commitments made by India (1997) reflect the limited nature of the commitments made by India (See Appendix Table 15.4). India undertook the following commitments in 1997:

- For voice telephony
  - there will be of one operator other than DOT/MTNL in each service area for a period of 10 years after which the position will be reviewed
  - The private operator should be a company registered in India in which total foreign equity must not exceed 25%
- The service operator will be permitted to provide long distance service within the licensed service area only
- Resale of voice telephony will not be permitted, but licensees can grant franchises for providing public call offices service
- In the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.
- For circuit-switched data transmission services
- For facsimile services
- For private leased circuit services
  - The private operator should be a company registered in India in which total foreign equity must not exceed 25%
  - The service operator will be permitted to provide long distance service within the licensed service area only
  - In the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.
- For cellular mobile telephony
  - There will be two cellular operators in each service area, including one public sector operator
  - The private operator should be a company registered in India in which total foreign equity must not exceed 25%
  - The service operator will be permitted to provide long distance service within the licensed service area only.
- Has MFN exemptions with regard to accounting rates.
- Additional commitments taken are as follows:
 

Commitment to a revised text (i.e. revised by India for its purpose) of the reference paper for regulatory framework. This revised text either deletes some provisions from the reference paper or alters it to clarify India's commitment. Appendix Table 15.4 compares the relevant text of the reference paper and the commitment made with respect to those provisions by India.

Compared to the commitments made by India in the last round, the current offer (2005) covers new areas. The restriction that only licensed voice telephony service providers can provide data, facsimile and private leased circuits has been dropped from India's list of offer, as has been the constraint to deploy only GSM technology for cellular mobile service provision. India has thus offered to maintain technology neutrality in

the grant of cellular mobile licenses. Additional commitments to review the opening of the national and international service have been deleted in India's latest offer. In any case, these had become redundant given domestic developments. Further there is now no restriction on the number of players in Basic, national and international service. India has committed to unlimited competition in these service segments. The commitment to allow foreign equity participation of 25 % has been relaxed to 49% in all categories except ISPs. For ISPs the offer has been enhanced from 51% to 74%. In the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required. Perhaps, this provides the window for enhanced foreign equity participation subject to FIPB approval which is normally done on a case to case basis. While the revised offer shows significant improvement over the Uruguay Round commitments and initial offer (submitted in January 2004), it is significantly less than the existing liberal regime.

If India were to bind its existing regime in telecom there are perhaps no concessions that India can leverage in the telecom sector itself due to the following reasons:

- One, there does not seem to be any major constraint on India's telecom operations in developed countries, including with respect to any planned investments in other countries. In general, Indian telecom companies are not planning major investments in telecom ventures in large markets; in any event, there is considerable flexibility provided in these markets in case Indian firms contemplate operations there. In certain cases where investment abroad may be considered by the major Indian companies, request for such investment comes from the Governments of the countries concerned, such as Sri Lanka, Nepal and Afghanistan.
- Two, currently for the near future, the Indian market is likely to be the focus of attention for the Indian players. As described in detail above, the sector in India is on the verge of a second burst of high growth due to the opportunities in rural areas and as a result of coming of 3G. In such a scenario, the major Indian providers such as Airtel, Tata Tele Services, Vodafone-Essar, BSNL/MTNL, and Idea will focus on consolidating their business in the Indian market. And finally, although telecom is a growing market there is intense competition among domestic players in developed markets to make such new entry unattractive for Indian companies.

The only real possibility is that India like other SAFTA countries will look to trade off increased market access in telecom under GATS to secure benefits in sectors of their comparative advantage, such as Mode 4.

### *Pakistan*

For many years Pakistan adopted a traditionalist approach to the telecommunications sector. The state monopoly served as a cash cow: rate rebalancing was largely ignored; international traffic was constrained; investment was directed disproportionately toward rural areas; and taxation on both carriers and consumer devices slowed market demand. Pakistan has recently embraced dramatic steps to reform the sector, best captured as three broad themes:

- Opening the market for basic fixed line services to competition through minimal licensing requirements;
- Renewing efforts to restructure and privatise Pakistan telecommunications corporation limited (PTCL), the incumbent operator; and,
- Updating its mobile sector policy, including introducing two new operators in 2004.

The benchmark legislation for telecom is the *Pakistan Telecommunication (Re-Organisation) Act 1996*. The Law established the regulator, the Pakistan telecommunication authority, PTA; created PTCL as a statutory corporation (which was later partially privatised through a public market listing); and granted PTCL a monopoly over basic services until 31 December 2002, among other matters. The PTA was initially embedded within the ministry of information technology (MoIT), the highest policy body for the sector.

The first significant step of the government's liberalisation program was to open the fixed-line sector to competition. In July 2003 the government published the *Telecommunication De-regulation Policy*. The policy codifies the scope and rights for competitive entry in basic services, and sets broad terms for interconnection. The centerpiece is the establishment of two new categories of basic services licenses: Local loop (LL), for fixed line telecommunication within the 14 PTCL regions, and Long-distance and International (LDI), for connectivity among regions. In March 2004, the government opened both classes of license to general competition. The process specifically allows participation by foreign firms. The registration fee for a LL license is \$10,000 per region. For the LDI license, which

includes rights to provide international connectivity, the fee is \$500,000 plus a \$10 mn performance bond. LDI licensees will also be subject to 'stringent requirements of technical and financial capability, experience and roll out,' including specific targets for deployment; the objective is to raise the barriers of entry to encourage strategic operators. Companies can obtain permission to operate in multiple service areas, or to combine LL and LDI franchises. License duration for both is 20 years. Fees for any spectrum required are subject to separate licensing fees. Tariffs on both types of licensees are not regulated for carriers that do not have significant market power. After a long history of monopoly control, liberalisation of the basic services sector, however has not met with much success. In fixed local loop, PTCL controls 98% of a market which is showing signs of stagnating. Overall fixed phone service saw a negative growth of 5% in the quarter ended March 07 and total subscribers were 4,995,902.

Beginning February 2004, additional competition was introduced in mobile telephony in Pakistan. An auction was held 14 April 2004, with winning bids submitted by Norway-based Telenor and UAE-based Warid Telecom. The net effect of introducing additional mobile competition has been overwhelming. As a result of competition, mobile sector in particular and the telecom sector in general in Pakistan is booming. This year the annual growth rate of mobile telephony segment was 80%, taking the total number of subscribers to over 70 mn. With the entry of two new telecom players in 2004, mobile telephony is witnessing intense competition and as a result prices have fallen substantially. As on date there are 6 cellular service providers in the country. In a recent development, Paktel was taken over by China Mobile for an amount of \$460 mn. This deal has the potential to shakeup entire mobile market and also reflects the attractiveness of the Pakistani market.

Pakistan has sixteen international long distance players. A growth of 173% was registered in long-distance traffic though due to intense competition and low tariffs profits remained low. In the WLL segment four players have started operations. Pakistan introduced this technology in 2004, and since then average quarterly growth has been 39%. On the Internet front, the DSL segment grew at 82% whereas Dial Up had a slower growth of 14%. Total number of DSL subscribers however remained very low at 26,611. Total FDI

inflow in the telecom sector in last three years was more than \$3 bn.

**Table 15.5 Key Telecom Indicators for Pakistan**

Population	159
Fixed lines	4.73
Fixed teledensity	2.97%
Mobile phones	70.01
Mobile density	44%

Source: [www.pta.gov.pk](http://www.pta.gov.pk)

Comparison of the applicable regime described above and the commitments made by Pakistan (1994) reflect the limited nature of the commitments made (see Appendix Table 15.5). Pakistan undertook the following commitments in 1994:

- For voice telephony:
  - Mode 3, i.e. 'commercial presence' unbound for voice telephony.
  - Commitments under 'commercial presence' are subject to incorporation in Pakistan with 100% maximum foreign equity participation permitted.
  - Until 2003, no bypass of PTCL network and PTCL shall have exclusivity.
- For circuit switched data transmission services
- For facsimile services
- For private leased circuit services: PTCL except for domestic VSAT, is the exclusive service provider for seven years. This exclusivity shall expire by the year 2003.
- Has filed for MFN exemptions with regard to accounting rates.

Pakistan's commitments also did not endorse the regulatory principles enshrined in the Reference Paper. Compared to the meager commitments made by Pakistan in the last round, the current offer (2005) covers new areas. Pakistan now offers to end exclusivity on cross-border supply of voice telephony as of January 2004, with no limitation on commercial presence.<sup>9</sup> Also commits on full competition in private leased circuit services (transmission capacity) as of January 2004. Further the offer allows competition in satellite-based services, including voice telephone and value-added services subject only to restrictions on cross-border supply to preserve monopoly rights on basic and international networks and services until their expiry.

<sup>9</sup> Under Mode 3, 'None' has been specified against voice telephony services under market access. This implies there exist no limitations on access. However under the general conditions, the schedule reads as follows: *the number of operators, service providers and licensees may be limited due to technical constraints.*

It also commits to open markets for data transmission, e-mail, internet and intranet, domestic VSAT, trunked radio services, videoconferencing, telemedicine and tele-education.

*Additional commitments* taken are as follows: Pakistan endorses the reference paper with minor alteration that cost oriented interconnection rates shall be implemented by year 2008. Further, privatisation of PTCL is on the anvil. The management of the Company shall be transferred to a selected strategic operator.

Unlike for India, Pakistan's offer is closer to its applicable regime, although similar to other SAFTA nations, Pakistan has not offered to bind its applicable regime. The rationale for this is similar to that discussed for India and Bangladesh above.

### Sri Lanka

Fuelled by progressive market reforms, economic liberalisation, and pent up consumer demand, cellular services in the country grew by 61%. Total number of cellular subscriber stood at 1,884,076. Fixed line also grew at a faster rate of 52%, which is higher compared to other nations. Total number of fixed line subscribers stood at 5,412,496. Teledensity in the Island nation touched 36.7, where mobile density was 27.1. The Internet growth however lagged behind and registered a growth of mere 13%. However, with the launch of 3G services, it is expected that the growth rate will improve.

Sri Lanka has four licensed telecom service providers each in mobile and fixed line, and twenty-four ISPs. Sri Lanka Telecom is the largest service provider in the country. NTT holds 35% stake in the company, 49.2% is owned by the Government of Sri Lanka, and 15.3% is listed on the Colombo Stock Exchange. SLT currently has a customer base of more than 2 mn, and has 85% market share in fixed line business. SLT is the only integrated operator in this country to offer fixed line, data, and mobile services. Lanka Bell is the second fixed phone provider which uses CDMA technology to service its customers, with a customer base of more than 500,000 active subscribers; the Lanka Bell user base serves well over 10% of the country's population. Suntel is another CDMA player with 300,000 customer base. Tigo formerly called CellTel registered a growth of 42% in revenues, and had 2.3 mn customers at the end of year 2006. SLT subsidiary, Mobitel's subscriber base was 0.8 mn by December 2006, an increase of 111% y-o-y basis. It plans to introduce 3G services soon. Hutch Sri

Lanka is wholly owned subsidiary of HTIL which has a subscriber base of more than 0.7 mn.

MTN Dialog Telekom is the largest GSM service provider. In addition to its core mobile telephony business, the company provides international services, supporting an international gateway infrastructure providing retail and wholesale international voice and data services under the brand name of Dialog Global. The company also provides internet services through Dialog Internet – a full-fledged ISP. Dialog Telekom also operates Dialog SAT, a mobile satellite service, which is a fully owned subsidiary of Telecom Malaysia. It added over one million net subscribers within a period of one year. The company's cellular subscriber base increased by 46% to reach 3.37 mn subscribers by 31 March 2007. The company has also implemented a WiMax Network in Colombo. It has the distinction of being the first 3G operator in South Asia to commence commercial operations. Bharti Airtel has bagged the license as fifth Mobile operator and plans to invest \$150 mn. The company has got the approval to offer both 2G and 3G services.

**Table 15.6 Key Indicators for Sri Lanka**

Population*	20
Fixed lines*	2.08
Fixed teledensity	10.4%
Mobile phones*	6
Mobile density	30%

\* million.

Sources: <http://www.trc.gov.lk/>

Comparison of the applicable regime described above and the commitments made by Sri Lanka (1997) reflect the limited nature of the commitments made. (See Appendix, Table 15.6). Sri Lanka undertook the following commitments in 1997:

- For voice telephony:
  - There will be of one operator for International Long Distance until 1999 with an FDI limit of 35%.
  - Offers duopoly in international basic voice services from 2000, subject to satisfactory progress by the monopoly on tariff rebalancing.
  - Foreign equity participation of up to 35% permitted for a strategic partner in the government owned operator SLT.
  - For local and domestic long distance four operators licensed; commitment to review the number of licences permitted in 2000.
  - Commits to two licenses (in addition to SLT)

for supply by wireless local loop of basic voice telephony, data transmission, payphones, voice mail and facsimile; the two licensees are guaranteed exclusivity for five years.

- Commits to five licenses for public payphones services and for paging services licenses with possible additional suppliers of each to permitted subject to economic needs tests.
- For all suppliers other than SLT, foreign equity permitted up to 40% with investments over 40% subject to case-by-case approval.
- For circuit switched data transmission services
- For facsimile services
- For private leased circuit services: Commits to six operators of data communication services. For GMPACS services supplied through own gateways, indicates that issuance of licenses is under consideration.
- For cellular mobile telephony:
  - Commits to four operators of cellular mobile services
  - For all suppliers other than SLT, foreign equity permitted up to 40% with investments over 40% subject to case-by-case approval.
- Has filed for MFN exemptions with regard to accounting rates to permit the Government or the Government-run operator to apply differential measures, such as accounting rates, in bilateral agreements with other operators or countries.
- Additional commitments taken are as follows:
  - Sri Lanka has committed to the reference paper on regulatory principles.

Sri Lanka has not submitted an offer to the WTO or at least it is not available in the public domain. The gap between the applicable regime and commitments for Sri Lanka are wide and there has been considerable criticism of this disparity. For example, it has been stated that it is unlikely that the level of commitments made by the government of Sri Lanka (GoSL) would be accepted by the parties to the GATS today.<sup>10</sup> But they were accepted, and there is no specific overt pressure on GoSL to improve its commitments at this time. Such pressure may arise either when the Doha Process gets restarted or within the context of bilateral or plurilateral trade negotiations, especially with countries that have significantly liberalised their telecom sectors and are home to regional investors. One reason

GoSL would consider making concessions in telecom services is to gain concessions in a different sector such as apparel exports. This was the primary objective of GoSL in the tentative negotiations with the USA on an FTA in 2003.<sup>11</sup>

### *Nepal*

Despite a very politically volatile situation in Nepal, the telecom sector saw a good growth rate. On the fixed service front the quarter ending July '07 more than 57,00 new lines were added, most lines being catered by CDMA network, viz., fixed wireless and limited mobility. The overall growth rate in six months was 20.31%. The fixed line penetration is still low at 2.73%. The gap between fixed line penetration and mobile penetration is still getting wider with mobile penetration jumping to 5.67%.

There are two fixed line service providers NDCL and UTL and their market share is 88% and 12%, respectively. NDCL is providing service in all the districts of Nepal through wire-line as well as wireless service. Both operators have obtained license to operate limited mobility service in addition to their fixed service license.

Mobile services saw growth of over 50% in last six months in terms of net subscriber addition. Nepal Telecom has introduced 3G mobile services since 17 May 2007. Rural service was expanded in Nepal under the fifth phase telecom project, through Japanese (JICA) and IDA (World Bank) fund. Country's seventy-five district centres have automatic telecommunications service, including STD and ISD. On the Internet services front, even with more than thirty ISPs currently operating, this sector has not shown any noticeable performance. Growth of Internet subscribers in the quarter ending July was just 62,586 and the growth in six months ending July 2007 was at 25%. Out of the forty-two licensed ISPs, thirty-two are currently operating.

The subscriber base of incumbent NDCL has reached 8,68,046 whereas that of Spice Nepal is 7,02,975 hence a total of 15,71,021 subscribers. The number of postpaid subscribers has gone down by 1644. NDCL distributed 2,629 new lines in the last quarter whereas SNPL distributed 2,12,260 lines in the same period. SNPL now holds 44.75% of the market share, 8.75% more than the previous quarter whereas that of NDCL continued to decrease in this quarter as well, going down to 55.25%. The mobile customer base

<sup>10</sup> See Samarajiva, Rohan (2007) Sri Lanka's telecommunications commitments under GATS: Assessment and issues for the future, LIRNEasia, [www.lirneasia.net](http://www.lirneasia.net)

<sup>11</sup> *Ibid.*

is growing basically due to prepaid mobile scheme, which has crossed the 1.5 mn mark at the end of this quarter.

Since 1995, Nepal has initiated the involvement of the private sector in the development of the telecommunication services. To make this work more systematically and regularly, the telecommunication of 1997 and telecommunication regulation of 1998 had been implemented. Nepal Telecommunications Authority has been established as an autonomous regulatory body on 4 March 1998.

There are several issues pending with the regulator which include, VoIP and internet telephony legalisation, mechanism for the allocation/assignment of spectrum and frequency fee determination for WiMax band, amendment of the Telecom Act 2053, disbursement of the rural telecom development fund (RTDF) for providing telecom service in rural areas, issues regarding the use of Nepal electricity authority's fibre network by other licensed telecom operators and use of VPN by ISPs to provide data communication service, mechanisms to encourage ISPs in rural areas of Nepal.

**Table 15.7 Key Telecom Indicators for Nepal**

Population	28
Fixed lines	0.764353
Fixed teledensity	2.73%
Mobile phones	1.57
Mobile density	5.61%

Source: <http://www.nta.gov.np/>

In 2004, Nepal undertook the following commitments:

- For voice telephony:
  - No limitation on number of service providers will exist on January 2009. However, foreign participation permitted through a joint venture with up to 80% equity participation.
- For circuit switched data transmission services
- For facsimile services
- For private leased circuit services:
  - No limitation except that foreign participation permitted through a joint venture with up to 80% equity participation.
- For cellular mobile telephony:
  - By 2004 two mobile operators will be licensed
  - No limitation on number of service providers will exist on January 2009; however, foreign participation permitted through a joint venture with up to 80% equity participation.

- Mobile technology will not be prescribed but will be left to the choice of the operator upon the date of accession.

- Additional commitments taken are as follows: Nepal has committed to the reference paper. The gap between the applicable regime and commitments for Nepal is the minimum among SAFTA countries that have made commitments under GATS.

Of the other two countries, Bhutan is not a member of WTO while the Maldives has not made any commitments in Telecom.

### *Bhutan*

Major reforms have been taking place in Bhutan, especially in the telecommunications and other ICT service sectors, for the last few years. In principle, the functionality of regulation, policy, and operations has been segregated from one other with the enactment of the Bhutan Telecommunication Act 1999. As the result of this Act, the once-government owned department of telecom has been transformed into a state-owned corporation and a separate regulatory agency has been created within the ministry. As an initiative of government restructuring, the former ministry of communication has been bifurcated into two separate ministries, namely, ministry of information and communication and ministry of work and human settlement, in June 2003. The government of Bhutan sees telecommunications and other ICT services as important and essential catalysts for the overall development of the country. In order to reap the fruits of ICT for development, a committee consisting of different ICT players, including members from government, private investors, NGOs, and donor entities, was established and given the task to discuss and develop a national ICT policy and strategies in 2004. The committee has recognised the importance of the telecommunications infrastructure for the overall development of ICT related services, and it is felt that there is a need to liberalise and introduce competition in the telecommunications market by 2007. Though policies and strategies have been developed for opening the Bhutanese telecommunications market, actual mechanisms for opening up the market have not yet been formulated. Currently, the telecom scenario is not very good with overall teledensity at mere 4.03%. But with policy changes in place we may see a spurt in growth in the coming years.

### *The Maldives*

The Maldives is the smallest nation of SAFTA. The Maldives boasts an efficient, upto date telecommunication system. Through recent efforts of long-time monopoly telco, Dhivehi Raajjeyge Gulhun (Dhiraagu), there is now full telephone service coverage. Dhiraagu is a joint venture between the Government of the Maldives (65%) and Cable & Wireless plc (UK) with 35%. Along with its fixed-line network, the company also operates a GSM mobile service and was, until recently, the country's sole licensed ISP. But Wataniya Telecom Maldives, a sister company of Wataniya telecom international, become the second operator after it was issued a licence as the new mobile phone operator in February 2005. Telecom density in Maldives is highest among SAFTA countries at 98.76%, while the fixed line penetration is low at 10.88%.

TAM was established in September 2003 as a separate entity with a mandate of regulating the telecommunications sector, creating a conducive environment for promoting competition in telecommunication services and developing the sector in accordance with the national policies and regulations. The ministry of transport and communication now has the role of policy making while the telecommunications authority assumes the responsibilities of regulating the telecommunication sector.

**Table 15.8 Key Telecom Indicators for Maldives**

Population	330,000
Fixed lines	36729
Fixed density	11.13
Mobile phones	320,000
Mobile density	0.96969697

Source: <http://www.mcst.gov.mv/>

### ■ COMPARISON OF WTO COMMITMENTS MADE BY SAFTA WITH THE ACTUAL POLICY IMPLEMENTED

The foregoing analysis has shown that SAFTA country commitments in the Uruguay Round were limited both in terms of sectoral coverage and modes of delivery and that most countries did not bind the existing regime. While full commitments were offered in Mode 1 generally, only partial commitments have been made in Mode 3. Nepal's commitments dated 2004 are the most recent and also the most liberal of all the SAFTA countries. It permits up to 80% foreign participation in all categories, while limiting the number of cellular

providers to 2. In other categories there is no explicit limitation on number of providers and w.e.f. from January 2009, there will no limitation on number of service providers in any category. For other countries, specifically India, Sri Lanka, Pakistan and Bangladesh the commitments are meagre. Foreign equity has been restricted to 25 in India and 40% in Sri Lanka. While Pakistan has no restriction on foreign equity (it can go upto 100%) the number of providers has been left 'unbound', thereby reducing the quality of the commitment. Further, the language of the commitments is often ambiguous, thereby diminishing their value. For instance, when Bangladesh committed to 'four licenses issued' in cellular telephony, the ambiguity in the choice of tense was not an accident: the licenses in question had already been issued.<sup>12</sup>

Commitments in Mode 4 in all countries are to the extent stated in the horizontal schedule. All SAFTA members have undertaken MFN exemptions with respect to accounting rates. While Sri Lanka and Nepal have fully committed to the Reference Paper, India Pakistan and Bangladesh have offered additional commitments to review the lack of guarantee on regulatory principles.

Comparison of the WTO commitments of SAFTA countries with the applicable regime as it has evolved over the few years reflects the fact that the applicable regime is far more liberal than the commitments made. As detailed in the previous section, some of the recent policy initiatives render countries like India, Pakistan, Sri Lanka and Nepal as exceedingly liberalised telecommunication economies. Given liberalisation of the sector at home and the limited nature of the commitments, the gap between the commitments and applicable regime has widened. This remains the case even when one considers the revised offers, where available. This picture can be seen, for example, from the tables in the Appendix tabulated separately for each country. Some information in the tables is either not available or reflects the fact that revised offers have not been submitted by the countries or are not available in the public domain.

