Issues and Prospects of Free Trade Agreements for Bangladesh: Theory and Experience*

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1. INTRODUCTION

Regional cooperation or integration, as is often interchangeably used, particularly in the form of trade–related agreements, either bilateral or multilateral, have now become more than ever a global phenomenon. In fact, the world now is divided into several trade blocs. In almost all parts of the globe, Latin and North America, Western Europe, Africa, Southeast and South Asia; regional cooperation in one form or another, is at work today with varying degrees of integration of participating countries, which is usually considered as an important policy option in a second best world for growth and development. Bangladesh, as a member of least developed countries, also opted for this popular but not uncontroversial policy option only very recently in the mid 1980s through taking the initiative of forming SAARC (South Asian Association for Regional Cooperation) in 1985, although SAARC is not a trade agreement rather a broad forum for mutual collaboration in economic, social, cultural, scientific and technical fields. Later, however, in order to promote cooperation for pursuing common economic objectives of the region, SAARC countries decided to establish Preferential Trading Arrangement (PTA) the agreement of which was signed in 1993 as SAPTA or SAARC Preferential Trading Arrangement (the rounds I, II, and III have already been implemented in 1995, 1996, and 1998 respectively) and also embarked upon a program of establishing a Free Trade Area called South Asian Free Trade Area (SAFTA) by 2001. In order to reap the full benefits of cooperation through further liberalization of trade, the SAARC Chamber of Commerce and Industry (SCCI) has recently expressed its interest to form a SAARC Economic Union by 2008. These are all multilateral initiatives in South Asia. On the bilateral front, South Asian nations are also engaged in regional

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cooperation through creating Free Trade Areas (FTAs) on bilateral basis. For example, Srilanka and India have signed an agreement on FTA in 1998. Following the suits of other nations in the region, Bangladesh, very recently, has started showing her keen interest for bilateral free trade agreements with India, Srilanka and Pakistan and, with that end in view, has held several rounds of talks with these countries in the mean time. Her recent initiative to actively participate in the BIMSTEC (Bangladesh, India, Myanmar, Srilanka and Thailand Economic Cooperation) through a framework of agreement on FTA to be signed on February 10, 2004 in Bangkok, Thailand, and interest aired in the last OIC summit held in Malaysia to form an Islamic Common Market are quite indicative of present regime's optimistic attitude towards one or other form of regional cooperation as an effective policy option for harnessing development potentialities of the country. The main objective of the present paper is to have an overview of the issues relevant for Bangladesh with respect to regional cooperation particularly in the form of FTA – both bilateral and multilateral, and the possible benefits and costs that could emanate from these agreements in the short–run as well as in the medium and long–run. Accordingly, the paper is structured as follows. Section 2 briefly presents different concepts or dimensions of regional cooperation. Section 3 dwells upon the theory of regional cooperation with special emphasis on FTA along with some of its major benefits and costs. Section 4 reports some experience of cooperation from across the globe. Section 5 illustrates the issues and prospects of SAPTA and SAFTA along with the bilateral talks of Bangladesh on FTA. Section 6 concludes the paper with some policy suggestions.

2. FORMS OF REGIONAL COOPERATION:

Regional cooperation may assume different forms. The simplest form of cooperation could begin with a **sectoral** approach, where contracting countries could select one or more specific sectors or areas for effective cooperation in the profiles of production, choice of technology, marketing, government policies, etc. The process of regional cooperation in Europe, in fact, started in this way following a proposal of the then French foreign minister, Robert Schuman, for pooling European coal and steel resources.[1] In 1952, European Coal and Steel Community was established and by the end of 1954 nearly all custom duties, quota restrictions and other barriers to community trade in coal, coke, pig-iron and scrap iron had been removed.[2]

Preferential Trading Arrangements (**PTA**) can be considered as an offshoot of this form of cooperation where the contracting countries offer not a single product or products of a single sector rather a list of products and services in which they are willing to provide preferential market access in their economies to other members of the group. Under this arrangement, the contracting countries need to arrive at a consensus for the extent of phased reduction in the tariff and non-tariff barriers on a preferential basis for the suppliers of other member countries. This **product-by-product** approach indeed implies a very slow process of cooperation, which, however, can be hastened by agreeing upon across the board tariff reduction.

