

Ninth Tranche of the Development Account Project

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Enhancing the Contribution of Preferential  
Trade Agreements to Inclusive and Equitable  
Trade

COUNTRY STUDY SERIES

# Review of Bangladesh's Engagement in Preferential Trading Arrangements

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The Development Account is a capacity development programme of the United Nations Secretariat aiming at enhancing capacities of developing countries in the priority areas of the United Nations Development Agenda. The ninth tranche of the Development Account is aimed at supporting Member States in designing and implementing strategies and policies towards sustainable, equitable and inclusive development. Trade is an important part of this process, as expanding trade and investment has driven growth in many developing countries, leading to major reductions in poverty and overall increases in welfare. However, substantial variations in performance among countries persist and, as a consequence, not all countries - and much less all groups and individuals within countries - have been able to benefit equally from trade. In particular, the least developed countries, landlocked developing countries, and other countries with special needs, have not benefited from trade as much as some other developing countries. In order for these countries to foster further economic and social development, they need better access to markets alongside further development of productive and supply capacity.

Towards that end, the project 'Enhancing the Contribution of Preferential Trade Agreements to Inclusive and Equitable trade', led by the Economic and Social Commission for Asia and the Pacific (ESCAP), in partnership with the Economic Commission for Africa (ECA) and the Economic Commission for Latin America and the Caribbean (ECLAC) aims to increase the potential benefits of preferential trade agreements for a set of developing countries identified to be in crucial need for assistance. The project aims to increase the capacity of these countries in identifying the potential benefits and costs of preferential trade agreements, increasing their means to effectively negotiate development-focused preferential trade agreements, and better utilize already negotiated concessions for their benefit. The identified beneficiary countries are: Burkina Faso, Guinea, Mauritius, and Senegal (Africa); Ecuador, Guatemala, Honduras and Jamaica (Latin America); and Bangladesh, the Islamic Republic of Iran, Mongolia, Myanmar, and Viet Nam (Asia-Pacific). The project will involve capacity building national workshops in the pilot countries, followed by a capstone regional dialogue for the different countries to share experiences and learn from another. Furthermore, the training materials, in addition to background documents and other materials derived from the workshops, will be made available online through a public knowledge sharing platform for all interested users as reference material.

The most significant output of the project will be enhanced capacity among government officials and trade negotiators to formulate inclusive development-friendly preferential trade agreements so that trade arising from such policies has inclusive and equitable results: improvements in labour standards and wages; the elimination of child labour; positive impacts on gender equality; and enhanced contribution to general welfare, in particular for marginalized excluded groups.

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## **1. Introduction**

In the past few decades, the world has seen noteworthy growth in Regional Trading Arrangements (RTAs) among both the developed and the developing countries. It is argued that RTAs or integrated economies enhance growth and development of an economy through providing possibility of increased market size and economics of scale. Moreover, regional integration plays a crucial role in the dynamics of today's global and regional politics. The result is an increase in the number of regional trading arrangements among all the economies, particularly in the Asian continent.

Regional integration and cooperation initiative in South Asia started with the formation of the South Asian Association for Regional Cooperation (SAARC) in 1985. SAARC includes Afghanistan, Bangladesh, Bhutan, India, Nepal, the Maldives, Pakistan and Sri Lanka. SAARC countries signed the SAPTA (SAARC Preferential Trading Arrangement) in April 1993 which came into force in December 1995, with the aim of promoting intra-regional trade and economic cooperation within the SAARC region through the exchange of concessions. SAPTA was replaced by the South Asian Free Trade Area (SAFTA) in January 2006, designed to more proactively promote and facilitate intraregional trade among the SAARC members. Besides SAFTA there are three bilateral free trade agreements (FTAs) in South Asia, which are India-Sri Lanka bilateral FTA, India-Bhutan bilateral FTA, and Pakistan-Sri Lanka bilateral FTA. Furthermore, the Bangladesh-Bhutan-India-Nepal (BBIN) is an initiative for a sub-regional cooperation. Despite these, South Asia is one of the least integrated regions in the world. The proportion of within-South Asia trade in the region's global trade hovers around 5% mark.

There are a number of challenges and tasks ahead for greater integration in South Asia. The presence of the long 'sensitive lists', non-tariff barriers (NTBs), lack of trade facilitation and political relations between countries appear to be major barriers to intra-regional trade in South Asia. Furthermore, though liberalization of the services trade is a critical economic agenda, there has not been much progress on the South Asian Agreement on Trade in Services (SATIS) after it was signed in 2010. Also, South Asia remains one of the lowest recipients of Foreign Direct Investment (FDI) among the developing regions, with around 90% of the FDI inflow in South Asia is destined to India. Like trade, intra-regional FDI in South Asia comprises of only less than 5% of the total FDI flow and India is the dominant investor within the region.

Against this backdrop, this paper reviews the Preferential Trading Arrangements for Bangladesh. It reviews the history, trade pattern and current status of the PTAs Bangladesh is involved in. The paper also sheds light on the challenges Bangladesh is experiencing and the possible policies that can be taken to overcome the challenges. Section II provides a review of the theoretical literature on PTAs; Section III undertakes an overview of Bangladesh's involvement in different PTAs; Section IV analyzes the empirical evidence of Bangladesh's experience with PTAs; Section V identifies the challenges and policy options for making PTAs effective for Bangladesh and Section VI draws the conclusion of the paper.

## **2. Review of Theoretical Literature on PTAs**

Popularity for regional integration has largely increased in the recent few decades. This significant increase in regionalism has put much importance on RTAs. PTAs are very useful instruments for countries those intend to engage in regional integration to achieve goals relating to trade, labor,

foreign investment, environment etc. Countries engaged in regional integration use PTAs to collectively reduce tariffs among the member countries while non-member countries receive no preference. Regional Trading Arrangements (RTAs) can be broadly categorized into five types: Preferential Trading Arrangements (PTAs), Free Trade Areas (FTAs), Customs Union (CU), Common Market (CM) and Economic union (EU). PTAs are agreements where tariffs are lowered among the member countries but upheld at the same level for non-member countries whereas FTAs are agreements where tariff are reduced to zero for member countries but maintained for the non-member countries. CUs decide collective trade policies for member and non-member countries, and in this context adopt a common external tariff schedule for the non-member countries while executing FTA among the member countries. CM provides member countries the advantage of free movement of factors of production alongside the facilities of CU, and EU is where the regional agreement includes common economic laws in addition to the advantages of CM.

