SAPTA to SAFTA : Need for a Moratorium?

by Zaid Bakht

Historically, the trade performance of SAARC countries varied significantly because of the difference in the size of the respective economies, their structure of production, and pursuance of divergent macro policies ... If SAPTA has to impart equitable benefit to the South Asian economies, the concessions granted to LDCs will have to be substantive. Granting of unilateral free trade facility to LDCs and relaxing the rules of origin are of prime necessity

IN South Asia, economic cooperation was initiated with the setting up of the South Asian Preferential Trading Arrangement (SAPTA) in 1993. The fact that it took eight years to move towards economic cooperation after South Asian Association for Regional Cooperation (SAARC) came into existence and the fact that even after five years since the initiation of SAPTA and two rounds of negotiations under it, the benefits of SAPTA are unclear underscore two points. First, economic cooperation may be a contentious process even at the primary level of preferential trading. Second, given the asymmetry in the relative size of the member economies, the varying degree of openness of these economies and the lack of complementarity in their production structure the potential benefits of preferential trading arrangement accruing to the less developed member economies remain highly suspect. All these make transition from SAPTA to SAFTA less than an obvious choice.

The Move Towards Regionalization: In spite of the well-recognized benefits of global free trade the negotiation process towards multilateral based global free trade regime under the auspices of the GATT has been long drawn and arduous. Some countries that were in support of speedier integration proceeded with the formation of regional free trade area being dissatisfied with the pace of negotiation *a la* GATT. Some other countries saw this move as a threat to their own economic interest, and sought to form their own regional groupings as a reactive response. The formation of SAPTA seems to have been triggered more as a reactive response to the changing global trade regime.

The urge towards foreign economic cooperation came partly from the fact that South Asia has been largely by-passed by the recent rapid growth of world trade. The proliferation and strengthening of the regional backs around the world also gave the clear signal that international trading system would be further fragmented to the detriment of the developing countries.

The Risk Factors in Regionalization: Unlike global free trade, regional trading arrangements are not necessarily positive sum games. When a country enters into a preferential trading arrangement (PTA) this results in trade creation and trade diversion effects.

Trade creation consists of the induced shift in demand away from domestically produced higher-cost products toward lower-cast products produced by other PTA member countries. This shift results in production and consumption effects. The production effect is the savings generated by moving resources out of the high-cost sectors. The consumption effect is the gain in consumers' welfare from the substitution of lower-cost foreign goods for higher-cost domestic goods. Trade diversion consists of an induced shift in import away from a non-PTA country to a potentially higher-cost PTA member country, which results in the loss of welfare for the importing country.

The net benefit of the trading arrangement would depend on the trade-off between the trade creation and trade diversion effects. This in turn will depend to a critical extent on the initial conditions, resource endowments, production structures, structure of export, export-import complementarities, competitive strength and relative comparative advantage.

In the situation where the size of the production base varies between the member economies in a big way, the trade diversion effect is likely to be higher for the smaller economies and as a result the accrual of benefit is likely to be less for the smaller economies compared to the larger ones.

Thus, when member economies are of unequal size and strength, the asymmetric incidence of benefit of preferential trading arrangement in favor of the larger ones remains as a major risk factor.

The Pattern of Intra-regional Trade: International trade has in general played a relatively smaller role in South Asian economies because of the inward looking development strategy, which the economies of the region historically followed. Even in 1996, the share of South Asia in world export barely met the 1 per cent mark.

Within this small volume of international trade undertaken by South Asia, intra-regional trade features even less significantly. Import from intra-regional sources was 1.9 per cent of the region's import in 1985 and it rose marginally to 3.7 per cent in 1996. The share of export going to the region in the region's total export was 4.5 per cent in 1985 and it came down to 4 per cent in 1996.

The small volume of intra-regional trade again has a lopsided distribution amongst the countries of the region. India is the dominant player in the intra-regional trade flows accounting for 57 per cent of intra-regional export in 1990. On the other hand, Bangladesh dominated the scene with respect to intra-regional imports, Bangladesh accounting for nearly 36 per cent of all intra-regional imports flowed into Bangladesh.