The **PTA** is an interim step towards establishing a **Free Trade Area (FTA).** A FTA is also considered to be a loose form of cooperation where member countries agree to remove tariffs and other barriers to trade, while each member country retains its own commercial policy to countries outside FTA. The aim of FTA is to partly, or in the end, to totally, eliminate customs duties and restrictions to trade between them. As each member of a FTA keeps its own custom tariff and commercial policy in force toward outsiders, rules are needed to determine which goods inside the area can move freely from one country to another. In other words, it is basically the rules of origin that are very important for FTA. Examples of FTAs include the **EFTA** (European Free Trade Agreement), **NAFTA** (North American Free Trade Agreement formed in 1993 by the U.S., Canada and Mexico), **Mercosur** (in Latin America formed in 1991 by Argentina, Brazil, Paraguay & Uruguay), **Andean Pact** (reactivated as FTA in 1990 by Bolivia, Colombia, Ecuador, Peru and Venezuela), **Group of 3** (G 3 – a FTA includes Colombia, Mexico and Venezuela), Caricom (in the Caribbean) and **AFTA** (ASEAN Free Trade Area established in 1992).

A **Customs Union** is deeper than FTA with respect to commitments within which trade restrictions are abolished but which has a concerted commercial policy towards non-members and common external tariff on imports from them, though the tariff rates may vary between commodities.

Even higher order of cooperation is the **Common Market** in which, in addition to the common external tariff and the concerted commercial policy of the custom union, it aims at establishing a unified market area with the free movement of good, services and factors of production (viz., labor and capital). The **European Common Market** until 1992 is a conspicuous example of functional common market.

The highest and most organized form of cooperation is the **Economic Community** or **Economic Union** which not only aims at achieving common external tariff and commercial policy and removal of restrictions on trade of goods, services and factors of production within the union, but also aims at harmonizing agricultural and industrial policies, concerted monetary, fiscal and exchange rate policies as a step to a common currency and a common central bank. The **European Union** is currently passing through such a critical phase of regional cooperation.

3. THEORY OF FREE TRADE AGREEMENT

Typically, the stylized analyses based on static models assume that under free trade agreements all tariff and non-tariff barriers are completely dismantled and that all the effects of liberalization materialize. They also assume that all other basic parameters – import and export elasticities, technology, structure of preferences – remain fixed. In short, demand and supply functions are altered only by the modified tariff structure. But when partial equilibrium techniques are used, existing studies, following Jacob Viner (1953)[3], estimate **trade creation** and **trade diversion** effects on consumers, producers and government[4]. Generally speaking, a FTA or customs union has effects on both the export and import sides. New export opportunities to partner countries yield net trade-creation effects and are beneficial; but the net import effects may be ambiguous, and depends, among others, on the size of the countries and pre-existing trade flows.

Thus the theory of Customs Union, following Viner**,** and the mainstream theoretical research on the subject, suggests certain degree of uncertainty of net gains that might accrue from regional trade agreements particularly FTAs. It is, therefore, difficult to pass any categorical judgments on the economic impacts of any kind of trade–related cooperation mentioned in the preceding section. In static and partial equilibrium settings, the basic concepts of the theory are those of trade creation and trade diversion**.** Trade creation affects the economy favorably while the trade diversion adversely affects the economy. An agreement (a FTA or Customs Union) is more likely to lead to trade creation if (a) the contacting countries are actually competitive but potentially complementary, (b) the cost differentials between the countries in goods they both produce is larger, (c) the initial tariff differentials between the contacting countries is greater, (d) the volume of trade originally covered by the contacting countries is larger, and the losses caused by trade diversion would be smaller if the tariffs to the countries outside FTA (rest of the world) is smaller[5]. But the **static** and **partial equilibrium** approaches have their own theoretical pitfalls. The analysis of trade creation and trade diversion effects in static sense simulates the trade impacts of FTA at a particular point in time (say a year) and, therefore, is unable to capture the effects if tariff reductions are phased in over a period (say 10 or 12 years). Again, the partial equilibrium analysis is only capable of capturing the trade impacts of FTA.

But, as we all know, FTA will not only affect trade alone; through trade it will also impact overall growth, income distribution, employment, industrial structure, technology, foreign direct investment (FDI), etc. Since the empirical foundation of dynamic analysis is still weak, comparative static analysis using Applied General Equilibrium (AGE) or Computable General Equilibrium (CGE) models are largely used in simulating the effects of FTA or Customs Union or any other form of regional cooperation. Keeping these theoretical loopholes in mind, let us see what could be the benefits and costs FTA in a competitive situation.