Viner (1950) linked RTAs with welfare maximization and also introduced the concepts of 'trade creation' and 'trade diversion'. Trade creation is when a country substitutes its locally produced goods by cheaper imports from member countries while trade diversion is the substitution of cheaper imports from the non-member countries by costlier imports from member countries. Viner (1950) stated that efficiency of the member country is an important component that determines the welfare gain. The establishment of RTAs will enhance welfare when member countries are more efficient than non-member countries. However, if member countries are relatively less efficient than non-member countries, then there will be negative welfare gain or welfare loss. Precisely, trade creation is associated with welfare gain and trade diversion is associated with welfare loss. Thus, Viner (1950) emphasizes that the impact of RTAs depends on the extent to which the member countries have created or diverted trade.

Further, Meade (1955) and Lipsey (1957) analyzed that trade diversions can be beneficial in a case where distortions in consumer pattern are reduced offsetting the loss of efficiency due to decrease in production. Corden (1972) stated that welfare gain and loss from trade creation and diversion are pertinent but economies can benefit from reduced cost of production specialization and economies of scale. Also, Venables (1987) analyzed that trade diversion can have welfare gains when market power of inefficient domestic monopolies is reduced by new competition from imports in the domestic market. Bhagwati and Panagariya (1996) argued that welfare gains from trade creation and diversion vary from a single country to a trade bloc. Welfare gain of an individual country depends on the income distribution effect of tariff revenue but trade creation implies welfare gain for the trade bloc.

However, RTAs formation is also subject to certain criticisms. Popularity of regionalism and substantial increase in regional agreements are opposing the essence multilateralism. Numerous trading blocs could be a stumbling block for multilateralism rather than a building block for multilateral liberalization. Increase in the number of regional arrangements has formed a complex 'spegetti bowl' situation of overlapping and conflicting provisions (Bhagwati and Panagariya ,1996). Feridhanusetyawan (2005) argued that multiple and overlapping trading arrangements increase the transaction cost of trade. In addition, RTAs can have discriminatory effects on trade for the Least Developing Countries (LDCs).

Further, tariff reductions under an RTA may not lead to price reductions for goods imported from the member countries, as the domestic market is seen as a 'captive market'. For example, SAFTA critics allege that Indian exporters may find a 'captive market' for their exports to Bangladesh (World Bank, 2006); even though Bangladesh reduces the tariffs for Indian products, their prices may not fall in Bangladesh if the Indian products are priced to match or just undercut similar products imported from outside the RTA (with higher tariffs) (Raihan, 2012).

Baysan *et al* (2006) argued that the economic case for south Asian regional integration was relatively weak. The authors pointed out three important features of the South Asian economies that might make an FTA among them *economically* unattractive. First, the economies are relatively small in relation to the world both in terms of the GDP and trade flows. Though in terms of population, the region is substantial (one fifth of the world) the current per-capita incomes are tiny so that the economic size of the region remains small: less than one twentieth of the world in terms of the GDP. And if India is taken out of the picture, this proportion drops to 0.4 percent. Bayson *et al* (2006) further argued that the probability that most efficient suppliers of the member countries were within the region was slim. Therefore, the probability that the FTA is likely to be largely trade diverting is quite high. The second reason relates to the relatively high levels of protection among the SAARC economies. If the country participating in a regional arrangement were itself open, it would not suffer from trade diversion even if it were tiny. It is, however, evident that the level of protection within the SAARC region remains high in all countries. According to Bayson *et al* (2006), the third and final reason that makes the economic case for SAFTA weak concerns the political economy of the selection of excluded sectors and RoO. When countries are allowed to choose sectors that can be excluded from tariff preferences in an FTA, domestic lobbies make sure that the sectors in which they may not withstand competition from the union partner are the ones that get excluded. In addition, the RoO can also be subject to abuse by the bureaucrat administering them. In cases where imports from the partner may be threatening an inefficient domestic competitor, bureaucratic discretion may be employed to block entry of the imports.

In contrast to the arguments put forward by Bayson *et al* (2006) policy makers and many business people in South Asia and especially in Bangladesh are rather optimistic about SAFTA. They see SAFTA has significant potentials to expand trade among the member countries. It is also hoped that the member countries will be able to gain significantly by having greater market access in other South Asian countries, and especially in India. Those who argue for SAFTA state that despite the little volume through formal channel, substantial trade is already taking place in South Asia with informal trade amounting to a large proportion of formal trade. Taking into account the informal trade the 'real' intra-regional trade would be anywhere between 8-10 percent. Although studies have shown that there are limited complementarities in the SAARC region, it is argued that this was also the case in ASEAN during the mid-1970s, and that dormant complementarities in the region could be invigorated by intra-regional investment and FDI.<sup>1</sup> They also argue the cost of non-cooperation to be quite high (CUTS, 2012; RIS, 2004 and 1999; GEP, 1998; CUTS, 1996). The debate is, therefore, far from settled. Irrespective of the debate, there is a general belief that regional cooperation in South Asia should not be viewed only from the trade perspective, and that there are many gains from regionalism in other areas.

### **3. Overview of Bangladesh's Engagement with different PTAs**

Growing global trend of regionalization has been a driving force behind the rising popularity of different kinds of regional trading agreements. Bangladesh has made progress by engaging in different bilateral or multilateral agreements. So far, Bangladesh has signed four PTAs with other developing and emerging economies; Asia-Pacific Trading Arrangement (APTA), SAARC Preferential Trading Arrangement (SAPTA), South Asian Free Trade Area (SAFTA), and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC). These PTAs have become a vital instrument for regional integration enhancing trade and investment.