An implication of the finding that the applicable regime in SAFTA countries is more liberal compared to, both commitments and revised offers, is that there is scope for improving commitments without further changes in national policy. However with the Doha Round talks stalled, there is no pressure on these countries to improve the quality of their commitments using the GATS framework of request and offer. Further,

<sup>12</sup> Mattoo et al.

it is unlikely that SAFTA countries will seek multilateral concessions in the telecom sector in response to improving the quality of their commitments in telecom. India's interests lie in ITes and movement of natural persons, Pakistan's and Sri Lanka's in textiles and apparels etc. SAFTA members may, therefore seek offsetting concessions in other sectors in multilateral negotiations in response to say, binding their regime at the current levels when negotiations get underway again.

One possible explanation for the meager level of commitments made by SAFTA countries in telecom under the multilateral framework is provided by Fink et al. They note that the failure to complete the negotiations before the end of the Uruguay Round effectively turned basic telecommunications into a single-sector negotiation. As a result countries with no export interests in telecommunications (for example, SAFTA countries, among others) committed to the policy status quo rather than to new liberalisation. In fact, certain countries bound to less than the status quo, with respect to certain aspect of their regimes. India did this with foreign equity participation.

While the GATS commitments have been frozen at the status quo, unilateral liberalisation has progressed in each of these countries at varying pace to engineer a radical transformation of the sector in the respective countries. Table 15.9 provides summary indicators for the telecom sector. However, apart from Maldives, no other country is close to achieving telecoms penetration observed in the advanced countries. For example, mobile teledensity has breached 100% in most of Western Europe, and these countries are now focusing on delivering high speed digital data services through next generation networks (NGN).

Thus, while telecom sector has progressed in each of the countries, there is still a lot of development that

needs to occur. Although overall teledensity has increased considerably after the introduction of competition, mounting evidence exists in countries such as India and Pakistan that penetration has been overwhelming biased in favour of urban areas. And it will still be sometime before the stalled WTO talks get underway again. Liberalisation at the multilateral level presents uncertainly, making it attractive for countries to pursue liberalisation at the plurilateral or regional level. Telecommunication is an important sector in all the US FTAs. It is an important sector covered under the Indo-Singapore Comprehensive Economic Cooperation Agreement (CECA) – the first (and so far only) bilateral agreement signed by India encompassing the service sector. Trade in services within SAFTA will be highly dependent on the growth of telecommunication network, connectivity and charges. Opportunities, therefore, exist for SAFTA countries to cooperate in this sector at the regional level. This is discussed in the next section.

#### ■ OPPORTUNITIES AND NEED FOR FURTHER LIBERALISATION IN THE SECTOR

A truly extraordinary feature of telecommunications performance in SAFTA countries over the recent years has been the widespread diffusion of mobile telephony. In each of the countries, including the Maldives, there is currently more than one mobile operator and unlike fixed-line services, the mobile telephony segment was subject to competition from the beginning. Table 15.9 above shows that mobile teledensity exceeds fixed teledensity for the entire sample and in certain cases by a sizeable amount.

The exponential growth of mobile telephony can be attributed to the introduction of digital cellular technology and the opening of mobile service provision to additional operators, i.e. to a liberal policy environment. Interestingly, unlike Europe and the Americas, where mobile services are likely to be a complementary service, as most business and households already have access to the fixed network, in SAFTA mobile can be a substitute to fixed-line services, particularly in countries with long waiting lists for fixed line. In Nepal and to an extent in India and Sri Lanka, one of the factors driving cellular growth is the popularity of pre-paid plans. At the end of March 2007, 70% of Nepalese mobile subscribers were using these plans. Additions to the mobile subscriber base in other countries are also overwhelmingly on the pre paid platform.

The policy environment for mobile has been more

Table 15.9 Summary Indicators in SAFTA

S. No.	Country	Population (in million)	Tele-Density Fixed (Lines per 100)	Mobile (Lines per 100)	Tele Rev/GDP
1.	India	1110	5	20	2.1
2.	Bangladesh	144	1	22	1.6
3.	Sri Lanka	20	10.4	30	2.0
4.	Pakistan	159	2.97	44	2.4
5.	Nepal	128	2.73	5.61	1.6
6.	Bhutan	2.33	.013	3.53	NA
7.	Maldives	0.33*	11.13	96	NA

Source: WDR: 2008, *Agriculture for Development*, World Bank, WTDR, 2006 and individual regulator web sites

liberal partly because there is less need to protect incumbent operators with state ownership. While competition may have always existed for mobile telephony, other restrictive policies and regulatory shortcomings adversely affected mobile performance. For example, high import taxes on handsets in India and Pakistan slowed consumer adoption of cellular technology in the initial years. High interconnection prices with the fixed-line network negatively affected mobile operators. For example, in Bangladesh, the incumbent's lack of responsiveness with regard to interconnection led to the operation of a mobile network independently of the fixed-line network. When the adverse policy was removed, it was accompanied by massive growth.

What emerges therefore in the sector is a picture of competition having been 'managed' across most countries of SAFTA. While the traditional public monopoly is becoming a rarity, most governments seem reluctant to forego discretionary policy-making and delegate choices completely to the market.<sup>13</sup> Thus, governments have been unwilling to allow unrestricted entry, and in most cases there are limits to the extent of private and foreign ownership. In India, foreign ownership ceiling was increased from 49% to 74% after protracted lobbying and debate that stretched well over three years. In Sri Lanka the committed ceiling on foreign equity is 40%, despite the fact that foreign equity has brought in recognised benefits to the sector. In Pakistan, although 100% foreign equity is permissible, approval is done on a case by case basis and virtually no competition has emerged in the access sector.

There is also a high degree of variability in the acceptance of regulatory principles, adherence to which is crucial for engendering competition in the sector. While Nepal and Sri Lanka have endorsed the RP on regulatory principles, Pakistan and India are reviewing their commitment in this respect. Perhaps the most important disciplines of the reference paper relate to *interconnection*. It is required that interconnection must be inter alia on non-discriminatory, transparent and reasonable terms, conditions (including technical standards and specifications) and rates; of a quality no less favourable than that provided for its own like services or for like services of non-affiliated service suppliers or for its subsidiaries or other affiliates; at cost-oriented rates; and in a timely fashion. Other reference paper provisions provide for competition

safeguards, greater transparency and require the creation of dispute resolution mechanisms. Competition safeguards oblige Members to prevent a major supplier from abusing control over information, or engaging in anti-competitive cross-subsidisation – i.e. to prevent a major supplier from using profits made in one segment of the market to subsidise its *output* sales in another segment and thus drive out rival suppliers.

The approach of SAFTA countries to the principles in the Reference Paper reveals an interesting pattern of reluctance to assume key multilateral disciplines. That independent regulators are not yet established in many countries reflects an unwillingness to guarantee the independent action by regulators in countries such as India, Maldives, Bhutan and Bangladesh. Furthermore, a number of countries (India, Pakistan, Bangladesh) have excluded the central commitment to guarantee interconnection at cost-based rates. These departures reveal that where there is domestic resistance, adoption of multilateral disciplines may not be sufficient to create enabling conditions for sector reform. In this situation, the motivation has to be developed around the potential benefits of unilateral liberalisation.

Economic theory has us believe that trade liberalisation is good, and that even unilateral liberalisation under certain conditions can be good. The actual changes to policy pursued by SAFTA countries with regard to telecom services support this view. In the past 5–10 years, governments have acted unilaterally to reduce entry barriers, increase competition and reduce termination rates. Yet, more barriers exist that need to be dealt with to fully exploit the potential of telecommunications liberalisation.

SAFTA offers significant investment opportunities in Telecom. As Table 15.9 shows, while mobile teledensity has surpassed fixed and is in the range of 20–30% (excluding Maldives), it is still below the industrialised world average. SAFTA is home to 24% of the World's population but contributes only 2% to World GDP. In terms of sectoral contribution to GDP, telecommunication revenue in SAFTA countries is also below the world average of 3.1% (ITU 2003). Finally the growth of the knowledge-based sector is directly dependent on the speed of development of telecom network. Hence, countries need investment in this key infrastructure sector.

It has been demonstrated that foreign equity is important for the growth of the telecommunication sector since it leads to better incentives for technology

<sup>13</sup> *Ibid.*

transfer and improved management leading to lower prices and better services. When FDI (Foreign Direct Investment) was first allowed in this sector, it helped domestic players in two ways. Firstly, operators were able to share risks. Getting equity from abroad was an attractive source of capital for domestic players in the early stages since it was costless form of finance until profits were made. Secondly, domestic operators imported most of the equipments from abroad and foreign equity was able to finance it. Easing entry restrictions and increasing the threshold for foreign equity further will enable new investments especially in Bangladesh and Pakistan, two countries with large populations and enormous unmet demand.

The popularity of prepaid mobile, in SAFTA countries accounting for as much as 70% of customers, has lowered barriers to telecom use by the financially constrained. But wireless is not the only thing that matters. The technological and business innovations that make possible the current levels of participation and that will enable millions more to participate are not new. Consumer-driven content and further refinement in business models focussed on mobile broadband plans are tipped to be the likely winners in coming years. Other key developments expected in the future include the further progress towards next generation networks (NGN), moving infrastructure to an IP packet-based, full service typology. In addition, many of the major players having consolidated businesses to strengthen their positions in the face of increased competition will begin to launch additional services (such as Vodafone with broadband), capitalising on growth areas in other sectors and further contributing to the convergence of technologies. Increased cooperation among SAFTA economies in this sector will perhaps catalyse this process.

What has held back their deployment has been the lack of investment; what has held back investment for the most part has been the unsatisfactory policy and

regulatory environment (Samarajiva 2007). Poor policy and regulatory environments drive up the costs of supplying telecom services by increasing regulatory risk. An uncertain and discretionary policy and regulatory environment constrains investment. In all countries of SAFTA, the regulator responds to political economy pressures. In India TRAI's powers have been restricted by the government and has been hard pressed to try and establish its independence. PTA has been recently created and needs to ensure that lessons from India are truly incorporated into the institutional design.

## ■ CONCLUSION

Benefits of the telecommunications sector are no longer thought to be confined to the sector itself. The role of telecommunications as essential to the facilitation of international trade, economic development, and the enrichment of citizens' lives has become widely accepted (WTO 1998). Many emerging economy governments which joined in making GATS commitments on basic telecommunications had come to view inadequate telecommunications networks and services as an impediment to achieving their full economic potential. The framework developed by GATS, under the WTO regime, has caused basic changes in the market structure of telecommunications sector across the world.

The paper has shown significant gap between commitments made by countries under GATS and the applicable regime. By not binding the existing regime, countries retain discretionary power to 'backslide' which is not a good signal for increased investment. Countries should consider improving the commitments under GATS because such an action will improve the regulatory environment of the telecom sector and create the conditions for foreign investment on favourable terms. The decision should be taken because governments believe it to be in the interests of the people of SAFTA and not due to any external compulsion.

# 16 ■ Cross-Cutting Issues and Conclusion

Apart from the sector specific issues, which have been discussed in respective sectoral chapters, there are some cross-cutting issues which are relevant to many services sectors particularly construction, education, health and tourism services. Issues such as developing MRAs, issuance of visa, conducive FDI regime and uniform taxation policy are some of the cross-cutting issues which warrant more detailed discussion. While the former two issues can be addressed with a view to facilitating movement of service providers in the region, the latter ones can have very positive implications especially on commercial presence. Thus all South Asian countries are expected to address these issues if they wish to gain from trade in services.

## ■ MUTUAL RECOGNITION AGREEMENTS

As discussed in the previous chapters, developing MRAs is a crucial element for delivery of services particularly through Mode 4. Lack of recognition of qualifications, skills, or experience is one of the most common barriers affecting Mode 4 (Chanda 2005). It either denies market access altogether to foreign service providers or induce such suppliers to perform in a capacity that is below their level of qualifications (academic or otherwise). The mechanisms for assessment of equivalence of qualification, licensing, and other requirement related regulations with a view to improving market access have been developed under a number of regional arrangements – the prominent examples being the European Union, NAFTA, TTMRA (between Australia and New Zealand), etc. Since the area of domestic regulation is not covered by market access commitments the issue becomes all the more important. Under the GATS thus far not much progress has been made. India raised the issue of implementation of obligations under Article VII of GATS on recognition

in the special sessions of CTS vide its negotiating proposal on Mode 4.<sup>1</sup> India rightly considers that obligations under Article VII are an area of crucial significance, especially for professional services. It has also an impact on the value of commitments for professional services because the value of such commitments is greatly affected by the manner in which such obligations carried out by members.

On India's request when the WTO secretariat compiled the notification obligations in 2003, it was found that during the past three years only two such agreements had been notified by members as required under Article VII: 4 (c).<sup>2</sup> The sectors to which such notifications refer are often unclear from the notifications. Moreover, as all the agreements notified so far had been *post-facto* notifications, adequate opportunities were not provided to other members to indicate their interest in participating in these negotiations and negotiating their accession to such agreements or negotiating comparable one with the member(s) concerned.

Issues relating to recognition are also closely linked to the mandate in Article VI: 4 regarding disciplines for qualifications requirements and procedures, licensing requirements and procedures and technical standards as all such measures have a bearing on recognition (India 2003). Thus recognition is one of the core issues under the work programme of the working party on domestic regulation (WPDR). India views the progress with respect to recognition issues as one of the crucial elements for effective market access in Mode 4 especially for professional services. Lack of recognition can act as a significant barrier to providing services under Mode 4. In light of this, India suggests that the WPDR should consider the following alternative approaches for addressing the issue of recognition. These approaches can possibly be undertaken in parallel:

<sup>1</sup> India's Negotiating Proposal on Mode 4, WTO Document, S/CSS/W/12, 24 November 2000.

<sup>2</sup> WTO Communication from India, Implementation of Article VII of GATS, JOB (03)/120, 24 June 2003, [http://www.commerce.gov.in/trade/international\\_trade\\_services\\_informal\\_papers\\_1.asp](http://www.commerce.gov.in/trade/international_trade_services_informal_papers_1.asp) last visited on 1 November 2007.

Development of disciplines for professional services,

- Effective operationalisation of Article VI: 6 of GATS by establishing guidelines for recognition of qualification, and
- Possibility of undertaking additional commitments under Article XVIII of GATS for verifying a foreign service provider's competence to provide the service with a view to laying out a transparent procedure for recognition and to reduce the burdensomeness of domestic regulation on this score.

Once again, India along with Pakistan and others suggested elements for disciplines on qualification requirements and procedures (India and others 2005). The paper discusses five types of problems arising on qualification requirements and procedures:

- Equivalence and recognition of qualification requirements – in the absence of any mechanism to establish the equivalence of foreign qualifications, education, training, and experience to these requirements, market access could be impaired.
- Different levels of governments – in view of multiple and varying sets of such requirements at different levels of governments, meeting requirements in one jurisdiction does not in any way guarantee that the service supplier is entitled to practice in other jurisdictions within the territory of the member.
- Examination requirements – various preconditions may exist for sitting for such examinations including host country language, residency and experience in host country. Further scope and frequency of such examinations can be of some concern.
- Education, training and experience requirements – these requirements could become unduly complex and burdensome including by being tied only to host country systems and institutions, thus impairing a service supplier's capacity to meet them.
- Lack of international standards – in most services, there are no internationally accepted benchmarks of qualifications required to practice a particular profession. Even where such standards exist, some members may insist on much higher standards without adequate justification thereof.

As regards the issue of equivalence, the study suggests that apart from providing transparency to any qualification requirements, mechanisms for taking account of foreign qualifications should be established.

Equivalent criteria/standards as applied to domestic recognition of qualifications may be applied to recognition of foreign qualifications. This does not imply harmonisation of standards but that unduly burdensome requirements should not be applied to verify foreign qualifications which could result in impaired market access. Where educational systems are found to be practically comparable, either the foreign qualifications could be recognised or a procedure should be established, for example, through an examination to verify whether the educational qualifications prescribed have been met. Further, a mechanism for verification of professional competence must be established containing features like work experience; holding a common professional examination to test educational qualifications, work experience, training; membership of professional associations/institutions in the home country to check the bona fides of the service supplier and his registration in home country.

However, approaches to mutual recognition and MRAs' coverage may vary to a great extent. Zarrilli suggests that two basic approaches have been singled out as the basis for mutual recognition. According to the so-called vertical approach, recognition is provided on a profession-by-profession basis, and as a result of the harmonisation or coordination among the parties to an MRA of the education and training required by each profession (harmonisation-based approach) (Zarrilli 2005). In the case of a horizontal approach, on the other hand, mutual recognition is provided without prior harmonisation of curricula and training requirements, on the basis of a broad equivalence of qualifications (equivalence-based approach). While the vertical approach normally leads to unconditional market access, Zarrilli argues that the process is a long and laborious one and usually requires significant time and efforts. On the other hand, the horizontal approach leads to much faster and concrete results than the vertical approach and is the main reason why countries are relying on it as the basis for their MRAs. As the establishment of equivalence with respect to qualification, licensing and standard requirements vary from country to country, in the South Asian context it would be a wise idea to follow the horizontal approach which is also the essence of the Indian proposal.

Chanda suggests that any progress on the issue of recognition requires initiatives to be taken simultaneously at three levels (Chanda 2005). The first is to improve the framework for MRAs. The second is to address more broadly the entire concept of recognition, such as the assessment of competence and

determination of equivalence. The third is to address the operational difficulties facing the South Asian countries in negotiating recognition agreements, given institutional, technical, and financial constraints and Mode 4 interests that tend to fall outside the purview of most MRAs. Regarding the first step it is noted that India has requested the members to meet the notification obligations thereby providing opportunities to interested members to actually participate in such negotiations before they enter a substantive phase. Further, members have been requested to improve the content of all such notifications by clearly stating the services sectors/sub sectors they address, making available the full text of the agreement for the benefit of other members. Finally, India suggested the secretariat to have a mechanism for information exchange with a view to specific information on the use of multilaterally agreed criteria for recognition purposes. Under the GATS the development of the Guidelines for Domestic Regulation and Guidelines for Mutual Recognition Agreements in Accountancy Services have been a positive development which are also likely to facilitate the recognition process. Efforts are on to have such guidelines for other services sectors as well.

However, the most common way to achieve recognition has been through bilateral agreements. Article VII of the GATS recognises this as permissible. There are differences in education and examination standards, experience requirements, regulatory influence and various other matters, all of which make implementing recognition on a multilateral basis extremely difficult. In this regard, it has been suggested that bilateral negotiations will enable those involved to focus on the key issues related to their two environments (WTO 1997). WTO further suggests, once bilateral agreements have been achieved, however, this can lead to other bilateral agreements, which will ultimately extend mutual recognition more broadly (WTO 1997).

In view of the above, it could be suggested that in the South Asian context horizontal approach to arriving at MRAs would be easier, simpler and less time consuming. In addition, even if only some of the South Asian countries agree to such mechanism the exercise could be fruitful without waiting for others to join. India and Sri Lanka are already working on it hence other likely candidates could be invited to join. It may also be noted that soon an MRA will be entered into, which will allow doctors, accountants and architects trained in India to practice in Singapore and vice-versa (Suryaprakash 2005). Thus by having an MRA with

Singapore, India will set a good example for other countries from the region to follow in line.

As already discussed, all five services – construction, tourism, health, telecommunications and education services should be covered by MRAs. However, MRAs are most needed in construction services because the sector is heavily dependent on professionals and other workers at various skill levels for delivery of services. In construction services, professionals such as engineers, architects, town planners, etc. can be discussed for developing MRAs. Similarly, wherever possible other workers could also be covered. In addition, service providers in tourism and education too will be covered by the discussion on MRAs.

Professions of architecture and town planning are largely regulated in various countries in South Asia and regulatory bodies are in place. Therefore, developing MRAs would be easier for these services. Unlike architecture, engineering profession comprises a broad range of many different engineers and in many South Asian countries does not have regulatory bodies. The absence of regulatory body in engineering services seems to have prevented South Asian engineers from gaining market access within and outside the region. In semi-skilled professions and trades, such as carpentry, repair work, plumbing, it has been suggested that the lack of occupational guilds for apprenticeship and training and for certifying competence and quality affects exports of such manpower (Chanda 2005).

### **Regulatory Professional Bodies in SAFTA Countries**

In India, the Council of Architecture (COA) has been constituted under the Architects Act, 1972 (COA 2007). The CAO is charged with the responsibility to regulate the education and practice of profession throughout India. Any person desirous of carrying on the profession of 'Architect' must have registered him/herself with the COA. There are 108 institutions, which impart architectural education in India leading to recognised qualifications. The standards of education being imparted in these institutions are governed by the council of architecture (minimum standards of architectural education) regulations, 1983.

The COA grants license to practice if the applicant is resident in India, has qualified from one of the institutes listed in the schedule to the Architect Act, and has obtained permission for further residency in India (Kumar 2005). By 2005, over 30,000 Indian and

only 62 foreign architects were registered in India (*Ibid*). Foreigners seeking to enter the Indian market can do so either as individuals (after registering with the COA) or after setting up a partnership firm in India, in collaboration with registered Indian or foreign architect. Such permission is granted to individual architects alone and firms cannot be registered with the COA. Moreover, appointment of foreign architects as consultants to an Indian architect for supply of service in India is permitted, subject to approval by the government. Though the COA allows foreign architects, its rules are still restrictive and need to be modified by removing residency and partnership requirements.

In addition to the COA, there is another body in India which works for architects. The Indian institute of architects (IIA) is the national body of architects in the country (IIA 2007). Having started in the year 1917, the institute today has more than 15,000 members. The institute has a major role to play in promoting the profession of architecture by organising and uniting in fellowship the architects of India to promote aesthetic, scientific and practical efficiency of the profession both in practice and in education. IIA is represented on various national and international committees connected with architecture, art and the building industry and is also actively associated with union of international architects (UIA), commonwealth association of architects (CAA) and South Asian association for regional co-operation of architects (SAARCH).

The Pakistan council of architects and town planners (PCATP) ordinance 1983 has been promulgated with a view to give recognition and protection to the profession of architecture and town planning in Pakistan. The council has wide-ranging powers and is authorised to perform all functions and to take steps connected with or ancillary to all aspects of the two professions including laying down standards of conduct, safeguarding interests of its members, assisting the government and national institutions in solving national problems relating to the professions, promotion of reforms in the professions, promotion of education of these professions, reviewing and advising the government in the matter of architecture and town planning education, etc., interestingly, PCATP recognises architectural and town planning qualifications granted by institutions outside Pakistan including the qualification of bachelor of architecture offered by Bangladesh university of engineering and technology, Bangladesh; qualifications recognised by the council of architecture, India; qualifications recognised by the Institute of town planners, India (PCATP 2007).

Requirements for architects to serve in Sri Lanka are laid out by the institute of architects of Sri Lanka which is governed by law and is based on International union of Architects (UIA) (Taneja et al. 2004). Sri Lankan and other foreign nationals are allowed to practice in Sri Lanka provided their degree is recognised in UIA and that they clear the examination conducted by the IASL. Several foreign architects work in Sri Lanka, but the requirements to practice in Sri Lanka are often violated. Foreign architects, including Indian, either go through the BOI-agreed investments or go for short-term to provide services on a visitor's visa. In view of a flow of architects between Sri Lanka and India and the respective authorities which are in place, it has been suggested that the two countries should explore the possibility of signing MRA under the FTA.