It may also be noted that compared to 1990, India's share in intra-SAARC export has registered a sharp rise (from 57.3% to 79%) in 1996 whilst her share in the intra-regional imports has registered a significant decline (from 13.9% to 7.1%). In contrast, Bangladesh's share in intra-regional export declined from 7 per cent in 1990 to less than 3 per cent 1996 while its share in import registered sharp rise.

Bangladesh's Trade Deficit with South Asia: Between 1985 and 1996, Bangladesh's import from South Asia increased at a compound rate of 27 per cent anum. For 1990-96, this rate was 30 per cent per anum. Bangladesh's overall import grew at a lower rate during the corresponding periods. As a result, the share of imports from South Asia in Bangladesh's total import rose from 3.5 per cent in 1985 to 17.5 per cent in 1996.

India and Pakistan are Bangladesh's major trading partners within the SAARC region accounting for more than 95 per cent of her imports from South Asia and 75 per cent of her exports to South Asia. Between 1985 and 1996, Bangladesh's export to these countries registered absolute decline. As a result, Bangladesh's trade deficit with South Asia expanded at a very rapid pace. In fact, Bangladesh incurred deficit in trade with all six SAARC countries in 1996-97.

The above data relates only to legal trade. If one adds to this illegal import, which is estimated to be between 125 and 150 per cent of legal import from India, the extent of deficit would rise even further. A study carried out on cross-border trade in 1994 found that more than half of the illegal imports consisted of agriculture, livestock, fishery and poultry products. Most of the manufactured items belonged to the consumer good category. A recent up-date of the study has found that certain capital good items such as automobile parts have gained in importance in the smuggled goods basket but the dominance of agriculture, livestock, and manufactured consumer goods has continued.

Unlike her imports Bangladesh's export to South Asia has a very narrow base. Only six items, namely, raw jute, fertilizer, jute goods, frozen fish, tea and leather accounted for 92 per cent of Bangladesh's export to the region in 1995-96. Similarly, illegal export is also comprised of few goods. Only four items, namely, copper & brass, hilsha fish, synthetic textiles and electronic parts account for 92 per cent of all illegal exports.

Factors Contributing to Bangladesh's Trade Deficit

(a) Faster Trade Liberalization: The proximate cause behind Bangladesh's growing trade deficit with her SAARC neighbours is the faster pace at which trade liberalization was implemented in Bangladesh. As can be seen from Table 1, unweighted average tariff rate in 1995 was higher in both Pakistan and India — the two major trading partners of Bangladesh.

Bangladesh also dismantled her non-tariff barriers fairly rapidly. Between 1990-91 and 1995-96, the number of HS 8-digit controlled items were brought down from 21.5 per cent to only 2 per cent of the total number of tariff lines. In contrast, 44 per cent of the tariff lines in India, most of which were consumer goods, were subject to virtual import ban in 1995.

(b) Exchange Rate Appreciation: The second proximate reason behind increase in Bangladesh's trade deficit with India and Pakistan is the appreciation of Taka vis-a-vis Indian and Pakistani Rupee. As Table 2 shows, the nominal exchange rate vis-a-vis these two currencies appreciated secularly between 1990 and 1995. Evidence also suggest that similar trends persisted with respect to real exchange rate also.

(c) The Role of SAPTA: According to the stated basic principle, SAPTA is to involve exchange of trade related concessions in a way that is equitably beneficial to participating nations. In assessing equitable benefit, respective levels of economic and industrial development are to be taken into account. In particular, the least developed members are to be accorded concrete preferential measures in their favour. The concessions are to be provided in relation to tariff, para-tariff, non-tariff, non-tariff and direct trade measures. Direct trade measures include negotiation of long term contracts with a view to assisting LDCs to achieve reasonable levels of sustainable exports.

Thus, in principle SAPTA does seem to recognize the risk factor involved in preferential trading amongst unequal partners in terms of asymmetric incidence of benefit. In practice, however, almost nothing has been done to give an operational meaning to this concern. There are several indications of this critical failure.

Rules of Origin: The rule stipulates that in order to qualify for preferential treatment the product must not contain imported inputs more than 50 per cent of the FOB value of the product. For LDCs, the requirement was lowered to 40 per cent. But this concession granted to LDC is hardly meaningful because these countries will have very few products that have 40 per cent local content.