FTA is generally built on strategic considerations arising from imperfect and incomplete market at home and abroad, which handicap the spread of efficiency gains in certain sectors and the development of new productive patterns with progressively higher degree of value-added. The conventional literature on the benefits and costs of FTA focuses attention in a framework of competitive equilibrium. In this framework, FTA is beneficial if the effects of trade creation (shift toward cheaper sources of supply) are larger than those of trade diversion (shift toward more costly source of supply). The crucial issue, however, is how benefits and costs are measured. Apart from trade creation through guaranteed market access, FTA ensures economic efficiency in different product lines through raising competition and promoting specialization in regional market, balances regional investment pattern, creates potential platform for non-traditional products, helps exploit externalities through providing foreign market as catalyst, etc. Moreover, in the face of economies of scale, what otherwise would be costly trade diversion can eventually become a cost-reducing welfare-enhancing effect. Expansion of regional market can also attract FDI. These, however, are all potential benefits of FTA rather than guaranteed outcomes, which will ultimately depend on nature of policy environment under which FTAs operate. The most frequently cited costs are as follows:[6]

(a) FTA can divert trade away from possibly more efficient firms, which are located in non-member countries. This has costs for domestic consumers and for non-member countries that lose market share. The trade diversion risks locking the partner economies into patterns of inefficient production.

(b) FTA can improve the terms of trade of member countries at the expense of non-member countries and give rise to incentives for maintaining or increasing protection.

(c) While FTA induces FDI in the expanded regional market, it can locate unevenly and, in the absence of harmonized incentives, may be a source of competition among partners and thereby may cause fiscal drain.

(d) Benefits are often asymmetrically distributed and initially concentrated in some members while others are dependent on uncertain spillover effects (in multilateralism).

(e) An explosion of FTA creates a spaghetti pattern of agreements with multiple hubs and spokes that give rise to distortions of trade, administrative costs, rent seeking and a difficult to predict distribution of gains among countries.

(f) The emergence of FTA can create defensive reactions, in which a country joins an agreement not because it is the best option, but because of the real or potential costs of being left out of an integration process.

(g) Finally, FTA distracts attention from multilateral rounds of liberalization and delays further unilateral opening.

Before we conclude the section, we want to iterate that evaluating the benefits and costs of FTA is no easy task. Part of the problem is the nature of the subject matter because it is a complex general equilibrium phenomenon with dynamic process, making it difficult to dissect for purposes of causal explanation. Moreover, a short-run analysis is incomplete because, when an agreement becomes successful, one expects to see initial costs compensated by benefits that play out over the medium and long run. Besides, FTA is usually evaluated in the light of what would have happened in its absence. Moreover, economists are interested in measuring changes in welfare; given the complications of defining this for a particular country they often use a proxy expressed in summary statistic reflecting growth in trade. However, conclusions about FTA rarely are based on the entire story. Much of the debate centers on static trade creation and trade diversion effects. This is partly because many economists consider these effects to be the fundamental dimension for evaluating FTA. One problem, however, is that the static analysis frequently uses a partial competitive equilibrium framework to jump to general conclusions about a process that is a general equilibrium phenomenon. Consequently, dynamic approach is resorted to, which is still weak. Nevertheless, the models of dynamics are sufficiently specified to suggest that the benefits behind the dynamics of FTA are potentially large. It is therefore worth the effort to go beyond static trade creation-diversion analysis (which has its ambiguous dimensions as well) to begin to better understand, even if only very imperfectly, the longer-term dynamics. What we should remember is that any sort of transformation has costs. So FTA will involve some unwanted trade diversion costs. However, countries justify these costs by the greater benefits that are expected, which are spread over a longer period of time.

4. EXPERIENCE OF FTA IN OTHER REGIONS

4.1 Mexico and Latin America

In the 1980s Mexico went through a very acute debt crisis, caused by macroeconomic imbalances, inefficient policies and highly protected import-substituting industries. To get rid of these economic ailments, it rapidly started stabilization and structural adjustment in 1983. It liberalized trade by lowering its protection rate to a maximum of 20 per cent and completely freed 75 per cent of its production[7]. It also opened up its capital market. In 1993, it became the member of NAFTA (North American Free Trade Area, the other two members are the United States and Canada) and signed a number of bilateral trade agreements with many Latin American countries like Chile (1991), Bolivia (1994), Costa Rica (1994), Colombia (1994), Venezuela (1994), Nicaragua (1998), etc. As a result of opening up the economy and signing regional trade agreements – both bilateral and multilateral, massive foreign investment, approximately US$15 billion a year, was attracted to Mexico[8]. Its industrial production grew rapidly with widening diversity. Employment in its manufacturing sector increased, and its industrial production was restructured, not destroyed. In other words, overall unemployment did not increase because of FTA, as was feared initially, rather it was observed that more jobs were created in Mexico as a result of accession to NAFTA. But wage structure followed the same pattern as in the U.S., with higher wages for skilled workers and stagnating or decreasing wages for unskilled workers [9] (the Stolper-Samuelson Theorem[10]).

