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How Can South Asia Turn Its Proximity from a Burden to an Advantage?

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Around the world, trade has played a critical role in reducing poverty. Some of the most successful countries in East Asia, Europe, and North America owe much of their success to strong trade relations with their neighbors. However, South Asian countries have yet to reap the benefits of proximity. Intraregional trade accounts for a little more than 5 percent of South Asia's total trade, compared with 50 percent in East Asia and the Pacific and 22 percent in Sub-Saharan Africa.

The World Bank's recent report, *A Glass Half Full: The Promise of Regional Trade in South Asia,* clearly illustrates the gaps between current and potential trade in South Asia. Using a gravity model, it shows that total goods trade within South Asia could be worth $67 billion rather than the current value of $23 billion. For instance, formal trade between India and Pakistan could be 15-fold more than current levels. The force of gravity—the degree of trade attraction between countries—is also manifest in high levels of informal trade. Informal trade has been estimated at 50 percent of formal trade in South Asia, aggregating assessments of various studies covering the 1993 to 2005 period.[1]

The large gaps between actual and potential trade arise because South Asian trade regimes discriminate against each other. This can be shown through an index of trade restrictiveness. Based on global trade data, such an index generates an implicit tariff that measures a country's tariff and non-tariff barriers on imports. In India, Pakistan, and Sri Lanka, the index is two to nine times higher for imports from South Asia than from the rest of the world (table 1). Moreover, although the average burden of non-tariff measures may not appear high, it is high for specific product and market combinations in South Asia. It varies from over 75 percent to over 2,000 percent. Sri Lanka consistently appears on the list of product-market combinations with the highest trade restrictiveness index in the region.

Barriers that have held back trade and investment within South Asia include tariffs and para tariffs, real and perceived non-tariff barriers, connectivity costs as manifested in the cost of air travel, and the broader trust deficit.

Tariffs and Para Tariffs

Despite the significant liberalization of tariff regimes in South Asia since the 1980s, average tariffs in the region are still high compared with the world average (13.6 and 6.3 percent, respectively, in 2016).

The South Asian Free Trade Area (SAFTA) was established in 2006, but it is still far from achieving the goal of tariff-free trade. Although South Asian countries have reduced tariffs, several countries in the region have simultaneously introduced protectionist para tariffs, which are nontransparent taxes levied on imports, but not on domestic

TABLE 1. Overall Trade Restrictiveness Index, Selected Countries in South Asia, 2011

	Origin of imports	
Importing country	South Asia	Rest of world
Afghanistan	3.84	4.65
India	4.59	0.50
Sri Lanka	1.01	0.33
Nepal	10.59	6.87
Pakistan	3.00	0.51

Source: Kee and Nicita 2017.
Note: The Overall Trade Restrictiveness Index calculations use applied tariffs that take into account bilateral preferences. (See Kee, Hiau Looi, and Alessandro Nicita. 2017. "Trade Fraud, Trade Elasticities and Non-Tariff Measures." Paper presented at the First Mid-Atlantic International Trade Workshop, University of Virginia, Charlottesville, VA, December 8–9.)

output. Elimination of para tariffs has been kept outside the ambit of SAFTA and other free trade agreements in the region. Bangladesh, Pakistan, and Sri Lanka maintain high para tariffs; they are not used in Nepal and are low in India.[2] Including para tariffs, the simple average tariff in Bangladesh in fiscal year 2016/17 almost doubles, from 13.3 to 25.6 percent; in Sri Lanka in 2016, the average tariff rises from 10.8 to 22.4 percent. For many individual products in these countries, the combination of para tariffs and customs duties results in high protection rates of 40 to 80 percent.

Additionally, almost 35 percent of intraregional trade in the South Asian Association for Regional Cooperation (SAARC) falls under sensitive lists, comprising goods that are exempted from the tariff rationalization program. In Bangladesh and Sri Lanka, up to 45 percent of imports from other SAARC members fall under their sensitive lists, and over 39 percent of India's exports to the region fall under the sensitive lists of various partners. Intraregional trade in goods on the sensitive lists is subject to normal tariffs, which can be quite high in many sectors, including consumer goods and agriculture.

Non-Tariff Measures

Access to each other's markets has also been eroded through the application of non-tariff measures, that is, policy measures other than tariffs. Although all countries can legitimately impose non-tariff measures to protect consumer health and plant and animal life, they become non-tariff barriers if they are more burdensome than necessary, such as border testing of imports taking inordinate amounts of time.

An example of a non-tariff barrier is the port restrictions imposed by several countries in the region. For instance, Pakistan allows only 138 items to be imported from India over the Attari-Wagah land route, the only land port between the two countries. Thus, bilateral trade is dominated by trade along the sea route, which is not necessarily the most cost-effective for two countries with a long, shared land border. Bangladesh and India impose some restrictions on imports from each other at certain ports.