Engineering services are unorganised and unregulated in India. There are two professional bodies namely, the institution of engineers (India) (IEI) and the engineering council of India (ECI) which have been active in providing some sort of informal regulation to professional engineers (Kumar 2005). Of the two, the IEI is older and from a humble beginning in 1920 today it is a multi-disciplinary professional body. Similarly, the ECI intends to develop registers for professional engineers and consulting engineers. However, the greatest regulatory hurdle with regard to engineering services is that there does not exist any legal statute to govern these services, which apparently has prevented this sector from formally entering into any meaningful arrangement with similar bodies in foreign countries to obtain market access for Indian engineers. In order to overcome this hurdle the Engineering Council of India has drafted an engineers bill which is awaiting the Parliament approval (ECI 2007). India has been exporting engineering services to a number of countries in the world (Kumar 2005). Specialised engineering consultancy services are an important export sector for India, first to Africa and Asia, then to the Middle East and likely to other markets (*Ibid*). Most Indian consultancies are involved in some form of environmental and energy consultancy. India's proven comparative advantage in the sector has encouraged the government to open its markets to competition by removing controls on foreign capital participation and extending full national treatment to foreign firms supplying their services in India.

The IEI certifies an applicant as a 'Professional Engineer' (PE) (IEI 2007). Qualifications for certification as PE includes a bachelor's degree in engineering or equivalent recognised by the government of India,

experience of seven years, professional experience of two years, membership of recognised professional engineering associates, etc. Similarly, competency requirements for PE include application of engineering theory, standards and practices; management of engineering works; continuous development in engineering profession; etc. Assessment is done on the basis of a written examination, evaluation of professional, experience for at least seven years after acquiring engineering degree, evaluation of two years professional experience in significant engineering work and evaluation of CPD. Criteria for recognition of foreign engineers are:

- Engineers registered as PE by the members of EMF shall automatically be certified in India. They will be exempted from examinations and other requirement as they would have been examined under an equivalent system and would have bachelor's degree or equivalent in engineering from an accredited institution and at least seven years experience.
- Others with engineering degree from foreign universities will be required to go through all the procedures including examinations as for engineers with Indian degree. As regards fee, it is same for the applicants from India and Nepal and different for other applicants from all other countries. It is also interesting to note that IEI provides guidelines for engineering students, polytechnic students, technicians' chapters, chartered engineers and professional engineers.

Similarly, in Sri Lanka too there is no legislation passed by the Parliament that makes it legally binding for an engineer to register with the Institute of Engineers of Sri Lanka. However, Sri Lanka specifies organisations and companies for which membership with IEI is mandatory. Foreign engineers can acquire membership to the IEI provided they clear the local examinations. Where such membership is not required, foreign engineers can practice without membership.

The institution of engineers, Bangladesh (IEB) is the national professional organisation of the country.<sup>2</sup> It is registered under the Societies Registration Act of the country. IEB includes all disciplines of engineering. Currently, it has in its roll more than 25000 engineers. Since its establishments, IEB has been promoting and disseminating knowledge and practice of engineering and science. One of the major goals of IEB is to ensure the professional excellence and continuous professional

development of the engineers in the country. It has also been working relentlessly to establish close and co-operation with the other professional bodies both in Bangladesh and outside the country.

Established in 1968, Nepal engineers' association (NEA) is an independent non-profit organisation of Nepalese engineers (NEA 2007). Today, it represents more than 7500 engineers. NEA was founded with a noble aim of developing engineering professionals to promote the development process by application of engineering sciences and technologies and at the same time increasing the interaction, goodwill and cooperation among engineers in Nepal and protect their professional rights. NEA also aims to develop relations, fellowship and goodwill with international engineering associations and institutions.

As already discussed in Chapter 10, Pakistan engineering council (PEC) is the regulatory body established by an Act of Parliament which regulates engineering education, gives certification to professional engineers and advises government on all engineering and construction related issues. Perhaps Pakistan is the only SAFTA member country which has a statutory regulatory body for professional engineers.

The Institution of Engineers, Pakistan (IEP) works as non-governmental organisation (NGO) under the Societies Registration Act. The institution provides platform for interaction between academia and other stakeholders and works for continuous improvement of engineering students, academia, and professional engineers. It came into existence in 1948, as successor to the Institution of Engineers, UK. The major objective of IEP is promoting professional development of engineers. IEP has concluded agreements of collaboration with 31 foreign professional societies including IEI; IEB; Institution of Engineers, Sri Lanka; and NEA.

As engineering remains an unregulated profession in many of the South Asian countries their qualifications based on graded institutions and a minimum working experience in their home country should be considered adequate to allow them to work in all these countries. While efforts could be made to have a statutory body, as in the case of India, a bill is awaiting the Parliament's approval, the aim should be that movement of engineers is not made hostage to a lack of statutory regulatory body.

From the foregoing it appears that professional associations, with or without delegated governmental authority, perform a number of functions related to capacity building, development of curricula,

<sup>2</sup> The Institution of Engineers, Bangladesh, <http://www.iebbd.org/aboutus.htm>, last visited on 9 December 2007.

accreditation, licensing and MRAs. The fact that MRAs negotiated by bodies with no governmental authority are most likely non-binding on states, does not mean that the requirements and other initiatives taken by such entities do not have an impact on the market. On the contrary, they usually are powerful tools to regulate market entry (Zarrilli 2005:16). If applied in the South Asian context and as noted in Tables 5.1 and 5.2, no country should insist on having a statutory body for each and every profession. In fact in the case of India, though the engineering profession is not regulated by a statutory body, there are two important professional associations working for many years to take care of this profession. Either of these two or both national professional bodies may be authorised to function as a regulatory body. Despite not having a legal body in place, India has received a provisional signatory status in the Washington Accord – an agreement between the bodies responsible for accrediting professional engineering programmes in each of the signatory countries. Similarly though Bangladesh does not have a statutory regulatory body for architects, the country has an insti-

tute of architects Bangladesh which is a professional institution engaged in the development of the profession of architecture in Bangladesh. Moreover, the Institute of Architects Bangladesh is affiliated with the UIA, CAA, and the architects regional council for Asia and the SAARCH.

As regards licensing there are some professions such as architecture, medical, accountancy, etc., that require a license before practicing. In such cases, the relevant regulatory bodies need to have a common South Asian body which could set minimum criteria for smooth movement of professionals in all seven countries. However, care has to be taken for those countries where such bodies do not exist. In such cases the concerned government department can act as regulatory bodies. The available literature suggests that regulatory bodies exist in India, Sri Lanka, Pakistan, and Bhutan.

Although construction and related engineering services is the most important sector to have various MRAs to facilitate movement of professional and workers in all South Asian countries, the efforts to develop MRAs should not be limited to this sector

**Table 16.1 Architectural Services**

<b>Restrictions in South Asia</b>	<b>Expected to be removed by having MRAs</b>
Non-recognition of qualifications	In architectural services there are various qualifications like bachelor of architecture, 4 year/3 year diplomas in architecture, BA (Hons) in architecture in Pakistan; 5 year bachelor of architecture in India, etc. MRAs among the regulatory bodies in these countries will recognise equivalent degrees/diplomas and facilitates movement of architects in the region.
Non-recognition of standards	Even in one country all the institutes imparting education in architecture do have the same standard and for India there cannot be one benchmark with regard to the standard all institutes follow. Hence architects from the best institutes in India may like to be equivalent to their counter parts in other South Asian countries. Thus ranking of institutes like A, B, and C, etc., may appear to be a solution to the problem of non recognition of standards.
Non-issue of license to practice	In view of the fact that if a profession is regulated, no one can practice it without a license, the profession of architecture is a regulated one in countries like India, Pakistan, and Sri Lanka and in these countries an architect can practice only when s/he obtains a license from a body like the Council of Architecture in India, the Pakistan Council of Architects and Town Planners in Pakistan and the Institutes of Architecture in Sri Lanka. Once such bodies develop MRAs architects from these countries will become eligible to obtain license for practice.
Modal restrictions other than Mode 4	Though Mode 4 is affected most in the absence of MRAs, other modes are also somehow affected. A company may feel more comfortable to offshore (Mode 1) its architectural services to professionals whose academic and/or professional qualifications are in adherence with international standards or have been scrutinised during the process of negotiation of an MRA. A similar situation may arise when a client would like to receive architectural services abroad from such architects whose credentials are recognised. In Mode 3 also MRAs can be helpful. However, in the case of professionals providing services through foreign commercial presence (Mode 3), mutual recognition issues seem to be less relevant than for Mode 4, considering that in most cases the requirement imposed by the host country is that a local professional sign or certify the final output of a professional activity, though professional from different origins and backgrounds may have contributed to it.

**Table 16.2 Engineering Services**

<b>Restrictions in South Asia</b>	<b>Expected to be Removed by having MRAs</b>
Non-recognition of qualifications	Not as varied as in the case of architecture, however, there are some variations if the qualifications in engineering profession.
Non-recognition of standards	The problem of standard is more acute in the case of engineering than that of in architecture. In India for instance, there are hundreds of engineering colleges and along side it has IITs. Here not only the standard is different the course content is also not same.
Non-issue of license to practice	Engineering profession largely remains unregulated in South Asia though there are professional bodies in many countries like India, Pakistan, Sri Lanka, etc. as of now MRAs must first agree to the equivalence of qualifications and then these bodies could be upgraded to become regulatory authorities. However, even without having the statutory power they may be engaged in negotiation of MRAs.
Modal restrictions other than Mode 4	There may be a difference in the degree of impact as compared with architecture, the supply of engineering services through other modes is also affected by not having MRAs.

alone. In health, higher education and tourism – What about health? also there is tremendous scope for MRAs. As already noted, a significant amount of trade in health services is already taking place in the region particularly between India on one side and Bangladesh, Sri Lanka and Nepal on the other. Developing MRAs could greatly facilitate movement of health professionals/workers across the region. Possible MRAs in the sector can cover medical and dental services, veterinary services, and services provided by midwives, nurses, physiotherapists and para-medical personnel. As discussed in the chapter on education, almost all South Asian countries lack quality teachers and one of the ways to tackle this problem would be to allow movement of teachers and the other solution could be to develop intuitions to provide regular training to teachers with a view to upgrading their skill levels. Some institutions in Pakistan can be selected to provide training in management. In the hospitality sector Maldives could be a better place to train teachers and also professionals working in tourism business.

In tourism education there are institutions now in almost all South Asian countries and here developing MRAs will greatly facilitate the movement of persons at various skill levels. In this case also the approach should be to develop minimum criteria so that the movement of tourism workers becomes hassle free.

In addition, in the context of South Asia the economic imperatives warrant that we must bring down the skill ladder if all countries are to reap the benefit of Mode 4 liberalisation. In this regard, as given in the list of service providers (Table 16.3), persons having lower skill should also be covered. Further, mechanisms should be explored and more thought should be given to formulation of common norms rather than ‘harmonisation’.

The following restrictions in South Asia are likely to be removed by developing MRAs among SAFTA countries (Tables 16.1 and 16.2).

**Table 16.3 List of Mode 4 Service Providers for Construction and Related Engineering Services**

<b>S. No.</b>	<b>Occupational Title</b>
1.	Building architect
2.	Interior architect
3.	Landscape architect
4.	Town planner
5.	Civil engineer (General)
6.	Dredging engineer
7.	Dock and harbour Construction engineer
8.	Structural engineer (General)
9.	Building construction engineer
10.	Sewerage & Sanitary engineer
11.	Soil mechanic & Piling engineer
12.	Trenchless technology engineer
13.	Quantity surveying engineer
14.	Transportation and highways engineer
15.	Electrical engineer (General)
16.	Electromechanical equipment engineer
17.	Electrical traction engineer
18.	Power generation & Distribution engineer
19.	Lift engineer
20.	Air-conditioning & Refrigeration engineer
21.	Cartographers
22.	Carpenter
23.	Electrician
24.	Fixer/fabricator
25.	Foreman
26.	Mason
27.	Mechanic-AC
28.	Painter
29.	Plumber
30.	Technician
31.	Welder
32.	Supervisor
33.	Surveyor
34.	Fitter

Source: CECA between India and Singapore and ESCAP.

## ■ ISSUANCE OF VISA

Visa and work permit systems vary widely between countries and opaque and cumbersome administrative procedures for entry can undermine market access granted under Mode 4. Enterprises frequently face the loss of business because the current visa regimes of countries make it impossible for them to deploy resources to meet business needs. In order to address such entry related issues, the idea of a single visa available for entry in all WTO member countries has been discussed for quite a while now (Kumar 2005). Thus, while the Indian negotiating proposal (India 2000) has elaborated this idea in the form of a GATS visa, the World Bank (World Bank 2004) has proposed a service provider visa (SPV). The GATS visa or SPV can certainly bring about considerable improvement over the existing system in regard to gaining temporary access by service providers in WTO member countries.

The idea of a single visa for service providers can be proposed for South Asia also where it would be far easier to arrive at consensus in view a small number of countries involved compared to the entire WTO membership. As has already been discussed that in recent years countries such as Sri Lanka and to a limited extent India have relaxed their visa regime for South Asian people particularly tourists. The SAARC has also made some efforts to ease the visa regime in the region. Thus, in order to make huge gains from services trade, it would be necessary to have a liberal visa regime in place. There are other regional groupings which have developed this kind of facility and there is every reason why this region too should have similar arrangement in place.

## ■ FDI REGIME

While Mode 4 could benefit most from developing MRAs and having a liberal visa regime, it is the FDI regime that affects Mode 3. In recent years, South Asia as a whole has taken a number of steps to liberalise its FDI regime. However, from the low level of intra-regional FDI flows it appears that still a lot needs to be done.

Bhattacharya (2007) suggests that only India has been investing to some extent among the South Asian countries within the region, investments directing mainly towards Sri Lanka and Nepal. A foreign investment of 2.6% in Sri Lanka has been coming from India, while for Nepal Indian investments contribute to the extent of 51%. Most of the FDIs in Bangladesh

are coming from extra-regional sources. However, the share of South Asian FDIs in the total inflow has shown upward trend during the last decade, increasing from 1.55% (\$1.4 million) in 1995 to 1.60% (\$9.3 million) in 2000 and reaching 3.82% (\$32.3 million) in 2005. Within the total investment coming from the South Asia region to Bangladesh, Pakistan was the single largest source (79%) in 2005 (\$25.5 million), while Indian investment of \$1 million was the single largest source (47%) in 2006.

Apart from the general problems related to investment in other regions, the obstacles with the South Asian countries contain some distinguishing features. In this regard, Bhattacharya argues that FDI outflow from India and Pakistan is controlled (restricted by means of minimum holding periods, classes of investors, etc.) and partly restricted (prohibited without permission) in countries like Sri Lanka and Bangladesh. It is interesting to note that services account for a growing share of outward FDI flows from the Indian economy, constituting 45% of total FDI outflows for the 1999-2003 period (Chanda 2005). In view of various obstacles to FDI, Bhattacharya suggests that implementation of RTAs in South Asia can significantly give rise to intra-regional investment. At present, three bilateral treaties exist in the South Asian region between Bangladesh-Pakistan, Pakistan-Sri Lanka and Sri Lanka-India. Signing of a regional investment treaty and double taxation treaties among the countries will be an important step to remove the obstacles to investment. Under a common investment framework, investment potentials of all South Asian countries could be developed in a coordinated manner. Thus, he suggests, harmonisation of the rules and procedures and mutual recognition of the rules and standards are some of the essential means for enhancing intra-regional investment in South Asia. Regional economic integration in South Asia could work as a catalyst in improving intra-regional investment and generate new incomes, employment, and trade helping the region in its fight against poverty.

## ■ TAXATION POLICY

Uniform taxation policy is another area that plays a significant role in the transaction of services. Under GATS there is a provision on national treatment that requires member countries not to discriminate between foreign services and domestic services. However, the provision on national treatment is not the same as is in the case of GATT where this is a non-negotiable

principle. Under the GATS national treatment is thus a negotiated principle. Though many member countries provide national treatment in many services sectors, this cannot be taken for granted and members at large still seem to consider that full national treatment may not be accorded in services.

In the South Asian context given varied sizes of countries and differences in the level of economic development across the region, different forms of taxation policy can arguably be one of the major barriers to trade in services. Taxation policy seems to be more complicated in those countries where states have federal structure as taxes are levied at various levels. India and Pakistan are the prime examples having federal structure. Other countries like the Maldives, Bhutan and to a limited extent Nepal, Sri Lanka and Bangladesh tend to have a taxation policy which seems to apply to only one or two levels.

Although taxation policy is fairly complex area, regional integration may bring about some amount of uniformity across the region. In addition, countries can also learn from one-another's experience.

## ■ CONCLUSION

South Asia is home to 21% of the world's population. However, the total income here is merely a little over 2% of the world's total income (CENTAD 2006). On the positive side, South Asia is growing faster than the rest of the world. With a population of 1.5 billion South Asia is a significant market. Even conceding that per capita income in the region is relatively low (\$766 in 2006), the collective purchasing power is so large that the world can ill afford to ignore it. In addition, at present this region may not look very attractive but in view of its high growth rate it is likely to become far more important market in the near future.

Overall, the services sector is growing faster than manufacturing and agriculture in the region. Services constitute a major sector in all South Asian countries contributing 54.3% to the total GDP of the region (South Asia Data Profile, The World Bank). However, this sector's contribution to GDP in individual countries varies from as low as about 37% in Bhutan to as high as 82% in the Maldives (The World Bank 2007). Bhutan and Nepal are the only two countries from the region where contribution of services is well below 50% of GDP and this should not surprise us because in these countries the services sector is largely dominated by tourism and owing to different reasons tourism has not yet played the desired role. In the case of Bhutan, it is

relevant to point out that the country had been relatively conservative in opening its tourism sector. However, since it liberalised its tourism, the sector has grown exponentially albeit from a very low base which is likely to be reflected in the form of increased share of services in GDP only in due course. Whereas Nepal, a tourism-dependent country, has been facing difficult times and as a result the number of tourist arrivals has rather declined in recent years.

In South Asia, India clearly stands out as the largest services exporting and importing country. With a share of 2.7% of world exports of services, India was the tenth largest services exporting country in the world in 2006 (WTO 2007). In addition, as the balance of services trade has been in favour of India, this has largely offset the deficit in goods trade in recent years. However, India is a major services importing country as well and with some improvement in their supply capacity other South Asian countries can grab a portion of this large pie. After India, Pakistan is a major services importing country in the region. In 2006, Pakistan imported \$8.1 billion of services and was the 34th largest services importing country in the list of leading importers in world services imports (excluding intra-EU (25) trade).

It has been suggested that though there has been a significant increase in the share of services in output of all South Asian economies, there is tremendous 'asymmetry' in South Asian services trade: The output and characteristics of this trade are largely driven by rapid growth of this sector in India (CENTAD 2007). In India, the structure of services trade has shifted from traditional sectors like travel and transport towards business services. However, as CENTAD suggests, there has been no such major shift in the services trade of other South Asian countries. Nevertheless, the latest data suggest that in other countries too a shift could be seen in the composition of services exports. In the case of Pakistan the share of finance & insurance and wholesale & retail trade sub-sectors increased in the overall services sector in recent years (State Bank of Pakistan 2007). Likewise, share of other commercial services (other than transport and travel) has increased from 50 to 61% in Bangladesh export of services (WTO 2007). In the case of the Maldives where tourism overwhelmingly dominates the economy, share of other commercial services in its total exports was almost negligible at 1% in 2000, but has now increased to 3% of the total services exports. However, in Nepal a reverse trend has been seen because share of other commercial services in its overall services exports has rather declined from 47% in 2000 to 40% in 2005.

As in the case of India, the role of the services sector is crucial in sustaining the growth of Pakistan's economy. The services sector in Pakistan has sustained strong growth for the last six successive years. The sector has been a major contributor to the overall growth in GDP with its remarkable real growth averaging 7% over the past four years while major growth at the rate of 8% or more occurring only in the last two years (Burki and Hussain 2007). Thus, services are assuming the role of a new growth powerhouse in the country by contributing 68% to GDP growth in 2005-06. As Pakistan's economy has grown rapidly, the sustained high pace of growth in the economy is also reflected in a record level of investment during 2006-07, with the investment to GDP ratio rising to a record high of 23% (State Bank of Pakistan 2007). Another striking feature was the unprecedented level of FDI (\$5.1 billion) in the economy.

Like Pakistan, with the advent of economic liberalisation in Bangladesh since late 1980s, inflow of FDI registered an upward trend from a very low base. Total FDI inflow increased from \$ 92 million in 1995 to \$ 579 million in 2000 and reached 845 million in 2005. The economist intelligence unit (EIU) in its report on 'World Investment Prospects to 2010: Boom or Backlash?' showed that Bangladesh will receive \$ 600 million of FDI on an average a year during the period between 2006 and 2010 (Xinhua 2006). As per FDI projection in the report, Bangladesh is in the third position among the South Asian nations. India and Pakistan securing 19th and 64th position respectively have left Bangladesh behind them in this subcontinent while Sri Lanka attaining 81st position has been placed behind Bangladesh. As regards Nepal, India is the chief source of FDI in Nepal so far, followed by the United States, the People's Republic of China, the British Virgin Islands, Norway, Japan, the Republic of Korea, Canada and Hong Kong, China in terms of the amount of approved FDI (UNCTAD-ICC 2003). The major area of FDI has been manufacturing, followed by services and, in particular, tourism (*Ibid.* 18). India is an important source of investments in Bhutan and Maldives as well.

### Special Treatment for LDCs

The GATS regime is particularly important to LDCs, which suffer from severe constraints to economic development due to poor infrastructure and a lack of institutional and human capacities to cope with the challenges arising out of the liberalisation of trade in services (Raihan and Mahmood 2004). Others explain

how LDCs are left behind in the services sector (CENTAD 2007). There are systemic domestic factors such as poor quality of public spending in key sectors like education, and skewed direction of public spending – in favour of services consumed by rich households.

In view of their special position, the modalities have been developed for LDCs with an aim to provide the required flexibility to actively participate in the ongoing services negotiations. As per the provisions of the LDC Modalities, LDCs should not be obliged to offer national treatment to foreign service providers or to make 'additional commitments' (GATS Article XVIII) on regulatory issues – e.g. qualifications, standards and licensing requirements (WTO 2003). In response to requests, LDCs have been given flexibility to make commitments compatible with their development, trade and financial needs and which are limited in terms of sectors, modes of supply and scope.

The modalities also provide that 'preferential market access mechanism' should be created for achieving effective market access for LDCs to developed country markets. Regarding movement of natural persons members should open their markets to all categories of natural persons from LDCs, particularly unskilled and semi-skilled persons. However, what is interesting about these Modalities is that they significantly reduce the negotiating burden of LDCs, which are now expected to be able to focus on just a few sectors of export and import interests (Raihan and Mahmood 2004)

The LDC modalities seem to be one of the reasons why Bangladesh and the Maldives have not yet submitted any offers during the ongoing services negotiations. However, unless they offer commitments they may not be able to seek market access for their services and eventually not making any commitments will not be in their own economic interest. In this regard, Raihan and Mahmood suggest that the GATS negotiations are strategically important for LDCs, including Bangladesh, for the following three fundamental reasons: retaining and deepening competitiveness in goods exports; opportunities through increased tradability of services; and improvement of quality of services in domestic markets (2004). They also argue that LDCs should stop insisting that they do not need to open any sectors. In fact, they further argue, many sectors would benefit through an open policy regime and a predictable competitive environment.