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<sup>1</sup> Intra-regional trade in ASEAN was close to 6 per cent in the mid-1970s, but now has increased to around 23 per cent. ASEAN too was characterized by limited complementarities at the beginning but the situation changed with preferential trading, FDI and intra-regional investment (SACEPS, 2002).

### 3.1. Bangladesh's engagement in APTA

Initiated by ESCAP, the Asia Pacific Trading Agreement (APTA), initially known as the Bangkok Agreement and renamed in 2005, was signed in 1975. APTA changed its name in 2005 and was previously known as the Bangkok Agreement. The APTA is one of the oldest form of trading arrangement and the first trading arrangement to involve the developing countries. The agreement was initially formed by Bangladesh, India, South Korea, Laos and Sri Lanka and later joined by China and Mongolia in 2001. The trading agreement aims to facilitate trade and investment through liberalizing trade and enhancing intra-regional economic cooperation.

APTA agrees to approve common operational procedure for the certification and verification of the origin of goods. The agreement also has the provision for differential treatment for countries with special needs such as the LDCs. Bangladesh as a least developing country attains duty free access to the APTA member states. This duty free access has been recently increased to over 10,000 items from 4000 earlier. APTA's aim to strengthen trade and economic cooperation included the merchandising goods.

APTA focuses on provisions for trade facilitation, promotion, protection and liberalization of investment and trade in services. The trade agreement that involves 2.6 billion population and large economies spanning from East to South Asia with the provision of expanding to other region and foresees great prospect in the promotion of South-South trade. APTA has held four ministerial council meetings since 2005 discussing and negotiating over trade policies. The latest was held in January, 2017 welcomed Mongolia as a new member of the trading arrangement. In addition, council meeting revised the national list of tariff concessions and rules of origin. Moreover, it carried out the negotiations for future development, discussed the role of APTA as regional trading agreement and the establishment of APTA Chamber of Commerce and Industry Network.

Table 1 shows the Intra-APTA trade in Asia. China leads the region in exports closely followed by South Korea. India also has substantial exports in the trading region. However, Lao PDR and Mongolia, as new members, contribute to trade least in the region. Bangladesh's trade with other APTA member countries is low. Bangladesh's net export with most countries is negative i.e. Bangladesh imports more than it exports from the member countries. Since, Mongolia is a new member, it trades a negligible amount with Bangladesh. It is evident and expected for China to be the largest trading partner of Bangladesh. The geographical proximity and cultural ties with India play pivotal role in the large trade among them. Moreover, Bangladesh has large volume of imports from South Korea major items comprising of iron and steel, plastics and machinery. Among the APTA countries, Bangladesh is least integrated with Lao PDR and Mongolia.

**Table 1: Intra-APTA trade**

		Exports (US\$ millions)						
		China	Bangladesh	India	Lao PDR	South Korea	Sri Lanka	Mongolia
Imports (US\$ millions)	China	0	869.40	11,764.13	1,359.61	158,974.53	273.44	3,622.60
	Bangladesh	14,300.64	0	5,668.79	0.35*	1,158.42	118.87	NILL
	India	58,397.76	677.10	0	172.41	12,214.05	632.27	2.35
	Lao PDR	986.97	0.14	23.93	0	126.41	2.14	0.00
	South Korea	93,707.10	293.11	3,465.42	22.74	0	70.87	10.36
	Sri Lanka	4,286.88	29.35	4,118.25	7.59	324.42	0	2.12
	Mongolia	988.54	6.00	9.76	0.02	208.71	1.08	0

Note: All data are available for 2016, values marked with \* are latest available data for 2015

Although, APTA gives Bangladesh the scope to access to larger markets in Asia, the trading agreement is lagging behind for many reasons. APTA is based on the 'positive list' approach that makes negotiations tough. Non-tariff barriers impede preferences given to the goods. Also, preferences are not given to the actively traded goods hence many tariff preferences are not utilized properly. The variations among the margin of preferences are not same, some margin of preferences remain very small. However, one of the greatest drawbacks of this trading agreement is that the negotiations regarding tariff concessions, non-tariff measures, trade facilitation, trade in services and investment are still going on and the agreement is yet to be operational.

### 3.2. Bangladesh's engagement in SAPTA

SAARC was formed with the aim to work jointly on the areas of health, population, cultural exchange and sports. However, in the early 1990s, the South Asian economies began relaxing their import substitution policies to more liberal economic policies. The member states of the SAARC in 1993 agreed to promote trade and economic cooperation along with the other areas of integration. SAPTA agreement was signed in April, 1993 and started its operation in December, 1995 with the aim to promote trade by reducing tariff and other barriers. SAPTA negotiated under four broad approaches: on product-by-product basis, across the board tariff reductions, sector wise, and direct trade measures. The agreement focused on special treatment to the least developed countries by the developing countries.

The agreement of SAPTA offered member states to gain from tariff preferences within the trading bloc. The agreement had a provision for 'most favored nation' for the member countries. This implies that facilities provided by a developing country to the least developing countries must be offered to all least developing countries and facilities provided to a developing country by another developing country must be provided to all member states. Moreover, least developing member states could be given preferences without having to reciprocate. Further, for products that are not completely produced by the member states, 'rules of origin' required the value of the raw material or imported inputs to not exceed 50% of the value of final product. For least developing countries, this limit was extended to 60% to the value of final product. In 1999, this requirement was reduced to 30% for developing countries and 40% for least developing countries.

SAPTA ensured preference to the least developing countries yet the trade arrangement struggled to contribute significantly to the regions welfare. In addition, several rounds of negotiations failed to increase the limited amount of products that were given priority by the SAPTA member states. The SAPTA inter-regional import figures showed maximum gain by Pakistan (39.6 percent), followed by Nepal (35.2 percent), India (30 percent), Bhutan (17 percent) and Sri Lanka (12 percent) but the gain for Bangladesh and Maldives was marginal (Mukherji, 2000). Despite the several priorities SAPTA provided to the least developing countries, Bangladesh's trade involvement within the region was stagnant.