It is important to distinguish between real and perceived complaints, to focus the attention of policy makers on genuine issues. Indeed, the results of detailed surveys carried out among traders involved in Bangladesh-India and India-Nepal trade[3] demonstrate clearly that information asymmetries play a large role in creating misperceptions about the existence of non-tariff barriers. For example, exporters and importers of food products in Bangladesh, India, and Nepal are not aware that there are several public and private laboratories in India that are accredited by India's National Accreditation Board for Testing and Calibration Laboratories as well as recognized by the Food Safety and Standards Authority of India (FSSAI). Hence, the historical dependence on only one public laboratory, namely, the Central Food Laboratory in Kolkata, continues for testing food imports into India, adding to the time taken for border clearance.

Another common theme in the survey results is delays stemming from inadequacies in border infrastructure. For instance, very few border points have electronic data interchange, risk management systems, and single windows.[4] India has integrated FSSAI into its single-window system and introduced risk-based profiling to identify high-risk consignments of food imports. This allows border authorities to subject food imports to risk-based, random testing of up to 10 percent of the consignments when accompanied by valid test certificates recognized by India. However, electronic data interchange, which is generally a prerequisite for single-window systems, is required to enable the risk-based system to work and expedite clearance of food imports. Eventually, to realize their efficiency gains fully, national single windows need to be interoperable between countries, so that border authorities of exporting and importing countries can exchange information, doing away with the need to furnish the same information twice.

The analysis in the report also highlights procedural delays. For instance, product registration and authorization processes, which are mandatory for pharmaceutical imports, are cumbersome and time-consuming in Bangladesh and Nepal.[5] Such processes harm the countries' pharmaceutical industries, given their heavy dependence on imports of raw materials.

High Costs of Connectivity

The disproportionately high cost of trading in South Asia arises, among others, from complex customs procedures, inadequate infrastructure at many border points, and compliance costs associated with non-tariff measures. The average level of trade costs is 20 percent higher between country pairs in South Asia than between country pairs in the Association of Southeast Asian Nations.[6] It costs more to trade between some countries in South Asia than with, say, Brazil.[7]

A key aspect of trade costs is connectivity. Regional air connectivity in South Asia is restricted, and poor even between capitals. From this context emerged the success story of India–Sri Lanka air services liberalization, which has involved the progressive liberalization of bilateral air connectivity. Today, Indians and Sri Lankans enjoy direct connections between Colombo and at least 12 Indian cities on around 147 flights per week.

The first bilateral Air Services Agreement between India and Sri Lanka was signed in 1948. Decades of negotiations, amendments, and policy persistence, especially from Sri Lanka, helped liberalize air services between the two countries. Major amendments in 2003 and 2011 led to a freer bilateral air services market by allowing prices to be market-determined, permitting private airlines to operate flights on bilateral routes, easing capacity limits and redefining them as flights per week rather than seats per week, and opening new destinations.

During 2004–17, air services between India and Sri Lanka grew rapidly, and picked up at a faster pace after the end of the civil war in Sri Lanka in 2009.[8] In 2017, air services between the two countries continued to exceed, by a large margin, the services between the other two well-connected country pairs in South Asia: India-Nepal and India-Bangladesh. The reforms also had a positive impact on competition and pricing: prices fell, initially by 20 to 40 percent on routes with competition, but the declines were rolled back partially as Sri Lankan Airlines came to dominate the bilateral air services market, accounting for 80 percent of the supply capacity.

The demand for India–Sri Lanka air services was also shaped by events such as the end of the Sri Lankan civil war, authorization of visas upon arrival for Indian travelers by the Sri Lankan government in 2003, and implementation of the India–Sri Lanka Free Trade Agreement in 2000.

Multiple connections with India have allowed Sri Lanka to capitalize on the widespread growth of the Indian middle class. By 2005, India had become the largest source of foreign tourists in Sri Lanka, and this also played a part in the post–civil war spurt in growth in the island country. The number of Sri Lankan tourists arriving in India has also steadily grown since 2003.

Trust Deficit

Trust promotes trade, and trade fosters trust, interdependency, and constituencies for peace. South Asia's complicated history and size asymmetry, perpetuated by insufficient people-to-people interactions, have rendered trust a fragile commodity. An initiative by the Governments of Bangladesh and India, aimed at recapturing the once-thriving economic and cultural relationships, is changing cross-border relations and reducing incentives for smuggling. This is occurring through *haats*, local border markets that enable small-volume trading among local communities on both sides of the border.

Detailed field work and a stakeholder survey in the four operational India-Bangladesh border *haats* confirm significant increases in the income of vendors and the creation of livelihood opportunities for women and marginalized workers, such as transporters, laborers, and providers of ancillary services, in India and Bangladesh. For example, Indian laborers at the *haats* earn one-third or more of their average monthly income from just four days of working at the *haats*. The *haats* have also led to a reduction in informal and illegal trading and generated a peace dividend. In supplying spaces for people to meet, reconnect, or establish fresh social and economic ties, they have improved cross-border relations. More than half of the Indian respondents to the survey have a positive view of Bangladeshis, and an overwhelming proportion of the Bangladeshi respondents have a positive view of Indians at the *haats*, views they attributed to their exposure to their Indian neighbors.