First Round of Trade Agreement: After exchanging request and offer lists, the SAARC nations finalized the first round schedule of concessions in April 1995. Table 3 gives a summary picture of the agreed concessions. Column 2 in the Table shows the number of items of which concessionary rates were granted by each country; column 3 gives the existing, average unweighted tariff rate in the respective country on the items granted; column 4 shows the average unweighted concessionary tariff rate granted under SAPTA, and finally column 5 indicates the implied rate of concession.

As is evident from the Table, concession granted under the first round of SAPTA agreement is of rather modest magnitude. While the average unweighted tariff rate of the 226 items was 27.2 per cent the average concessionary rate granted under SAPTA was 21.6 per cent.

Secondly, the special treatment accorded to LDCs does not appear to be all that special. While Bangladesh offered a concessionary average rate of 23.1 per cent the rate offered by more industrialized Pakistan was 35.8 per cent. Even India's offer rate of 20.9 per cent is only marginally lower than that of Bangladesh and Bhutan and higher than that of Nepal.

Of course, the number of items on which concessionary rates have been granted by India and Pakistan are much larger than those granted by the LDCs. But how relevant are these items in relation to the exports from the countries concerned?

Out of the 106 items offered by India for preferential treatment, only 21 commodities currently figure in SAARC intra-regional trade. As far as Bangladesh is concerned, only one of the aforementioned 21 commodities (urea/ammonium sulphate) is actively traded with India while another five items are traded at an insignificant level. Only in the case of 18 out of the 214 items, on which other members have offered concessionary tariff rate, Bangladesh had any exports to the SAARC region during 1993-94 and 1994-95.

Thus, the SAARC countries, while agreeing in principle to enhance the level of regional cooperation, have not been able, in the course of the first round of SAPTA negotiations, to make any significant breakthrough in terms of intensifying the existing trade links amongst the member countries, or by way of promoting new trading opportunities.

Second Round Trade Negotiations: The second round of trade negotiation was completed in November 1997 covering a total of 1871 products. The main feature of the second round is the inclusion of more items that are relevant for current intra-regional trade and greater degree of tariff concessions. As Table 4 shows degree of concessions varies from 10 to 40 per cent. For LDCs the concession is 5-10 per cent more. There is also the provision of removal of NTB for LDCs for certain items.

Although the concessions granted to LDCs in the second round are more subtantive than before, they are not sufficient to make a significant impact on the current low level of export of these countries. If the LDCs are to be really supported in raising their exports to the region, bolder action in the form of unilateral free trade facility will be required.

To enhance and diversify Bangladesh's and other LDCs productive capacity and export capability, SAARC cooperation will be needed in the form of finance, technology and market. Although the SAPTA document does talk about all these, hardly any initiative has been taken in this regard.

Historically, the trade performance of SAARC countries varied significantly because of the difference in the size of the respective economies, their structure of production, and pursuance of divergent macro policies. Implementation of SAPTA did not have any bearing on this trend as the scope of SAPTA negotiation remained rather limited. If SAPTA has to impart equitable benefit to the South Asian economies, the concessions granted to LDCs will have to be substantive. In this respect, granting of unilateral free trade facility to LDCs and relaxing the rules of origin are of prime necessity. There is also the need for cooperation in the area of investment, technology transfer and market support to facilitate expansion of the export base of the LDCs.

Until the export capability of the LDCs are improved through these measures, transition to SAFTA will accentuate current inequalities in terms of trade performance. The resulting loss of welfare on the part of the smaller economies may jeopardize their future growth prospect. Transition to SAFTA, therefore, should be put on hold until the pro active role of SAPTA in favour of the LDC's has been fully worked out.