Hossain and Kibria (2001) illustrated that over the years 1992-99, although Bangladesh world export and imports increased<sup>2</sup> its trade with South Asian region countries remained the same. Bangladesh's export increased marginally from \$83 million in 1995 (i.e. before the SAPTA agreement) to \$86 million in 1999 (i.e. 3 years after the SAFTA agreement) and imports fell from \$1151 million in 1995 to \$1054 million in 1999 among the SAARC region.

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<sup>2</sup> Bangladesh's imports from the world in 1995 and 1999 were US\$6496 million and US\$8296 million respectively while its exports to the world in 1995 and 1999 were US\$ 3129 million and US\$ 4520 million (Hossain and Kibria, 2001).

### 3.3. Bangladesh's engagement in SAFTA

Since, SAPTA did not bring about the expected trade boost, the member states of SAARC agreed to move towards an arrangement of Free Trade Area (FTA) from SAPTA and South Asian Free Trade Area (SAFTA) was formed in 2004. SAFTA started its operation in 2006 with the core objectives to facilitate trade, remove restriction from intra-regional trade and investment, develop and improve communication systems, transport infrastructure and transit facilities. SAFTA aims to reduce all tariff barriers to zero among the region. The agreement provides least developing countries extended time frame than developing countries to reduce its tariffs to 5% or below. However, unlike SAPTA, SAFTA allows products on sensitive list to be excluded from tariff reduction.

Table 2 depicts the pattern of intra-SAARC trade. India is the top export destination as well as the biggest import source of Bangladesh in South Asia. In 2016, Bangladesh imported around US\$ 5669 million from India while exported only US\$ 677 million. Bangladesh imports more from Pakistan and Sri Lanka than it exports resulting in a negative trade balance of around US\$ 608 million and US\$ 90 million respectively. However, export of Bangladeshi goods to Afghanistan, Bhutan, Maldives and Nepal are very minimal and imports from Afghanistan, Maldives and Nepal are almost negligible. The trade pattern of the economy demonstrates weak integration of Bangladesh with South Asian countries.

**Table 2: Intra-SAARC trade**

		Exports (US\$ million)							
		Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
<b>Imports (US\$ million)</b>	<b>Afghanistan</b>	0.00	4.71*	0.00	472.99	0.00	9.12*	1,369.77	0.63
	<b>Bangladesh</b>	0.05*	0.00	39.97*	5,668.79	0.28	0.05*	656.16	118.87
	<b>Bhutan</b>	NILL	2.44*	0.00	374.21	0.00	1.49*	0.00	0.04
	<b>India</b>	282.29	677.10	127.33	0.00	6.25	385.31	461.08	632.27
	<b>Maldives</b>	0.00	3.13	0.01**	180.15	0.00	0.03	6.40	104.24
	<b>Nepal</b>	0.08*	2.62*	3.09*	4,526.22	0.00	0.00	0.81	1.26
	<b>Pakistan</b>	369.90	48.60	0.11	1,592.58	6.32	0.96	0.00	66.33
	<b>Sri Lanka</b>	0.05	29.35	0.00	4,118.25	86.18	0.21	304.12	0.00

Note: All values are available for 2016, values marked with \* are latest available data for 2015 and \*\* are latest data available for 2013

SAARC member states are mostly involved in trade with the developed countries. The strong sharing of historical and cultural heritages between India and Bangladesh and India and Sri Lanka have made Bangladesh and Sri Lanka to be the two highest importing countries in the region from India. SAFTA has performed relatively poor in comparison to other trading arrangements. The region also has substantial amount of barriers to trade. Despite of reducing tariffs on large product coverage, non-tariff barriers prevent the growth of trade. Poor physical infrastructure and weak institutional structure result in impeding trade in the form of non-tariff barriers. Poor condition of road, rail and waterways as well as bureaucratic inefficiencies, inadequate enforcement of rules, custom delays, asymmetric standard of products among countries and corruption are few of the factors that assist in restricting trade in the region. Poor Infrastructure at the ports lead to long hours of delay leading to higher trade cost. The South Asian Regional Standards Organization (SARSO), a specialized body of SAARC, was established with the aim to harmonize standards and facilitate intra-regional trade that will combat issues related to standardization and conformity assessment. However, SARSO is has not developed it full capacity and operate fully.

In addition, products on 'sensitive lists' that are excluded from tariff preferences are subject to heavy political influence. Domestic lobbies safeguard those industries that do not face competition from the member countries imports.

Furthermore, the political condition of the region plays a significant role. Political relations between India and Pakistan had been a bumpy ride and these sour relations result in large informal trade among the countries that drive up the cost. Political tensions between India-Pakistan divert their trade through UAE, raising the cost and reducing the gain for the countries.

### 3.4. Bangladesh's engagement in BIMSTEC

The Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) was mainly established to connect the countries of South Asia and Southeast Asia. Since its inception in 1997, BIMSTEC has created a platform for members of SAARC and ASEAN to strengthen their connectivity. However, the corridor connectivity in the Bay of Bengal region has performed relatively weak as compared to other regional organizations. Regional development and integration in this region would require a multidimensional approach. Beyond the basic land connectivity, unexplored potentials from cultural, digital, financial and other forms of integration need to be extracted. BIMSTEC aims to achieve (i) tariff concession on trade in goods (ii) customs cooperation (iii) trade in services (iv) investments (v) dispute settlement mechanisms for the member of BIMSTEC. Moreover, BIMSTEC has agreed to cooperate in 14 priority sectors; Trade and Investment, Transport and Communication, Energy, Tourism, Technology, Fisheries, Agriculture, Public Health, Poverty Alleviation, Counter-Terrorism and Transnational Crime, Environment and Natural Disaster Management, Culture, People to People contact, Climate change, for the development of member countries. A success of the BIMSTEC agreement will stimulate trade and investment in the region and draw outside nations to invest and trade with BIMSTEC in the future.