Not only Mexico, the 1990s witnessed a wave of regional integration in Latin America where as many as 15 agreements – FTA and customs union – were signed. Between 1990 and 1997, the region's exports expanded by 95 per cent; imports grew even faster, at 127 per cent[11]. Imports as a percentage GDP now equal more than 20 per cent, up from 10 per cent in 1990[12]. Moreover, the region's growth of imports has consistently exceeded that recorded at the world level: according to WTO estimates, the value of world imports grew by an average 7 per cent a year between 1990 and 1996, compared to 15 per cent for Latin America[13].

4.2 APEC Countries

With the help of an **Applied General Equilibrium** (AGE) model called **Global Trade Analysis Project** (GTAP), Philip D. Adams simulates the effects of trade liberalization on the APEC countries, taking in the U.S., Japan, Canada, and most of the South-East Asian nations[14]. The simulations, using a multi-country AGE model with 37 commodity types and up to 20 regions of the world, conclude that at the macroeconomic level, the trade liberalization generates an increase in the capital stock and hence in real GDP in all regions other than the rest of the world, which maintains existing barriers to trade. Domestic consumption is assumed to expand in line with GDP but investment expands with the capital stock, i.e., more rapidly than GDP. Hence, overall domestic spending in each APEC region expands more than GDP and their trade balances move towards deficit. Imports expand sharply when protection is reduced. Exports are stimulated by depreciations of the real exchange rate. The analysis further observes that the implications for each region's industries primarily depend on the extent to which the trade liberalization exposes the industries to additional import competition and on industries' export orientation. Examples of sectors, which are strongly stimulated by the liberalization, are the agricultural industries of Australia, New Zealand and Taiwan; and some of the manufacturing sectors (e.g., textiles, clothing and footwear and chemical products) of South-East Asia. Transport is the sector, which, overall is adversely affected by trade liberalization[15]. The paper finally concludes that trade liberalization offers large long-term benefits in terms of increased GDP to those which liberalize.

4.3 Morocco and Tunisia

In 1995, Morocco and Tunisia – the first two Arab countries, signed Association Agreements that committed them to integrate into a FTA with the European Union (EU). The implementation of the agreements is scheduled to take place over 12 years, and it is still not clear how effective the FTA will be before the time is up. But the impacts of FTA on the economies of these two North African lower middle-income countries in the last few years were rather clear, of course in a comparative static sense. During the period 1990 and 1995, the real GDP growth rates of Morocco and Tunisia were 1.0 and 4.0 per cent respectively. But between the period 1995 and 2002, Morocco and Tunisia registered relatively fair growth rates, which were 3.4 and 5.1 per cent respectively[16]. The performance in the foreign sector was also noticeable. The exports/GDP ratio (or export propensity) of Morocco which was about 26% in 1995, stood at 30% in 2002. The corresponding figures for Tunisia were 40.5% and 44.3%. More specifically, export shares in Morocco and Tunisia both increased during the first half of the 1990s, stabilizing afterwards until 2001 when they experienced a significant rise[17]. From the data available in the website of the World Bank, it is observed that trade openness (or trade ratio) in Morocco measured as the sum of real exports and imports of goods and services as a share of real GDP increased from 58.53% in 1995 to 64.48% in 2002. The corresponding figures for Tunisia are 86.55% and 94.2%[18]. Although the FDI figures for Tunisia are not readily available, the World

Bank data show that the FDI in Morocco in 1992 was U.S.$503 million, which stood at U.S.$2658 million in 2001.

However, there are economists who observe no significant correlation between trade policy reforms of the countries like Mexico, Morocco or Tunisia and their growth in GDP[19]. They argue, " we find little evidence that open trade policies – in the sense of lowering tariff and non-tariff barriers to trade – are significantly associated with economic growth"[20] Because, according to them, the methods of ascertaining the link between trade policy and growth have serious shortcomings. Also there are studies which observe that trade policy reforms had minimal impacts on employment[21].

In spite of this controversy inherent in the subject as mentioned earlier, we can see that the usual predictions of the static models that FTA would prove costly to these two countries have been proved unfounded. It should be mentioned here that Moroccan and Tunisian manufactured goods have had free access to EU markets since 1976. Thus so long as agriculture is excluded, the proposed FTA offers the two countries no additional export advantages, while requiring them gradually to remove their own trade barriers against manufactured goods imported from the EU. Nevertheless, these two countries have been reaping benefits from the new opportunities generated by the FTA's dynamic effects, e.g., increased FDI. Indeed, estimates indicate that further reforms coupled with more domestic and foreign investment could make the benefits of FTA outweigh its costs, if any, and increase employment, income and growth in real terms[22].

