

Chapter 3

OPPORTUNITIES OF SAFTA

3.1 GROSS NATIONAL INCOME IN SOUTH ASIAN COUNTRIES

India is by far the largest SAARC economy, while Pakistan and Bangladesh are the second and the third largest (Table 3.1). These three economies are of crucial importance for any sub-regional integration and cooperation plan to operate successfully, albeit India and Pakistan would be the dominant constituents of any formal regional integration agreement. The size of the GNP and per capita income of the seven South Asian economies according to the latest available data are as follows.

Table 3.1 Gross National Income (GNI) in 2004

In US\$	GNI in billions of dollars	GNI Per Capita in billions of
Bangladesh	61.3	440
Bhutan	0.70	760
India	673.2	620
Pakistan	90.7	600
Nepal	6.6	250
The Maldives	n/a	2,300
Sri Lanka	19.5	1,010

Source: The World Bank, 2006. *World Development Indicators*, Washington DC.

If per capita GNI is taken as a measure, Sri Lanka is the second most prosperous sub-regional economy (Table 3.1). The island country of the Maldives has the highest per capita GNI.

3.2 TARIFF RATES IN THE SOUTH ASIAN ECONOMIES

Tariff levels in Bangladesh, India and Pakistan were exceedingly high until 1990. In the early 1990s, more South Asian economies changed course and began liberalizing their domestic trade regimes by slashing tariffs. Both India and Bangladesh began liberalizing trade policies and cutting tariff rates in the early 1990s. India continued gradual tariff reduction during the 1990s and the early 2000s. Nepal and Pakistan began liberalization and slashing tariff rates in 1997. Bangladesh's tariffs were the highest in the region but the government has gradually lowered them over the years. Consequently, during the 1990s the South Asian economies succeeded in moving away from the stringently protectionist quasi-autarkic regimes of the past simultaneously increasing their trade with the global economy. However, it must be pointed out that, first, this evolution was slow, much slower than that of China. There was backtracking on tariff reforms in Bangladesh and India during 1997-2001 period. Second, trade liberalization in the sub-region was far from uniform, with Bangladesh, India and Pakistan still adhering to several interventionist policies. As set out above, while considerable tariff liberalization occurred in the South Asian economies, they continue to be among the most highly protected in the world, after the socialist economies. Table 3.2 depicts the supporting evidence.

Table 3.2 Tariff Rates in the South Asian Economies (in percent)

Economy	Year	Simple Average	Weighted Average	Standard Deviation
Bangladesh	2004	18.42	15.87	10.2
Bhutan	2002	16.61	18.2	10.9
India	2001	32.3	26.5	13
The Maldives	2003	20.21	20.7	13.2
Nepal	2003	13.61	16.8	10.9
Pakistan	2003	17.1	14.46	10.9
Sri Lanka	2001	9.25	6.68	9.3

Source: Computed from COMTRADE Database of the United Nations by Mukherji (2005).

In the sub-region, the simple and weighted average tariffs were highest in India and lowest in Sri Lanka. The levels of average

applied tariffs were also the highest for this sub-group of economies. In 1989-90 applied average unweighted tariffs for the South Asian economies stood at 76 percent in comparison to the figure for the East Asian economy which was only 20 percent. The South Asian economies laboured under the ISI regime for decades. In terms of growth and industrialization, they not only failed to keep pace with the dynamic economies of East Asia but also failed to learn the *modus operandi* of brisk real GDP growth from them until recently (Das, 2005a).

Non-Tariff Barriers (NTBs) and Para-Tariff Barriers (PTBs) also present serious problems towards sub-regional integration. In April 2006, trade ministers of the seven countries met in Dhaka to identify and review the NTBs and PTBs and plan a strategy to restrain them. To this end, the SAFTA Committee of Experts (SCOE) was established, which has been scheduled to meet twice a year.

To achieve the SAFTA objectives of enhancement of intra-trade, intra-regional investment, economic cooperation and sub-regional integration in South Asia, it is indispensable for the member countries to let the past be the past and put the tarnished legacy of mistrust and tensions behind them. The present generation of policy mandarins needs to approach SAFTA with a fresh mindset. Without a change in the mindset of the policymakers, regional integration may well remain a pipe dream for a long time to come. In an era of on-going economic and financial global integration, there is an imperious need to pragmatically take the necessary economic policy measures to achieve mutually beneficial goals of regionalization, which in turn could be a building block for moving towards future globalization.

However, at present, the SAFTA member economies are at a low level of per capita income and economic development. As they move up their respective growth trajectories, each is likely to develop complementarities with the others. If this sub-group of economies continues to grapple with its present hurdles and take small and measured steps, in the medium-term South Asian economies stand to gain in welfare terms even from shallow regional integration. The emerging complementarities—and reduced mutual distrust—are sure to lead to growth of symbiotic relationship among them. In addition, there is a political economy argument

of SAFTA increasing bargaining power of this sub-group of economies in trade negotiations with the rest of the world.

3.3 TRADE PREFERENCES

Economically, the region is small in relation to the outside world and remains heavily protected. These features imply that trade preferences to regional partners will likely be trade diverting rather than trade creating. Some of the potential opportunities that can be exploited by the members of SAARC are outlined below.

3.3.1 Duty Free Import

Apart from economic gains that India is looking for, it should also aim at earning the goodwill of the people of these nations by being more accommodative to them. Under the SAFTA, Bangladesh and Maldives have been given some concessions. India had announced that it will allow duty-free import of forty Bangladeshi products to India. This is a welcome measure as it is hoped to reduce the adverse trade balance of Bangladesh.

India should show similar gesture to other neighbouring countries especially Nepal, Bhutan and Sri Lanka and allow their products to have an access to Indian markets in a big way. It is imperative that one does not get caught in the paranoia that the goods from these countries would flood the Indian market. Their production bases are so small that it will call for huge investments before they can produce goods in scale to actually flood the Indian markets. In fact after the liberalization many of the Indian companies have shifted their production bases to some of these countries.

3.3.2 Inclusion of New Countries

Due to difference in outlook and opinion maintained by India and Pakistan, SAARC was significantly impeded in attaining overall economic development of the region including reduction of poverty and growth of intra-regional trade. Politics as opposed to economics had always ruled the SAARC. If this process cannot be stopped, SAARC it will jeopardize the very existence of SAARC in the long-run. The key point for the smaller members like Bangladesh, Nepal, Bhutan, Sri-Lanka and Maldives, is to form a sub-group

and be united in the same platform. In addition, these countries can play a dominant role to induct China and Japan effectively within the fold of SAARC so as to minimize the lopsidedness created by the opposite stand of India and Pakistan.

India must also take a lead in admitting more members. Central Asian countries can be admitted as dialogue partners. This will ensure accessibility to new markets as well as new resources. And if economic integration is strong enough, adding a new member might give SAARC a greater bargaining power in the international arena. If China and Japan are included as members in spite of their geographic locations, the power of SAARC will be immense and all the member countries, even the LDCs will be benefited in terms of greater trade and economic development. Furthermore, Japan and China are expected to play their role in evolving a dynamic, efficient and proactive SAARC. Their presence will overshadow all other member states in the SAARC and help the latter to behave in a more consistent manner. With China and Japan sitting in the organization, India's desired status of a SAARC Super Power will effectively be put under control.

At the thirteenth SAARC summit in Bangladesh, Afghanistan has been admitted as a member of SAARC. It is India which can again take initiative in this direction by lobbying with SAARC countries for central Asia. Even if it calls for amending the original SAARC charter India should be able to carry the other members along with it on this issue.

3.3.3 Opportunities for Foreign Direct Investment

Most of the South Asian countries have undertaken far-reaching economic reforms; they have adopted industrial policies that encourage foreign direct investment (FDI) resulting in an increase in FDI flows. However, the amount of inflows attracted by the region remains relative to East Asia and South East Asia quite insignificant. In 1998, it was only US\$ 3.43 billion, a mere 0.5 per cent of global flows. In contrast, China received more than 10 per cent of all global inflows. By 2002 although total FDI flows to South Asia had increased to US\$4.58 billion, this was still well below 1 per cent of global FDI flows.

The sectors that have attracted most foreign investment vary between countries. In the case of Bangladesh and Sri Lanka, the textile and garment sectors account for 28 per cent and 16 per cent of FDI respectively. In contrast, 56 per cent of FDI has gone into infrastructure projects in India while 40 per cent of all FDI has gone into the power sector for Pakistan. Despite the fact that FDI from outside the region has been far greater than intra-regional investments, there are signs that intra-regional investments are increasing. The major outward FDI flows are from Indian firms, which have started to expand FDI both within South Asia and beyond. Firms from other South Asian countries are also increasingly undertaking FDI within the region and investing in a wide range of sectors and activities.