BIMSTEC is the connection between SAARC and the ASEAN countries. Despite several negotiations, SAARC did not perform as per the expectations of the nations and mainly due to the consistent political tension between India and Pakistan. BIMSTEC will connect India with Thailand giving access to larger markets and for both the countries and benefit the smaller economies in the economic cooperation. BIMSTEC aims to strengthen land connectivity between the two regions. A successful BIMSTEC will give economies of both the region access to each other markets through enhancing trade and injecting foreign investment. Foreign direct investment can flow from the bigger economies like India and Thailand to smaller economies like Bangladesh, Myanmar etc. That is, BIMSTEC will help investments to flow from developed regions to less or underdeveloped regions. Bangladesh has been experiencing sluggish investment in the recent years, injection of foreign investment can improve the domestic situation and enhance business confidence to the local investors.

Table 3 shows the intra-regional trade flow scenario of the BIMSTEC countries. The intra-BIMSTEC trade amounts to around US\$ 37 billion according to the latest data available. The leading contributors to the regional exporters are India, Thailand and Myanmar, exporting. The top three exporters unaided contribute to around 90 percent of exports to the region. Following them are Sri Lanka and Bangladesh, with regional export volumes of less than one billion US\$. Bhutan has the lowest export and import volumes. The largest regional importers in the BIMSTEC region are India, Thailand and Bangladesh. Bangladesh has the largest trade deficit in the BIMSTEC intra-regional trade. India's largest exporting partners in the region are Bangladesh (US\$ 5,668 million) and Nepal (US\$ 4,526 million), followed by Sri Lanka (US\$ 4,118 million) and Thailand (US\$ 3,114 million). Analyzing Bangladesh and Sri Lanka's export figures illustrates that India is their largest exporter as well. The strong cultural and historical ties among the nations are strong influential factors behind

the large export volumes. Thailand has biggest export volumes with India (US\$ 5,650 million) and Myanmar (US\$ 4,108 million). Myanmar and Thailand also have similar ethnic and historic ties from the past that is reflected in the trade volumes. Besides, their association with the ASEAN trade bloc is also echoed. Further, it can be observed that Thailand and India have a significant trade association and are expanding well into one another's large market. Similarly, Myanmar's exports have also been observed to infiltrate well in to the Indian market (US\$ 1,016 million). Besides India and Thailand, Myanmar has low trade volumes with the other economies. Nepal and Bhutan- the landlocked economies have the marginal trade in the region. Bhutan's export volumes are significantly low with its major trading partner being India (US\$ 195 million). The case is very similar with Nepal, where it exports US\$ 490 million worth of goods to India.

**Table 3: Intra-BIMSTEC trade**

		Exports (million US\$)						
		Bangladesh	Bhutan	India	Myanmar	Nepal	Sri Lanka	Thailand
Imports (million US\$)	Bangladesh	0.00	21.91*	5,668.79	153.83**	6.83	98.48	844.90
	Bhutan	5.25*	0.00	374.21	0.00	1.49	0.02	11.37
	India	639.90	195.02	0.00	1016.30	489.55	848.78	5650.14
	Myanmar	8.53**	0.01***	859.97	0.00	0.01	1.73	4108.21
	Nepal	24.80	3.09	4,526.22	9.86	0.00	3.60	53.72
	Sri Lanka	37.71	0.00	4,118.25	21.44	0.02	0.00	497.18
	Thailand	63.43	0.04	3113.56	3556.63	0.81	37.75	0.00

Data source: UNCOMTRADE; All are latest available data for 2015 or 2016, \*marked are latest data available for 2012, \*\*marked are latest data available for 2011, \*\*\*marked are latest data available for 2010; figures in US\$ thousand

Since the inception of BIMSTEC, trade among the countries has been significantly poor and largely dominated by the two large economies of the region; India and Thailand. Bangladesh largely imports from India and Thailand and India is the largest importer for Bangladesh. Although, Bangladesh is involved to some extent of trade with all the economies of the trading arrangement but there are enormous resources and vast untapped potential to explore for Bangladesh. In the case of foreign direct investment, Bangladesh receives investment from India, Thailand and Sri Lanka only and there is no outflow of fund from Bangladesh to other BIMSTEC economies.

Although, it been 20 years since the inception of BIMSTEC, it is yet to be operational. The South Asian countries are protectionist in nature that hinders free flow of trade. Apart from that, the non-tariff barriers condense the advantages obtained from tariff preferences. Weak Infrastructural connectivity is a major issue. Inadequate port facilities and poor transport network through road, rail and water obstructs expanding of trade and investment. Also, the ease of doing business in Bangladesh is rather on a higher difficulty level. Asymmetric rules, complicated procedure and large requirement of documents discourage investors in the region. Finally, the countries are yet to overcome from its political issues relating to borders, refugees and bureaucratic hurdles. The regional progress has also been delayed due to lack in the political will. Understanding and resolving domestic and regional issues will boost BIMSTEC's growth prospect.

#### **4. Review of Empirical Research on Bangladesh Experience with PTAs**

Empirical evidence has shown diverse results of the impacts or welfare gains of Bangladesh in involvement in different trading arrangements. It is believed that due to the different methodologies used in these empirical researches, it has resulted in inconclusive outcomes. Generally, three methodologies have been used: (i) gravity model, (ii) partial equilibrium model; and (iii) a general equilibrium model.

The gravity models basically try to explain bilateral trade flows with a set of explanatory variables that try to predict the impact of the arrangement on bilateral trade flows<sup>3</sup>. Gravity models, for the analysis of any RTA, have been used widely to predict the impact of the agreements on the bilateral trade flows. The studies that employ the gravity model include Srinivasan and Canonero (1995), Sengupta and Banik (1997), Hassan (2001), Coulibaly (2004), Hirantha (2004), Tumbarello (2006), Rahman (2003), Rahman *et al* (2006) and Rodriguez-Delgado (2007). The findings of these studies have been mixed. For example, studies by Srinivasan and Canonero (1995), Sengupta and Banik (1997) predicted that the impact of a South Asian FTA on trade flows would be small for India but much larger on the smaller countries. Sengupta and Banik (1997) predicted a 30 percent increase in the official intra-SAARC trade and as much as 60 percent if illegal trade became a part of official trade. Coulibaly (2004) found net export creation, and Tumbarello (2006) and Hirantha (2004) found net trade creation from SAPTA. On the other hand, Hassan (2001) found net trade diversion effect from SAPTA, while Rahman (2003) found the dummy variable for South Asia to be insignificant, indicating that a regional integration is unlikely to generate significant trade expansion in this region.