5. SAARC, SAPTA, SAFTA, BIMSTEC AND BILATERAL FTAS

The idea of South Asian regional cooperation was first proposed by Bangladesh in 1980 with a view to holding periodic, regional-level consultations among countries in South Asia on matters of mutual interest and possible cooperation in economic, social, cultural and other fields. As a result, SAARC formally came into existence with the adoption of the Charter at its first summit in Dhaka in 1985 (7 – 8 December). In December 1991, the sixth summit held in Colombo approved the establishment of an Inter-Governmental Group (ICG) to formulate an agreement to establish a SAPTA (SAARC Preferential Trading Arrangement) by 1997. But well in advance of the date stipulated in Colombo summit, the framework agreement on SAPTA was finalized in 1993, and formally came into operation in December 1995. The agreement reflected the desire of the SAARC countries to promote and sustain mutual trade and economic cooperation within the SAARC region through exchange of concessions. So far three rounds of talks on this agenda have taken place. The first two rounds of trade negotiations under SAPTA were concluded on product-by-product basis and the third round was based on chapter-wise. The fourth round has been decided to be held chapter-wise, sectoral and across the board. The tenth summit held in Colombo in 1998 decided that in order to accelerate progress in the next round of SAPTA negotiations, deeper tariff concessions should be extended to products which are being actively traded, or likely to be traded, among members; that discriminatory practices and non-tariff barriers should be simultaneously removed on items in respect of which tariff concessions are granted or have been granted earlier. Measures to remove tariff and non-tariff barriers and structural impediments should also be taken in order to move speedily towards the goal of a South Asian Free Trade Area (SAFTA). SAPTA was, therefore, envisaged primarily as the first step towards the transition to a SAFTA leading subsequently towards a Customs Union, Common Market and Economic Union. A Committee of Experts for drafting a comprehensive treaty framework on SAFTA has already finalized a working draft following the decision taken in the eleventh SAARC summit held in Katmandu on 4 to 6 January 2002, which is now under consideration of member states. In the mean time, bilateral agreements on FTAs between some member countries have been signed (e.g., India and Sri Lanka) and negotiations for more of such arrangement are going on between Bangladesh and Sri Lanka, India and Pakistan. The recent bias of SAARC countries towards bilateral FTAs probably has emanated from the poor performance of SAPTA (For example, about 95% of total imports of Bangladesh from India takes place **not** under SAPTA but under general rules) and the bleak prospect of multilateral SAFTA.

The number of products covered and the depth of preferential tariff concessions agreed in the three rounds of negotiations under SAPTA are shown in Table: 1, which shows that the concessions covering a total of 4951 products range from 7.5% and 100%.

One of the core principles of the SAPTA agreement is that there should be special treatment for LDCs through the consideration of additional measures and reduction of domestic content requirement (i.e., the rules of origin) further so that the LDCs within SAARC (Bangladesh, Nepal, Bhutan, Maldives) can benefit equitably from trade liberalization.

Table 1: Tariff Concessions offered by SAARC Countries

Country	Number of Products	Depth of Tariff concessions
Bangladesh	572	10% and 15%
Bhutan	266	10%, 13%, 15%, 18% and 20%
India	2402	10%, 15%, 20%, 25%, 30%, 40%, 50%, 90% and 100%
Maldives	390	5%, 7.5%, 10% and 15%
Nepal	425	10% and 15%
Pakistan	685	10%, 15%, 20% and 30%
Srilanka	211	10%, 15%, 20%, 30%, 50%, 60% and 75%
TOTAL	4951	

Source: htt:/www.saarcnet.org

Table 2: Revised Rules of Origin

Items	Before Amendment	Before Amendment	After Amendment	After Amendment
Not wholly produced and obtained	For non-LDCs	For LDCs	For non-LDCs	For LDCs
Domestic value addition in an exporting country	50%	40%	40%	30%
Maximum input permitted from non-contracting states	50%	60%	60%	70%
Cumulative Rules of Origin				
Aggregate domestic value addition in an exporting country including inputs sourced from within the SAARC region	60%	50%	50%	40%
Maximum input permitted from outside the SAARC region	40%	50%	50%	60%

Source: http://www.saarcnet.org

Table: 2 shows the reduction in the rules of origin criteria (both for LDCs and non-LDCs within SAARC) in terms of the extent of value addition required before and after the downward revision in the SAPTA rules of origin.