For two of the SAARC countries, Nepal and Bhutan, India is the predominant source of FDI. On the other hand, none of the SAARC countries are significant investors in Pakistan though there is a very limited FDI flow from the other countries in the region. India is the largest investor among the SAARC countries in Sri Lanka, while Pakistan and Maldives are respectively second and third largest investors. In the case of Bangladesh, firms from India, Pakistan and Sri Lanka have in recent years invested US\$418 million in 133 ventures covering a wide range of sectors. In spite of India's huge internal market, investments from other SAARC countries have been quite insignificant, both in relative and absolute terms, accounting for less than one per cent of total foreign investment in India.

The most persuasive argument for public support to FDI is based on the prospect of knowledge spillovers. It is argued that FDI can result in a host of benefits for the home country that are due to technological, managerial and knowledge-based positive externalities. The benefits of these spillovers are maximized if FDI flows into knowledge-generating sectors. However, spillover externalities can only be effectively internalized if there is capability in local firms to engage in learning to absorb this knowledge. Furthermore, private sector FDI, according to eminent economist Walt Rostow, can be the viable bridge between the low savings rate and the required rate of investment necessary for a country to achieve economic development. For a country like Bangladesh where savings

rate is less than 10% of GDP, the major share of the investment gap is bridged by FDI and ODAs. While Investment rate is 17.5% of GDP for Bangladesh, this rate would have been significantly lower without the contribution of FDI from countries within and outside the SAARC region.

This suggests that FDI incentives should be tied to activities that create the strongest potential for spillovers. These activities should include education, training, export-related links and domestic joint ventures in technology-intensive sectors. Consequently, it is important to develop local technological capability and to maintain a low transaction cost investment-climate for domestic firms. It is felt that major impediments to internalizing FDI spillovers remain governance related. In this regard, strengthening the judicial systems and deregulating the economy would considerably lower the transaction costs for investors and strengthen property rights. Getting the governance structure right is particularly important for Pakistan, Sri Lanka, Bangladesh and Nepal, if they are to effectively compete with India as an attractive destination for FDI inflows.

Regional trade openness is another way to increase FDI inflows, as a larger regional market would make it more attractive for foreign ventures to invest in South Asia. However, the intra-regional location of FDI may continue to remain skewed in favour of India and this remains a cause of concern. Strengthening regional cooperation and improving governance is also expected to improve intra-SAARC FDI flows. Improved intra-SAARC inflows might generate regional externalities that increase the efficiency of investment. This may also provide the necessary impetus for investors to move freely between the SAARC countries, and seek out and further develop competitive advantages that these countries may possess. However, political stability and regional political harmony is imperative for strengthening regional cooperation and maximizing the benefit from higher levels of FDI inflows from within and outside the region.

3.3.4 Allowance of Quota Fill-up in International Export

At the global level, the Indian subcontinent's export prowess is blunted in industrialized countries' markets by various tariff and

non-tariff measures. To cite one example out of many: In the first three months of 2003, according to the US Progressive Policy Institute (PPI), goods imported into the United States from France totalled US\$6.846 billion from which tariff revenue of US\$80 million was collected, while total imports from Bangladesh were US\$557 million, for which US\$85 million in tariffs had to be paid. Indeed, for all of 2003, duties paid to US customs on imports of apparels from Bangladesh came to US\$306 million, while in the same year Bangladesh's gross receipt of bilateral US aid was less than US\$35 million. Ample discrimination against exports from the Indian subcontinent can be cited in many areas, including the movement of labour. Indeed, the strident Western outcry over outsourcing is a recent variation on a well-known theme.

In the face of unfavourable tariff and non-tariff barriers, SAARC member countries can help each other by jointly exporting to certain countries outside the SAARC circle. Different countries are given different levels of preferential access to different markets. Now if, for example, Sri Lanka has to meet a quota by USA and can only fill up 90% of the allotted amount, it can ask any of its SAARC members, for the example's sake Bangladesh, to provide the goods required to fill up that quota. Or, in effect, it can import from Bangladesh at a cheaper prices and fill up its quota. Thus Sri Lanka and Bangladesh could act as partners in exporting to USA, and mutually benefit from such a move: Sri Lanka, being able to utilize 100% quota, thereby not losing its market to competitors, and Bangladesh, being able to export more than its own quota to USA.

3.3.5 Energy Cooperation within South Asia

South Asia accounts for one fifth of the world population whereas it covers only over 3% of the total world area.¹ Per capita energy consumption in this region is; however, lower than other major geographical regions. There are significant variations within the region in terms of energy mix. For example, Bangladesh's energy mix is dominated by natural gas, which contributed 66.4% in 2002, while India relies heavily on coal, which contributed to 54.5% in 2002 to total energy consumption. Sri Lanka and the Maldives are

overwhelmingly dependent on petroleum, the dependency rate being 82% and 100% respectively. Pakistan is more diversified in this respect, with 42.7% from petroleum, 42.2% from natural gas and only 10% from hydroelectricity. The Himalayan countries of Bhutan and Nepal have the highest shares of hydroelectric power in their energy consumption mix at 80% and 31%, respectively, in 2002. This region is experiencing a rapid growth in energy demand, and as in ascension of important to world energy market.

Growth in energy and consequently the economy could have been faster through assessment and optional development and usage of diversified energy resources such as hydro resources of Nepal and Bhutan, natural gas of Bangladesh and coal from India etc. (Table 3.1 and 3.2), which are of prime importance. Cross-border energy trade could play an important role in achieving desirable supply demand levels between the countries of this region.

Expanding regional energy trade and investment is therefore, now timely and essential. However, basic principle of any cross-border energy trade lies in the fact that the imported energy must be competitive and cheaper than one produced within the country i.e., there is a dilemma regarding the true price of the energy prevailing in the country. South Asia is a region where present annual energy usage is among the lowest compared to global standard (see Table 3.3).

Resources like electricity, gas, and coal can be traded in bulk quantities among the neighbouring countries through integration high voltage transmission grids for electricity and through pipelines for gas etc. Electricity cannot be stored hence requires transmission lines to be developed across international boundaries. This can help optimize the production by sharing electricity operating reserves and gas shortage and at times providing for emergencies at cheaper cost. Transit of energy could be important where there would be cross-country and cross-regional transfers benefiting all i.e., the source country, cross country and the destination country. The South Asian cross-border trade in network energy is only limited to India, Bhutan and Nepal currently. There is significant scope of advancing regional economic development by increasing energy access and supply, and thereby improving energy security, reliability and quality in the region.

¹ www.southasia.net, www.saarctrade.com

Table 3.3 Current Rate of Extraction or Installed Capacity

Source of Energy	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Coal (million short tons as of 1999)	-	-	358.8	-	0.01	3.5	-
Oil (million barrels)	-	-	277.4	-	-	0.06	-
Natural gas (trillion cubic feet)	0.3	-	0.8	-	-	0.7	-
Hydro energy potential (MW)	230	355	21900	-	283	4825	1145
Large and medium	230					4820	1128
Small/mini and micro						5	17
Fuel wood (million MT)		0.78 MT	n/a	-	15 MMT	n/a	-10 MT
Biomass	n/a	0.793 MT	-250 MW	-	1.7 MMT	n/a	n/a
Biogas	5000 P	n/a	-2.98 Mil.U.	n/a	50000U	4137 U	2000 U
Energy from wastes	n/a	1	1700 MW	-	-0.9 MT	n/a	n/a
Solar photovoltaic	1642	n/a	50 MW	130kW	-2600 U	n/a	8000 U
Solar water heating	n/a	n/a	467692 sq.m.	n/a	n/a	n/a	n/a
Solar thermal collector area	n/a	n/a	n/a	n/a	-18000 U	n/a	18000 U
Wind Power	n/a	n/a	1167 MW	n/a	n/a	0	3MW

Notes: '-' : Resources not available; P: Plants; U: Units; MT: Million Tons, MMT: Million Metric Ton; n/a: Data not available; 1642 solar units sold by Bangladesh include 1506 units sold by the Grameen Bank, 11 warning lights installed in 1981 in Archa and 125 units installed by Bangladesh Inland Water Transport Authority in 1983; 10 million tons in Sri Lanka includes biomass. The number of oil barrels (in millions) for India is calculated by multiplying the daily extraction rate of 0.76 by 365, which may slightly overestimate the actual value.

Source: Bangladesh Energy Master Plan, Ministry of Planning, Government of Bangladesh, Dhaka; Government of Bhutan, Ministry of Planning, 5th five year plan; Electricity Authority 1999, Government of Nepal, Kathmandu; ESCAP, 2000, "Review of Critical Sustainable Energy Development Issues Specific to the Region" Note prepared by the ESCAP Secretariat for the High-level Meeting on Energy for Sustainable Development, Bali, 21-22 November; SAARC and WEC 2000, Renewable Energy in South Asia: Status and Prospects; London; World Bank, 2000, Meeting India's Future Power Needs: Planning of Environmentally Sustainable Development, Washington, D.C.