Rahman *et al* (2006) used an augmented gravity model to identify trade creation and trade diversion effects originating from SAPTA. It was found that there was significant intra-bloc export creation in SAPTA; however, at the same time there was evidence of net export diversion in SAPTA. It was also appeared that Bangladesh, India and Pakistan were expected to gain from joining the RTA, while Nepal, Maldives and Sri Lanka were negatively affected.

Rodríguez-Delgado (2007) evaluated the SAFTA within the global structure of overlapping regional trade agreements using a modified gravity equation. It examined the effects of the Trade Liberalization Program (TLP) which started in 2006. The study predicted that SAFTA would have a minor effect on regional trade flows. The gravity model simulation suggested that SAFTA TLP would influence regional trade flows mainly by increasing India's exports, and imports from Bangladesh and Nepal.

It should, however, be pointed out that studies based on the gravity model to estimate the welfare gains from regional trading arrangements (RTAs) are methodologically flawed. Firstly, the left hand side of the gravity equation is the bilateral trade, not the welfare. But, the concepts of 'trade creation' and 'trade diversion' directly relate to the welfare of the country in question. Furthermore, gravity models are partial equilibrium analysis; therefore, they fail to take into consideration the inter-sectoral and inter-regional linkage effects. Therefore, gravity models cannot actually estimate the welfare effects of any RTA, and therefore not capable of estimating the trade creation and trade diversion impacts of RTAs.

The major partial equilibrium studies on RTA in South Asia are by Govindan (1994), DeRosa and Govindan (1995), Pursell (2004), World Bank (2006) and Raihan (2011). The advantage with these models is that they are generally based on disaggregated data, and are also flexible enough which facilitates sector-specific study. However, the major problem with these models is that they ignore general-equilibrium interactions, and thus can't capture the inter-sectoral effects on the economy.

A partial equilibrium model for food sector, used by Govindan (1994), showed the effect of preferential liberalization within the region on intraregional trade in food. The study found that such

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<sup>3</sup> Typically, the exercise involves estimating a bilateral trade-flow equation with bilateral trade (imports, exports or total trade at the aggregate or sector level) as the dependent variable and country characteristics such as the gross domestic products, population, land area, distance, the commonality of language or cultural ties and the existence of preferential trade arrangements as independent variables. Once estimated, the equation can then be used to predict the impact of a union between country pairs that did not have such a union during the sample period.

preferential liberalization would generate welfare gains through increased trade in food within the region. The analysis by DeRosa and Govindan (1995), however, showed that the welfare gains were much higher when the member countries also go for unilateral liberalisation on a non-discriminatory basis. A partial equilibrium analysis on the cement industry by Pursell (2004) suggested that the preferential liberalization of cement industry between India and Bangladesh would lead to substantial gains through increased competition within the regional market.

With a view to exploring the potentials of India-Bangladesh bilateral FTA, World Bank (2006) provided a comparative assessment between Bangladesh and India with respect to a few industries like cement, light bulbs, sugar, and RMGs. The partial equilibrium simulation results suggested that in the case of cement, lights bulbs and sugar the likely effects of an FTA between Bangladesh and India seemed to be an expansion of Indian exports to Bangladesh, but no exports from Bangladesh to India. This was mainly because Indian export prices for these products were substantially lower than ex-factory before-tax prices of the same or similar products in Bangladesh. The simulations for RMGs predicted increased Bangladeshi exports to India, but also increased RMG exports from India to Bangladesh. The study found that a FTA would bring large welfare gain for consumers in Bangladesh provided there was adequate expansion of infrastructure and administrative capacity at custom borders. The study however cautioned that the benefits of such a FTA to Bangladesh could be wiped out if it had the effect of keeping out cheaper third-country imports, i.e., from East Asia, and such trade diversion costs could be huge. The study suggested that the only way to minimise the trade diversion costs would be through further unilateral liberalization.

Raihan (2011) applied the WITS/SMART partial equilibrium model to explore the trade effects of SAFTA on the member countries. The study showed that under a full implementation of SAFTA, some of the South Asian countries would be able to increase their exports within the region quite substantially. India would appear to be the largest gainer as her exports to this region would increase by US\$ 858 million. For Pakistan, Bangladesh and Nepal the rises in exports would be US\$ 169 million, US\$ 122 million and US\$ 90 million respectively. Sri Lanka's exports to the region would rise, but because of the India-Sri Lanka bilateral FTA its exports to the Indian market would rise in small amount. The study also showed that except for Maldives and Sri Lanka, for all other countries the rise in their exports to India would constitute major shares of the rise in their total exports to the region. Raihan (2011) however showed that much of the potential of the rise in exports among the South Asian countries would be restricted by the presence of stringent sensitive list under SAFTA.

The studies based on computable general equilibrium (CGE) models predicted the effects of the trading arrangement on all variables including production, consumption, trade flows in all sectors of the economy as also on welfare. The studies that apply the CGE model to SAFTA analysis are Pigato *et al.* (1997), Bandara and Yu (2003) and Raihan and Razzaque (2007). All these three studies employed the Global Trade Analysis Project (GTAP) database and model, though they differ in details due to the evolution of the GTAP data itself.

Pigato *et al.* (1997) found that SAFTA would produce benefits for member nations though unilateral trade liberalization would yield larger gains. The study by Bandara and Yu (2003) found that, in terms of real income, SAFTA would lead to gains for India and Sri Lanka, while Bangladesh would lose. The authors also endorse the view that South Asian countries might gain much more from unilateral trade liberalization and multilateral liberalization than from SAFTA.