Analysis of the requests to Bangladesh made by various developed countries suggests that professional, business services, and construction and related engineering services are among those services in which

Bangladesh has received requests. Construction and engineering services seem to be the main area in which most of the member countries that have sought market access through their requests are interested. Bangladesh has import interest in construction and related engineering services and it ought to undertake commitments. However, what is more interesting about education and tourism services is that Bangladesh has been suggested to have both import and export interests in these services and it has accordingly been advised to offer commitments and make request to seek commitments from other members. In both these services Bangladesh seems to be largely interested in opening Mode 3 in order to have foreign commercial presence.

The study suggests that all three services sectors – construction and related engineering services, education services, and tourism and travel-related services – have a negative balance-of-payments and these are thus sectors of import interest to Bangladesh (Raihan and Mahmood 2004). The GDP shares for education services (2.36%), tourism and travel-related services (0.67%) are comparatively low.

Opportunities through market opening would only be meaningful where the supply of service providers is of an adequate quality. Investment in training and education (fiscal resource issues) is a must for ensuring improved quality, standards, and competitiveness of service providers (Raihan and Mahmood 2004). Establishment of independent regulatory bodies and monitoring mechanisms to ensure standards is another way to create level playing fields. The strategy should include plans for active negotiations for MRAs with key markets. Short-term bilateral agreements with selected countries and institutions would be useful to understand the difficulties and streamline solutions. These efforts would help to bring transparency in mutual recognition.

Hence they argue that incremental liberalisation measures in the services trade might open windows of opportunity. However, the special position of LDCs should be taken into account also in the context of South Asia. One of the problems with regard to the South Asian LDCs is that they lack institutional capacity to cope with the burden of trade negotiations at WTO. For instance, since the Maldives does not have any representation in Geneva, due mainly to financial constraints, participation in the WTO activities is limited to those financed by WTO, e.g. Geneva Week, Ministerial Conferences, and technical assistance opportunities such as training, workshops, seminars, etc. (Maldives' TPR 2002). Similarly, Bangladesh and

Nepal are grossly underrepresented by their Missions in Geneva. However, it is a vicious circle which seems to be difficult to break. As they lack the capacity to fully participate in the proceedings of WTO, they are not able to gain the desired market access and since they do not gain market access, they are not able to generate required interest in international trade and eventually, do not accord priority to the multilateral trading system. Thus LDCs are marginalised in services talks and they may free ride or will be bypassed (CENTAD 2007). In this regard, LDC modalities should not be taken as a pretext not to participate in the negotiations, as other members may not put adequate pressure on them to open their markets.

At the regional level the LDCs modalities should give the LDCs a free hand to liberalise their services for other South Asian countries. Rather this should be used as an opportunity to bind-in the prevailing level of liberalisation. This will give them meaningful market access for their services as well as experience with respect to handling negotiations and once they succeed they would like the commitments undertaken at regional level to multilateralise in due course. It is also interesting to note that LDCs are not only looking at markets of developed countries but also developing countries. In this regard, the South Asian market will provide an important window to their exports.

### **Modal Interest in Services Trade**

South Asia's modal interests cover all four modes of the GATS. While the primary interest lies in movement of natural persons and cross-border supply, also significant are exports through movement of consumers and overseas commercial presence. However, it is mainly India which has an interest in all four modes, given its more mature services sector relative to the other economies of the region.

#### ***Mode 1 (Cross-Border)***

Market access commitments/offers in Mode 1 by the major industrialised countries are fairly liberal. Still there is scope for further liberalisation in Mode 1 through improved coverage of relevant services and through the scheduling of more full commitments, as currently less than half of the commitments are full or unrestricted. The liberalisation of Mode 1 by South Asian countries is significant given recent trends in intra-developing country trade via outsourcing. Therefore, all SAFTA member countries should liberalise this mode.

### *Mode 2 (Consumption Abroad)*

There also exists the potential to export education services through consumption abroad. Indian public and private medical institutions export medical education services through the provision of seats to foreign students from other countries in South Asia. Sri Lankan students come to Indian hospitals to study medicine. Pakistan, Sri Lanka and Bangladesh could invest in their education sector both directly and through collaboration with India to attract service seekers from within the region as well as globally. Pakistan could upgrade existing institutions of educational excellence such as the Lahore university of management sciences to attract overseas clients to serve the regional and even global markets.

Thus apart from Modes 1 and 4, Mode 2 is also an important mode for supply of services in South Asia. In this regard, there are three services sectors viz. tourism, education, and health that largely depend on this mode. Health is an interesting sector as this involves tourism and education apart from being important in its own right. In the South Asian region, patients come from Bangladesh, Sri Lanka, and Nepal to India for medical treatment. Thousands of patients come from Bangladesh alone each year seeking treatment in various Indian cities. From Nepal and Sri Lanka similarly patients visit India in large numbers for medical treatment. They also help generate health tourism in India.

### *Mode 3 (Commercial Presence)*

There is also scope to export education by establishing commercial presence overseas. Indian firms are increasingly emerging as exporters of capital. In segments like health services, some Indian companies are setting up with regional or international networks. There is growing interest among some Indian higher education services through establishment of offshore campuses as well as twinning and partnership arrangements. In both health and education services, there is potential for such commercial presence based exports of education services within the South Asian region. As Sri Lanka has a shortage of nurses, Apollo Hospital has also set up a nursing school.

South Asian countries also have strong import interests in the services sector, mainly in the form of FDI participation in their economies (Chanda 2005). As noted, all these countries have significantly liberalised their FDI policies in the past decade. Foreign participation through joint ventures, technology and management tie-ups, and subsidiaries is increasingly

being sought in services to alleviate infrastructural, financial, technological, and other constraints. However, in most of the South Asian countries services sectors other than tourism, education and construction have been the main drivers of FDI in the region.

Pakistan, for instance, has moved from a restrictive policy on FDI to encouraging FDI in areas like software development, tourism, and construction services. It has given permission for 100% foreign equity participation and waiver of a joint venture requirement in the case of social and infrastructure services and permits full repatriation of profits. Bangladesh has similarly liberalised its investment and industrial policies since the 1990s to encourage investments in energy, telecommunications, ports, highways and other civil works, software development and tourism services. In all but five sectors, it allows 100% foreign private investment with no prior approval requirements, or limits on equity participation, or restrictions on repatriation of profits and income, although there are requirements of local incorporation and registration with the board of investment. In response to such liberalisation, FDI in Bangladesh has increased. The services sector attracted around half of the total FDI in 2002. Apart from natural gas which accounted for around 30% of the total FDI inflows into the country, other sectors which remained priority area for investment included road and water transport, airports, power generation, transmission, and distribution, telecommunications, health, and education services.

It has been argued that the GATS negotiations provide the South Asian countries with an opportunity to bind in the autonomous liberalisation they have undertaken in the services sector. In particular, it enables them to signal their commitment to liberalisation of FDI policy in services and provide more transparent regimes for foreign participation. In this regard, the South Asian countries have significantly improved upon their earlier commitments, across all modes, and most noticeably in Mode 3. While India and Pakistan have made substantial improvements over their original commitments during the ongoing services negotiations, Sri Lanka has offered only marginal improvement. Nepal has already undertaken relatively liberal commitments during its accession negotiations. Bhutan an acceding WTO member country is also believed to have offered liberal commitments given the size of its economy and the country being an LDC. Bangladesh and the Maldives are the only two South Asian countries that have not so far offered to improve their original commitments. From a few studies done on

Bangladesh, it is evident that Bangladesh has received request from a number of WTO member countries to undertake liberal commitments in various services sectors and the studies have also suggested Bangladesh to undertake commitments given its strong import and export interests in many services sectors including construction and education services. Alongside it ought to improve upon its commitments in tourism services. Thus remains the Maldives about which there is no idea what it is going to offer during the ongoing negotiations.

It has been suggested that the commitments by the South Asian countries are on the whole more restrictive than prevailing policies, especially with regard to foreign commercial presence (Chanda 2005). Although the countries in this region have significantly liberalised their FDI policies and in several sectors have even permitted 100% FDI, for the most part, Mode 3 commitments by these countries are partial, with foreign equity being capped at a lower ceiling than that exists in practice. The commitments do not also cover some of those services which have been opened up to foreign participation. Thus, the commitments for the region clearly indicate the failure to lock in existing liberalisation.

#### *Mode 4 (Presence of Natural Persons)*

The area that is of immense significance to all South Asian countries (excluding perhaps Maldives) is Mode 4. India has been leading the negotiations on Mode 4 since the early 1990s in the multilateral trading system. India has invariably been supported by Pakistan in its efforts to seek market access for Mode 4. Sri Lanka has very clearly linked its further opening of the services sector to the satisfactory outcome on Mode 4 negotiations. As a leader of LDCs Bangladesh has always emphasised the need for having better market access for semi-skilled and low-skilled persons. Due to availability of a huge pool of trained and semi-trained workers, Pakistan expects most benefit from such flows. In fact, workers remittances play an instrumental role in the economies of six out of seven South Asian countries. South Asia received a total of but \$40 billion of workers remittances in 2006 accounting for about 4% of the region's GDP.<sup>3</sup> Moreover, for LDCs particularly Bangladesh and Nepal workers remittances account for a major share of their GDP. Workers remittances contribute about 15% to Nepal's GDP. The total official assistance and aid received by Nepal in 2005 was only about a third of the amount of workers

remittances. In Bangladesh, in 2003, the remittance earnings amounted to 46.76% of total export earnings; this volume was equivalent to 5.9% of GDP. Similarly, Pakistan's remittances at present are recorded at around \$ 4 to 5 billion per annum.

From the data on labour flows to developed and developing countries from South Asia it is evident that all South Asian countries have a strong interest in exporting labour-intensive services, at all levels of skills. However, there is a need for expanding the category of persons allowed to deliver services and thus less skilled or unskilled service providers through instruments like special visas and authorised recruiting agencies must be allowed.

What is however interesting about all south Asian countries regarding Mode 4 is that though they are very much interested in exporting services via Mode 4, all of them have a restrictive regime with respect to movement of natural persons. They have, thus, neither taken liberal commitments under the GATS regime nor have they liberalised this mode autonomously. Due to its dependence on foreign labour the Maldives seems to have a liberal Mode 4 regime in place and India has offered fairly liberal commitments on Mode 4 under the GATS particularly for professionals. Thus expatriates are allowed to work in Nepal if they obtain a work permit and such permits are granted for specialised technical expertise unavailable in Nepal and for key personnel of foreign investors. In all only 632 work permits were to foreigners in 1998–99, 663 in 1999–2000 and 806 in 2000–01. Foreigners other than Indians need a visa to enter Nepal. For India, a valid identification document issued by a government authority is sufficient. A similar restrictive regime exists in Sri Lanka, Bangladesh, and Bhutan.

Apart from working on SAFTA the South Asian countries need to take a common position as far as possible under the GATS also. So far only India and Pakistan have submitted some common proposals during the negotiations. Even if other countries' interests are restricted to a few sectors, still they can have a common strategy that will help them at the multilateral forum as well as at regional level. Construction, health and tourism could be some of the services sectors where this region can have some amount of convergence. Mode wise apart from Mode 4 there could be common interest in Mode 1 as well.

What appears from the study is that though the South Asian countries have traversed quite a long

<sup>3</sup> Author's calculations based on the data in South Asia Data Profile, The World Bank, April 2007.

distance in the reforms journey and have also made commitments at the multilateral trading system, in order to reap the benefits of liberalisation they need to further liberalise. This is so, because their level of commitments is far short of the level, autonomous liberalisation has achieved. Moreover, they need to undertake more liberal commitments at the regional level

without being much apprehensive about the adverse implication of liberalisation. Given the resource endowments the region has, it is expected that the five sectors – construction, tourism, health, telecommunications and higher education – can provide further fillip to the growth momentum and also help sustain that.

# 17 ■ Way Forward in SAFTA

## ■ WAY FORWARD

It has been recognised that trade and investment flows have played a crucial role in the economic integration of various regions of the world, and it could have been true for South Asia too. Although, intra-regional trade in South Asia has been increasing steadily, it continues to be low. The region lags far behind other regions in terms of economic integration though considerable potential exists. This study uses alternative methodologies and arrives at the conclusions that there exists economic rationale for SAFTA as all member countries gain by SAFTA, particularly Bangladesh. These results have also been supported by some other studies (Mukherjee 2004) which indicate economic gains that would accrue from SAFTA. However, there is much variation across studies in the magnitude predicted for these advantages. Furthermore, this study indicates the gains that may accrue to the member countries in terms of increase in services trade and foreign direct investments with SAFTA.

The study emphasises that FTA in goods will provide gains to all member countries; additional gains can be harnessed through deeper regional integration in services, trade facilitation and investments. The following steps will lead to achieving this goal:

### *Cutting Down the Size of Sensitive Lists*

The size of SAFTA's Sensitive List was negotiated with reference to the total number of items in HS system. No threshold was prescribed to ensure that members get an assured market access in terms of coverage of bilateral trade volumes. The present size of the sensitive list of 25% of the total number of items at 6-digit HS level is much bigger than any successful RTA. It has been understood that in the recent SMC meeting held on 3 March 2008 in New Delhi, the Ministers have decided that the committee of experts will start negotiations for the removal of items from the Sensitive List

(instead of a review after 4 years as prescribed under SAFTA). To facilitate the intra-regional trade and investment flows it is important that the size of the sensitive list of each SAFTA member is reduced drastically.

In order to achieve this objective, economic analysis can be adopted and the possibility of reducing sensitive lists of Bangladesh, India, Pakistan and Sri Lanka can be explored. The following criteria for reducing the Sensitive Lists are suggested:

- In case a country is competitive in a product in the Sensitive List compared to other three countries, its domestic industry may not be threatened from imports from the other three countries. Accordingly, that product may be removed from the Sensitive List. Competitiveness could be based on Revealed Comparative Advantage Analysis.
- In case a country has high global imports of a product in the sensitive list, it indicates that there is insufficient domestic supply capacity for the product concerned. Accordingly, that product may be removed from the sensitive list. In respect of non-LDC countries, 0.01% of total imports can be taken as high global imports in a particular tariff line. However, as LDCs are import-dependent, 0.04% of their total imports can be taken as the benchmark for high global imports.
- In case there are no global exports of a product from 3 countries in the sensitive list of the country concerned, it is unlikely to be imported into the country concerned from the other 3 countries. Accordingly, this product may be removed from the sensitive lists.

Based on above criteria sensitive lists of India, Pakistan and Sri Lanka can be reduced by more than 25%, and that of Bangladesh by 15%.

Accordingly, the following modality is suggested as a possible way forward for reducing the sensitive list:

- All non-LDC member countries of SAFTA reduce their negative list by 20–25%, based on considerations such as competitiveness of products in the sensitive list, global imports of products in the sensitive list and global exports of partner countries of products in its sensitive list. The corresponding reduction in the sensitive lists of LDCs could be 10–15%. The reduction could be made effective within a year.

### ***Timeframe for Tariff Liberalisation***

Given the timeframe for liberalisation of their tariffs in other FTAs (India – ASEAN/Singapore/Thailand, Pakistan – the People’s Republic of China, etc.), the current timeframe for tariff liberalisation (seven to ten years) needs to be shortened, implying advancement in the tariff liberalisation schedule.

### ***Duty-Free Market Access***

The present SAFTA treaty does not prescribe for a mandatory duty-free market access (the commitment is for bringing duties to 0–5%). The duty reduction to 5% may deny adequate preferential market access to the members and if the Doha Round succeeds, then a possibility of erosion of the SAFTA preferences cannot be ruled out. The study has estimated the gains that may accrue to member countries with 0% tariffs and finds the gains to be positive in all cases. This issue should also be included in the negotiating agenda of reviewing the TLP. It is important that all members decide to make it a duty-free agreement.

### ***Regional Cumulation***

The present RoO of SAFTA provides that in order to utilise the regional cumulation benefits the total regional value addition should be 50% (10% higher than the normal value addition) and the exporting party should have a minimum value addition of 20%. A similar provision which existed in SAPTA did not stimulate intra-regional trade; hence the concept of full cumulation without any value addition obligation to the exporting Party be explored. The impact of SAFTA RoO on effective preferential trade is not known and perhaps would take some time in dissemination of preferential trade data. It would therefore be important to conduct a study, in future, which can examine the impact of SAFTA RoO in intra – SAFTA trade. Have the rules facilitated value-added and greater economic activities in SAARC region or have impeded the trade

needs to be explored on the basis of actual trade and investment flows?

### ***Non-Tariff Barriers (NTBs)***

Many exporters from South Asia allege that NTBs have been put in place with the intention to restrict trade from neighbouring countries. Though such measures may be totally WTO-compatible, the fact that it creates difficulty to the exporters of neighbouring countries cannot be denied. The COE is discussing this issue in its meetings. It is important to identify such measures and document them for a focused discussion in the meetings so that such irritants are removed in a time bound manner. Secondly, even if these are WTO compliant standards or regulations, a fast track procedure is required for establishing equivalence, MRAs, conformity assessment procedures, accreditation, etc., in a time bound manner.

### ***Going beyond SAFTA in Goods***

SAFTA is an agreement covering only goods. Given the fact that worldwide now the negotiations are held for comprehensive coverage of issues like services, investments, IPRs, competition policy, SPS, TBT, etc., it may be beneficial for the region that SAARC catches itself up with the pace of these agreements. Therefore, the following be included in its agenda:

***South Asian FTA in Services:*** There is a historical existence of services trade in the SAARC region, most of which is through informal channels. There is no official statistics on sector-wise services trade, but the fact that SAARC nationals travel to each other, especially to India for education or medical treatment is well known. Studies have shown that the SAARC member countries have revealed comparative advantage in different sectors covering transport, travel and other services (Banga 2008, Mukherji 2005). This study also points out the services where intra-regional trade can be boosted. It is understood that the SMC meeting on 3 March 2008 in New Delhi decided to include the Agreement in Services in SAARC and a road-map is being drawn for the negotiations. This is a positive and welcome step and negotiations should be started as soon as possible. In order to make the Services agreement effective and successful, following measures would be necessary:

- The disaggregated data on services trade is not available for the individual SAARC members. In

order to have meaningful results in terms of preferential market access in services, it would be essential to have a proper and *comparable data on services*.

- SAARC members can consider *binding unilateral liberalisation in identified sectors of services* in the FTA in Services.
- In order to provide effective market access, it is essential that *MRAs in identified areas of services are facilitated* and agreement reached in the FTA. In this regard, special focus needs to be given to higher education, health and related services, tourism & travel, construction and engineering services.
- Given their stages of economic development, the SAARC LDCs can be benefited from services agreement only when they are given market access under Mode 4. The expansion of activities in the construction and infrastructure sectors in India, Pakistan and Sri Lanka can provide *greater opportunities to unskilled labours* of LDC members of SAARC and therefore market access commitments would need to be made under the agreement.
- Given their similar interests in communication and infrastructure, it would be essential that SAARC members *take higher commitments under Mode 1 and Mode 3*.
- In order to encourage member countries to take deeper and wider commitments in services, a flexible architecture of services framework may be considered whereby member countries, especially LDCs, are given the flexibility to impose a standstill on commitments taken in those sectors which might have been adversely affected by liberalisation under SAFTA.

**SAARC Investment Area:** To enhance the intra-SAARC trade and investment flows as well as backward-forward linkages between the investors of the region, it is essential that a blueprint for SAARC investment area be prepared and negotiations be held to finalise the agreement. The agreement will not only bring transparency and predictability in the respective regimes but would also ensure that investors' rights are protected and the reforms are 'locked-in'. One could also look at innovative methods of linking the preferential market access through 'equity sharing'

between the two SAARC members. There exist possibilities of vertically integrated FDI in many sectors, e.g. textiles, food processing, etc. Studies need to be encouraged in this area and member countries need to adopt policies to encourage investments so as to form supply chains in the region.

### *Trade Facilitation*

Studies<sup>1</sup> have pointed out that the cost of doing business through formal channels in the region is higher than through informal channels in SAARC. Moves should be initiated for standard setting and mutual recognition of standards through accredited testing laboratories. In order to minimise the cost of trade in the SAARC region it is essential that focused study on trade facilitation is carried out.

### *Cooperation in Infrastructure*

The members of SAARC are at different levels of economic development and so are their infrastructural supports to promote trade and investment flows. The countries in the region have common interest in the areas of road and railway construction, building of bridges and telecommunication development. SAFTA does not explicitly provide for transport facilitation, one would need to look beyond SAFTA to address this issue. This study has undertaken cost-benefit analysis of some micro transport facilitation projects in the region to demonstrate the gains from these projects to the country of origin. Joint projects for development of ports and land customs infrastructure for facilitating movement of goods should be initiated on priority.

### *Transit Treaty*

SAARC involves some members who are landlocked and therefore they face problems relating to accessibility to seaports for their trade. Given the geographical location of even other members which are not landlocked, it may be economical to transport goods through the land route, transiting through other SAFTA member. There is a need for a regional framework or treaty for promoting transit to promote unhindered movement of goods across borders.

### *S&D for the LDC Members*

Though the SAFTA provides for S&D treatment to be

<sup>1</sup> Taneja, Nisha, Muttukrishna Sarvanathan and Sanjib Pohit. 2003. 'India-Sri Lanka Trade: Transacting Environments in Formal and Informal Trading', *Economic and Political Weekly*, July 19, 3095-98.

accorded to LDC members and liberalisation of tariffs by the developing countries in three years, the TLP is for bringing the duties to 0–5%. There is no such commitment to grant duty-free treatment to LDCs at the end of TLP. At the 14th SAARC Summit, the Prime Minister of India stated that as the largest country in the region, India was ready to accept asymmetrical responsibilities including opening her markets to her South Asian neighbours without insisting on reciprocity. He also announced that before the end of the current year, India would allow the LDCs among its South Asian neighbours duty-free access to its markets (in SAFTA Agreement the commitment is for bringing the duties to 0–5%). It will also further reduce the sensitive list in respect of these countries. As per this announcement, India has eliminated its tariffs to zero (duty-free) for the LDC members with effect from 1 January 2008 whereas as per the SAFTA tariff liberalisation programme, the reduction to 0–5% for the LDCs was to be completed by 31 December 2008. India is also in the process of unilaterally reducing its Sensitive List for LDCs. It is important that other developing members like Pakistan and Sri Lanka announce for providing a duty-free market access to LDC members for non-sensitive items. Secondly, the SAARC LDCs also do not compete with each other in their respective markets and therefore, even the LDCs should decide for grant of duty-free market access to each other at the end of the TLP. Lastly, for the LDCs a fasttrack mechanism for providing technical assistance, capacity building, providing equivalence, MRAs and accreditation for facilitating their export items would need to be evolved.

### *Business to Business Interactions*

There is a SAARC chamber of commerce which aims for enhancing business to business interactions. However, given the fact that the intra-regional investment flows are miniscule, there is a need that this activity is given more focused attention and an institutional arrangement is built which provides that in the process of policy making, suggestions made by the SAARC chamber are accommodated by each member.