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Table 1
Structure of Tariff in Bangladesh, India and Pakistan

Country	Year	Maximum tariff (%)	Unweighted average (%)
Bangladesh	1995	50	25
India	1995	50	41
Pakistan	1995	65	49

Table 2
Bilateral Nominal Exchange Rate

Year	Taka per Indian Rupee	Taka per Pakistani Rupee
1990	1.933	1.578
1991	1.785	1.579
1992	1.474	1.561
1993	1.414	1.471
1994	1.395	1.312
1995	1.242	1.273

Table 3
First Round Trade Concessions under SAPTA

Country	No. of Items	Existing Tariff (%)	SAPTA Tariff (%)	Extent of Concession (%)
Bangladesh	12	25.6	23.1	10
Bhutan	11	24.5	21.3	13.3
India	106	43.7	20.9	52.2
Maldives	17	21.8	20.1	7.5
Nepal	14	15.4	13.9	9.8
Pakistan	35	40.6	35.8	11.8
Sri Lanka	31	18.8	16.6	11.7
All	226	27.2	21.6	20.6

Table 4
Summary of Concessions under Second Round

Country	Number of products of all members	Rate of concession (%)	Number of products for LDCs	Rate of concession (%)
Bangladesh	215	10	11	10
Bhutan	37	10	10	15
India	397	10, 15, 25, 40	514	25, 50
Maldives	2	10	3	15
Nepal	191	10	761	10, 15
Pakistan	232	10	131	15
Sri Lanka	72	10	23	10, 50, 60
Total	1114		757	

SME Financing in Bangladesh

Needed Urgent Reform

by Patrick Meagher

The broad gains in terms of economic growth and increased tax revenue to the government would be significant, if not dramatic, and these long-term gains more than offset the short-term costs of change.

THE potential for economic dynamism in Bangladesh depends to a large extent on the growth of small and medium-sized enterprises (SMEs). In both the industrial and the emerging economies, SMEs play a central role in exploiting new markets and in creating jobs. Equally important, they provide living proof that people of modest means can succeed economically. For Bangladesh, this means that a large segment of Bangladeshi society has a vital stake in the health of this sector — the financial institutions, the NGOs and associations, Government, and the potentially employed. Yet, the SME sector in Bangladesh continues to underperform in terms of enterprise expansion and employment growth. Why?

A major reason, confirmed in several recent studies, is a severe financial constraint. SMEs have access to neither the equity markets, the unsecured credit lines available to large corporations, nor the microfinance facilities afforded to many microenterprises. In obtaining working and expansion capital, they face high interest rates and transaction costs. They are frustrated by complex documentation requirements, delays of months or even years in loan approval, and demands for collateral that are difficult if not impossible for most to meet.

From the side of the financial institutions, the repayment risk represented by SMEs is relatively low. Smaller enterprises generally have better repayment records than large enterprises, and hence banks and other institutions would like to lend to them. However, these lenders face high fixed costs of lending, which make small loans unprofitable. Also, the possibility of a reverse or failure is always present in the life of an enterprise. Banks and other lenders suffer extreme difficulties in obtaining reliable information on potential borrowers and in enforcing loan agreements through the legal system.

Thus, credit market constraints trap willing lenders and borrowers in severe dilemma. Where do these constrains come from? While macroeconomic and cultural influences play a role, the main sources of the problem are institutional. The legal system does not provide sufficient clarity regarding parties' rights and priorities. In addition, enforcement of those rights is not certain, due to relatively weak court system. As a result, lenders must engage in costly risk management strategies involving extra documentation, background checks, collateral, and guarantees. These provide a kind of insurance, but also result in the high cost of finance. Furthermore, the rule of law is not strong enough to restrain conflicts of interest and corruption in the public sector, or in the system of corporate governance. The combination of legal uncertainty and incentives towards corruption makes SME credit a costly gamble for firms and lenders alike.

What is to be done? Although arrangements in which credit is extended on less-than-favourable terms for the lender have proven important for the development of smaller-scale industries, this approach does not ultimately offer a solution. Substantial reforms are urgently needed in order to bring much greater efficiency to the credit market in Bangladesh. This result will depend on changes in the legal system and related institutions. It has been known for some time that legal institutions supporting secure property rights and consistent enforcement of contracts are a necessary condition of rapid and sustainable economic growth. Legal certainty is one of the institutions that encourage specialized investments, including financial transactions, hence promoting growth. A key to achieving a steady high volume of finance, and the growth benefits that this brings, is the extent to which credit is based on objective criteria rather than personal relationships. Where objective standards predominate, they enable the use of a wide range of security by a diversity of finance providers, and therefore a clean and efficient system based on market principles.