The Way Forward

Given South Asia's context, an incremental approach to intraregional trade, backed by policy persistence, is appropriate. Such efforts would be complementary to, and a stepping stone for, deeper global integration. India's leadership would be critical to reduce the trust deficit and deepen regional cooperation. *A Glass Half Full* provides some specific policy options to catalyze regional trade:

Border tax distortions. To make SAFTA effective, reduce sensitive lists and para tariffs, in a time-bound manner.

Non-tariff barriers. A focus on improving information flows, simplifying procedures, and boosting infrastructure will be effective. Since India is the region's largest market, it could take the lead in creating awareness about its standards and import regulations. It could also proactively help partner countries build up their testing and certification capacity by fostering cooperation between Indian standards bodies and their South Asian counterparts, eventually working toward establishing equivalence and mutual recognition.

Connectivity costs. Policy makers across South Asia can draw several lessons from the India–Sri Lanka air services liberalization experience. It is in their interests to pursue this agenda more proactively with India, as did Sri Lanka, which had more to gain from improved connectivity with a larger market. There is a need to accelerate the operationalization of connectivity initiatives, such as the Bangladesh-India-Nepal Motor Vehicles Agreement, while also working toward expanding the agenda to improve connectivity with the western part of South Asia, and beyond.

Trust deficit. The trust deficit can be reduced by reinforcing the virtuous circle between trade and trust, as demonstrated by the Bangladesh-India border *haats*. They could be scaled up and replicated at other land borders in the region—perhaps on the India-Pakistan or Pakistan-Afghanistan border, where trade often takes the informal route. The recently proposed Kartarpur Corridor between India and Pakistan is another promising people-to-people initiative.[9]

Expanding people-to-people initiatives and focusing engagement between governments at the technical level may allow the balance to tilt in favor of economics over politics in the region.

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Endnotes

1. Taneja, Nisha. 2014. "Informal Trade in South Asia." Background paper, Asian Development Bank, Manila.
2. No data on para-tariffs are available for Afghanistan, Bhutan, or Maldives.
3. The survey focused on exports of tea, cardamom, and medicinal and aromatic plants from Nepal to India; exports of processed foods, ready-made garments, and jute bags from Bangladesh to India; exports of pharmaceutical raw materials to Bangladesh from India; and exports of pharmaceuticals from India to Nepal. The study focuses on measures relating to sanitary and phytosanitary standards and technical barriers to trade, because these account for a majority of the non-tariff barriers in South Asia.
4. So far, electronic data interchange is operational between India and Nepal on one corridor along Kolkata to the Nepal border (Jogbani and Raxaul), while coordinated risk management has been introduced at the Bangladesh-India border (Petrapole/Benapole).
5. The survey indicated that, for example, for pharmaceutical exports from India to Nepal, registration of a manufacturing company with Nepal's Department of Drug Administration (DDA) could take 6–12 months; company audit of the manufacturing company by DDA could take another 1–2 weeks; product registration of each product with the DDA could take 4–6 months; and product renewal for each product each year could take 2–3 hours.
6. Trade costs are directly inferred from observable bilateral and intranational (domestic) trade data and can vary depending on the underlying assumptions. The World Bank report follows the database guidelines that advise using the database to compare across country pairs or across time and avoid stand-alone interpretations of the data on single pairs. For the detailed methodology, see ESCAP–World Bank Trade Cost Database, United Nations Economic and Social Commission for Asia and the Pacific, Bangkok; World Bank, Washington, DC, http://www.unescap.org/resources/escap-world-bank-trade-cost-database.
7. For example, average trade costs are 56 percent higher between Bangladesh and Nepal than Bangladesh and Brazil, and they are 84 percent higher between Sri Lanka and Nepal than Sri Lanka and Brazil.
8. During 2004–17, air services between India and Sri Lanka, in flights and seats, grew at a compound annual growth rate of about 6 percent. Bilateral connectivity picked up at a faster pace after the end of the civil war in Sri Lanka in 2009: flights grew at 6.6 percent, and seats grew at 6.3 percent over 2010–17, more rapidly not only compared with the preceding years, but also relative to the air connectivity between India and Nepal (4.3 percent in flights and 5.1 percent in seats) and between Bangladesh and India (−1.3 percent in flights and 3.9 percent in seats) over the period.
9. The Kartarpur Corridor is a proposed border corridor between India and Pakistan, connecting the Sikh shrines of Dera Baba Nanak Sahib (located in Punjab, India) and Gurudwara Darbar Sahib Kartarpur (locate in Punjab, Pakistan), to allow pilgrims from India to visit the Gurdwara in Kartarpur, which is less than 5 km from the India-Pakistan border, without a visa.

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