### *Line of Credit*

Given the success of the Line of Credit that India has opened with Sri Lanka and its positive effect on trade and investment flows, one of the actions that can be recommended is to replicate the same with other members. Perhaps India can take a lead in this, as it is

the biggest partner of SAARC. In this regard, priority should be given to LDCs which have weak purchasing power and have limited financial resources.

Apart from the above action points, it would also be necessary that future research areas are identified well in advance. In this regard, the following areas for research can be recommended:

- With the growth of regional trade agreements worldwide as well as in Asia, a study on impact of such RTAs on SAFTA needs to be carried out. What would be the impact of overlapping agreements on intra-regional trade, and how the different RoOs will impact the trade and investment flows in the region needs further probing.
- The intra-regional investment flows have also been much skewed. A study on compiling data of the actual investment flows; impediments to investments; and suggestions to increase intra-regional investments needs to be carried out. The study should also suggest incentives or policy instruments that can be put in place to attract intra-regional investments. Country specific recommendations would be useful as there may be necessity to follow different policy measures to attract investments.
- The impact of trade liberalisation on specific sectors like textiles, food processing industries and some of sectors of services can be carried out and disseminated. What are the lessons to be learnt and how SAARC members can benefit together needs to be examined.
- A study should be carried out to identify the sectors where the backward-forward linkages among the industries can take place in the SAARC region. The study should also recommend how this integration can be made possible and what kind of policy instruments need to be put in place by individual SAARC members.
- Informal trade being very important segment in SAARC, a field based survey needs to be carried out to assess its actual potential. The study should also make policy recommendations as to how they can be converted to formal trade and highlight the benefits that may be passed on to the members and consumers.
- Food security in South Asia is a common cause of concern, what role SAFTA can play needs a deeper examination.

In order to make SAARC a meaningful coalition and a strong economic block, substantial progress

towards its economic integration is very important. The complementarities on different dimensions need to be explored so that the entire region progresses and the benefits are balanced. Therefore, broadening the current SAFTA agreement beyond trade in goods to include areas of services and investment is equally important. Evidence from other regional groupings shows that investment flows play at least as significant a role as trade in promoting regional integration. While free trade alone will yield gains, these are unlikely to

be great. However, dynamic long-term effects can be significant, particularly if combined with aggressive trade-facilitation measures, removal of NTBs, opening up the services sectors and, in particular, liberalisation of the investment regime. The full realisation of the gains of freer trade and investment would also require continuous and massive investment in physical infrastructure to connect the region more efficiently. A comprehensive action plan, therefore, is needed to make SAFTA a meaningful and effective regional trading bloc.



# **APPENDICES**



# Appendix 3

Using the RCA index, the competitive basket has been estimated for four major trading partners of the region, i.e. Bangladesh, India, Pakistan and Sri Lanka. The competitive basket is defined as the list of common products where each country has a revealed comparative advantage vis-à-vis the world, at the five digit SITC level. The different competitive baskets for the years 1991 and 2004 are presented in Table A3.1 and A3.14.

The results show that the competitive basket has expanded overtime and some new products have entered the basket. Textile products are still the products where all four major trading partners of the region compete in the third country market. However, these countries have gained competitiveness in products like shrimps, spices, woven carpets, cotton yarn wastes, etc.

**Table A3.1 Change in Competitive Basket in Intra-SAARC Region Overtime: 1991–2004**

1991 Competitive Basket		2004 Competitive Basket	
3611	Shrimps/prawns, frozen	3611	Shrimps/prawns, frozen
65751	Twine/cordage/rope/cable	7529	Spices nes, mixtures
84122		26331	Cotton yarn waste
84151	M/b trousers cotton wovn	26339	Cotton waste n.e.s.
84159	M/b trouser fibre nes wv	26902	
84162	Men/boy pyjama/etc. woven	65122	Rags/waste cordage/etc.
84169	Men/boy bathrobe nes wvn	65643	Hand-made lace
84221	Wom/girl suits woven	65751	Twine/cordage/rope/cable
84282	Wom/girl nightwear woven	65812	Cotton sacks/bags
84289	Wom/girl uwear nes woven	65847	
84321	Men/boy knit/croch suits	65959	Carpet,woven,textile nes
84323		84123	Mens/boys ensembles wovn
84324	Men/b trouser/etc. kni/cr	84151	M/b trousers cotton wovn
84371	Men/b trouser cotton k/c	84159	M/b trouser fibre nes wv
84379	M/b trouser fibre nes kc	84161	Men/boy underwear woven
84423		84162	Men/boy pyjama/etc. woven
84424	Women/g dresses knit/cro	84169	Men/boy bathrobe nes wvn
84483	Women/g nightwear knit/c	84221	Wom/girl suits woven
84511	Baby clothes woven	84281	Wom/g slip/petticoat wvn
84589	Wom/g appar nes not kn/c	84282	Wom/g nightwear woven
84812	Leather gloves, etc.	84289	Wom/girl uwear nes woven
		84321	Men/boy knit/croch suits
		84322	
		84324	Men/b trouser/etc. kni/cr
		84371	Men/b trouser cotton k/c
		84379	M/b trouser fibre nes kc
		84381	
		84382	Men/b nightwear knit/cro
		84389	Men/boy uwear nes kn/cr
		84421	Wom/girl knit/croch suit
		84424	Women/g dresses knit/cro
		84425	Women/g skirts knit/croc
		84426	Women/g trouser knit/cro
		84481	Women/g slips/etc. kni/cr
		84483	Women/g nightwear knit/c
		84511	Baby clothes woven
		84512	Baby clothes knit/croch
		84561	Men/b swimwear not kn/cr
		84591	
		84693	
		89221	

Bilateral change in the competitive baskets have also been estimated and presented in Tables A3.2 to 3.13. The data has been collected from COMTRADE. The tables present the competitive product baskets at

five digit SITC product level. The new products that have entered the competitive basket in 2004 have been separately presented.

**Table A3.2 Bangladesh and Pakistan: Competitive Product Basket where Revealed Comparative Advantage (RCA) is Greater than 1 in the Years 1991 and 2004**

Product Code	Description	Product Code	Description
3513	Fish (ex cod) dried/salted	84169	Men/boy bathrobe nes wvn
3611	Shrimps/prawns, frozen	84221	Wom/girl suits woven
29111	Bones etc.	84282	Wom/g nightwear woven
29116	Ivory/tortoise-shell/etc.	84289	Wom/girl uwear nes woven
29231	Bamboo for plaiting	84321	Men/boy knit/croch suits
65213	Woven cotton terry nes	84323	Men/b jackets knit/croch
65751	Twine/cordage/rope/cable	84324	Men/b trouser/etc. kni/cr
65842	Bed linen of cotton nes	84371	Men/b trouser cotton k/c
65843	Bed linen of othr fibres	84379	M/b trouser fibre nes kc
65847	Toilet/kitchen artic cot	84423	Women/g jackets knit/cro
84122	M/b suits fibre nes wovn	84424	Women/g dresses knit/cro
84151	M/b trousers cotton wovn	84483	Women/g nightwear knit/c
84159	M/b trouser fibre nes wv	84511	Baby clothes woven
84162	Men/boy pyjama/etc. woven	84614	Gloves etc. not knit/croc

**Table A3.3 Bangladesh and Pakistan: Additional Products in Competitive Basket where Revealed Comparative Advantage (RCA) is Greater than 1 in 2004**

Additional Product in 2004	Description for 2004	Additional Product in 2004	Description for 2004
3413	Fish, flat, fresh/chilled	65752	Knotted rope/twine nets
3422	Fish, flat, frozen	65822	Tents
3428	Fish nes, frzn ex liv/roe	66133	Nat stone tiles < 7 cm
4719	Cereal meal/flour nes	66749	Synth jewels nes unset
5459	Vegetables nes, frsh/chld	83119	Handbags, nes
6199	Sugars nes/invert sugar	83129	Trunks/cases/etc. nes
8125	Bran, etc. of rice	84123	Mens/boys ensembles wovn
8126	Bran, etc. of wheat	84161	Men/boy underwear woven
23222	Scrap unhardened rubber	84281	Wom/g slip/petticoat wvn
26331	Cotton yarn waste	84322	Men/b ensembles knit/cr
26339	Cotton waste n.e.s.	84381	Men/b underwear knit/cro
26902	Rags/waste cordage/etc.	84425	Women/g skirts knit/croc
29229	Nat gums/resin/etc. nes	84426	Women/g trouser knit/cro
29293	Veg brush/broom material	84481	Women/g slips/etc. kni/cr
43122	Veg fat/oil/fractions	84552	Girdles/corsets/braces
62991	Hardnd rubber/ebonite	84561	Men/b swimwear not kn/cr
65122	Cotton sewing thr retail	84563	Wom/g swimwear not kn/cr
65184	Syn stap (< 85%) yarn bulk	84599	Garments nes knit/croch
65242	Woven cotton dyed > 200g	84629	Womens hosiery nes
65265	Woven cotn mix prnt > 200g	84693	Shawls/scarves/etc.
65529	Knit/crochet fabric nes	84694	Ties/cravats/etc.
65621	Woven textile labels, etc.	89221	Newspaper etc. > 4 per week
65629	Non-woven text label, etc.		

**Table A3.4 Bangladesh and India: Competitive Product Basket where Revealed Comparative Advantage (RCA) is Greater than 1 in the Years 1991 and 2004**

Common Product 1991 and 2004 Product Code	Description for 1991 and 2004	Common Product 1991 and 2004 Product Code	Description for 1991 and 2004
03611	Shrimps/prawns, frozen	84169	Men/boy bathrobe nes wvn
07413	Black tea, pack to 3 kg	84221	Wom/girl suits woven
07414	Black tea, bulk	84281	Wom/g slip/petticoat wvn
29111	Bones, etc.	84282	Wom/g nightwear woven
29116	Ivory/tortoise-shell/etc.	84289	Wom/girl uwear nes woven
65197	Jute, etc., yarn	84321	Men/boy knit/croch suits
65496	Terry towelling exc cotn	84324	Men/b trouser/etc. kni/cr
65751	Twine/cordage/rope/cable	84371	Men/b trouser cotton k/c
65759	Articles of cordage nes	84379	M/b trouser fibre nes kc
65811	Jute, etc., sacks/bags	84424	Women/g dresses knit/cro
65969	Carpets/floor covrs nes	84426	Women/g trouser knit/cro
84122	M/b suits fibre nes wovn	84483	Women/g nightwear knit/c
84151	M/b trousers cotton wovn	84511	Baby clothes woven
84159	M/b trouser fibre nes wv	84561	Men/b swimwear not kn/cr
84161	Men/boy underwear woven	85152	Footw text up, leath sole
84162	Men/boy pyjama/etc. woven		

**Table A3.5 Bangladesh and India: Additional Products in Competitive Basket where Revealed Comparative Advantage (RCA) is Greater than 1 in 2004**

Additional Product in 2004	Description for 2004	Additional Product in 2004	Description for 2004
03633	Octopus/squid, frsh/chlld	65851	Curtains/drapes/blinds
05669	Vegetables nes, pres/frz	65892	Dusters, dish cloths etc.
07529	Spices nes, mixtures	65929	Carpet, knotted, oth text
26331	Cotton yarn waste	65959	Carpet, woven, textile nes
26339	Cotton waste n.e.s.	66113	Hydraulic lime
26661	Nylon/polyamide fil tow	66612	Household/toilet porcel
26902	Rags/waste cordage/etc.	67413	Zinc coated steel w > 600
29272	Cut foliage, etc.	69744	Iron/steel wool/scourers
55411	Toilet soap in bars, etc.	72721	Oil/fat extract machines
59224	Gelatin and derivatives	73141	Way-type unit head machn
61141	Tanned bov/equin leather	73591	Pts nes metal rmvl tools
61142	Prepd bov/equine leather	77585	Electric blankets
61152	Prepd sheep/lamb leather	84111	Wvn m/b coats wool/hair
61162	Prepd goat/kid leather	84112	Wvn m/b coats oth fibres
61179	Animal skin leather nes	84123	Mens/boys ensembles wovn
64121	Hand-made paper/board	84211	Wom/g overcoat/etc. wovn
65121	Cotton sewing thrd, bulk	84222	Womens/g ensembles woven
65122	Cotton sewing thr retail	84322	Men/b ensembles knit/cr
65132	Cotton yarn nes, retail	84381	Men/b underwear knit/cro
65133	Cotton (> 85%) yarn bulk	84382	Men/b nightwear knit/cro
65134	Cotton (< 85%) yarn bulk	84389	Men/boy uwear nes kn/cr
65182	Syn stap (>85%) yarn bulk	84421	Wom/girl knit/croch suit
65187	Art stap (< 85%) yarn mixt	84422	Women/g ensembles knit/c
65212	Unblchd cotton terry fab	84425	Women/g skirts knit/croc
65222	Woven cottn unbl > 200g/m <sup>2</sup>	84481	Women/g slips/etc. kni/cr
65225	Woven cotton nes < 200g/m <sup>2</sup>	84512	Baby clothes knit/croch
65291	Blchd wovn cotn nes < 200g	84521	Felt/nonwoven t clothes
65292	Dyed woven cotn nes < 200g	84591	Track suits knit/crochet
65295	Blchd wovn cotn nes > 200g	84592	Ski suits knit/crochet
65298	Print wovn cotn nes > 200g	84611	Handkerchiefs
65342	Wovn syn fib/manmade fab	84693	Shawls/scarves/etc.
65521	Knit/croch fab nes < 30cm	85111	Footw all rub/plast weld
65643	Hand-made lace	85122	Ski-boots leather uppers
65761	Felt hat bodies/forms	85141	Leather sandals
65812	Cotton sacks/bags	85149	Footwear nes leathr uppr
65819	Textile sacks/bags nes	88415	Glass spectacle lenses
65824	Pneumatic mattresses	89221	Newspaper etc. > 4 per week
65841	Knit/crochet bed linen	89311	Plastic sacks/bags/cones
65844	Knit/crochet table linen	89919	Moulded, carved goods nes
65845	Table linen of coton nes	89984	Button moulds/parts
65847	Toilet/kitchen artic cot		

**Table A3.6 Pakistan and India: Competitive Product Basket where Revealed Comparative Advantage (RCA) is Greater than 1 in the Years 1991 and 2004**

1991 and 2004 Product Code	Description for 1991 and 2004	1991 and 2004 Product Code	Description for 1991 and 2004
3428	Fish nes, frzn ex liv/roe	65819	Textile sacks/bags nes
3611	Shrimps/prawns, frozen	65821	Tarpaulins/awnings/blind
4231	Rice milled unbroken	65832	Cotton blankets
5429	Dried legumes nes	65841	Knit/crochet bed linen
5613	Mushrooms/truffles, dried	65844	Knit/crochet table linen
5797	Avocado/mango/guava frsh	65859	Furnishing articles nes
7526	Seed spices	65892	Dusters, dish cloths, etc.
7529	Spices nes, mixtures	65893	Life jacket/belt, etc.
8125	Bran, etc., of rice	65921	Carpet, knotted, wool/hair
26331	Cotton yarn waste	65959	Carpet, woven, textile nes
26339	Cotton waste n.e.s.	66381	Asbestos mfs nonfriction
26859	Coarse hair nes uncombed	66731	Prec/semi-p stone shaped
28791	Chromium ore/concentrate	69742	Copper kitchen equip nes
29111	Bones, etc.	84122	M/b suits fibre nes wovn
29116	Ivory/tortoise-shell/etc.	84151	M/b trousers cotton wovn
29229	Nat gums/resin/etc. nes	84159	M/b trouser fibre nes wv
29249	Pharmacy plants nes	84162	Men/boy pyjama/etc. woven
29299	Veg material/product nes	84169	Men/boy bathrobe nes wvn
61142	Prepd bov/equine leather	84221	Wom/girl suits woven
61151	Tanned sheep/lamb leathr	84282	Wom/girl nightwear woven
61161	Tanned goat/kid leather	84289	Wom/girl uwear nes woven
61162	Prepd goat/kid leather	84321	Men/boy knit/croch suits
65122	Cotton sewing thr retail	84324	Men/b trouser/etc. kni/cr
65132	Cotton yarn nes, retail	84371	Men/b trouser cotton k/c
65133	Cotton (> 85%) yarn bulk	84379	M/b trouser fibre nes kc
65159	Synth filament yarn nes	84382	Men/b nightwear knit/cro
65211	Cotton gauze exc narrow	84389	Men/boy uwear nes kn/cr
65212	Unblchd cotton terry fab	84421	Wom/girl knit/croch suit
65221	Woven cottn unbl < 200g/m <sup>2</sup>	84424	Women/g dresses knit/cro
65222	Woven cottn unbl > 200g/m <sup>2</sup>	84483	Women/g nightwear knit/c
65224	Woven cotton mix > 200g/m <sup>2</sup>	84511	Baby clothes woven
65225	Woven cotton nes < 200g/m <sup>2</sup>	84512	Baby clothes knit/croch
65231	Woven cotton bleach < 200g	84589	Wom/g appar nes not kn/c
65232	Woven cotton dyed < 200g	84592	Ski suits knit/crochet
65234	Woven cotton print < 200g	84611	Handkerchiefs
65241	Woven cotton bleach > 200g	84612	Shawl/scarf/etc. not kn/c
65292	Dyed woven cotn nes < 200g	84622	Womens long hosiery
65293	Color wovn cotn nes < 200g	84812	Leather gloves, etc.
65318	Wovn synth mix fabrc nes	89477	Sports gloves, etc.
65411	Woven noil silk fabric	89479	Sports goods nes
65643	Hand-made lace	89911	Animal mater carving, etc.
65751	Twine/cordage/rope/cable	89932	Matches
65812	Cotton sacks/bags		

**Table A3.7 Pakistan and India: Additional Products in Competitive Basket where Revealed Comparative Advantage (RCA) is Greater than 1 in 2004**

Additional Product in 2004	Description for 2004	Additional Product in 2004	Description for 2004
3716	Fish prepared, preserved nes	65496	Terry towelling exc cotn
3721	Crustaceans, prepared/preserved	65651	Embroidery, no vis. ground
4232	Rice milled, broken	65752	Knotted rope/twine nets
4719	Cereal meal/flour nes	65811	Jute, etc., sacks/bags
5422	Dried chickpeas	65824	Pneumatic mattresses
5424	Dried lentils	65831	Wool/hair blankets
5451	Onions/shallot, fresh/chilled	65839	Blankets of textiles nes
6121	Sugar, coloured/flavoured	65845	Table linen of cotton nes
7513	Capsicum dry/crush/grind	65846	Table linen of oth fibre
22211	Groundnuts in shell	65847	Toilet/kitchen article cot
22262	Mustard seeds	65851	Curtains/drapes/blinds
26652	Polyester fibres	65852	Bedspreads
26653	Acrylic/modacrylic fibre	66121	Cement clinkers
26672	Polyester fibre spinable	66122	Portland cement
26819	Wool, greasy, nes	66133	Nat stone tiles < 7 cm
26902	Rags/waste cordage/etc.	66749	Synth jewels nes unset
27312	Marble/etc. slabs	67939	Seamed pipes nes d > 406.4
27824	Magnesite	67941	Seam oil/gas pipeline nes
27861	Slag sand(iron/steel mf)	68427	Aluminium tube fittings
29293	Veg brush/broom material	69352	Copper netting/grill/etc.
33541	Petroleum bitumen/resids	69545	Household tools nes
52344	Sulphites/thiosulphates	69635	Safety razor blades
54291	Medicaments nes non-ret.	69734	Copper dom cook/heat eq.
55411	Toilet soap in bars, etc.	69743	Alumin kitchen equip nes
56229	Chem phosph fertilizr nes	69752	Copper sanitary ware
57433	Polyethylene terephthalat	77323	Ceramic elect insulators
59212	Maize (corn) starch	79355	Float/sub drill/etc. plat
59215	Starches nes	81229	Ceramic plumb fixts nes
59224	Gelatin and derivatives	83121	Leather trunks/cases/etc.
61141	Tanned bov/equin leather	83129	Trunks/cases/etc. nes
61152	Prepd sheep/lamb leather	84123	Mens/boys ensembles wovn
61179	Animal skin leather nes	84161	Men/boy underwear wovn
62991	Hardnd rubber/ebonite	84281	Wom/g slip/petticoat wvn
64239	Book covers/blotters, etc.	84322	Men/b ensembles knit/cr
65134	Cotton (< 85%) yarn bulk	84381	Men/b underwear knit/cro
65152	Polyester filament yarn	84425	Women/g skirts knit/croc
65171	Artif filam yarn retail	84426	Women/g trouser knit/cro
65182	Syn stap (> 85%) yarn bulk	84481	Women/g slips/etc. kni/cr
65184	Syn stap (< 85%) yarn bulk	84561	Men/b swimwear not kn/cr
65223	Woven cotton mix < 200g/m <sup>2</sup>	84591	Track suits knit/crochet
65243	Woven cotton denim > 200g	84692	Gloves, etc. nes knit/croc
65245	Woven cotton print > 200g	84693	Shawls/scarves/etc.
65251	Woven cotn mix blch < 200g	84694	Ties/cravats/etc.
65254	Woven cotn mix prnt < 200g	84811	Leather clothes
65261	Woven cotn mix blch > 200g	84813	Leather belts, etc.
65263	Woven cotn mix denm > 200g	84819	Leather clothing access.
65265	Woven cotn mix prnt > 200g	85115	Footwear rub/plast sole
65291	Blchd wovn cotn nes < 200g	85141	Leather sandals
65294	Print wovn cotn nes < 200g	85142	Footwear wood base/platf
65295	Blchd wovn cotn nes > 200g	85148	Footwear nes leathr sole
65298	Print wovn cotn nes > 200g	85149	Footwear nes leathr uppr
65317	Wovn synth fil fabrc nes	85152	Footw text up, leath sole
65331	Wovn p"ester sf/ctn < 170g	89221	Newspaper etc. > 4 per week
65352	Wovn art fil/strip fabrc	89919	Moulded, carved goods nes
65419	Woven silk fabrics nes	89991	Articles of gut/etc.