Table 3.4 Share of Energy Sources in Total Consumption

	Coal	Oil	Natural gas	Hydro electricity	Nuclear	Renewable
2010/11	52	30	14	2	1	1
2024/25	48	24	19	2	3	2

Source: Energy Sector in India, Implications for South Asian Trade, CPD-CASAC Study, March 17-18 2001, Dhaka.

Table 3.5 Commercial Energy Consumption

Country	Commercial Energy Consumption (1998)						
	Total Quadrillion (Btu)	Petroleum (%)	Natural Gas (%)	Coal (%)	Nuclear (%)	Hydro electric (%)	Other (%)
Bangladesh	0.4	29	69	0	0	2	0
Bhutan	0.01	30	0	9	0	61	0
India	12.51	30	7	55	1	6	0.2
Maldives	0.004	100	0	0	0	0	0
Nepal	0.04	57	0	8	0	32	4
Pakistan	1.74	43	38	5	0.2	13	0
Sri Lanka	0.17	76	0	0	0	24	0
South Asia	14.87	33	12	47	1	7	0.2

Source: US Energy Information Administration, International Energy Database, December 1999.

3.4 HYDROPOWER² FROM NEPAL AND BHUTAN

Nepal is well endowed with enormous hydro-power resources.³ This comparatively cheap source of power provides a distinct advantage for Nepal to embark on a program of rapid industrialization. Fortunately, the country has always been able to rely on foreign donors to finance the large-scale hydroelectric projects which provide most of its electricity. Several projects are already in the planning stages, awaiting a willing funding partner. The Karnali-Chisapani Project would be one of the world's biggest — a high

² SACEPS Task Force Report: A Policy Dialogue on South Asian Cooperation, Agenda for Economic Cooperation in South Asia by Rehman Sobhan, CPD Dialogue Report — Report 20: Growth Zone in South Asia — what can we learn from ASEAN.

³ www.bilateral.org, www.saarc.org, www.southasia.net, www.saarctrade.com

dam on the Karnali River in far-western Nepal. It would have a capacity of 10,800 megawatts, which is about 20 times that of Nepal's entire installed capacity. The entire project would cost \$4-8 billion to build and it would displace 60,000 people upstream.

In October 2002, Australia's Snowy Mountains Hydro (SMEC) signed a memorandum of understanding for the development of the 750-MW West Seti hydroelectric dam. It will mainly export power to India. Renewable power sources are increasing in Nepal through rural electrification programs, which aim to lessen the disparity in electricity access between rural (30%) and urban (70%) areas. The overall quality of Nepal's electricity infrastructure, however, is low and is frequently a target for attack by Maoist rebels.

Nepal has roughly 83,000 MW of hydropower potential, half of which is economically feasible for development. Less than 1% of this capacity has been developed, while the demand for clean, renewable energy in Nepal, northern India, and southwest China is expected to at least double over the next decade. Demand for power in Nepal is outstripping supply by 25 MW or 10% per year. The domestic energy demand, which stood at 270 MW in 2003, rose to 610 MW by 2005. India's energy deficit is expected to reach 20,000 MW by 2010, and China's deficit will reach 330,000 MW by 2015.

Private financing of hydropower development is extremely attractive to Nepal because it will reduce Nepal's reliance on donor financing in the energy sector, expedite development of Nepal's hydropower potential, and allow Nepal to utilize scarce financial resources for critically important social sector investments.

The large potential existing in the South Asia region can be seen by Bhutan and Nepal's possession of hydroelectricity of 30,000 MW and 43,000 MW, respectively. These can be exploited to export power to India and Bangladesh and earn foreign exchange. Nepal and Bhutan retain the potential to emerge as major sources of energy exports though harnessing the vast hydropower potential in their rivers. Indeed power is already Bhutan's largest source of export earnings directed to India which has helped to make it the only country in the region to have a trade surplus with India. However, Nepal's export-oriented hydropower projects have been

tied up in protracted negotiations with India, its principal prospective market for power. Bangladesh could setup a power grid in cooperation with Nepal whereby it will acquire electricity from Nepal. Generating electricity by itself is very expensive for Bangladesh. However, if it buys electricity from Nepal it will be able to supply electricity to the general people at a lower rate. The industrial units will be able to reduce the costs of production and per unit cost of items will also decrease.

Currently the two major hydropower projects in Bhutan are the Chukha (336MW) and Kurichu (60MW). In fact, Bhutan is currently exporting 80 per cent of its energy generation to India, which accounts for a third of its GDP. In return, Bhutan imports all its requirements of petrol from India. However, for a greater access to Bhutanese power, India will have to upgrade its transmission lines to reach the states of West Bengal, Bihar and Uttar Pradesh and may even need help from Bangladesh to allow a corridor for such lines.

Concordantly, Bangladesh can also be supplied with electricity from Bhutan through India, especially since Bhutan is expected to add another 1080 MW capacity in the next couple of years. With this expanded power generation and hike in tariff rates to 2.5 cents per unit under way, Bhutan can earn enormous foreign exchange for its developmental efforts. It is rather unfortunate, that although the SAARC region is rich with hydro power, only a very small proportion (11 per cent) has been exploited so far. A study conducted by the Asian Development Bank (ADB) showed that sub-regional cooperation among the countries of the Ganges-Brahmaputra-Meghna (GBM) basins could generate 25000 MW of power. A sub-regional growth quadrangle (since it would cover four countries Bangladesh, Bhutan, India and Nepal) could be established in the GBM area.

3.5 NATURAL GAS

Natural gas is being touted as the fuel of the century.⁴ Its usage has increased rapidly in South Asia over the last decade, growing about 59% between 1992 and 2002. In 2002, the region produced

⁴ www.bilateral.org, www.saarc.org, www.southasia.net, www.saarctrade.com

and consumed around 2.1 Tcf of natural gas of which 42% was consumed by India, 39% by Pakistan, and the remaining 19% by Bangladesh. It is estimated that the demand in India and Pakistan for gas would be 8 billion cubic feet per day by 2010. While a quarter of this demand could be sourced domestically, the rest will have to be imported. If the recoverable reserves of Bangladesh, India and Pakistan are harnessed judiciously; it could change the energy scenario in South Asia.

For the profitable exploitation of gas reserves, markets have to be viewed as integrated, cutting across national boundaries. Natural gas reserves are plentiful in Bangladesh, with 22.9 trillion cubic feet (Tcf) of reserves as per latest estimates of which 16 Tcf is already proven-enough to supply gas to the region for 40-45 at the current rate of consumption. Bangladesh does not have adequate resources to invest in gas exploration. Moreover, Bangladesh has foreign exchange constraints because of its adverse BOP situation. It is the net importer of oil to the tune of 3.5 million tons per year. Besides developing gas based domestic industries, export of a small proportion of gas (200 mcf gas per year) to India could fetch annual revenue of US\$ 400 million thus strengthening Indo-Bangladesh bilateral trade.

Bangladesh's gas reserves are located mainly in the eastern part of the country. In Eastern India too, there is an imbalance, with extensive gas reserves in Tripura but deficits in West Bengal, Bihar and Orissa. There is a proposal regarding a joint pipeline from Tripura via Eastern Bangladesh, across Western Bangladesh, on to West Bengal. This could turn out to be a very convenient and economical route for India and also facilitate gas transfer between the eastern and western portions of Bangladesh.

Iran has gas reserves of 741.6 trillion cubic feet and Turkmenistan of 102 trillion cubic feet. Not only does Iran possess 15 per cent of the world's gas reserves, but is also uniquely located on the transit point for the Caspian and the Central Asian gas. If these countries were to supply natural gas via pipelines, it would cost 35 per cent less than the cost of liquefied natural gas (LNG) in India and Pakistan. Iran is keen on building a 2,670 km long on-land pipeline to India through Pakistan, as it would provide a cheap route to sell its vast gas reserves. Concurrently, Afghanistan, Pakistan,

and Turkmenistan met in Islamabad in 2002 to revive the project of building the Turkmenistan-Afghanistan-Pakistan pipeline, with a possible extension to India. While Iran and Pakistan have shown great interest in the project, India has been reluctant to move forward due to continuing political and military tensions with Pakistan.

Sizable gas shortfall is expected in both India and Pakistan unless some major exploration and drilling operations are undertaken. The Tenth Plan of India had projected natural gas demand of 130 MMSCMD in the year 2006/07 which could rise to 175 MMSCMD in 2011/12. Indian Government policy in the recent years has sought to promote the import of natural gas in light of the fact that demand had outstripped production by 62 MMSCMD in 2006/07 taking the intermediate demand forecast by the Tenth Plan. It could be higher if the potential demand for natural gas is taken into account.

Though the South Asian countries, particularly India and Pakistan, have been envisaging both on-shore (Iran-Pakistan, Turkmenistan-Pakistan) and off-shore (Qatar-Pakistan, Iran-India and Oman-India) pipelines, nothing concrete has emerged as of it. There are a number of issues at play which includes: (i) huge financial implications, (ii) geo-political apprehensions, (iii) unsure confirmation of natural gas reserves, (iv) pricing of supplied gas, (v) third country approval of transit, and (vi) environmental fallouts. This has also been the case for the intra-regional gas pipeline between Bangladesh and India.