Any analysis for expanding trade and economic progress in South Asia must begin with the recognition and concern that the share of SAARC countries in total world trade today is less than 1% and that intra-SAARC trade, despite all efforts on SAPTA tariff concessions and relaxed rules of origin, remains a meager 3% of their total world trade. This compares poorly with 63.4% for intra-European (EU) trade, 37.2% for North America (NAFTA), 38.4% for East Asia (ASEAN)[23]. The cumulative loss to the region is rather colossal, which is confirmed by the large amounts of "unofficial trade" that continues to be traded across the borders of India and Bangladesh, Nepal, Pakistan and Sri Lanka. A recent survey conducted by the South Asia Enterprise Development Facility (SAEDF), an organization supported by the International Finance Corporation (IFC), reveals that about Rs. 3.42 billion (in Indian currency) of trade takes place between the seven Northeastern States (NES) of India and Bangladesh of which 43% takes place through informal trade route[24]. From the data available in the website of SAARC (), it can be observed that smaller economies like Nepal, Bangladesh and Maldives, are having substantial levels of trade with their neighbors. But India and Pakistan are the only two countries where the export levels to SAARC countries are much higher than the import levels, i.e., these two countries are having huge trade surpluses with their SAARC neighbors. Therefore, it is recognized that in an effort to materialize SAFTA, the base of traded commodities within SAARC must be enlarged from a meager level of 3% to at least 10% of their total world trade. Thus multilateral trade liberalization through SAPTA could not serve the purposes of LDCs like Bangladesh so far. Consequently, the interest for bilateral FTAs is growing, which are widely considered **not** as a "**stepping stone**" rather as a "**stumbling bloc**" for multilateral arrangements like SAFTA[25].

Again, Bangladesh along with four other members (India, Myanmar, Sri Lanka and Thailand) is also supposed to sign a framework of agreement on FTA (BIMST Economic Cooperation or BIMSTEC) in Bangkok on February 10, 2004, although Bangladesh, as usual, is less clear about the benefits of the deal. In a rapidly changing scenario, Thailand, Sri Lanka and India have said that they would sign the deal whether or not Bangladesh agrees to join such a framework. Both India and Thailand are in talks to sign a bilateral FTA. In order to improve bilateral trade with the countries like Myanmar and Thailand, India, bypassing Bangladesh, has established a new road linkage with Myanmar via Manipur. Sri Lanka and Thailand are also involved in similar talks while the bilateral FTA between India and Sri Lanka has proved to be a success. Under the circumstances, if Bangladesh decides to stay outside this multilateral FTA, there might emerge some real or potential costs of being left out in such a regional trade integration process, as mentioned earlier.

However, Peter Warr, an Australian consultant of ESCAP, in his recent report submitted to the Commerce Ministry of GOB has opined that Bangladesh would not gain much from the FTA with BIMSTEC countries[26]. National Board of Revenue is also known to have conducted a similar study in which it was also observed that Bangladesh would lose revenue, many industries would be forced to close down leading to huge job losses, and import dependence would increase[27]. The basis of this sort of skeptic conclusions regarding BIMSTEC is, however, not readily known. Probably the frustrating results of SAPTA as well as the unfamiliar markets, divergent levels of developments and meager volume of trade with Myanmar and Thailand, are putting brake on Bangladesh initiative to sign a FTA with these countries. Table: 3 shows that almost three-fourth of the merchandise exports of Bangladesh goes to Western Europe, North

Table 3: Direction of Merchandise Exports and imports of Selected Asian Countries in 2002

Country		Western Europe, North	Exports to (in %)	
	Asia	Western Europe, North		Western Europe, North
		And Central America	Asia	And Central America
Myanmar	61.2	29.2	91.6	3.9
Thailand	51.5	37.6	59.0	22.7
Bangladesh	6.0	73.6	62.4	15.5
Bhutan	88.3	10.0	65.9	32.6
India	26.9	50.1	25.5	30.1
Maldives	36.6	62.8	65.2	13.0
Nepal	51.3	45.6	60.7	12.5
Pakistan	20.2	56.2	31.9	27.1
Sri Lanka	11.5	70.4	65.3	19.3

Source: Key Indicators of Developing Asian and Pacific Countries, 2003,
Asian Development Bank, Tables 21 & 22, pp. 113 & 114. and Central America, while more than three-fifth of her imports originates from Asian region. Apparently Bangladesh is having large trade deficits with Asia as a whole. On the

other hand, the foreign trade of both Myanmar and Thailand are basically dependent on Asia. Under such a situation, if the BIMSTEC countries sign a FTA, it may be difficult for Bangladesh to penetrate the markets of these countries through competing out the Asian giants. It may also further widen the already existing trade deficits of Bangladesh with this region. This is, however, an observation based on static facts. From dynamic viewpoint, the long-run effects of such FTA may outweigh the short-run costs as observed elsewhere in the globe.