Raihan and Razzaque (2007) also used the GTAP model in explaining the welfare effects of SAFTA. The main contribution of their paper was to decompose the welfare effects of SAFTA (as calculated from the GTAP simulation results) into trade creation and trade diversion effects for individual South Asian countries. It appeared that Bangladesh would incur a net welfare loss from the SAFTA

scenario. Though, for Bangladesh there was a positive trade creation effect, the negative trade diversion effect would be large enough to offset the positive gain. However, all other South Asian countries would gain from SAFTA. The gain for India would be the largest. Raihan and Razzaque (2007) also explored the possible reasons for the large trade diversion effects for Bangladesh. From the GTAP simulation results it appeared that under SAFTA, imports from China and other low cost sources (all over the world) would decline while that from India would increase significantly, which indicated, as far as the imports into Bangladesh were concerned, a replacement of low cost import sources by a high cost source.

Hossain (2013) examined the impacts of BIMSTEC FTA on its member countries. GTAP model and database were used to evaluate the effects. Simulations results suggest that a complete removal of import tariffs among the member countries generate significant welfare gains for its members. The results also imply that some of the BIMSTEC member countries experience some adverse impact in case of terms of trade, industry output, balance of trade etc. However, the most encouraging fact is the opportunities of employment generation after full implementation of BIMSTEC FTA. Rahman and Kim (2016), also using the GTAP model, showed that the BIMSTEC FTA could promote the growth for the region, and argued that a large part of BIMSTEC's trade remained unrealized and the trade transaction cost was one of the major trading barriers prohibiting the growth of BIMSTEC intra-regional trade.

## **5. Policy Implications and Future Directions**

Bangladesh has been involved with four major PTAs over the decades. Though, South Asia is region of enormous untapped potentials but its performance has not been as per expectations. There are many underlying factors that may have impeded the performance. Both internal and external factors are involved in the slow performance.

Bangladesh should adapt policies to liberalize and facilitate trade that would reap welfare gains through alleviating poverty and inequality. Import policies liberalizing imports through reduction in tariffs and eliminating non-tariff barriers could be adapted. Bangladesh has significantly reduced tariff rates by engaging in different trade blocs such as SAFTA, BIMSTEC and APTA. However, the tariff rates can be reduced further and the negative list can be revised to encourage free flow of trade from partner countries.

Similarly, export-promoting policies should be adapted to make Bangladesh's exports more competitive in foreign markets. Different support measures could be provided to export oriented sectors. Bangladesh adapted similar policies to assist the RMG sector in late 1980s and 1990s including exemption of taxes, credit at concessionary rates, tax-free imports etc. Such supports should be extended to other sectors for export diversification. The RMG sector has been the sole booming exporting sector for over two decades. Concentrating on a single export industry poses higher risks of vulnerability. Diversification within the RMG sector would also lessen the probably risks i.e. increasing the number of RMG items that is produced for exports. Also, diversification of export-oriented industries and establishing backward and forward linkages in the industry reduce vulnerability of single orientation. Agro-processing, leather and ICT sector are some of the potential export industries of Bangladesh and if appropriate export policies are adapted, these sectors could become the leading foreign currency earners.

Though under the APTA, SAFTA and BIMSTEC, tariffs have been reduced substantially, the presence of non-tariff barriers is still hampering free flow of trade. In the SAARC region, a substantial amount of trade takes place through the informal sector due to raised cost of doing business in the formal

sector. The procedural complexities involved in export of products also play a crucial role behind the high cost. Collective effort from all the member countries of the trading blocs is required to address these issues. The road connectivity among the countries and also the infrastructure of the customs at the borders should be strengthened. The border points should be fully equipped to handle all documents and procedures relating to imports and exports. Further, introduction of standardized information, removal of procedural hindrances, testing centers and laboratories close to the border customs will simplify procedures and accelerate trade. Additionally, complex process, bureaucratic inefficiency, frequent changes in policies and corruption needs to be addressed through strict policy. However, many non-tariff measures are legitimate and for the protection of the industry. Sanitary and phytosanitary measures are imposed to protect humans, animals and plants from diseases and contamination. Similarly, counter veiling duties are imposed to protect domestic firms that are at the risk from dumping policy.

Further, harmonization of standards and policies are also vital. This would protect the industries by ensuring low price products are not dumped to damage their local industries and also safeguard the consumer welfare by ensuring uniform quality and standard. Moreover, out of the many unexplored potential sectors for Bangladesh, service sector is on the top-tier. Though, SAARC member states have started discussions regarding tourism and formalizing the informal labor movement but concrete policies are yet to be agreed upon. However, BIMSTEC and APTA have limited or no agreements about the trade in services yet.

Further, the countries need to be connected by land and water. Joint effort for infrastructural cooperation and development is vital to operate steady and uninterrupted trade. Infrastructure development should be aligned with national interest and regional interest. Similarly, economic policies should also be designed to benefit regional interest. However, a major factor behind the slow progress of the trading blocs has been the bilateral tensed political relations. In this regard, Bangladesh should always try to improve political relations with other member states. For example, the unsolved Rohingya illegal migration issue is a hindrance to the good relation between Bangladesh and Myanmar. Finally, in Bangladesh political instability and policy reversals are critical issues. On-going political conflicts affect business operation and business planning hampering foreign investment and trade. Similarly, unstable economic policies and policy reversal hinder the continuance of economic developments.

Despite the fact that tariffs rates in the South Asian countries, especially in India, have been coming down in recent time, intra-regional trade has not been boosted. Non-tariff barriers among the South Asian countries have long been pointed out as one of the major reasons behind the low intra-regional trade in South Asia. It can thus be argued that reduction in the non-tariff barriers among the South Asian countries is likely to have important implications in terms of improved market access of these countries to their neighbouring countries.

Hussain (2009) argued that NTBs, even in the absence of formal tariffs, could be a major constraint to trade liberalisation in South Asia. He iterated that the Group of Eminent Persons report had proposed the elimination of NTBs within seven years of the signing of SAFTA, yet NTBs were quite high in South Asia and the SAFTA Agreement had not adequately addressed this issue. The Agreement merely stipulated that member countries would 'inform' the SAARC Secretariat of all 'non-tariff and para-tariff measures' which would be reviewed by the SAARC Committee of Experts, and recommendations made to reduce such trade restrictions would be taken into consideration. And there was no binding commitment for countries within the terms of SAFTA to eliminate NTBs.