Indian concerns about the safety of the pipeline and assured supply through the territory of Pakistan can be addressed through a dialogue and legally binding guarantees by multilateral institutions. This can be even ensured by extending this pipeline to Nepal, Bhutan and Sri Lanka.

Swapping of Indian gas with Bangladesh gas is a proposal that also stands as a mutually gainful project. The proposal is that ONGC will sell the gas found in North East India, which could not be brought to mainland India since it would be too costly a proposition, to Bangladesh that would sell an equivalent quantity of gas to India in return. However, there has been no significant development on this front. Yet another proposal is to allow the right-of-way to

lay a gas pipeline across Bangladesh to bring Indian gas, stranded in North East, to mainland India. This will bring transit fees to Bangladesh without any gas sales from the country. However, progress on this proposal is also very slow. More than this, the delay in any deals has been very costly for the South Asian countries. Some experts suggest that recent discoveries in the East Coast (Godavari) in India may thwart the plans to import natural gas into the country.

In March 2004, Unocal, the largest foreign investor in Bangladesh's natural gas sector, shelved a proposal to export gas from the Bibiyana field to India, given the political obstacles to exports.

In March 2005, the state-run Gas Authority of India Ltd. (GAIL) signed a memorandum of understanding (MOU) with the Bangladesh Business Development Corp. Ltd. to cooperate in the areas of gas transmission, pipeline and distribution network development in Bangladesh. This follows a February 2005 MOU signed by GAIL and Bangladesh's Spectra Group to develop compressed natural gas (CNG) pipelines and retail outlets in Bangladesh. Tullow Oil also won state approval in March 2005 to build a pipeline and gas processing plant.

3.6 TRADE BETWEEN INDIA, BANGLADESH AND MYANMAR (TRI NATION)

India, Bangladesh and Myanmar have started discussion for tri-nation gas transmission pipeline, which would originate from Myanmar, cut across Bangladesh and terminate in India primarily to transport natural gas from Myanmar and eastern Indian state of Tripura for the energy hungry Indian market. Bangladesh is expected to provide a corridor and benefit as a transit country. The pipeline that will run through Bangladesh will be under the management of state-run Gas Transmission Company Limited (GTCL).

Benefits that can be derived by Bangladesh are as follows:

- Royalty and income from installation of the pipeline and transmission fees.
- US\$ 125 million a year as wheeling and maintenance charges.
- The construction of the pipeline is expected to bring at least US\$ 150 million through employment generation.

- A key pre-condition can be Bangladesh's right to use the pipeline for transmission of its own natural gas from one region to another or even to export the gas to India, in case Dhaka wishes to export its surplus.

3.7 BENEFITS FOR INDIA

- India has also untapped natural gas in Tripura state, which at the moment is unutilized due to poor accessibility. Hence, the proposed pipeline from Myanmar will serve a double purpose: supplying gas from both Myanmar and Tripura and also from Bangladesh when it agrees to export its natural gas.
- The other option for India is the India-Iran gas pipeline project. India, however, may not be an ideal market for gas as it lacks a power grid within its own territory. Such projects are time consuming to execute, and there can be change of regimes within this time. Only a stable national policy could ensure construction of a like project. Moreover, gas in Myanmar is owned by Indian companies like ONGC and GAIL.

Therefore, the tri state project is a more feasible one for India.

3.8 DESPITE THE SUBSTANTIAL BENEFITS, WHY ARE THESE PROJECTS NOT BEING REALIZED?

India wants gas from Myanmar at a lower tariff than the market rate. Myanmar is willing to sell it at the price it is now selling to Thailand (\$4.20 per thousand cubic meters of gas), while India is only willing to pay \$3.85. On the other hand, China has already offered Myanmar \$6.00. Therefore, there is a good chance that this project will not be realized in the end, and deprive the SAARC nations of its benefits. Also, at the moment India is blaming Bangladesh for the delay, mentioning Bangladesh's reluctance to give the right of way for the cross border gas pipeline. Hence, it becomes crystal clear that India has a big role to play in this tri-nation gas pipeline project.

As of now, Myanmar has already reached a deal with Petro China about this gas pipeline project. Myanmar will sell about 6.5 TCF to China at a rate of \$4.85 per thousand cubic feet gas. However,

Bangladesh can still be benefited from this agreement. The Chinese company said that it wants to lay the pipeline from Myanmar to Kunming over Teknaf of Bangladesh. But as an overall scenario, we find that China is taking up trade opportunities from SAARC countries, due to their competitive advantages and SAARC nations' political clashes.

3.9 OIL RESOURCES

South Asia contains reserves of only 5.7 billion barrels of oil, or around 0.5% of world reserves. In 2002, the region consumed around 2.72 million barrels per day (bbl/d) of oil, and produced approximately 0.70 million bbl/d, making South Asia a net oil importer of around 2.0 million bbl/d. Growing demand for transportation fuels and industrial power has been a major factor behind recent growth in South Asian oil consumption. Alarmingly, South Asia's oil imports are projected to more than double by 2020. The Middle East has been and is expected to remain the primary source of South Asian oil imports.

India: The vast majority of South Asia's oil production comes from India, which is around 819,000 bbl/d in 2003. The offshore Bombay High field accounts for approximately one-third of total Indian oil output. Between 1990 and 2000, South Asian oil consumption, led by India, grew by about 75%. India's oil consumption is forecasted to grow another 33% by 2010, reaching 2.8 million bbl/d up from 2.2 million bbl/d in 2002.

Pakistan: Most of the remainder of South Asia's oil production comes from Pakistan, which was around 62,000 bbl/d in 2003.

Sri Lanka: Oil consumption roughly doubled between 1991 and 2000. In 2002, Sri Lanka's oil consumption was 75,000 bbl/d. Sri Lanka imports all of its crude oil and uses it largely for electricity generation and transportation. In recent years, Sri Lanka has further increased oil imports in an effort to avoid over-reliance on hydroelectricity.

In **Nepal**, presently, eight blocks of nearly 5000 sq.km area each are available for exploration by local or foreign oil companies. Recent discovery of oil showings in some of the wells drilled in India situated close to Nepal border is encouraging for petroleum

exploration activity in Nepal. The southern Terai plains and the adjoining Siwalik Range have been divided into ten different blocks, each of nearly 5000sq.km, for the petroleum exploration and development by potential investors.

In an effort to reduce oil import dependence, a number of South Asian countries have sought to expand domestic petroleum exploration by attracting private and foreign investors. In July 2003, the Sri Lankan government approved the Petroleum Resources Act to allow for private and foreign investment in its offshore oil and gas fields. Similarly, Pakistan recently executed Production Sharing Agreements (PSA) with exploration companies based in France, Malaysia and Austria. India is making attempts to better implement its 1997 New Exploration Licensing Policy (NELP) to increase foreign involvement in exploration, most recently by awarding 15 exploration blocks in February 2004.

Several recent oil finds in India may reduce import dependence in South Asia. In September 2004, UK oil firm Cairn Energy confirmed the potential of its Mangala field at between 100 and 320 million barrels. Both Mangala and the nearby N-A fields are expected to yield 60,000 to 100,000 bbl/d when fully operational. In early 2004, Cairn Energy discovered another oil reserve in Rajasthan at the N-V-1 well. The find is expected to have reserves of at least 300 million barrels and likely more than 500 million barrels. Such discoveries follow several other finds by Cairn in early 2004. The exploration of new reserves will enable the countries in the region to reduce their dependence on imports from Middle Eastern countries and rely more on the SAARC countries, concurrently providing more opportunities for trade among its member nations.

3.10 THERMAL POWER AND COAL

Thermal power accounts for about 92 per cent of the installed capacity in Bangladesh, 73 per cent in India and 69 per cent in Pakistan. India has a large reserve of coal (206 billion tonnes) accounting for about 7 per cent of the world reserves. In India, 72 per cent of coal was used by thermal power plants in 1998. Pakistan is estimated to have 4.35 billion tonnes of measured coal reserves but imports 30 per cent of its demand.

In this context there is scope for cooperation among countries for their mutual benefit. Bangladesh, for example, could import coal from Raniganj in West Bengal and reap the benefit of proximity because coal can be transported at minimum cost by rail. There is also potential for cooperation between India and Pakistan in electricity generation using coal. A recent study by TERI has indicated that the cost of electricity generation at coal pitheads for India is around Rs 1.50 per Kwh, whereas the cost of generation and transmission in Pakistan is about Rs. 1.77. This shows that there are possibilities for cooperation, which could be mutually beneficial.