Achieving this legal certainty thus requires a targeted reform package:

First, new legislation is needed to make secured finance an engine of growth, as it is in several advanced and rapidly developing economies. A modern law in this area will make it possible for any finance provider, including a bank or any other creditor such as a dealer or supplier, to take and enforce a security interest in collateral of known and stable value. This approach, taken by a number of countries in North America, Europe, and East Asia, allows the use of many types of assets, ranging from inventory to accounts receivable and commercial paper. Such a step is critically needed in order to reduce the dependence of credit in Bangladesh on real estate mortgage security. Not only are land and buildings often not available to SMEs, but obtaining a mortgage is also a costly and uncertain business.

Second, legal and organizational structures that facilitate the flow of information are critically important in financial markets. These should include greatly improved security interest registration mechanisms as well as credit reporting systems. These systems enable creditors to monitor borrowers on the basis of objective information, both before and after a loan is agreed.

Third, the legal and administrative machinery must be adequate in enforcing the rules. Court adjudication, non-judicial enforcement of loan and security agreements, and governance in the public sector and banking system desperately need strengthening. The credit market, especially for SMEs, cannot reach its full potential until such improvements are made.

How can these changes come about in the current atmosphere of Bangladesh? Competitive SMEs, financial institutions, dealers and suppliers, and other potential users of the system such as municipalities, stand to gain substantially from reform. The broad gains in terms of economic growth and increased tax revenue to the government would be significant, if not dramatic, and these long-term gains more than offset the short-term costs of change. The critical question is whether reform can overcome the opposition of those currently able to protect themselves from fair competition, whether openly or illicitly. History shows that societies succeed when they create economic opportunity for the energetic and innovative, not just the well connected. This means having financial markets that *give credit where credit is due.*

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Asian Drug Scene

THE United Nations Drug Control Programme (UNDCP) has released a report titled Chemical Control in the Fight Against Drug Production — The South and South-west Asian Scene. And among its targets are the piece are the precursors — chemicals, solvents and reagents which have legitimate uses but become deadly when diverted to illicit drug manufacture for which they provide the critical mass. Like acetic hydride, which has legitimate uses in the pharmaceutical and leather industries, but is a vital precursor in the manufacture of heroin.

The report highlights the problems of illicit drug production and precursor trafficking in Afghanistan, Bangladesh, Bhutan, India, Islamic Republic of Iran, Maldives, Nepal, Pakistan and Sri Lanka. These countries have been particularly vulnerable to trafficking since the 1980s with the sharp increase in the abuse of synthetic drugs. Almost 80 percent of the world's production of opiates originates from the two main production areas, the Golden Crescent and the Golden Triangle (which runs alongside India's borders).

Afghanistan, part of the Golden Crescent, is the world's largest producer of illicit opium and heroin — it amassed 2,800 tons of opium in 1997, showing an increase of 25 percent since 1996. About 3.3 to 4.1 per cent of the global population consumes illicit drugs. The most widely abused drug is cannabis, consumed worldwide by 2.5 percent of the global population. North America, UK, Germany, the Netherlands, and Poland are the important centres for the clandestine production of synthetic drugs or amphetamine type stimulants like the popular Ecstasy.

India is a signatory to the 1988 UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances which provides a framework for the regulation of trade in precursors by prescribing licensing and monitoring systems. But as the largest manufacturer of essential chemicals in the region and importer of precursors meant for licit use, it is vulnerable to diversions. In 1995, industry in India formulated a voluntary code of conduct. The government also took measures to control the export of N- acetylanthranilic acid and ephedrine (two substances listed in Tables I and II of the 1988 Convention). Bangladesh, Nepal, Sri Lanka are in the process of drafting legislation for precursor control.

Grim Outlook on World Employment

THE International Labour Organisation's third World Employment Report, 1998-99, is out. Released on September 25, it reviews the global employment situation and examines how countries in different stages of development can evolve the best training strategies and systems to address the changes brought about by rapid globalisation and technological change. The outlook is grim, says the report.