Let us now look at the issues and prospects of bilateral FTAs between Bangladesh, India, Sri Lanka and Pakistan that are now in the process of laborious negotiations. Opinions of academics and policy makers are, however, divided in this respect. Those who are in favor argue that Bangladesh has already opened up her economy to a great extent including floating her exchange rate with convertibility in the current account, scaling down her tariff line from 150% in 1992-93 to 32.5% in 2002-03, and reducing the tariff structure from nine steps in 2001-2002 to five steps in 2002-2003[28]. If we consider the trade ratio as the degree of openness of an economy we see that Bangladesh (42.1) ranked second after Sri Lanka (88.8), followed by Pakistan (34.5) and India (19.41) in 2000[29].

Table 4: GNI, Exports and Imports of Selected SAARC Countries, 2002 (in million US $)

Country	Gross National Income	Total Exports	Total Imports
Bangladesh	48617	5617	7968
	(8.07)	(8.26)	(9.33)
India	477368	48430	60540
	(79.24)	(71.26)	(70.89)
Pakistan	60047	9530.7	11107.7
	(9.97)	(14.02)	(13.01)
Sri Lanka	16411	4386.4	5785.4
	(2.72)	(6.45)	(6.77)
TOTAL	602443	67964.1	85401.1
	(100)	(100)	(100)

Notes: Figures in the parentheses indicate percentage of the total.

Source: Key Indicators of Developing Asian and Pacific Countries, 2003,

So, opening the economy further will not do the harm. They argue that if a small country like Sri Lanka (having the highest openness), contributing only 2.72% of total income (GNI) of these four countries, as shown in Table: 4, can benefit from an agreement on FTA with a country like India (having about 80% of total income), then there is no reason of why Bangladesh, contributing 8.07% of total income would not gain from such an arrangement.

Asian Development Bank, Country Tables. To them, if Bangladesh goes into an agreement on FTA with India or with other SAARC neighbors, colossal damages to her economy as usually are feared would not likely to happen. In support of their view they draw the reference of prognosis that was proved groundless in the case floating versus fixed exchange rate debate.

But those who are against argue that Bangladesh is currently having a very meager level of trade with these SAARC countries. Moreover, whatever is the trade volume, she is facing continuous trade deficits with India, Pakistan and Sri Lanka. As we have already mentioned, only 6% of her total exports in 2002 (Table: 3) was directed to Asia in which the amount directed to these three SAARC nations was certainly meager. In 1999, the total exports of Bangladesh were U.S.$4520 million of which only 0.6 per cent was exported to these countries[30]. In the same year, total imports were U.S.$8352 million of which, however, 13.35 per cent originated from these three SAARC nations[31]. Thus with the present basket of exports, according to them, if Bangladesh enters into FTAs with India or Pakistan, the trade balance will further worsen. So, neither the pre-FTA level of trade nor the existing trade balance scenario immediately provides a strong basis to argue in favor of bilateral FTAs. Besides, Bangladesh does not have any prior experience of FTA. If she at all wants to go for such an arrangement, according to them, she may sign FTAs with small neighbors like Nepal, Bhutan or Srilanka on experimental basis and closely monitor the repercussions on her economy. They also frequently cite the security question particularly with India as an important factor that can undermine the potential benefits of FTA. Let us now try to put the usual benefits and costs of FTAs mentioned in section 3 into this perspective.

First, the benefit of FTA would be small if the pre-existing tariff level were low. The pre-FTA tariff structure of these countries including Bangladesh indicate that although, all of these countries have reduced tariff to a considerable extent, narrowed down the varieties of protection, moved toward fairly uniform tariff rates and unified exchange rate systems[32], yet it is observed that both average tariff on manufacturing and primary products, and the coverage of QRs, is still high compared to East Asian countries[33]. Thus the pre-FTA tariff structure of these four countries does offer a good ground for FTAs. Moreover, the prevalence of trade dwindling para-tariff (border charges, fees, etc) and non-tariff (regulations or practices other than tariff) barriers and other impediments of trade (e.g., anti-dumping or countervailing tax, etc.) also provides a sound basis for FTAs.

Table 5: Major Exports by Principal Commodity of elected SAARC Countries

Bangladesh	India	Pakistan	Sri Lanka
1 Jute Manufacture	1. Non-metallic mineral manufactures	1.Cotton yarn and Thread	1.Garments
2. Fish	2. Textile yarn, fabrics and articles, etc	2.Cotton Cloth	2.Tea
3. Leather	3. Clothing	3.Rice	3.Petroleum Products
4. Raw Jute and mesta	4. Coffee, tea, cocoa, spices and manufactures	4.Leather	4.Rubber
5. Tea	5. Leather products, n.e.s.	5.Raw Cotton	5.Precious Stones
			6.Desiccated Coconut
			7.Copra
			8.Coconut Oil

Source: **Key Indicators of Developing Asian and Pacific Countries, 2003,** Country Tables, Asian Development Bank.