3.11 SAARC GRID⁵

Discussions have been underway for some time among South Asian nations to develop a regional electricity grid connecting India, Bhutan, Nepal and Bangladesh. Such a grid would lead to increased efficiencies and reduced power generation and transmission costs. It has been estimated that the demand for power has been growing at the rate of 9 per cent per annum, which requires additional capacity of about 100,000 MW. The SAARC grid could be a viable way out for assuring quality power at a low cost, aside from ensuring mutual support during contingencies.

Cooperation can be initiated through sharing of information and technology on energy in general, and electric power and gas in particular. This will help to generate confidence among the cooperating partners and facilitate them to evaluate the benefits of cooperation from their respective perspectives. The existing wealth of technical knowledge and expertise available within the region can be mobilized to provide support to those who need them.

Several issues have impeded the implementation of a regional network for energy cooperation. Amongst these, political issues have been at the forefront. Mistrust is one such issue. The power exchange can incorporate transfer of power and joint construction and operation of transmission. Power exchange can also eventually

move towards joint construction of power stations. There is still a hefty amount of work needs that needs to be done prior to moving towards more advanced forms of energy cooperation in the region. The countries need an in-depth study of all possible modes of cooperation to identify specific areas, which are acceptable to the participating nations.

Without the proper political gumption, it is not possible to achieve regional cooperation in the energy sector. The decision on whether to cooperate or not rests ultimately in the hands of the policymakers. Cooperation areas should be identified through legal systems. That is with the help of legal system, determine how much a country would be benefited, the amount of responsibility, etc. needs to be specified so that no complexity arises. Prices of electricity and gas should be fixed to avoid future crisis. It is not possible to negotiate every single subject each and every time.

3.12 TRADE BETWEEN INDIA, BANGLADESH, BHUTAN AND NEPAL (SAGQ)

The concept of an interconnected power grid presented some real possibilities in terms of relatively easy-implemented project, which could benefit all the participating countries.⁶ An interconnecting regional grid in the South Asia Growth Quadrangle (SAGQ — comprising of Nepal, Bhutan, Bangladesh and north-east India) would reduce transmission and distribution losses by 90MW, resulting in savings of US\$ 79.12 million in investment for new capacity addition in the region. A 50 MW loss reduction through such interconnections would increase total savings of US\$ 123.08 million.

The major barriers are not technical rather non-technical ones like:

- Cross-border agreements
- Commercial operation
- Financing

It is unfortunate that such a concept, which was designed and aimed to benefit all countries involved, did not receive appropriate

⁵ www.saarc.org, www.southasia.net, www.saarctrade.com, www.asianews.net, www.cpd-bangladesh.org

⁶ SACEPS Task Force Report: A Policy Dialogue on South Asian Cooperation, *Agenda for Economic Cooperation in South Asia* by Rehman Sobhan, CPD Dialogue Report — Report 20: Growth Zone in South Asia — what can we learn from ASEAN.

response and impetus. Indeed there is a myriad of potential benefits of such a project.

3.13 ECONOMIC GAINS FROM POWER TRADING WILL HELP MEMBERS TO CUT BACK ON COSTS

Nepal loses \$24.7 million annually due to poor power quality, which is 0.47% of its GDP. Unplanned power interruptions averaged = \$0.49/k, while planned interruptions average = \$0.14/kWh. In Bangladesh's case power outages cost about \$1 billion annually and reduces GDP growth by 0.5%.

3.14 FINANCIAL LOSS REDUCTION

Reduce transmission and distribution losses by 90MW resulting in a saving of \$79.12 million. Border areas could be better served by interconnecting them, to reduce losses further; a loss reduction of 50 MW will enhance total savings to the level of \$123.08 million.

3.15 POWER TRADING REVENUES

For Bhutan export of 1,472 GWh to India in 2002-03 was valued at \$52 million. With an interconnected grid this will reach \$214 million annually. Furthermore, Nepal could've earned \$308 million by 2007, a figure would be projected to rise to \$1,248 million by 2031. Even in the case of Bangladesh the projected annual revenue from exporting power to India could be \$130 million.

3.16 GDP GAINS

In Bangladesh, power sector contributes to 1.3% of GDP. If additional demand of 100 MW is met, power sector's share of GDP will increase to 2%, with an annual growth of 9% from current 7%. For Nepal, a growth rate of 8% is achievable, addressing poverty and unemployment problems. This will trigger GDP from \$96 million (2002) to \$1.51 billion (2027). The value added by hydropower will respectively increase from 1.5% to 4.21%. Bhutan also stands to gain quite a bit, as their revenue from hydropower will go up to 36% from 11% of GDP.

3.17 FOREIGN EXCHANGE GAINS

Nepal could potentially earn a royalty of \$46 million in the first year of operation while Bhutan's export earnings will reach \$142 million from power. For Bangladesh export earnings will reach \$130 million. Also, as dependence on petroleum decreases, foreign exchange outflow from the region would also recede.

3.18 INCREASING INVESTMENT WITHIN SOUTH ASIA THROUGH JOINT VENTURE PROJECTS

Key joint venture projects can be undertaken to increase investment and growth in the region.⁷ Private sector joint projects in building a network of motorways and railways at international quality standards throughout South Asia can be facilitated. These modern road and rail networks would connect all the major commercial centres, towns and cities of SAARC countries with each other and with the economies of Central Asia, West Asia and East Asia.

Regional and global joint venture projects for developing new ports along both the western and eastern seaboard of South Asia, and at the same time upgrading existing ports to the highest international standards can also be undertaken. Building a network of airports, together with cold storages and warehouses could stimulate not only tourism but also export of perishable commodities such as milk, meat, fish, fruits and vegetables. Building dams to utilize the huge untapped potential for energy and irrigation in the mountain ranges of South Asia can be initiated. Projects for improving the irrigation efficiency of the networks of canals and watercourses in South Asia can also be embarked on.

SAARC members may be allowed to invest directly in other member countries. This will enable countries to enjoy benefits such as production-cost advantages and greater market coverage. A liberalized capital market will allow producers within the region to set up operations in those countries which offers access to lower costs, better technology and raw materials.

⁷ SACEPS Task Force Report: *A Policy Dialogue on South Asian Cooperation*, *Agenda for Economic Cooperation in South Asia* by Rehman Sobhan, CPD Dialogue Report — Report 20: Growth Zone in South Asia — what can we learn from ASEAN.

In order to create conditions favourable for promoting and protecting investments in South Asian countries both by regional investors and outside investors, a common investment platform should be formed based on a common investment framework and common approaches. The approach should include:

1. Harmonizing investment policies by taking a common stand towards FDI and simplifying rules and regulations for FDI in the region.
2. Harmonizing and coordinating macroeconomic policies to provide greater economic parity among investors in the region.
3. Ensuring that financial institutions (central banks, other related agencies) are properly integrated and banks are interconnected.
4. Harmonizing exchange rates, tax laws and customs laws.
5. Developing a legal framework through revision of the existing laws with current market realities and by setting up a SAARC Arbitration Council.
6. Developing a regulatory framework geared towards proper competition policy and anti-trust laws and harmonizing national standards and certification processes to ensure quality.

A key factor in encouraging investment cooperation will be the speeding up of the South Asian Free Trade Area (SAFTA). At this stage bilateral free trade and investment agreements can be concluded, which will not only stimulate trade but also investment.

Finally, it is important that the governments in the region become more proactive on a whole range of issues relating to regional cooperation in general and SAARC in particular. It is extremely important to have strong institutional support through close interaction and cooperation between governments, central banks, finance ministries, related government agencies and the business communities. Interaction, specifically between the private and public sectors, needs to be intensified in order to facilitate and encourage investment cooperation.

The proposal for a dedicated South Asian development fund may also be encouraged. The Fund was endorsed by SAARC at

least a decade ago but has been virtually stillborn. The Fund's mission needs to be clarified and new life needs to be breathed into the organization. It is advisable that two separate funds need to be developed. The first, should be dedicated to financing infrastructure development projects mostly located in the less developed countries. While funded primarily by SAARC, it will be supplemented by aid resources from outside the region to empower countries like Bangladesh, Bhutan, Maldives, Nepal and Sri Lanka to invest in various projects.

A second fund should be established as an Investment Fund, serviced by both public and private capital, to finance private sector investment projects within the weaker economies, which involve cross border investment as well as projects for serving regional markets. This should attract prospective investors from India and Pakistan and could be used to leverage further private investment from outside the region, which may even cover private investment in infrastructure projects.

3.19 INTRA INDUSTRY TRADE

While trade would take place only if there are differences in factor endowments, differences in technology and human capital can lead to intra-industry trade even in products with identical factor input requirements. Industries in which increasing returns are achieved at a fairly low level of output can accommodate many producers, with each producing differentiated products. Under these circumstances, each country will specialize in different varieties of the product and engage in intra-industry trade. The growth of regional integration schemes involving cross-country production sharing arrangements also increases intra-industry trade. Production sharing has become a major factor in regional trading arrangements, where approximately 30 per cent of the world trade in manufactured goods, is largely of the intra-industry variety. It must, however, be pointed out here that the regional production sharing arrangements generally emerge in response to a combination of factors including low tariffs, wage differentials, low transportation costs, and favourable government policies.