According to ILO estimates, by the end of 1998, one billion workers — one-third of the world labour force — are either unemployed or underemployed. The number of jobless will reach about 150 million by the end of this year.

The report analyses training systems worldwide in the context of increasing national competitiveness. It also examines policies and programmes for improving women's employment opportunities, and upgrading the skills of vulnerable groups like the young unemployed as well as older laid-off workers.

— WFS/News Network

Of Cultural Bonds, Restrictions and Tandoor Strike!

Tarun Basu writes from Islamabad

FOR a first time Indian visitor to Pakistan, there is a profusion of this-is-no-different feeling from the moment one lands in Lahore by a Pakistani Airline flight from Delhi.

Punjabi bon homie and banter from Immigration officials greets one on arrival and the owner of the airport restaurant shows a special gesture to visiting Indian journalists by agreeing to payment in Indian currency.

The dominant *lingua franca* in the Pakistani capital seems to be Punjabi, just as it is in Delhi. So is the salwar suit the common satorial statement of women. Saris are a rare sight, at least in the capital, though one is told one sees them more in Lahore and other cities.

The Pathani suit, the long-flowing shirts and pyjamas, is however a distinguishing feature among men and is a preferred formal wear to shirts and trousers.

The common thread in Punjabi culture on both sides is quickly compared with Punjabi-speaking Indians and, for past visitors from here to Delhi, the common weaknesses for kebabs make many talk nostalgically of the gastronomic surprises in the bylanes of Old Delhi.

That former Pakistani High Commissioner Riaz Khokhar, now ambassador in Washington, would often slip away from the starched diplomatic circle to savour the food variety in the labyrinthine maze around the Jama Masjid mosque in the old city was let out by an old colleague now in the media world.

Hussain is effusive in his welcome of Indian journalists and bestows personal attention on every guest. But his comments about the Nawaz Sharif government being media-friendly draws sniggers from the local journalists fraternity.

Agha Shahi, the formidable former Pakistani foreign minister, is a dinner guest. His advanced age and enfeebled physique, however, do not stop him from talking about the "inflexibility" of Indians over Kashmir or praising the "simplicity" of Indira Gandhi with whom he had had a number of interactions.

Sharif's pet Shariah Bill and pandering to the clergy are a familiar topic of discussion with the feeling widely prevalent that it was a political ruse by the Prime Minister to keep power and authority. There is a feeling, at least among the West-inclined elite, that the bill will increase religious bigotry, cultural puritanism and intolerance while hurting women the most.

The prevailing mood against conservatives and cultural policing was reflected in a magazine report on a pop music concert where the writer talked about youth letting go of inhibitions "perhaps a bit too energetically" and lamenting the fact "that (youth) never gets to express itself either individually or collectively."

"Our country needs more occasions like these," pleaded the writer. "There should be some place at least where our youth can express itself in some form."

It is not only pop concerts that are drawing crowds in Pakistan but the "Titanic" as well. The film has apparently brought cinema lovers back to movie theatres in droves and decaying halls have sprung back to life.

A newspaper wrote about how a pre-independence vintage cinema theatre in Peshawar was seeing cash registers ringing after a long time with the screening of the superhit love tragedy. A recent *women's only* show was overpacked with 650 women turning up for a 500-seater hall and causing a traffic snarl in its vicinity.

The newspaper commented that this response was in sharp contrast to the otherwise empty cinema halls as the "sleaze and dirt shown on celluloid in the name of Pashto movies and Urdu films based on pirated versions of Hindi films have discouraged cine-going."

Pakistan's economic crunch has begun to squeeze and is reflected in every sphere of activity and governance. Journalists accredited to the foreign office talk mockingly of how the snacks and 'samosas' with tea at the daily briefings had been discontinued as an economy measure. The scribes are demanding the restoration of the repast.

Others who are on the war path include the 'tandoor' owners who went on strike on October 16 in protest against the government order to reduce the price of 'naan' and 'roti' (staple flour-based diet of the subcontinent) from Rs 2 (4 cents) to Rs 1.50.

— India Abroad News Service