Second, if we look at the composition of major exports and imports of these countries (Table: 5), we see that in many sectors they are competitive, although in many sectors again complementarity exists. For example, exports of textiles and clothing continue dominate total manufacturing exports countries like Bangladesh, Pakistan and Sri Lanka the shares of which are respectively 76, 78 and 50 percent[34]. By December 2004, when MFA will be phased out, Bangladesh will face severe competition with these SAARC members including India. Under the changed scenario, Bangladesh can try to survive in the tariff/quota-free international market by importing necessary raw materials from Pakistan or for that matter, from India, for her RMG industry (the so-called SAARC cumulation) and regain her lost markets of raw jute, jute goods, tea, etc. Although, countries like Pakistan, Sri Lanka, India, China, Indonesia, etc. will, as they are now, remain the big competitors of Bangladesh in this respect, because at that time they will be able to export RMG without any quota or tariff through converting the fabrics they export now. Here, however, Bangladesh may enjoy some competitive edge over other countries with respect to unit labor cost. **Third,** it is usually argued that FTAs will adversely affect the existing industrial structure of Bangladesh. But this fear also would be misplaced if the scale economies and vertical linkages among industries were taken into account. It is true that FTAs may lead to losses of some industries and gains of others. But countries like Bangladesh where labor is relatively cheap, labor-intensive downstream firms can attract capital-intensive upstream firms. In other words, agglomeration of vertically linked industries (e.g. composite textiles and RMG) may offset the potential loss in this respect. **Fourth**, if agriculture is included in the FTA and rules of origin are relaxed, many agricultural and non-traditional products like battery, cosmetics, cement, light engineering products, spares of machineries and transports, etc. may add to this list of exports. **Fifth,** intra-regional investment flow and increased FDI in the post-FTA regional market can open up new product lines and generate employment opportunities. **Sixth,** the fear of fiscal loss also seems to be less reasonable in view of relatively low volume of imports from the countries under consideration and already scaled down tariff structure. Nonetheless, whatever loss would be incurred, it could be compensated by resorting to less distortionary taxes like VAT. **Finally,** an analysis of the political economy of FTA particularly with India suggests that FTA with India might be able to help bridge up the existing chasms in the relationship between these two countries. Here, however, the chauvinistic attitude of India should be relinquished and its treatment to Bangladesh as a LDC must be ensured in conformity with the WTO and SAPTA rules of business. In her recent talks with Bangladesh on FTA, India is reported to have demanded transit facilities and withdrawal of bar imposed by Bangladesh on the import of sugar and yarn from India using the land routes in exchange of 118 products for which Bangladesh wanted tariff-free entry. As a result, the FTA talks between India and Bangladesh have reached deadlock. It is relevant to mention here that there are some other lingering issues with India like sharing of the waters of 54 common rivers, cross-border terrorism, demarcation of territorial boundary, etc. that have been contributing to worsening political relationship between these two neighbors. India’s recent initiative to adopt an inter-river linking project will certainly widen this gap further. We think that many of these bilateral issues are more political than economic, which can be resolved if a meaningful and effective FTA is worked out. Because mutually benefiting economic agreements may help resolve political problems and bring these two countries closer.

It should, however, be remembered that all these issues and prospects of FTAs discussed above in the context of Bangladesh are probable and based on long-run assumptions. It is natural that many economic costs, real or monetary, hidden or overt, may wreak upon the economy immediately but the corresponding benefits that would ensue may spread over a longer period of time and outweigh these costs. Everything, however, depends on the objective conditions under which the policies pertaining to FTAs operate.

6. POLICY SUGGESTIONS

In order to make FTAs a success, the following policy suggestions may be put forward:

(a) FTAs should be negotiated and applied on the principles of overall reciprocity and mutuality of advantages of the contracting nations taking into account the respective levels of industrial, technological and overall development.

(b) Preferential measures must be ensured for the LDCs in order to resist the possibility of unequal distribution of benefits.

(c) Para-tariff, non-tariff and other barriers to trade must be removed.

(d) High-intensity trade items should be identified on priority basis.

(e) Supporting trade-augmenting measures like opening of land routes between the member countries, improving infrastructural linkages like port, harmonization of measures and standards, custom valuation system, dispute settlement procedure, etc. should be enforced and monitored meticulously.

(f) Proper investment climates (both political and economic) of the contracting nations should be ensured and their investment policies be harmonized so that intra-regional and international investments may flow. In this respect, the 'Agreement on the Promotion and Protection of Investment' should be signed between the SAARC nations.

Notes

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more efficient source by a less efficient one following changes in tariff rates; the extent of which again will depend on relative changes in the tariff rates of the contracting countries as well as the substitution response of domestic output.

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34. Ibidem.