There are significant gains to be accrued through intra-industry trade between India and the other SAFTA nations. There are a

number of viable prospects for Indian entrepreneurs to set up either Joint Ventures, or wholly owned subsidiaries:

- In Bangladesh, manufacturing of shirts (not hand printed), tanned or crust hides, grains (finished), sacks and bags of other plastic, and other finished tanned leather can be potential recipients of such FDI.
- In the Maldives, manufacturing articles for conveyance or packing goods of plastics, air conditioning machines, and water pumps are also appropriate.
- In Pakistan, joint ventures in cane sugar and some chemical products.
- In Sri Lanka, the manufacture of printing and writing paper, plastic goods, and soap cutting and molding machinery.

3.20 THE SEVEN SISTERS

The Seven Sisters of India are the seven relatively unexplored and isolated Indian states — Assam, Nagaland, Tripura, Meghalaya, Manipur, Mizoram and Arunachal Pradesh — which for many years was closed to foreigners. Most Indologists believe that if you draw a straight line from Kanpur to Chennai, to the west this hypothetical line lays the rich India; and to the east lays the poor India. Ironically, however, a large chunk of South Asia's natural wealth lies in this poor region, be it coal, iron ore, bauxite, limestone, oil, natural gas, bamboo, food and agricultural products, hydro-electric power or tourism potential.⁸ The stated grievances of the Seven Sisters against the Indian Government include charges of neglect and indifference to the endemic poverty of the region and allegations of active discrimination against the tribal and non-tribal people of the region by the center.

3.21 TRADE POTENTIALS IN NORTH-EASTERN REGION

The region has natural gas reserves of 190 billion cubic meters, coal reserves of 909 million tonnes, hydro-electric potential estimated at 49,000 MW, oil reserves pegged at 513 million tonnes, limestone

reserves of 4933 million tonnes and a forest cover that comprises 25% of the country's entire forest area. The northeast harvests 8.1 million tonnes of bamboo, which is about 54% of the country's share and valued at Rs. 10 billion (US\$ 209 million). The bamboo sector is currently expanding into neighbouring China to meet the huge internal market and to satisfy increasing exports. The average yearly household income from bamboo shoots in China ranges from US\$ 2,500, to US\$ 10,000. In contrast, there is little or no export of bamboo products from this region. With the right initiative, the region could compete in fulfilling the worldwide demand for bamboo to a considerable extent.

Despite its rich agro-climatic condition, the region is not self-sufficient in context of food grains. The region is ideally suited to produce a whole range of plantation crops (including tea, rubber, coffee, cashew), spices, fruits and vegetables, flowers and herbs, much of which could be processed and exported to the rest of the counties and worldwide. The region is also well known for its traditional art and crafts, especially in the field of handloom textiles and handicraft products.

The products that are currently being exported from the region can be generally classified under two categories, (i) products of North Eastern origin (with or without value addition) exported outside the region and (ii) products exported through the Customs check posts located on the international borders in the region.

The first category includes major commodities like tea, cotton, jute, etc., that are plantation products and major export earners for the region and the country; it also includes goods that are exported through the mainland after value addition either in the North East or outside. These products are exported mostly indirectly through Trading/Export houses and Merchant exporters located in Kolkata and other cities. The important products exported from the region under this category are pineapple products, medicinal herbs, broomsticks, grass, *tejpatta*, orchids, limestone, coal, tea processing machinery, handloom textiles, woollen carpets and cane and bamboo products. The second category of goods consists of commodities exported to Bangladesh, Myanmar, Bhutan and China either through formal trade, border trade or informal/unaccounted trade.

⁸ SACEPS Task Force Report : A Policy Dialogue on South Asian Cooperation, Agenda for Economic Cooperation in South Asia by Rehman Sobhan, CPD Dialogue Report — Report 20: Growth Zone in South Asia — what can we learn from ASEAN.

Handlooms are a household industry in the region. Although the industry has tremendous export potential, it suffers from non-availability of adequate raw materials and high cost of yarn due to the transportation cost involved in sourcing raw materials from outside the Northeast.

Cane and bamboo products are an important handicrafts item in the North Eastern Region. Khadi and Village Industries Commission, who have the responsibility under the Ministry of Industries to oversee and assist the development of this sector, have reported that the lack of coordination in ensuring the availability of the raw materials and its uses impedes the orderly growth of this industry.

North East contributes approx. 95% of the total tea production (Rs. 9,000 crores) in the country. A number of schemes are operated by the Tea Board to help the tea growers. In the recent years, organic tea has emerged as a new product, which could have a large consumption in the foreign market. 20 lakh holdings have been identified in Assam and Bengal for the production of organic tea. The rapid growth in the demand for organic tea worldwide could provide substantial focus which is imperative to the growth of the industry.

Coffee has substantial growth and export potential in the North East. However, coffee plantations have not met with an equal degree of success in the North East primarily because of failure of the cooperatives through which the coffee farming has been encouraged. Although, 10,000 hectares have been planted, the production is only about 200 tonnes per annum.

In some pockets of North East such as Tripura and Manipur, rubber is grown and the area under its cultivation is on the rise. In Tripura, a World Bank assisted scheme is under implementation for promoting rubber plantations. Meghalaya and Arunachal offer large potential for development of floriculture, especially orchids.

There is, however, a renewed focus on border trade in view of the need to forge closer commercial and economic links with the larger markets in the fast developing South East Asian economies. The North Eastern States have already established a large volume of informal trade with Myanmar and also with Bangladesh. With a combination of judicious policies and programs, they can form

important gateways to expanded trade with the more affluent Asian markets.

The scenario in the neighbourhood of the north east is changing. Myanmar has been admitted as an Associate member of the ASEAN and is expected to benefit from the resultant investment and trade flows. The setting up of a SAARC Free Trade Area (SAFTA) and the removal of quantitative limits on a large number of products under SAPTA agreement augurs well for the North Eastern Region, in terms of larger export opportunities. In addition, a sub-regional economic cooperation grouping involving Bangladesh, India, Sri Lanka, Myanmar and Thailand (BIMSTEC) has been launched. India's participation in this grouping is expected to serve India's interests in reinforcing her close relations, and trade ties with its SAARC neighbours including Bangladesh.

3.22 TRADE ROUTES

India had enjoyed a rail transit through erstwhile East Pakistan up until the 1965 Indo-Pak war. Transport of commodities to and from the NEER has become difficult ever since this means of transport and communication through Bangladesh had been snapped. This has particularly affected the southern sub-region vis-à-vis Cachar, Hailakandi and Karimganj districts of Assam, and the States of Mizoram, and Tripura which had been traditionally connected with Kolkata via Bangladesh directly and not through the Brahmaputra Valley of Assam, as is the case now. Manipur had been able to cater to substantial part of its requirements through Nagaland with Dimapur as the railhead.

The Trade Agreement with Bangladesh provides for mutually beneficial arrangements for the use of their waterways for commerce between the two countries and for the passage of goods between two places in one country through the territory of another. Accordingly, the Surface Transport authorities of the two Governments had signed an Agreement on Inland Water Transit and Trade in 1972. The last Protocol was renewed on 22nd August, 1995 effective from 4th October, 1995 for a period of two years initially. Under the protocol, a total of eight river routes between the two countries have been identified for cargo transit purposes. However, the protocol provides transit only between

Kolkata and two points in Assam. No points on the approved river routes touch Meghalaya and Tripura.

Ministry of Surface Transport has proposed doubling of the total number of agreed river routes under the protocol from the present eight to sixteen routes. The proposed new routes include Kolkata-Chittagong and Karimganj (Assam)-Chittagong routes. The inclusion of Chittagong among the river routes would help improve the economy of the North Eastern Region significantly. There is also a proposal that Ashuganj should be declared a port of call and transshipment of Indian cargo from Ashuganj to Agartala by road should be permitted.

Border trade has special significance for the economies of the North-Eastern States due to their unique geographic location. 98% of their border is shared with the neighbouring countries of Myanmar, Bangladesh, China and Bhutan.

Of these, the trade conducted through the borders with Myanmar and Bangladesh is especially important for a myriad of reasons. Concurrently, in light of the fact that these two nations account for the major portion of the border trade with the North Eastern States, India has to forge special trade relationships with both Myanmar and Bangladesh, to fully explore the possibilities of border trade.

Mizoram had two river routes vis-à-vis Kolodyne river and Karnaphuli river which were used for transit and trade earlier. The Kolodyne river enters Akyab port whereas Karnaphuli river enters Chittagong port. The closure of these waterways had affected the economic life of people living in Mizoram. It would be worthwhile to revive these routes in the interest of closer interaction and promotion of border trade.