**Table A3.8 Sri Lanka and India: Competitive Product Basket where Revealed Comparative Advantage (RCA) is Greater than 1 in the Years 1991 and 2004**

1991 and 2004 Product Code	Description for 1991 and 2004	1991 and 2004 Product Code	Description for 1991 and 2004
03611	Shrimps/prawns, frozen	84123	Mens/boys ensembles wovn
03619	Crustaceans n.e.s. frozen	84151	M/b trousers cotton wovn
05648	Fruit/nut meal/flour	84159	M/b trouser fibre nes wv
05671	Vegtbls/fruit in vinegar	84161	Men/boy underwear woven
07412	Green tea, bulk	84162	Men/boy pyjama/etc. woven
07413	Black tea, pack to 3 kg	84169	Men/boy bathrobe nes wvn
07414	Black tea, bulk	84221	Wom/girl suits woven
07432	Tea/etc. extract/essence	84281	Wom/g slip/petticoat wvn
07511	Pepper whole	84282	Wom/g nightwear woven
07525	Nutmeg/mace/cardamoms	84289	Wom/girl uwear nes woven
07529	Spices nes, mixtures	84321	Men/boy knit/croch suits
27851	Natural quartz exc sand	84324	Men/b trouser/etc. kni/cr
27852	Mica/mica waste	84371	Men/b trouser cotton k/c
28783	Titanium ore/concentrate	84379	M/b trouser fibre nes kc
29293	Veg brush/broom material	84382	Men/b nightwear knit/cro
29299	Veg material/product nes	84389	Men/boy uwear nes kn/cr
55135	Essential oil concentrat	84421	Wom/girl knit/croch suit
62594	Solid/cushion tyres	84424	Women/g dresses knit/cro
65184	Syn stap (< 85%) yarn bulk	84425	Women/g skirts knit/croc
65199	Veg fibre yarn nes, paper	84426	Women/g trouser knit/cro
65241	Woven cotton bleach > 200g	84481	Women/g slips/etc. kni/cr
65643	Hand-made lace	84483	Women/g nightwear knit/c
65751	Twine/cordage/rope/cable	84511	Baby clothes woven
65812	Cotton sacks/bags	84512	Baby clothes knit/croch
65959	Carpet,woven,textile nes	84561	Men/b swimwear not kn/cr
66729	Diamonds,worked,unmountd	84589	Wom/g appar nes not kn/c
66731	Prec/semi-p stone shaped	84812	Leather gloves, etc.
66739	Prec/semi-p stone worked	89477	Sports gloves, etc.
69978	Tin articles nes	89731	Prec mtal jewellery/clad

**Table A3.9 Sri Lanka and India: Additional Products in Competitive Basket where Revealed Comparative Advantage (RCA) is Greater than 1 in 2004**

<b>Additional Product in 2004</b>	<b>Description for 1991 and 2004</b>	<b>Additional Product in 2004</b>	<b>Description for 1991 and 2004</b>
03428	Fish nes, frzn ex liv/roe	65265	Woven cotn mix prnt > 200g
03633	Octopus/squid, frsh/chlld	65332	Woven other sf/cotn < 170g
04719	Cereal meal/flour nes	65521	Knit/croch fab nes < 30 cm
05729	Citrus nes, fresh/dried	65632	Braids/trimmings/etc.
07512	Pepper crushed/ground	65752	Knotted rope/twine nets
08125	Bran, etc., of rice	65761	Felt hat bodies/forms
12232	Pipe tobacco, etc.	65823	Sails
23121	Natural rubber-smoked	65847	Toilet/kitchen artic cot
23221	Reclaimed rubber-primary	65929	Carpet, knotted, oth text
26331	Cotton yarn waste	66133	Nat stone tiles < 7 cm
26339	Cotton waste n.e.s.	66134	Marble, etc., worked
26571	Coconut fibre (coir) raw	66612	Household/toilet porcel
26579	Coconut fibre nes	66722	Diamonds, sorted, cleaved
26589	Veg text fibre nes/waste	66749	Synth jewels nes unset
26902	Rags/waste cordage/etc.	68212	Copper refined
29229	Nat gums/resin/etc nes	68214	Copper alloys nes unwrt
29272	Cut foliage, etc.	69661	Plated table cutlery set
41111	Fish liver oil	69971	Copper chain/parts
42239	Refined coconut oil	77111	Liquid dielec transfrmrs
52251	Zinc oxide, peroxide	83129	Trunks/cases/etc. nes
54117	Provitamin/vitamin mixt.	84112	Wvn m/b coats oth fibres
54139	Other antibiotics(bulk)	84211	Wom/g overcoat/etc. woven
59864	Activated carbon	84322	Men/b ensembles knit/cr
62133	Unhard vulc rubber nes	84381	Men/b underwear knit/cro
62542	Tyres, new, bicycles	84591	Track suits knit/crochet
62559	Tyres nes, other	84692	Gloves, etc., nes knit/croc
62591	Inner tubes	84693	Shawls/scarves/etc.
62991	Hardnd rubber/ebonite	84694	Ties/cravats/etc.
65122	Cotton sewing thr retail	84699	Made-up/part cl accs nes
65176	Multi-fil artif yarn nes	89221	Newspaper etc. > 4 per week
65186	Art stap (> 85%) yarn bulk	89311	Plastic sacks/bags/cones
65187	Art stap (< 85%) yarn mixt.		

**Table A3.10 Sri Lanka and Bangladesh: Competitive Product Basket where Revealed Comparative Advantage (RCA) is Greater than 1 in the Years 1991 and 2004**

1991 and 2004 Product Code	Description for 1991 and 2004	1991 and 2004 Product Code	Description for 1991 and 2004
03513	Fish (ex cod) dried/salted	84282	Wom/girl nightwear woven
03611	Shrimps/prawns, frozen	84289	Wom/girl uwear nes woven
05459	Vegetables nes, frsh/chld	84321	Men/boy knit/croch suits
07413	Black tea, pack to 3 kg	84323	Men/b jackets knit/croch
07414	Black tea, bulk	84324	Men/b trouser/etc. kni/cr
65751	Twine/cordage/rope/cable	84371	Men/b trouser cotton k/c
65843	Bed linen of othr fibres	84379	M/b trouser fibre nes kc
65847	Toilet/kitchen artic cot	84423	Women/g jackets knit/cro
84112	Wvn m/b coats oth fibres	84424	Women/g dresses knit/cro
84119	Men/boy overcoat nes wvn	84426	Women/g trouser knit/cro
84151	M/b trousers cotton wvn	84482	Women/g panties knit/cro
84159	M/b trouser fibre nes wv	84483	Women/g nightwear knit/c
84161	Men/boy underwear woven	84511	Baby clothes woven
84162	Men/boy pyjama/etc. woven	84561	Men/b swimwear not kn/cr
84169	Men/boy bathrobe nes wvn	84563	Wom/g swimwear not kn/cr
84219	Wom/girl ocoat nes woven	84581	Ski suits not knit/croch
84221	Wom/girl suits woven	84614	Gloves, etc., not knit/croc
84281	Wom/girl slip/petticoat wvn		

**Table A3.11 Sri Lanka and Bangladesh: Additional Products in Competitive Basket where Revealed Comparative Advantage (RCA) is Greater than 1 in 2004**

Additional Product in 2004	Description for 1991 and 2004	Additional Product in 2004	Description for 1991 and 2004
03633	Octopus/squid, frsh/chlld	83119	Handbags, nes
05779	Nuts edible, frsh/dry nes	84123	Mens/boys ensembles wovn
07524	Cloves, whole/clove/stem	84211	Wom/g overcoat/etc. woven
07529	Spices nes, mixtures	84322	Men/b ensembles knit/cr
26331	Cotton yarn waste	84381	Men/b underwear knit/cro
26339	Cotton waste n.e.s.	84382	Men/b nightwear knit/cro
26902	Rags/waste cordage/etc.	84389	Men/boy uwear nes kn/cr
28229	Waste/scrap alloy st nes	84421	Wom/girl knit/croch suit
29272	Cut foliage, etc.	84425	Women/g skirts knit/croc
65122	Cotton sewing thr retail	84481	Women/g slips/etc. kni/cr
65141	Synth filament sewing th	84489	Wom/girl uwear kn/cr nes
65187	Art stap (< 85%) yarn mixt.	84512	Baby clothes knit/croch
65242	Woven cotton dyed > 200g	84523	Wom/g waterproofs woven
65521	Knit/croch fab nes < 30 cm	84551	Brassieres
65643	Hand-made lace	84552	Girdles/corsets/braces
65761	Felt hat bodies/forms	84562	Men/b swimwear knit/croc
65812	Cotton sacks/bags	84564	Wom/g swimwear knit/croc
65813	Man-made text sacks/bags	84591	Track suits knit/crochet
65822	Tents	84619	Clothing acc nes not k/c
65929	Carpet, knotted, oth text	84691	Kn/cr gloves impreg/coat
65959	Carpet, woven, textile nes	84693	Shawls/scarves/etc.
66611	Kitchen/table porcelain	84821	Plastic clothing/access
66612	Household/toilet porcel	84843	Knit/croch/lace/etc. hats
66613	Coarse ceramic houseware	84848	Parts for headgear
68632	Zinc sheet/strip/foil	85159	Footwear textile upr nes
69312	Copper rope/cable non-el	89221	Newspaper etc. > 4 per week
82121	Mattresses supports	89311	Plastic sacks/bags/cones

**Table A3.12 Sri Lanka and Pakistan: Competitive Product Basket where Revealed Comparative Advantage (RCA) is Greater than 1 in the Years 1991 and 2004.**

1991 and 2004 Product Code	Description for 1991 and 2004	1991 and 2004 Product Code	Description for 1991 and 2004
03513	Fish(ex cod)dried/salted	84321	Men/boy knit/croch suits
03611	Shrimps/prawns, frozen	84323	Men/b jackets knit/croch
05799	Dried fruit nes,mixtures	84324	Men/b trouser/etc. kni/cr
05995	Juice,one fruit/veg nes	84371	Men/b trouser cotton k/c
07529	Spices nes, mixtures	84379	M/b trouser fibre nes kc
29299	Veg material/product nes	84382	Men/b nightwear knit/cro
65241	Woven cotton bleach>200g	84389	Men/boy uwear nes kn/cr
65643	Hand-made lace	84421	Wom/girl knit/croch suit
65751	Twine/cordage/rope/cable	84423	Women/g jackets knit/cro
65812	Cotton sacks/bags	84424	Women/g dresses knit/cro
65843	Bed linen of othr fibres	84483	Women/g nightwear knit/c
65847	Toilet/kitchen artic cot	84489	Wom/girl uwear kn/cr nes
65959	Carpet,woven,textile nes	84511	Baby clothes woven
66731	Prec/semi-p stone shaped	84512	Baby clothes knit/croch
82125	Mattresses other mater	84523	Wom/g waterproofs woven
84151	M/b trousers cotton wovn	84589	Wom/g appar nes not kn/c
84159	M/b trouser fibre nes wv	84591	Track suits knit/crochet
84162	Men/boy pyjama/etc. woven	84614	Gloves, etc., not knit/croc
84169	Men/boy bathrobe nes wvn	84691	Kn/cr gloves impreg/coat
84221	Wom/girl suits woven	84692	Gloves, etc., nes knit/croc
84282	Wom/g nightwear woven	84812	Leather gloves, etc.
84289	Wom/girl uwear nes woven	89477	Sports gloves, etc.

**Table A3.13 Sri Lanka and Pakistan: Additional Products in Competitive Basket where Revealed Comparative Advantage (RCA) is Greater than 1 in 2004**

Additional Product in 2004	Description for 1991 and 2004	Additional Product in 2004	Description for 1991 and 2004
03413	Fish, flat, fresh/chilled	65752	Knotted rope/twine nets
03422	Fish, flat, frozen	65822	Tents
03428	Fish nes, frzn ex liv/roe	66133	Nat stone tiles < 7 cm
04719	Cereal meal/flour nes	66749	Synth jewels nes unset
05459	Vegetables nes, frsh/chld	83119	Handbags, nes
06199	Sugars nes/invert sugar	83129	Trunks/cases/etc. nes
08125	Bran, etc., of rice	84123	Mens/boys ensembles wovn
08126	Bran, etc., of wheat	84161	Men/boy underwear woven
23222	Scrap unhardened rubber	84281	Wom/g slip/petticoat wvn
26331	Cotton yarn waste	84322	Men/b ensembles knit/cr
26339	Cotton waste n.e.s.	84381	Men/b underwear knit/cro
26902	Rags/waste cordage/etc.	84425	Women/g skirts knit/croc
29229	Nat gums/resin/etc. nes	84426	Women/g trouser knit/cro
29293	Veg brush/broom material	84481	Women/g slips/etc. kni/cr
43122	Veg fat/oil/fractions	84552	Girdles/corsets/braces
62991	Hardnd rubber/ebonite	84561	Men/b swimwear not kn/cr
65122	Cotton sewing thr retail	84563	Wom/g swimwear not kn/cr
65184	Syn stap (< 85%) yarn bulk	84599	Garments nes knit/croch
65242	Woven cotton dyed > 200g	84629	Womens hosiery nes
65265	Woven cotn mix prnt > 200g	84693	Shawls/scarves/etc.
65529	Knit/crochet fabric nes	84694	Ties/cravats/etc.
65621	Woven textile labels, etc.	89221	Newspaper, etc. > 4 per week
65629	Non-woven text label, etc.		

**Table A3.14 Change in Competitive Basket in Intra-SAARC Region Overtime: 1991–2004.**  
**SITC Codes-5 Digit Level**

**Sri Lanka**

1991	2004		
66611	Porcelain or china tableware and kitchenware	3411	Fish, live
84551	Brassieres, whether or not knitted or crocheted	3639	Other molluscs/aquatic invertebrates, frozen, dried, salted or in brine incl flours, meals pellets of aquatic invbrts oth thn crustaceans hum consmpt
89972	Brooms, brushes (including brushes which are parts of machines, etc., or vehicles), mops and feather dusters; prepared knots and tufts; paint pads; etc.	5483	Arrowroot, salep, jerusalem artichokes, sweet potatoes, roots and tubers with high starch or inulin, fresh or dried, sliced, etc., or not; sago pith
		5892	Nuts, groundnuts and other seeds, prepared or preserved, n.e.s., whether or not containing added sugar or other sweetening matter or spirit
		5996	Mixtures of fruit and vegetable juices, unfermented and not containing added spirits
		7411	Green tea (not fermented) in immediate packings of a content not exceeding 3 kg, whether or not flavoured
		23129	Natural rubber (other than latex) n.e.s., in primary forms or in plates, etc.
		23222	Waste, pairings and scrap of unhardened rubber and powders and granules obtained therefrom
		29269	Live plants, n.e.s. (Including their roots), cuttings and slips; mushroom spawn
		51222	Glycerol (glycerine), glycerol waters and glycerol lyes
		52257	Lead oxides; red lead and orange lead
		53343	Paints and varnishes n.e.s., including enamels, lacquers and distempers; prepared water pigments used for finishing leather
		62999	Articles of unhardened noncellular vulcanised rubber, n.e.s.
		63421	Densified wood in blocks, plates, strips or profile shapes
		63549	Wood marquetry and inlaid wood; caskets and cases for jewelry and cutlery, etc., of wood; ornaments of wood; wooden coat and hat racks, etc.
		63591	Wooden tools, tool bodies and handles, broom or brush bodies and handles; boot or shoe lasts and trees of wood
		63599	Manufactured articles of wood, n.e.s.
		64214	Paper sacks and bags (including cones), n.e.s.
		64235	Albums for samples or collections of paper or paperboard
		65143	Sewing thread of synthetic staple fibres, packaged for retail sale or not
		65612	Narrow woven fabrics, n.e.s., containing 5% (weight) or more elastomeric yarn or rubber thread
		65613	Narrow woven fabrics, n.e.s.
		65829	Camping goods, n.e.s. of textile materials

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1991	2004
	65899 Needlecraft sets, consisting of woven fabric and yarn (with or without accessories) for making rugs, tablecloths, etc., packaged for retail sale
	66244 Unglazed ceramic flags and paving, hearth or wall tiles; unglazed ceramic mosaic cubes and the like
	66245 Glazed ceramic flags and paving, hearth or wall tiles; glazed ceramic mosaic cubes and the like
	77119 Electric transformers, n.e.s.
	77129 Parts of electric power machinery (other than rotating electric power generating machinery and equipment), and parts thereof
	77281 Boards, panels, consoles, desk, cabinets and other bases not equipped with their electrical apparatus
	77311 Insulated electric winding wire
	77829 Parts of electric filament or discharge lamps (including parts of sealed beam lamp units and ultraviolet or infrared lamps) and arc lamps
	79295 Parts of airplanes or helicopters, n.e.s.
	82127 Sleeping bags
	83122 Trunks, suitcases, vanity cases, executive cases, briefcases, school satchels, etc., with outer surface of plastics or of textile materials
	84621 Panty hose and tights
	84842 Hats and other headgear, plaited or of strips of any material, whether or not lined or trimmed
	89281 Paper and paperboard labels of all kinds, whether or not printed
	89425 Toys representing animals or non-human creatures
	89449 Entertainment articles, n.e.s., including festive, carnival or other entertainment articles, except christmas tree lights and other christmas articles
	89471 Fishing rods, hooks, other tackle and landing nets; butterfly, etc. Nets; decoys (not collectors items or decoy calls); hunting, etc. Requisites, n.e.s.
	89824 Percussion musical instruments (e.g., drums, xylophones, cymbals, castinets, maraccas)
	89929 Artificial flowers, foliage or fruit and articles and parts thereof, of materials other than plastics
	89972 Brooms, brushes (including brushes which are parts of machines, etc., or vehicles), mops and feather dusters; prepared knots and tufts; paint pads, etc.

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# Appendix 8

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## Intra SAARC FDI Collaborations

India is one of the SAARC countries where overseas investment policy has been substantially liberalized in recent years. Indian companies can invest up to US\$ 100 million (US\$ 150 million SAARC countries, excluding Pakistan and Myanmar and up to Rs 7000 million by way of rupee investments in Nepal and Bhutan) in a year without approval of RBI or GoI provided the overseas investment is not real estate-oriented. Funding of such investments can be out of balances held in exchange earners foreign currency account (EEFC) of the Indian company or 100% of ADR/GDR proceeds or withdrawal of foreign exchange from an authorised dealers in India up to 200% of the net worth of the Indian company.

India's investment in South Asian countries was US\$ 164.53 million during the period 1996–2002, being no more than a little over 2% of its overseas world investment. Nepal was the most important destination of Indian investment followed by Sri Lanka. Since 2002 however Sri Lanka has overtaken Nepal as India's largest investment destination in South Asia.<sup>1</sup>

By virtue of its proximity and the Trade Treaty with India, close economic linkages between India and Nepal have manifested themselves, inter alia, through Indian investment and joint ventures in Nepal. Government of India has established a special 'Nepal Window' to facilitate approvals for Indian investment in Nepal and the limit for 'fast track' approval by Reserve Bank of India for investments in Nepal has been raised in July 2000 to Rs 350 crores (Indian

currency). In 2000 there were over 265 approved Indian joint ventures in Nepal of which over 100 are operational, with a cumulative total Indian investment amounting to between 36–40% of the total FDI in Nepal. In 2004 there were 114 operational Indian joint ventures in Nepal with authorised capital of NR 14.33 billion. Of these, 22 joint ventures had authorised capital of NR 100 million and above. [See Table A8.1 (a)].

There have not been any specific investments in Pakistan through India. However, of late, some signs of possible investment are visible. Reliance Industries is in advanced negotiations to acquire the petrochemical business of ICI-Pakistan close to US\$ 300 million. ICI Pakistan which comprises of 5 Pakistan businesses of polyester, soda ash, chemicals, life sciences and paints is one of the largest quoted companies on Karachi, Lahore and Islamabad stock exchanges. The \$2.2 billion Indian software services major Tata Consultancy Services (TCS) has taken the first steps to set up a base in Pakistan. If it succeeds, TCS will become the first Indian IT Company to the market. Dabur India will soon have a foothold on Pakistan soil for it will be setting up a manufacturing joint venture with Pakistani firm by the end of this year, Ayurvedic products will be the fulcrums of their joint ventures in Pakistan. Pakistan Government has given them note to set up the subsidiary marketing venture in Pakistan, which would make their products available to consumers at cheaper rate. [See Table A8.1 (b)]. Table A8.1 (a), (b) and (c) list some of the successful examples of intra SAARC FDI and technical collaborations in the region.

<sup>1</sup> Ananya Raihan (2006) 'Regional Economic Cooperation: Investments and Joint Projects', [http://www.southasianmedia.net/conference/conference\\_envisioning/vision\\_goup\\_5.htm](http://www.southasianmedia.net/conference/conference_envisioning/vision_goup_5.htm)

Table A8.1 Intra-SAARC FDI

## (a) Indo-Nepalese Collaboration

Indian Company	Nepalese Company	Type of Collaboration	Sector
MTNL	United Telecom Ltd. (UTL)	Joint venture company in collaboration with Telecom Consultants India Limited (TCIL), Videsh Sanchar Nigam Limited (VSNL) and NVPL (Nepal Ventures Pvt. Ltd., a Nepalese Company)	Telecom
LIC	Life Insurance Corporation (Nepal)	Joint venture in collaboration with Vishal Group Limited	Life Insurance

## (b) Indo-Pakistani Collaboration

Indian Company	Pakistani Company	Type of Collaboration	Sector
Hewitt, India	Arwen Tech	HR skills assessment and strategy for training of call centre personnel	IT
Compare, India	Creative Chaos	Joint venture	IT

## (c) Indo-Sri Lankan Collaboration

Indian Company	Sri Lankan Company	Type of Collaboration	Sector
Tata Infotech	John Keells Institute of Information Technology (Pvt) Ltd	Technical collaboration	IT
Aptech Ltd., India	Mackwood Infotec (Pvt) Ltd	Technical collaboration	IT
CEAT India	CEAT-Kelani Associated Holdings Ltd	Joint Venture between RPG Goenka Group, India, and the Associated Motorways Group, Sri Lanka.	Tyre manufacturer
Bengal Waterproof Ltd, Calcutta, India	Bensiri Rubber Products (Pvt) Ltd	wholly owned subsidiary	Rubber
Ishar Group, Indore, India	GTB Colombo Corporation Pvt Ltd	Subsidiary of Ishar Group	alloy and special steel
Gujarat Ambuja Cement, India	Ceylon Ambuja Cement and Midigama Cement	wholly owned subsidiaries	Cement
Indian Hotels Co Ltd	Taj Lanka Hotels Ltd	subsidiary	Hotels
Asian Paints Ltd	Asian Paints Lanka Ltd	subsidiary	Paints
Nilkamal Plastics, Bombay, India	Nilkamal Easwaran Plastics (Pvt) Ltd	Joint venture between Nilkamal Plastics, Bombay, India and the Easwaren Brothers Group, Sri Lanka	Property development, import and export trading, and manufacturing activities
Gujarat Glass Ltd	Ceylon Glass Company Ltd	Owned by acquisition	Glass
NIIT Ltd, India	Unisoft Institute of Technology (Pvt) Ltd	Joint Venture	IT

# Appendix 11

**Table A11.1 On an Employment Scale**

Which countries are expected to grow their Travel & Tourism Economy Employment the most between 2006 and 2015?

**Travel & Tourism Economy Employment, 2006–15**  
(‘000 of Jobs)

1.	The People’s Republic of China	13,968.7
2.	United States	2,440.4
3.	Mexico	2,434.3
4.	Indonesia	1,838.1
5.	India	1,812.2
6.	Brazil	1,433.4
7.	Spain	1,754.4
8.	Pakistan	1,245.0
9.	Russian Federation	1,213.7
10.	Japan	927.7

Progress and Priorities 2005/06, World Travel & Tourism Council, 2005, [www.wttc.travel/bin/pdf/original\\_pdf\\_file/progresspriorities05-06.pdf](http://www.wttc.travel/bin/pdf/original_pdf_file/progresspriorities05-06.pdf), last visited on 30 Oct 2007.

**Table A11.2 On an Employment Scale**

Country	2003–13 T&T Economy Employment (‘000 of Jobs Created)
The People’s Republic of China	11,492.9
Indonesia	4,192.5
Mexico	3,914.1
<b>India</b>	3,845.1
Former Soviet Union	2,221.0
Brazil	1,853.8
United States	1,559.1
<i>Bangladesh</i>	1,103.6
Spain	971.2
<b>Pakistan</b>	967.7

Source: Progress and Priorities 2003–04, World Travel and Tourism Council, 2003, p. 10.