The ADB-FICCI (2010) study also highlighted that though SAARC made steady progress toward liberalising its trade regime through progressively lowering tariff rates over time, the decline in tariffs as a result of regional, bilateral, and unilateral liberalisation shifted the focus to NTBs as

alarming measures of protection and regulatory policy instruments. The study pointed out that as tariff and quantitative restrictions on trade had been progressively reduced, other trade costs arising from regulatory burden, inadequate infrastructure, and generally inefficient customs procedures and logistics of moving goods across borders had become much more significant. The study suggested that inadequate infrastructure and cumbersome regulatory environment would cost trade substantially higher than those from tariff barriers.

Rahman (2010) highlighted that whilst SAFTA has made some headway in moving towards duty-free access for tradable goods, NTB issues have tended to remain relatively less-addressed within the context of the SAARC. He emphasised that if regional cooperation had to be deepened through vertical integration and promoting cross-border supply-chains, NTBs in South Asia would need to be addressed adequately with due importance, as NTBs would pose the next major challenges to strengthening regional economic and trade cooperation in South Asia.

Raihan (2011), in his study on economic corridors in South Asia, showed that there would be significant prospects of the rise in intra-regional trade among the four eastern South Asian countries. The paper argued that the gains from reduction in trade transaction costs would be much bigger than the gains from tariff liberalisation. The study emphasised the importance of removal of such non-tariff trade barriers to generate significant rise in trade among these countries.

De, Raihan and Kathuria (2012), in their study on India and Bangladesh bilateral trade, identified a number of NTBs in both the countries and highlighted that a bilateral Free Trade Agreement between India and Bangladesh would increase their bilateral trade significantly if transaction costs were also reduced through the reduction in NTBs. The study mentioned that presence of non-tariff measures/barriers in both countries would restrict the realisation of much of the bilateral trade development potentials.

Raihan and De (2013) and De, Raihan and Ghani (2013), while analysing India and Pakistan bilateral trade, identified several NTBs restricting the potentials of the rise in bilateral trade between these two countries. These studies suggested that in addition to rationalising import duties, these two countries should eliminate quantitative restrictions, regulatory duties, and other para-tariffs, and several other measures that had been restricting trade in the past. Despite the fall in average tariffs, trade restrictiveness of both India and Pakistan had been heavily triggered by the large volume of NTBs. In promoting trade between India and Pakistan, the major stumbling block had been the presence of such NTBs. Deeper cooperation between India and Pakistan could potentially result in significant reductions of these barriers.

Despite 'pessimistic' scenarios, there are aspirations for greater regional integration in South Asia. Also, countries in South Asia aim for expanding integration with the rest of Asia, especially with the East and Southeast Asian countries. India has bilateral FTA with the ten member states of the Association of Southeast Asian Nations (ASEAN), which came into effect in January 2010. Furthermore, under China's Belt and Road Initiative (BRI), the Bangladesh-China-India-Myanmar economic corridor (BCIMEC) paves the opportunity for greater economic and trade integration between two economic giants in Asia, namely China and India. BCIMEC also provides an opportunity for Bangladesh to exploit huge potential benefits from such economic and trade integration. However, BCIMEC has not yet been launched due to the political tension between India and China.

The most comprehensive regional integration initiative in Asia so far has been the Regional Comprehensive Economic Partnership (RCEP) which is a proposed FTA between the ten member states of the ASEAN and the six states with which ASEAN has existing FTAs (Australia, China, India, Japan, South Korea and New Zealand). RCEP is one of the proposed mega trading blocs of recent

time. RCEP negotiations were formally launched in November 2012 and until now 18 rounds of negotiations have taken place. RCEP represents 45% of the world's population, accounts for about 40% of the world's GDP, and makes up around 30% of world trade. As the sole party from South Asia, RCEP has created significant opportunities for India to integrate with the advanced economies in Asia and the Pacific and to participate further with the global value chains. There are views that RCEP can help reduce the overlaps among Asian FTAs, rationalize rules of origin, and promote FDI flows and technology transfers by multinational corporations. However, being the non-members, RCEP has led to some important implications for the other South Asian countries. There are concerns that the RCEP will lead to the escalation of bars in standards and trade governance which might work as significant non-tariff barriers for the South Asian countries, especially for the LDCs, while exporting to the RCEP countries. Therefore, there is a need for strong efforts to improve the quality of trade infrastructures, capacities, and institutions in these countries.

There are also risks of other South Asian countries with respect to the potential loss of market access from the erosion of trade preferences. Simulations using the global general equilibrium model (the GTAP model) suggest that the RCEP FTA would lead to gains, in terms of the rise in real GDP, for all RCEP member countries including India (Raihan, 2017). In contrast, all other South Asian countries would experience fall in real GDP, and the major affected countries would be Nepal and Bangladesh as these two countries enjoy the largest trade preferences both in India and China. A hypothetical 'extended RCEP' scenario, where all other South Asian countries could join the RCEP FTA, would lead to gains for all South Asian countries, and India's gain would become larger than what would be observed under the RCEP. Therefore, other South Asian countries should negotiate for their participation in the RCEP. The 'extended RCEP' scenario would certainly lead to the meaningful integration of South Asia, East Asia, Southeast Asia and the Pacific.

## **6. Conclusion**

This paper has reviewed the experiences of four PTAs in which Bangladesh is engaged. The paper elaborated on the challenges Bangladesh is experiencing and the possible policies that can be taken to overcome the challenges. Bangladesh has to pursue deeper regional integration agenda with its neighbor and with other Asian countries. There are convincing evidences that deeper regional integration is needed for generating and sustaining economic growth in Bangladesh which can ensure employment creation and contribute to poverty alleviation. Inarguably, deeper regional integration through trade and transport facilitation, along with the presence of efficient regional supply chains, will increase the competitiveness of Bangladesh to better participate in the global market.

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