3.23 BARRIERS

Unfavourable Indian trade policies are stunting the growth of Bangladesh exports in the northeastern region of India, despite the fact that there exists high potential for Bangladesh products. Bangladesh can cater to the needs of the people of this region in return for the unused resources prevailing in those regions. For India it is quite difficult to supply even consumption goods to

those regions because the transportation cost is extremely high. Moreover, it cannot setup construction sights in those regions because the price of the product when it reaches the target market becomes high due to exorbitant transportation costs.

It is important to note, however, that there are significant barriers for Bangladesh to effectively penetrate the north-eastern markets:

- High tariff wall with a number of non-tariff and para-tariff barriers.
- Lack of proper knowledge on Bangladeshi products.
- Underdeveloped infrastructure and cumbersome import formalities.
- Restrictive vehicular movements and absence of customs facilities.

Bangladesh has a chronic trade deficit with India, which has leaped to around US\$ 1.00 billion in 2001-02 fiscal. The country, however, enjoys trade surplus as far as business with the NEI is concerned. The main exports from Bangladesh to North Eastern region of India (NEI) include *hilsa* fish and food products while main imports include:

- Mineral products such as coal, limestone and boulder stone; and
- Horticultural products like ginger, orange, citrus fruits, garlic, pears, onion, rice, dry chilly.

3.24 COMPETITIVE ADVANTAGE OF BANGLADESH

Bangladesh believes that it has a comparative advantage in developing bilateral trade with the NEI due to:

- **Geographical Proximity:** The region is in close geographical proximity with Bangladesh and its only connection with mainland India is through a narrow land corridor, sometimes referred to as the Siliguri Neck or "Chicken's Neck" in the north of Bangladesh. For example, distance from Kolkata to Agartala is about 1,680 kms, whereas the distance from Dhaka to Agartala is only 150 kms.
- **Economic Potential:** The region has a market of 38.5 million people which accounts for 3.5 percent of the purchasing

power of India. The low domestic production of the region, which is approximately US\$4.17 billion, reflects their dependence on other Indian states and other countries for consumer goods. Furthermore, the consumers in North East India are sensitive to high prices because of their life style and buying capacity. The industrial base in Bangladesh offers high quality NS reasonably priced consumer products which can cater to the needs of the people of the seven sisters.

- **Lower Transportation Cost:** Bangladesh is connected with most parts of the seven sisters through road network. Since the North East is located far from the rest of India, transporting goods between NEI and other regions takes longer than transporting goods between Bangladesh and NEI. For example, delivery time between Kolkata and NEI may often range between 7 and 10 days, while it requires 1.5 to 2 days to transport goods to NEI from any corner of Bangladesh. The cost of transportation of a truck of goods between Kolkata and Agartala may range between Tk. 35,000-40,000 (\$500-\$600) while the transportation cost between Dhaka and Agartala ranges between Tk. 2,000-3,000 (\$30-\$40).
- **Socio-cultural Cohesiveness:** The people of two regions share some common cultural heritage. Many people from both sides can communicate easily. For example, in Tripura, more than 90 percent people can speak Bengali, in addition to the similarities in the lifestyles of people in the two countries.
- **Economic Benefits:** North East India enjoys the lowest sales tax in India, which is currently 8%. A number of goods exported to and imported from India enjoy duty concessions under South Asian Preferential Trade Agreement (SAPTA). The Indian government has recently announced duty concession on 90 items imported from Bangladesh. Bangladesh can be a viable partner in the development of seven sisters in a number of ways:
 - *Cement Trading*
 - Bangladeshi Cement Industry has a production capacity of 2.5 times its local demand. Bangladesh can import lime stones at very competitive rates from Assam and Bhutan, allowing them to sell cement at lower prices.

- Concurrently, Cement can be exported to the seven sisters to build up infrastructure.
- However, the Indian Government needs to reduce import barriers by allowing Bangladeshi vehicle enter into the seven sisters.

– *Joint Venture for Fertilizer*

- Bangladesh and India can jointly go for fertilizer factories since Bangladesh has a sizeable wealth in natural gas.
- The infrastructure can be developed near the border of the seven sisters and Bangladesh.
- This will help developing the agricultural base of the seven sisters as well as Bangladesh, since both the regions are agro-based.

– *Joint Venture for Power*

- A common power grid between the regions will greatly facilitate the growth in industrial activities mentioned above.

Apart from the official trade between Bangladesh and the NEI, a large quantum of unofficial trade from Bangladesh also takes place in the region. Though there are 32 land customs stations (LCS) along the NEI, only 13 are currently operational.

While India had proposed for transit through Bangladesh to its north eastern states, the latter failed to see any economical benefits of such a move. Hence, Bangladesh's reluctance to comply with India's proposal has left NEI in a state of deprivation and pervasive political instability. If Bangladesh and India enter into a joint venture then both the economies will be benefited.

At present India claims to be ready to make any kind of concessions to Bangladesh for allowing its territory to carry goods to seven north-eastern Indian states. As an initiative India has already removed some of the trade barriers to Bangladeshi products including cement, and has been working on allowing more items to seven north eastern states billed as seven sisters. Referring to transit and trans-shipment, India could have a mentality to allow 100% Bangladesh transports for carrying goods from central India

to the remotest states, which are rich in natural resources, but poor in education and economy.

3.25 TOURISM

Tourism has always been a widely discussed issue in the SAARC summits as it is considered as one of the integral factors in enhancing the regional cooperation between the nations in the trading bloc. There are also many additional opportunities to expand cooperation with the SAARC nations. Indeed, the tourism sector within the SAARC region has been in a state of neglect for a very long time. The sector has low capital investment but relatively high earning potential. At one point of time the viability to start a daily air services to link the capitals of all the SAARC countries was even considered. This idea can be revived again. We can learn from the ASEAN experience. All the ASEAN capitals are linked by air and they have special low airfares for travel within ASEAN countries. In addition to this, rail, road and sea links must be strengthened among the SAARC countries wherever possible.

There is enormous potential for tourism in the SAARC region. The centuries old civilization with its rich and unique cultural diversity, exquisite cuisines, extremely diverse and vast array of geography, splendid archaeological monuments, historic sites of religious significance and above all very hospitable people of South Asia, make the region a very attractive place for intra-regional as well as international tourism.

Poor infrastructure, safety and security concerns, poor marketing, non-existence of a policy to provide visa on arrival, political uncertainty, unwarranted fear psychosis, economic slow down, low incomes, high rate of inflation, cumbersome visa procedures and exorbitant hotel tariff were identified to be the major hurdles to developing the tourist sector in the region.

The SAARC Tourism Ministers' meeting was held in Colombo on 29th July 2005. The meeting focused on methods that could be utilized to develop tourism in the SAARC region, especially through cooperation and coordination between SAARC countries. The meeting:

- Convinced the members that existing easy geographical access among the SAARC countries will open tremendous opportunities for tourism;

- Recognized that package tours for several destinations and intra-regional travel could be implemented in the SAARC region;
- Affirming the apriori notion that, public and private sector partnership is essential for the development of tourism;
- Resolved to forge ahead with strategies with a proactive joint campaign to promote inter-region and intra-region tourism which will be beneficial to all the countries in the SAARC region thus bringing in economic, social and cultural dividends to the people in the region;
- Recognized that the future development of tourism for the region largely depends upon the level of cooperation in transport sectors vis-à-vis, Air, Sea and Land;
- Believed that simplification of immigration procedures and other frontier formalities will enormously facilitate the travelers into and within the region; agreed to work on mechanisms to reduce frontier formalities, introduce special packages, and improve air accessibility;
- Agree to work on further mechanisms to create awareness and promote the region to the world market and within the travelers of the region;
- Agreed to enhancing the prospects and awareness of tourism in the region through inviting media personnel, travel agents and tour operators, exchange of tourism experts etc;
- Considered the possibility of issuing one visa that would be valid for travel within the region;
- Resolved that relaxation of visa for journalists must be considered as a proactive move and expected to achieve the goal for greater people-to-people contact.

Although many ideas are being discussed by the Tourism Ministers of SAARC about making travel within the region more cost effective and easy,⁹ implementation of these ideas are yet to be seen. One hopes that the Dhaka Declaration does not meet the same fate as the Islamabad Declaration concerning tourism.

⁹ *The Daily Star*, June 2009.

3.26 TRADE OF SERVICES

The SAFTA agreement involves trade in goods only. It makes no reference to trade in services, one of the fastest-growing, high value-added components of world trade. Services are increasingly playing an important role in the economies of South Asia with the sector contributing 40 percent on average to the region's GDP.

SAFTA members can and should agree on liberalizing the entry of professionals and skilled and semiskilled workers. Inclusion of unskilled workers would be ideal. The cross-border movement of people would be mutually beneficial in education, information technology, medical services, and technical services while enhancing geographical mobility of labour. Allowing such movement would definitely benefit Bangladesh because it has a surplus of unskilled workers, and an exportable surplus of semiskilled workers can easily be created. In fact, it is widely known that remittances from Bangladeshis working abroad are a major source of foreign exchange in Bangladesh.