**Table A11.3 On a Relative Scale**

**Travel & Tourism Economy Employment, 2006–15**  
(‘000 of Jobs)

1.	Montenegro	9.9
2.	The People’s Republic of China	9.2
3.	India	8.6
4.	Reunion	8.3
5.	Croatia	7.8
6.	Sudan	7.7
7.	Vietnam	7.7
8.	Laos	7.6
9.	Czech Republic	7.5
10.	Guadeloupe	7.2

Progress and Priorities 2006/07, World Travel & Tourism Council, 2006, [www.wttc.travel/bin/pdf/original\\_pdf\\_file/progresspriorities06-07.pdf](http://www.wttc.travel/bin/pdf/original_pdf_file/progresspriorities06-07.pdf), last visited on 30 Oct 2007, p.7.

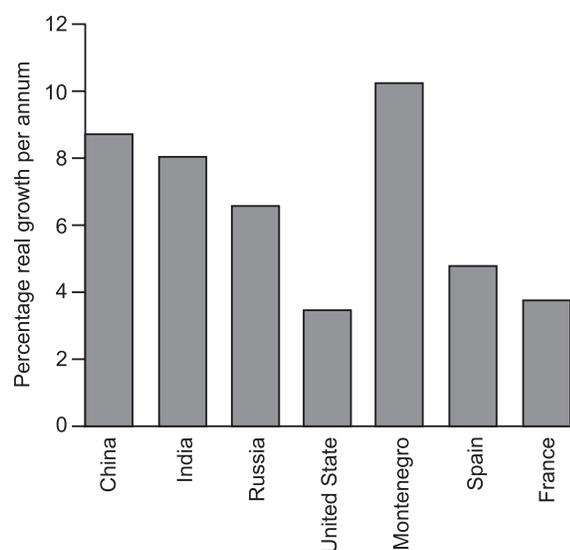
**Table A11.4 On A Relative Scale.**

Countries expected to grow their Travel & Tourism Demand most rapidly between 2007 and 2017 are:

**Travel & Tourism Demand 2007–17,  
% Annualised Real Growth**

1.	The People’s Republic of China	9.1
2.	Montenegro	8.6
3.	India	7.9
4.	Croatia	7.8
5.	Dem Rep of the Congo	7.8
6.	Vietnam	7.5
7.	Romania	7.4
8.	Namibia	7.1
9.	Hong Kong, China	7.0
10.	Chad	7.0

Source: Progress and Priorities 2007/2008, World Travel & Tourism Council, 2007, [www.wttc.travel/bin/pdf/original\\_pdf\\_file/finpp\\_2007.pdf](http://www.wttc.travel/bin/pdf/original_pdf_file/finpp_2007.pdf), last visited on 30 Oct 2007, p. 6.



**Fig A11.1 WTTC Ten Year Forecast up to 2016**

Source: Viewpoint, Fourth Quarter, 2006, World Travel & Tourism Council, [www.wttc.travel/bin/pdf/original\\_pdf\\_file/viewpoint4q06.pdf](http://www.wttc.travel/bin/pdf/original_pdf_file/viewpoint4q06.pdf), last visited 30 Oct, 07.

**Table A11.5 Nepal Tourism**

Year	Tourist Arrivals
1995	363,395
1996	393,613
1997	421,857
1998	463,684
1999	491,504
2000	463,646
2001	361,237
2002	275,468
2003	338,132
2004	385,297
2005	375,398*

Source: Ministry of Culture, Tourism and Civil Aviation, Nepal, 2005, [http://www.cbs.gov.np/year%20Book%202005/chapter9/chap09\\_2.pdf](http://www.cbs.gov.np/year%20Book%202005/chapter9/chap09_2.pdf), last visited on 30 October 2007.

\*Figure from [www.tourism.gov.np/tourism\\_statistics.pdf](http://www.tourism.gov.np/tourism_statistics.pdf), last visited on 8 November 2007.

**Table A11.6 Bhutan: Tourism Statistics, 2002–06**

	2002	2003	2004	2005	2006
Hotel rooms available (number) 2	1,239	1,270	1,202	1,548	1,532
Average length of stay (nights)	7.0	7.0	8.0	8.5	8.0
Total tourism receipts (in million of US dollars)	8.0	8.3	12.5	18.5	23.9
Tourist arrivals (number)	5,599	6,261	9,249	13,625	17,909
Tourist arrivals by country					
Total Europe	2,015	2,671	3,478	4,973	6,848
Germany	346	496	671	1,042	1,074
France	192	288	434	532	708
Italy	177	331	462	529	648
Other Europe	1,300	1,556	1,911	2,870	4,418
United States	1,913	1,803	3,243	4,681	5,018
Japan	892	952	1,087	1,554	1,815
Australia	214	165	315	458	774
Other	565	870	1,126	1,959	3,454
Tourist arrivals by purpose					
Touring	5,242	5,823	8,742	13,013	16,578
Trekking	357	438	507	612	1,331

Source: (IMF 2007: 28).

# Appendix 12

Original Commitments/Initial/Revised Offers in Construction, Tourism and Education Services

**Table A12.1 India's Revised Offer**

## I. Horizontal Commitments

Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of Natural Persons

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment
All sectors included in this Schedule	<p>(4) None for the following categories:</p> <p>(a) Business visitors (entry for this category shall be for a period of not more than 180 days)</p> <p>(b) Intra-corporate transferees (Managers, Executives and Specialists) – Entry for persons in the above categories shall be for a period of five years.</p> <p>(c) Contractual Service Suppliers – Employees of juridical persons</p> <p>(i) Employees of a foreign based company who travel to India temporarily for short periods of stay of up to one year in order to perform a service pursuant to a contract between their employer and a client located in india where the employer does not have an affiliate office and where remuneration must be paid solely to the employer and</p> <p>(ii) Employees of a foreign... to fulfil qualification and licensing requirements where presence in India is an essential condition for the fulfilment of these requirements. The service contract has to be obtained in one of the sectors listed below and subject to additional conditions mentioned in the sub-sector:</p> <ul style="list-style-type: none"> <li>– Engineering/Integrated engineering/Architectural Services</li> <li>– Hotels and restaurant/Travel agency and tour operator/Tourist guides services</li> </ul> <p>(d) Independent Professionals:</p> <p>(i) Natural persons who travel to India temporarily for short periods of stay up to 12 months... in order to perform a service pursuant to a contract between them and a client located in India for which they possess the necessary qualifications and has obtained registration with the professional body and remuneration is to be paid solely to the natural person; and</p>	<p>(3) In case of collaboration with public sector enterprises or government undertakings as joint venture partners, preference in access will be given to foreign service suppliers which offer the best terms for transfer of technology.</p> <p>(3) Taxation laws for domestic and foreign service suppliers, as per the provision of the Income Tax Act, 1961, shall apply.</p> <p>(3) Subsidies, where granted, shall be available only to domestic service suppliers.</p> <p>(4) None, except for requirement of requisite visa and the conditions attached to entry and temporary stay under such a visa for each of the categories specified in the market Access column including: For categories (c) and (d): Proof of contract and possession of requisite educational and professional qualifications relevant to the service to be provided including work experience.</p>

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment
	(ii) Natural ... for short periods of stay up to 12 months in order to fulfil qualifications and licensing requirements, where presence in India is an essential condition for the fulfilment of these requirements. The contract has to be in one of the categories listed in (c) (ii) and subject to additional conditions as mentioned in the sub-sector.	

## II. Sector Specific Commitments

### Architectural and Urban Planning and Landscape Architectural; Engineering and Integrated Engineering; and Construction and Related Engineering Services

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment
<b>I. Business Services</b>		
A. Professional Services		
Architectural services (CPC 8671) and Urban planning and landscape architectural services (CPC 8674)	(1) and (2) None (3) None except that the establishment would be through incorporation as partnership firm constituted by Architects and subject to the condition that in the case of foreign investors having prior collaboration in this sector in India, FIPB approval would be required. (4) Unbound except as in the horizontal section	(1), (2), and (3) None (4) Unbound except as in the horizontal section
Engineering Services (CPC 8672) and Integrated Engineering services (CPC 8673)	(1) None (2) None (3) None except that the establishment would be only through incorporation and subject to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required. (4) Unbound except as indicate din the horizontal section	(1), (2), and (3) None (4) Unbound except as indicate din the horizontal section
3. Construction and related engineering services		
A. General construction work for building (CPC 512)	(1) and (2) None (3) None except that the establishment would be only through incorporation and subject to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.	(1), (2), and (3) None (4) Unbound except as indicate din the horizontal section
B. General construction work for civil engineering (CPC513)	(3) None except that the establishment would be only through incorporation and subject to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.	
C. Installation and assembly work (CPC 514 + 516)	(4) Unbound, except as in the horizontal section	
D. Building completion and finishing work (CPC 517)		
E. Other (CPC 511 + 515 + 518)		
<b>II. Education and Tourism and Travel Related services</b>		
5. Education Services		
Higher Education (CPC 923)	(1) None subject to the condition that service providers would be subject to regulations, as applicable to domestic providers in the country of origin. (2) None	(1), (2), and (3) None (4) Unbound except as in the horizontal section

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment
	(3) None subject to the condition that fees to be charged can be fixed by an appropriate authority and that such fees do not lead to charging capitation fees or to profiteering. Subject further to such regulations, already in place or to be prescribed by the appropriate authority. In the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required.	
	(4) Unbound except as in the horizontal section	
9. Tourism and travel related services		
A. Hotels and other lodging services (CPC Ex. 641)	(1) None (2) None (3) Only through incorporation and subject to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required. (4) Unbound except as in the horizontal section	(1), (2), and (3) None (4) Unbound except as in the horizontal section
B. Travel agencies and tour operator services (CPC 7471)	(1) None (2) None (3) Only through incorporation and subject to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required. (4) Unbound except as in the horizontal section	(1), (2), and (3) None (4) Unbound except as in the horizontal section
C. Tourist guides services (CPC 7472)	(1) Unbound* (2) None (3) Only through incorporation and subject to a total ceiling of 500 tourist guides conversant in Chinese, Spanish, Portuguese, French and Japanese and in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required. (4) None for tourist guides conversant in Chinese, Spanish, Portuguese, French and Japanese languages subject to a total ceiling of 500. For others: Unbound except as in the horizontal section.	(1) Unbound* (2) None (3) None (4) Unbound except as in the horizontal section

(\*) Unbound due to lack of technical feasibility

Note: India has not taken any MFN exemptions in the above three sectors.

Source: Based on India's Revised Offer – WTO Document No. TN/S/O/IND/Rev.1, 24 August 2005 available at Department of Commerce website – [http://commerce.nic.in/trade/international\\_trade\\_special\\_sessions.asp](http://commerce.nic.in/trade/international_trade_special_sessions.asp)

Table A12.2 Pakistan's Initial Offer

## I. Horizontal Commitments

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment
All Sectors included in this schedule	<p>(3) (i) Except in the case of representative offices commitments under Mode 3 are subject to incorporation in Pakistan with maximum foreign equity participation of 60%.</p> <p>(ii) All expenses of representative offices shall be met by remittances abroad. Such offices shall restrict their activities to the undertaking of liaison work or of representing the interest of the parent company abroad.</p> <p>(4) Unbound except for measures concerning the entry or temporary stay of natural persons falling in following categories:</p> <p>A. Intra-corporate Transferees</p> <p>a. Managers</p> <p>b. Executives</p> <p>c. Specialists</p> <p>B. Business Visitors are natural persons listed below who enter for temporary stay in Pakistan after obtaining a work visa for time periods as indicated against each category:</p> <p>(a) Business Persons – Stay 30 to 180 days</p> <p>(b) Service Sales Persons – Stay 30 to one year</p> <p>C. Professionals-who seek to engage, as part of a services contract granted by a juridical entity engaged in substantive business in Pakistan, in an activity at a professional level included in the specific commitments of Pakistan. Stay 30 days to one year</p> <p>D. Independent Professionals who meet the necessary educational requirements and/or alternative credentials of that profession in Pakistan; whose visit has been sponsored by a juridical person in Pakistan for temporary stay for imparting training. Stay 30 days to one year</p> <p>E. Other skills: Natural persons having skills <i>inter alia</i> in information technology, construction engineering, tourism, educational services... who enter for temporary stay to impart training. Stay 30 days to one year to one year, subject to labour market test</p>	

## II. Sector Specific Commitments

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment
<b>I. Business services</b>		
A. Professional Services	(1) Unbound	(1) Unbound
(d) Architectural Services (CPC 8671)	<p>(2) None</p> <p>(3) (a) foreign equity shall not exceed 51%</p> <p>(b) Service shall be supplied by a natural person or by a registered firm having local partners in majority or in case of a company, 70 % holding of Pakistani nationals</p> <p>(c) ENT based on inquiry to gauge if direct or indirect government subsidy being provided</p>	<p>(2) None</p> <p>(3) Subject to fulfilment of all requirements and conditions applicable only to foreign investors/juridical entities</p> <p>(4) Unbound except as in the horizontal section. (1), (2), (3), (4) Unbound for subsidies</p>
	(4) Unbound except as in the horizontal section	

Contd . . .

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment
(e) Engineering services for building infrastructures: harbours, dams, hydel power, and airports, only (CPC No. 8672)	(1) Unbound (2) None (3) (i) Maximum of 51% foreign shareholding in engineering consultancy companies; (ii) Subject to partnership and/or joint venture with Pakistani engineers or engineering companies. (4) Unbound except as in the horizontal section	(1) Unbound (2) None (3) None (4) Unbound
(f) Integrated engineering services (CPC No. 8673)	(1) Unbound (2) Unbound* (3) (i) maximum of 51% foreign shareholding in engineering consultancy companies; other than those registered with the securities and exchange commission of Pakistan (ii) Subject to partnership and/or joint venture with Pakistani engineers or engineering companies; other than those registered with the securities and exchange commission of Pakistan (4) Unbound except as in the horizontal section	(1) Unbound (2) Unbound (3) None (4) Unbound, except as in the horizontal section
3. Construction and Related engineering Services		
B. Construction Work for civil Engineering for bridges, elevated highways, tunnels and subways (CPC 5132)	(1) None (2) None (3) (i) As in measures applicable to horizontal commitments (ii) Subject to partnership and/or joint venture with Pakistani engineers or engineering companies. (4) Unbound except as in the horizontal section	(1) None (2) None (3) None (4) Unbound
Construction Work for Civil Engineering for Waterways, harbours, dams and other waterworks (CPC 5133)	(1) None (2) None (3) (i) As in measures applicable to horizontal commitments (ii) Subject to partnership and/or joint venture with Pakistani engineers or engineering companies. (4) Unbound except as in the horizontal section	(1) None (2) None (3) None (4) Unbound
5. Educational Services		
C. Higher Education Services (CPC 923) excludes public funded institutions	(1), (2) and (3) None (4) Unbound except as in the horizontal section	(1), (2) and (3) None (4) Unbound except as in the horizontal section (1), (2), (3), (4) subsidies unbound
D. Adult Education (CPC 924)	(1), (2) and (3) None (4) Unbound except as in the horizontal section	(1), (2) and (3) None (4) Unbound except as in the horizontal section (1), (2), (3), (4) subsidies unbound
E. Other education Services (CPC 929)	(1), (2) and (3) None (4) Unbound except as in the horizontal section	(1), (2) and (3) None (4) Unbound except as in the horizontal section (1), (2), (3), (4) subsidies unbound
9. Tourism and Travel related Services		
A. Hotels and restaurants (including catering) (CPC 614-643)	(1) None (2) None (3) None (4) Unbound except as in the horizontal section	(1) None (2) None (3) None (4) Unbound except as in the horizontal section
B. Travel agencies and tour operator services (CPC 7471)	(1) None (2) None (3) None (4) Unbound except as in the horizontal section	(1) None (2) None (3) None (4) Unbound except as in the horizontal section

Source: WTO Document No TN/S/O/PAK, 30 May 2005.

Table A12.3 Sri Lanka's Uruguay Round Commitments

## Horizontal and Sector Specific Commitments

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment
All sectors included in this schedule	<p>(3) Foreign Investment: Certain limitations, conditions and qualifications pertain specifically to some forms of commercial presence by foreign enterprises, as indicated below:</p> <p>(a) Foreign investors may invest in any sector of the economy other than the following activities, which are reserved for citizens of Sri Lanka: (i) Moneylending; (ii) Pawn brokering; (iii) Retail trade with a capital of less than US\$1 million; (iv) Businesses providing personal services other than for export of tourism; and (v) Coastal fishing.</p> <p>(b) The foreign investment law applicable to foreign investors is the Greater Colombo Economic Commission (GCEC) Law No. 4 of 1978, as amended to date, presently known as the Board of Investment of Sri Lanka (BOISL) Act by G.C.E.C. (Amendment) Act No. 49 of 1992 (referred to as "the Law"), supplemented by: (i) BOISL Regulation No. 1 of 1978, as amended to date; and (ii) BOISL Regulation No. 1 of 1991.</p> <p>(c) The BOISL is responsible for the approval and facilitation of foreign investment throughout the country, other than for investments made by purchasing shares in the Colombo Stock Exchange, or for investments in a number of activities, which are regulated by other Statutory Agencies, including the following: (i) Banking; (ii) Financial institutions; (iii) Insurance; (iv) Trading services on the Colombo Stock Exchange; (v) Air transportation; (vi) Coastal shipping; (vii) Branch or Liaison Office of companies incorporated outside Sri Lanka; (viii) Lotteries.</p> <p>(d) Foreign investment of up to 40 per cent of equity in a company proposing to carry on a business activity listed below other than those listed above will be automatically approved by the BOISL. Foreign investment in excess of 40 per cent (and up to 100 per cent) in a company proposing to carry on a business activity listed below other than those listed above will be approved by the BOISL on a case-by-case basis in consultation with the relevant State Agencies. This situation will be reviewed every two years with the aim of further simplification. The relevant sectors are the following: (i) Construction and residential buildings; (ii) Mass transportation; (iii) Telecommunications; (iv) Mass communications; (v) Education; (vi) Professional services; (vii) Freight-forwarding; (viii) Travel agencies; (ix) Shipping agencies.</p> <p>(e) If a foreign investor wishes to locate his/her enterprise outside any Export Processing Zone, he/she can either purchase or lease land suitable for his/her enterprise. If a foreign individual buys land, he/she will be liable to pay a tax at 100% of the purchase price. However, if a foreign investor incorporates a company in Sri Lanka under the Companies Act and buys the land in the name of the company, there will be no liability or such tax even though the shareholders of the company are foreign nationals, because a company incorporated in Sri Lanka under the Companies Act is deemed to be equivalent to a citizen of Sri Lanka for the purpose of this tax.-Joint venture. In relevant sectors when a joint venture partner is a public sector enterprise or a government undertaking, while granting access, preference will be given to foreign service suppliers/entities, which offer the best terms for transfer of technology.</p>	

Contd . . .

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment
	(4) Movement of natural persons is subject to Sri Lankan laws on immigration, consumer laws, and other relevant laws and regulations. Aliens, who intend to work or to conduct business in Sri Lanka, shall have to obtain the relevant work permits in addition to complying with the immigration requirements.	
9. Tourism and travel Related Services		
A. Hotel and Lodging Services	(1) Unbound* (2) Unbound (3) None except horizontal measures specified above (4) Provisions of labour, immigration and customs laws	(1) Unbound (2) Unbound (3) None (4) None
B. Travel Agency and Tour Operation Services	(1) None (2) Unbound (3) None except horizontal measures specified above (4) Provisions of labour, immigration and customs laws	(1) None (2) Unbound* (3) None (4) None

(\*) Unbound due to lack of technical feasibility.

**Table A12.4 Bangladesh's Uruguay Round Commitments**

Sector/ Subsector	Limitations on Market Access	Limitations on National Treatment
9. Tourism and travel Related services		
A. Five star hotel and lodging services (CPC 641)	(1) Unbound* (2) Unbound (3) Commercial presence requires that foreign providers incorporate or establish the business locally in accordance with the relevant provisions of Bangladesh laws, rules and regulations. There is no fixed ratio of equity between local and foreign investors. Foreign equity to the extent of 100% is allowed. (4) In Bangladesh, the entry and residence of foreign natural persons (service providers) are subject to Bangladesh's immigration and labour laws, regulations, guidelines and procedures. There is no restriction in issuing work permits to foreign nationals in Bangladesh. The employment of foreign natural persons for the implementation of the foreign investment shall be agreed upon by the Government and such personnel shall be employed in higher management and specialized jobs only.	(1) Unbound* (2) Unbound (3) None (4) None

(\*) Unbound due to lack of technical feasibility.

Source: WTO Document No. GATS/SC/8, 15 April 1995.

Table A12.5 Nepal's Commitments

## I. Horizontal and Sector Specific Commitments

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment and Additional Commitments
All Sectors included in this schedule	<p>(3) None:</p> <p>The The conditions of ownership, operation and juridical form and scope of activity as set out in a license or other form of approval establishing or authorising the operation and supply of services by an existing foreign service supplier, will not be made more restrictive than they exist as of the date of Nepal's accession to WTO.</p> <p>(4) Unbound, except for temporary entry and stay of natural persons of another Member in the following categories:</p> <p><b>Service sales persons</b> Persons not based in the territory of Nepal and receiving no remuneration from a source located within Nepal, who are engaged in activities related to representing a service supplier for the purpose of negotiating for the sale of services of that supplier where:</p> <p>(a) Such sales are not directly made to the general public, and</p> <p>(b) The sales person is not engaged in supplying the service.</p> <p>Entry for persons named in these two categories is limited to a ninety-day period, which may be renewed.</p> <p><b>Persons responsible for setting up a commercial presence</b> Persons who are employees of an enterprise not having commercial presence in Nepal and who stay temporarily in Nepal for the purpose of setting up a commercial presence of that enterprise in Nepal. Personnel engaged in setting up commercial presence shall present proof of the commencement of business operation within one year of the date of entry of that person. Entry for the above-listed persons is limited to one year period, which may be renewed.</p> <p><b>Intra-corporate transferees (ICTs)</b> Managers, executives and specialists as defined below who are employees of firms that provide services in Nepal through a branch, subsidiary or affiliate established in Nepal and who have been in the prior employment of their firm outside Nepal for a period of not less than one year immediately preceding the date of their applica-</p>	<p>(1) None, except with respect to foreign exchange provided to foreigners (excluding those categories of persons covered by commitments in this agreement) to pay for any cross-border services</p> <p>(2) None</p> <p>(3) None, except</p> <ul style="list-style-type: none"> <li>– A foreign investor reinvesting earnings is required to obtain the permission of the Department of Industry.</li> <li>– All foreign investments except for Financial Services require approval by the Department of Industry.</li> <li>– Incentives and subsidies are available only to enterprises wholly owned by Nepalese nationals.</li> </ul> <p>(4) Unbound except for measures concerning the categories of natural persons referred to in the market access column</p> <p>Selling and buying real estate is the constitutional right of every Nepalese citizen. The Civil Code prohibits anyone from selling, mortgaging, gifting or endowing or disposing any real property to a foreign individual.</p> <p><b>Additional Commitments</b> Except where an environmental impact assessment is required, decisions of the department are normally provided within 30 days of the date of application. Approval of an investment will not normally be withheld except for failure to meet environmental standards. A foreign investor making an investment in foreign currency shall be entitled to repatriate the following amount outside Nepal:</p> <ul style="list-style-type: none"> <li>(a) The amount received by the sale, in whole or part, of the investors share of equity;</li> <li>(b) The amount received as profit or dividend as a result of an equity investment;</li> <li>(c) The amount received as the payment of the principal of and interest on any foreign loan; and</li> <li>(d) The amount received under an agreement to transfer technology approved by the Department of Industries or the Department of Cottage and Small Industries.</li> </ul>

Contd . . .