South Asia has a fast and growing trade in services. Large numbers of South Asians cross each other's borders as tourists, pilgrims, professionals, students and health care seekers as well as providers. Nepal, Maldives, Sri Lanka and India are major tourist destinations both globally and within the region. India is a major attraction for students and health care seekers while Indian nurses and doctors are much in evidence in a number of hospitals in Bangladesh, Nepal, Maldives and Bhutan. Managers and professionals from India are in service in Nepal and Bhutan just as Indian and Pakistani managers are running textile mills in Bangladesh while Bangladeshi cooks and waiters are ubiquitous in Maldivian tourist resorts. There is scope for cooperating in the energy and telecommunication services sector in South Asia as well. These areas, in fact, appear to be more attractive than mere enhanced trade in goods.

With the enhancement in the quality of service delivery across the region, the trade in services will grow and may do so exponentially, since this is an area where South Asia has a degree of comparative advantage.

3.27 READYMADE GARMENTS

The post MFA era was believed to be the contributor to the decline of the RMG sector, which has been the highest contributor of export revenue for Bangladesh for quite some years. However, this perception is now been proven false and the scales of favour have tipped on our side as China has been given quota restraint for another 5 years. SAARC as a pact has the potential to dominate the RMG global market if they undergo economic integration. While Bangladesh's performance in the post MFA world has been praise worthy, it cannot afford to be complacent. While it has a revealed comparative advantage in abundant, and cheap, unskilled labour, it has one of the longest lead times among all the regional RMG producing countries. A part of the reason is the lack of any significant backward linkage system, in addition to not enjoying the benefits of centrally bonded warehouses. Given that Bangladesh is not ideal for producing cotton and other source materials, it can be cheaply imported from India, Pakistan and Sri Lanka to Bangladesh, where they can be manufactured into garments at cheap prices by both Bangladesh and Sri Lanka and exported internationally. In addition, the prospects of joint training programs to enhance the productivity of the RMG workers in the neighbouring countries can be an effective way of sharing both physical and technological resources. Hence, SAARC can work as a single manufacturing unit with member countries being actors in different stages of production.

3.28 INFRASTRUCTURE WITH EMPHASIS ON TRANSPORTATION

The need for transport integration is perhaps the most urgent for South Asia since it is integral to the operationalization of a free trade area. So far SAARC has done very little to address the issue of transport integration. A number of meetings have been convened by the SAARC Secretariat to look at the issue of standardizing the transport infrastructure but it lacks the quintessential strategic vision to guide the integration process largely because of the underlying political tensions, which severely impedes issues of transport connectivity.

3.28.1 Cross Border Linkage

SAFTA brings new hopes, builds confidence and generates a chain of opportunities for the South Asian countries to look beyond the SAARC region. A critical aspect of this new horizon is the possibility of cross border infrastructural linkages which is now taking a firm shape. An attempt has been made here to briefly highlight how much the South Asian people could gain if the region is able to realize the reopening of trade route to China through Sikkim and participate in the Kunming initiative, both within the region and with West and Central Asian countries.

Road to China through Nat Hula Pass in Sikkim

The reopening of the traditional trade route between Tibet Autonomous Region (TAR) of China and Sikkim in India through Nat hula pass in 2006 is likely bring about a significant change in India's economic exchanges with South Asian countries. This agreement is likely to have a much larger scope both in terms of the coverage of geographical regions and nature of goods and services. This is because of a relatively easier accessibility to the pass leading to markets and more developed physical and institutional infrastructures in and around the trading points. Furthermore, this trade route was a very active means of economic exchanges for Tibet and consequently India and other countries mainly through the Calcutta port before it was closed in the early 1960s. Institutions like banking, post offices and custom points were set up and had remained functional for many years.

China has been consciously trying to make economic inroads at the very local level. It has extensively used the border trade as its main instrument to realize this goal of local economic integration. It is broadly estimated that border trade through its 120 inland towns and ports constitute nearly half of China's total foreign trade of \$ 1 trillion. A major driving force for China to open its border for more trade and investment intercourse has been the urgent need to bring its own provinces in the periphery, mainly the western region, to the national mainstream. This could supplement mainland China to expand its politico-military leverages over these units.

Though a significant section of policy echelons in India consider reopening of Nat hula Pass route in Sikkim as a mere symbolic border trade venture, China at least in the long run looks at it as a vital physical economic entry into the 1.3 billion people market of South Asia. In terms of feasibility this is arguably the shortest route (roughly 590 km between Lhasa, Tibet and Gangtok, Sikkim) to reach the ever burgeoning middle class in Indian mainland, Bangladesh, Bhutan and Nepal.

The distance between Siliguri and Phulbari corridor is hardly 10-30 km. Bangladesh, Bhutan and Nepal can in the long run potentially use this route. The high level Nat hula Trade Study Group in its report recommended that in 2015 there should be inclusion of movement of freights to and from the neighbouring countries including Bangladesh, Bhutan and Nepal through this route. And 2018 onwards SAARC tourism should be integrated with tourism activities of third countries of the region including Bangladesh, Bhutan and Nepal. The Nat hula pass should be opened for all the tourists who wish to cross the border.

The Kunming Initiative

The Kunming Initiative is another potential area where India's north East, East and Bangladesh could be integrated to trade with Myanmar and China. There have been several visits by the trade, development and investment officials and private sector delegates from Yunan Province to mostly the Eastern and North Eastern states of India including West Bengal and Assam. With their single point agenda of establishing trade and investment linkages with the vast untapped market and naturally contrasting but well endowed regions of eastern India, these delegates gave an impression that they have been given carte blanche by their federal government to negotiate the larger process of "Kunming Initiative." Its advocates are actively promoting the reopening of Stilwell road (named after General Joseph Warren Stilwell 1883-1946, Chief of Staff to Allied Forces in China-Burma-India). Built by the US forces during the Second World War this double track all-weather road connects Assam (61 kms) in India, with Kunming (632 km) in China) via Myanmar (1,033 km). It has remained unused for the last five to six decades. The single-mindedness with which they are pursuing

this 'Initiative' even involves Bangladesh, Myanmar and other neighbouring countries.

For enhanced regional investment cooperation an integrated transport network is essential.¹⁰ Towards this end, the following recommendations are imperative:

1. Opening up borders and improved border management.
2. Open sky policy for South Asian countries.
3. Opening up ports (for example, Chittagong port) of Bangladesh can be used as a regional hub port to serve Eastern South Asia as well as land-locked South West China which is keen to have access facilities to a port in the Bay of Bengal, while Mongla Port can be developed and modernized to take care of Nepal's exports and imports as well as those of Bangladesh.
4. Constructing a Trans South Asian railway.
5. Building integrated roads and high ways.
6. Integrating South Asia's road and railway network with that of the ASEAN countries and China.
7. Developing coastal shipping and feeder networks in the region.
8. Improving infrastructure for telecommunication.
9. Developing a cross-country transport system linking Nepal, Bhutan, West Bengal, Bangladesh and the North Eastern States of India.

3.28.2 Drawbacks of SAFTA

A major drawback of the Treaty is the long duration that it envisages for establishing the Free Trade Area. Going by past experiences, the process can be derailed by any adverse development in the political relationship between the countries of the region. Moreover, the long SAFTA process envisaged in the Treaty is likely to be overtaken by events at both bilateral and multilateral levels. Series of bilateral free trade agreements will make the SAFTA process

redundant and same outcome can be expected because of the anticipated reduction in tariffs and trade liberalization through negotiations under the WTO.

Another major deficiency and element of uncertainty in the SAFTA Agreement is the "sensitive" or negative lists of products. No datelines have been fixed for concluding the negotiations on these items. It does not subscribe categorically to the phasing out of the sensitive list. The Agreement only provides that the sensitive list "shall be reviewed after every 4 years — with a view to reducing the number of items." Moreover if the list is too long, it will limit the scope of free trade and detract from the provision of Article XXIV of GATT (1994) that a free trade area should cover "substantially all trade."

SAFTA Treaty does not include provisions for the liberalization of trade in Services which is a major lacuna. Services have become an important driver of the economies of SAARC countries accounting for nearly 50 percent of the GDP of most of these countries. It also leaves out liberalization of investment in the region. This is a severe shortcoming because it is not possible to take full advantage of the enlargement of the market brought about by trade liberalization, without freer movement of capital.

The SAFTA Treaty contains no specific provisions for deeper integration. The measures for a more integrated region may come within the scope of Article 8, under the title "Additional Measures." However, this Article is couched in very general terms and implies no commitments on the part of the member states to pursue any of the special measures listed under this Article to set up a mechanism for pursuing the additional measures.

¹⁰ SACEPS Task Force Report: *A Policy Dialogue on South Asian Cooperation. Agenda for Economic Cooperation in South Asia* by Rehman Sobhan, CPD Dialogue Report — Report 20: Growth Zone in South Asia — what can we learn from ASEAN.