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment and Additional Commitments
	<p>tion for admission and who fall with one of the following categories:</p> <p>(A) Executives and Managers</p> <p>(B) Specialists</p> <p>Entry for the above-listed categories of ICTs is limited to a 3 years initial period that may be extended for up to 7 years for a total period not to exceed 10 years.</p> <p>Temporary entry and stay of ICTs may be limited to 15% of local employees. This commitment shall be further liberalised after five years from the date of accession.</p>	
3. Construction and related engineering services		
B. General Construction work for civil engineering (CPC 513)	<p>(1) None</p> <p>(2) None</p> <p>(3) None, except only through incorporation in Nepal and with maximum foreign equity capital of 51 per cent. Foreign equity participation will be increased to 80 per cent after 5 years from the date of accession.</p> <p>(4) Unbound, except as indicated in horizontal section</p>	<p>(1) None</p> <p>(2) None</p> <p>(3) None</p> <p>(4) Unbound, except as indicated in horizontal section</p>
E. Other (CPC 511 + 515 + 518)	<p>(1) None</p> <p>(2) None</p> <p>(3) None, except only through incorporation in Nepal and with maximum foreign equity capital of 51 per cent.</p> <p>(4) Unbound, except as indicated in horizontal section.</p>	<p>(1) None</p> <p>(2) None</p> <p>(3) None</p> <p>(4) Unbound, except as indicated in horizontal section</p>
5. Educational Services		
C. Higher Education Services (CPC 923)	<p>(1) None</p> <p>(2) None</p>	<p>(1) None</p> <p>(2) None</p>
D. Adult Education Services (CPC 924)	<p>(3) None, except only through incorporation in Nepal and with maximum foreign equity capital of 51 per cent and except for education services funded from state resources. Foreign equity participation will be increased to 80 per cent after 5 years from the date of accession</p>	<p>(3) None, except for education services funded from state resources.</p>
E. Other Education (CPC 929)	<p>(4) Unbound, except as indicated in the horizontal section.</p>	<p>(4) Unbound, except as indicated in horizontal section.</p>
9. Tourism and Travel Related Services		
A. Hotel, lodgingservices (CPC6411) (star hotels only); Graded restaurants (CPC6421-6423)	<p>(1) None</p> <p>(2) None</p> <p>(3) None, except only through incorporation in Nepal and with maximum foreign equity capital of 51 per cent for travel agency and tour operator (CPC 7471) and 80 per cent for hotel, lodging services (CPC 6411) (star hotels only), and graded restaurants (CPC 6421-6423).</p>	<p>(1) None</p> <p>(2) None</p> <p>(3) None</p> <p>(4) Unbound, except as indicated in the horizontal section</p>
B. Travel agencies and tour operators (CPC 7471)	<p>(4) Unbound, except as indicated in the horizontal section.</p>	

## II. Nepal – List of Article II (MFN) Exemptions

Sector or Sub-sector	Description of measure indicating its inconsistency with Article II	Countries to which the measure applies	Intended Duration	Conditions creating the need for the exemption
All Sectors	Allocation of non-convertible currency effected by commercial banks without involvement of Central Bank	India	Indefinite	To facilitate border traffic and regional integration by providing for full current account convertibility of Nepalese rupees into Indian rupees
Tourism	Higher allocation of convertible currency for travel purposes	All OECD countries	Indefinite	To facilitate border traffic and regional integration by providing for full current account convertibility of Nepalese rupees into Indian rupees

## III. Nepal – Air Transport Services

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment
11 C. Air Transport Services		
(d) Maintenance and repair of aircraft (CPC 8868)	(1) None (2) None (3) None, except only through incorporation in Nepal and with maximum foreign equity capital of 51 per cent. Foreign equity participation will be increased to 80 per cent after 5 years from the date of accession (4) Unbound, except as indicated in the horizontal section.	(1) None (2) None (3) None (4) Unbound, except as indicated in the horizontal section.

Source: WTO Document No. GATS/SC/139, 30 August 2004.

**Table A12.6 Bhutan's Offer of Horizontal and Sector Specific Commitments**

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment
All Sectors included in this Schedule	(3) To establish a new commercial presence in Bhutan, minimum size of foreign investment is US\$0.5 million, foreign investor's equity holding limited to 70%, unless otherwise indicated in the sectoral commitments and the Business must also be incorporated in Bhutan. The investment shall be governed by sector specific policies and procedures as established in the sectors included in this schedule. Unbound for measures regulating publicly funded services including with respect to national treatment.	(3) Foreign investors are required to foster transfer of technology, introduction of management skills and provide training and employ Bhutanese nationals at all levels in the enterprise.  The shares held by foreign nationals and foreign juridical persons in locally incorporated companies are not transferable without prior permission by the Government of Bhutan.
3. Construction and related Engineering Services		
A. General construction work for buildings For warehouses and industrial building (CPC 51230)	(1) None (2) None (3) Services must be provided through incorporation where the foreign investor equity shall be limited to a maximum of 49% and jobs below US\$ 11 million to be reserved for the domestic industry. (4) Unbound, except as indicated in the horizontal section.	(1) None (2) None (3) None (4) Unbound, except as indicated in the horizontal section

Contd . . .

Sector/Sub-sector	Limitations on Market Access	Limitations on National Treatment
B. General construction work for civil engineering	(1) and (2) None	(1) None
– For highways (except elevated highways) streets, roads, railways and airfield runways (CPC 51310)	(3) Services must be provided through incorporation where the foreign investor equity shall be limited to a maximum of 49% and jobs below US\$ 11 million to be reserved for the domestic industry.	(2) None
– For bridges, elevated highways, tunnels and subways (CPC 51320)	(4) Unbound, except as indicated in the horizontal section.	(3) None
– For long distance pipelines, communication and power lines (cables) (CPC 51340)		(4) Unbound, except as indicated in the horizontal section
– For local pipelines and cables, ancillary works (CPC 51350)		
– For construction, mining and manufacturing (CPC 51360)		
5. Educational Services		
C. Higher education services	(1) None	(1) Unbound
– Higher Secondary education services (CPC 9222)	(2) None	(2) Unbound
– Post secondary technical and Vocational education (CPC 9231)	(3) Services provided jointly with local Educationists. Foreign investor equity to be limited to a maximum of 51% and except for education services funded from state resources.	(3) Unbound
	(4) Unbound, except as indicated in the horizontal section	(4) Unbound, except as indicated in the horizontal section
9. Tourism and travel related Services		
A. Hotels and restaurants (excluding night-clubs) (CPC 641)	(1) None	(1) None
– Food Serving services (CPC 642)	(2) None	(2) None
– Beverage serving services for consumption on the premises (CPC 643)	(3) Establishment limited to hotels with maximum capacity of 50 rooms in urban areas and a maximum capacity of 15 rooms in rural areas.	(3) None
	(4) Unbound, except as indicated in the horizontal section.	(4) Unbound, except as indicated in the horizontal section

Source: WTO Document No. WT/ACC/SPEC/BTN/2/Rev.2, 30 April 2007.

Note: This offer has not yet been made public.

## Laws/Regulations/Policies

### *Bangladesh*

1. Bangladesh Medical and Dental Council Act, 1980
2. The Foreign Private Investment (Promotion and Protection) Act, 1980
3. The Investment Board Act, 1989

### *Bhutan*

1. Foreign Direct Investment Policy 2002
2. Foreign Direct Investment Rules and Regulations 2005

3. The Bhutan Medical and Health Council Act, 2002

### *India*

1. Dentist Act, 1948
2. Foreign Exchange Management Act, 1999
3. Indian Medical Council Act, 1956

### *Nepal*

1. Foreign Investment and One-Window Policy, 1992
2. Foreign Investment and Technology Transfer Act, 1992

3. Health Institute Operation Act
4. Nepal Medical Council Act, 1964 (2020 B.S.)  
Nepal Nursing Council Act, 2053 B.S.

*Pakistan*

1. Board of Investment Ordinance, 2001
2. Foreign Private Investment (Promotion and Protection) Act, 1976

3. Pakistan Medical and Dental Council Ordinance, 1962

*Sri Lanka*

1. Exchange Control Act
2. Greater Colombo Economic Commission Law, 1978

# Appendix 14

**Table A14.1 Telecommunications Service Classification in W /120 and United Nations Central Product Classification (UNCPC)**

MTN.GNS/W/120	UNCPC*
C. Telecommunication services a. Voice telephone services 7521	<p>7521 Public telephone services</p> <p>75211 <u>Public local telephone services</u> – Switching and transmission services necessary to establish and maintain communications within a local calling area. This service is primarily designed (used) to establish voice communications, but may serve other applications such as text communication (facsimile or teletex) and is generally provided for a flat monthly fee independently of the number of calls made by the subscriber. <u>Exclusions</u> – Private line services and rental services of terminal equipment are classified in class 7522 (Business network services) and 7541 (Equipment rental services), respectively.</p> <p>75212 <u>Public long distance telephone services</u> – Switching and transmission services necessary to establish and maintain communications between local calling areas. This service is primarily designed (used) to establish voice communications, but may serve other applications such as text communication (facsimile or teletex) and may be provided on a toll or flat rate basis. This service provides the customer with access to the supplier's and connecting carrier's entire telephone network or, in some instances, to a limited number of exchange areas (WATS service).</p>
b. Packet-switched data transmission services c. Circuit-switched data transmission services 7523** d. Telex services 7523**	<p>7523 Data and message transmission services</p> <p>75231 <u>Data network services</u> – Network services necessary to transmit data between equipment using the same or different protocols. This service can be provided via a public or dedicated data network (i.e. via a network dedicated to the customer's use).</p> <p>75232 <u>Electronic message and information services</u> – Network and related services (hardware and software) necessary to send and receive electronic messages (telegraph and telex/TWX services) and/or to access and manipulate information in databases (so-called value-added network services).</p>
e. Telegraph services 7522	7522 (see below)
f. Facsimile services 7521** and 7529**	<p>7521 (see above) 7529 Other telecommunications services</p> <p>75291 <u>Paging services</u> – The summoning of a person to the telephone through the use of an electronic pager. This subclass includes tone, voice and digital display paging services.</p> <p>75292 <u>Teleconferencing services</u> – Network and related services necessary to hold a one-way or two-way fully interactive video conference.</p> <p>75299 <u>Other telecommunications services n.e.c.</u> – Telecommunications services, not elsewhere classified. This class includes mobile maritime and air-to-ground communications services.</p>
g. Private leased circuit services 7522** and 7523**	<p>7523 (see above) 7522 Business network services</p> <p>75221 <u>Shared network services</u> – Network services necessary to establish telephone communications between selected (point-to-point or multi-point) locations (terminals) via a public (shared) network. This type of service is primarily used to establish long distance voice communications but some versions can also accommodate facsimile and data transmission. It is provided on a pay-as-you-use basis at discount rates over regular long distance telephone charges.</p>

## MTN.GNS/W/120

## UNCPC\*

	75222 <u>Dedicated network services</u> – Network services necessary to establish telephone communications between selected (point-to-point or multi-point) locations (terminals) via private line(s). This type of service is primarily used to establish voice communications between distant PBX's (tie line), between a distant location and a PBX (off premises extension), between a PBX and a distant exchange area (foreign exchange) or between designated telephone sets, but may also accommodate data transmission. It is provided on a lease basis.
h. Electronic mail 7323**	7523 (see above)
i. Voice mail 7323**	
j. On-line information and data base retrieval 7323**	
k. electronic data interchange (EDI) 7323**	
l. enhanced/value-added facsimile services, incl. Store and forward, store and retrieve 7323**	
m. code and protocol conversion	n.a.
n. on-line information and/or data processing (incl.transaction processing) 843**	843 Data processing services 8431 84310 <u>Input preparation services</u> – Data recording services such as key punching, optical scanning or other methods for data entry. 8432 84320 <u>Data-processing and tabulation services</u> – Services such as data processing and tabulation services, computer calculating services, and rental services of computer time. 8433 84330 <u>Time-sharing services</u> – This seems to be the same type of services as 84320. Computer time is bought; if it is bought from the customer's premises, telecommunications services are also bought. Data processing or tabulation services may also be bought from a service bureau. In both cases the services might be time sharing processed. Thus, there is no clear distinction between 84320 and 84330.
o. other	n.a.

Source: WTO (8<sup>th</sup> December, 1998) S/C/W/74

Note: \* United Nations Provisional Central Product Classification, Statistical Papers, Series M, No. 77, 1991.

\*\* Indicates that the service specified constitutes only a part of the total range of activities covered by the CPC concordance (e.g. voice mail is only a component of CPC item 7523).

Table A14.2 Bangladesh: WTO Commitments and Applicable Regime

Type of Service	Commitment in 1997		Applicable Regime 2007			Revised offer has not submitted a revised offer		
	No. of Providers	FDI Limit	No. of Providers	Period of License	FDI Limit	No. of Providers	Period of License	FDI Limit
ILD	Monopoly of Govt.		International Gateway (3+1) Licenses to be awarded	15	0%			
NLD/local leased circuits	2 + 1		5					
Cellular Mobile	4		6					
Fixed local loop			5 (In Sept 07, 4 national PSTN licenses issued) in addition to the existing BTTB.					
VSAT(CUG)	Full competition		24					
Internet Service Providers	Full competition		94					
Reference Paper Principles	No commitment, review indicated without any timeframe							

Table A14.3 India: WTO Commitments and Applicable Regime

Type of Service	Service Area	Commitment in 1997			Applicable Regime in 1997			Applicable Regime 2007			Revised offer		
		No. of Providers	Period of License	FDI Limit	No. of Providers	Period of License	FDI Limit	No. of Providers	Period of License	FDI Limit	No. of Providers	Period of License	FDI Limit
ILD	International	1	10	25%	1	No limit	49%	Un-limited	20 years	74%	2	20	49%
NLD	National	1	10	25%	1	No limit	49%	Un-limited	20 years	74%	2	20	49%
Cellular Mobile	Circle	2	10	25%	2	10 years	49%	4	20 years	74%	2	20	49%
Fixed local loop	Circle	2	10	25%	2	10 years	49%	Un-limited	20 years	74%	2	20	49%
VSAT	National	NA	NA					Un-limited	20 years	74%	2	20	49%
Internet Service Providers	National Circle wise, SSA wise	2	Un-bound	51%	Un-limited	10 years	49%	Un-limited	15 years	With gateways – 74% Without gateways – 100%	2	10 years	74%
Reference Paper Principles		Largely non-compliant in respect of core disciplines			Somewhat compliant			Fully compliant			Largely non-compliant in respect of core discipline		

Table A14.4 Maldives: WTO Commitments and Applicable Regime

Type of Service	Service Area	Commitment in 1997			Applicable Regime in 1997			Applicable Regime 2007			Revised Offer		
		No. of Providers	Period of License	FDI Limit	No. of Providers	Period of License	FDI Limit	No. of Providers	Period of License	FDI Limit	No. of Providers	Period of License	FDI Limit
ILD													
NLD													
Cellular Mobile													
Fixed local loop													
VSAT													
Internet Service Providers													
Reference Paper Principles													
Has made no commitments but operates a liberal policy regime.													

Table A14.5 Nepal: WTO Commitments and Applicable Regime

Type of Service	Commitment in 2004		Applicable Regime 2007		Revised offer (has not submitted)		
	No. of Providers	FDI Limit	No. of Providers	FDI Limit	No. of Providers	Period of License	FDI Limit
ILD	No limitation	80% joint venture	2	100			
NLD	None		2	100			
Cellular Mobile	By 2004 2 operators will be licensed.	80%	2	100		has not submitted	
Fixed/WLL Limited mobility service	None	80%	2/6	100			
VSAT Network providers	None	80%	12	100			
Internet Service Providers	None	80%	42	100			
Reference Paper Principles	Finally Committed to regulatory principles						

Table A14.6 Pakistan: WTO Commitments and Applicable Regime

Type of Service	Commitment in 1994		Applicable Regime 2007			Revised offer (2005)		
	No. of Providers	FDI Limit	No. of Providers	Period of License	FDI Limit	No. of Providers	Period of License	FDI Limit
ILD	UNBOUND	100%	16	20	100%	May be limited due to technical constraint This exclusively shall expire by the year 2003. None as of 1.1.2004.		100%
NLD	UNBOUND	100%	12	20	100%			100%
Cellular Mobile	UNBOUND	100%	6	20	100%			100%
Fixed local loop			Monopoly/4	20	100%	Privatisation of PTCL is on the anvil. The management of the Company shall be transferred to the selected strategic operator. Exclusive license for operation of basic telephony services for a period of 7 years granted to the PCTL.		
VSAT			Open Competition					
Internet Service Providers								
Reference Paper Principles	Largely Non Complaint	Have not committed to the Reference Paper		Partially compliant		Except cost based interconnection, agreed to principles of ref. paper Pakistan endorses the reference paper as attached in the schedule with minor alteration that cost oriented interconnection rates shall be implemented by the year 2008.		

Table A14.7 Sri Lanka: WTO Commitments and Applicable Regime

Type of Service	Commitment in 1994			Applicable Regime 2007			Revised offer (2005)		
	No. of Providers	Period of License	FDI Limit	No. of Providers	Period of License	FDI Limit	No. of Providers	Period of License	FDI Limit
ILD	Monopoly		35%	32	10 years		not in public domain		
NLD	19994		*40%						
Cellular Mobile	4		40%	5	20 years				
Fixed local loop	4		40%	4	20 years				
VSAT			40%						
Internet Service Providers	6		40%	20					
Reference Paper Principles	Fully committed to regulatory disciplines								

beyond 40% and upto 100% allowed on a case by case basis

# Appendix 15

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## ■ REFERENCE PAPER

### Scope

The following are definitions and principles on the regulatory framework for the basic telecommunications services.

### Definitions

Users mean service consumers and service suppliers.

**Essential facilities** mean facilities of a public telecommunications transport network or service that

- (a) are exclusively or predominantly provided by a single or limited number of suppliers; and
- (b) cannot feasibly be economically or technically substituted in order to provide a service.

A **major** supplier is a supplier which has the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market for basic telecommunications services as a result of:

- (a) control over essential facilities; or
- (b) use of its position in the market.

## 1. Competitive Safeguards

### 1.1 *Prevention of Anti-competitive Practices in Telecommunications*

Appropriate measures shall be maintained for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anti-competitive practices.

### 1.2 *Safeguards*

The anti-competitive practices referred to above shall include in particular:

- (a) engaging in anti-competitive cross-subsidisation;

- (b) using information obtained from competitors with anti-competitive results; and
- (c) not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services.

## 2. Interconnection

2.1 This section applies to linking with suppliers providing public telecommunications transport networks or services in order to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier, where specific commitments are undertaken.

### 2.2 *Interconnection to be Ensured*

Interconnection with a major supplier will be ensured at any technically feasible point in the network. Such interconnection is provided.

- (a) under non-discriminatory terms, conditions (including technical standards and specifications) and rates and of a quality no less favourable than that provided for its own like services or for like services of non-affiliated service suppliers or for its subsidiaries or other affiliates;
- (b) in a timely fashion, on terms, conditions (including technical standards and specifications) and cost-oriented rates that are transparent, reasonable, having regard to economic feasibility, and sufficiently unbundled so that the supplier need not pay for network components or facilities that it does not require for the service to be provided; and
- (c) upon request, at points in addition to the network termination points offered to the majority of users, subject to charges that reflect the cost of construction of necessary additional facilities.

### **2.3 Public Availability of the Procedures for Interconnection Negotiations**

The procedures applicable for interconnection to a major supplier will be made publicly available.

### **2.4 Transparency of Interconnection Arrangements**

It is ensured that a major supplier will make publicly available either its interconnection agreements or a reference interconnection offer.

### **2.5 Interconnection: Dispute Settlement**

A service supplier requesting interconnection with a major supplier will have recourse, either:

- (a) at any time or
- (b) after a reasonable period of time which has been made publicly known to an independent domestic body, which may be a regulatory body as referred to in paragraph 5 below, to resolve disputes regarding appropriate terms, conditions and rates for interconnection within a reasonable period of time, to the extent that these have not been established previously.

## **3. Universal Service**

Any Member has the right to define the kind of universal service obligation it wishes to maintain. Such obligations will not be regarded as anti-competitive *per se*, provided they are administered in a transparent,

non-discriminatory and competitively neutral manner and are not more burdensome than necessary for the kind of universal service defined by the Member.

## **4. Public Availability of Licensing Criteria**

Where a licence is required, the following will be made publicly available:

- (a) all the licensing criteria and the period of time normally required to reach a decision concerning an application for a licence and
- (b) the terms and conditions of individual licences.

The reasons for the denial of a licence will be made known to the applicant upon request.

## **5. Independent Regulators**

The regulatory body is separate from, and not accountable to, any supplier of basic telecommunications services. The decisions of and the procedures used by regulators shall be impartial with respect to all market participants.

## **6. Allocation and Use of Scarce Resources**

Any procedures for the allocation and use of scarce resources, including frequencies, numbers and rights of way, will be carried out in an objective, timely, transparent and non-discriminatory manner. The current state of allocated frequency bands will be made publicly available, but detailed identification of frequencies allocated for specific government uses is not required.



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# Quantification of Benefits from Economic Cooperation in South Asia

This report provides a thorough and comprehensive account of the impact of the South Asia Free Trade Agreement (SAFTA) on the region as a whole, on individual countries in the region, and on specific sectors within countries.

The main conclusion is that SAFTA will contribute to stronger economic growth in the region. The welfare gains from trade in goods arise on account of improvements in complementarity within the region in recent years, implying exports of member countries are becoming increasingly regional. Country-wise analysis of the impact of SAFTA on production, employment, trade and welfare has been also undertaken.

The study arrives at quantitative results using robust econometric methodologies, including revealed comparative advantage indices, complementarity indices, intra-industry trade indices, panel data estimations, gravity model estimations, SMART simulations, and GTAP models. The tools enable sophisticated analysis of the effects of SAFTA, including feedback effects, across sectors and countries. The modeling results also offer valuable qualitative information by making predictions for alternative policy scenarios.

The study finds that benefits are much larger if measures to establish more efficient regional trade, transportation, and infrastructure networks are simultaneously undertaken. To estimate the gains from transport facilitation, benefit cost analysis for specific projects has been undertaken.

The study demonstrates that extension of SAFTA to cover foreign direct investment and services brings dynamic gains to the region.

The report will be immensely valuable in fostering economic links in South Asia. It will be particularly useful to policy-makers in the region, researchers on trade and development issues, and representatives of business and industry.

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ISBN 023-063-637-3



  
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