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Inclusive growth and trade facilitation: Insights from South Asia

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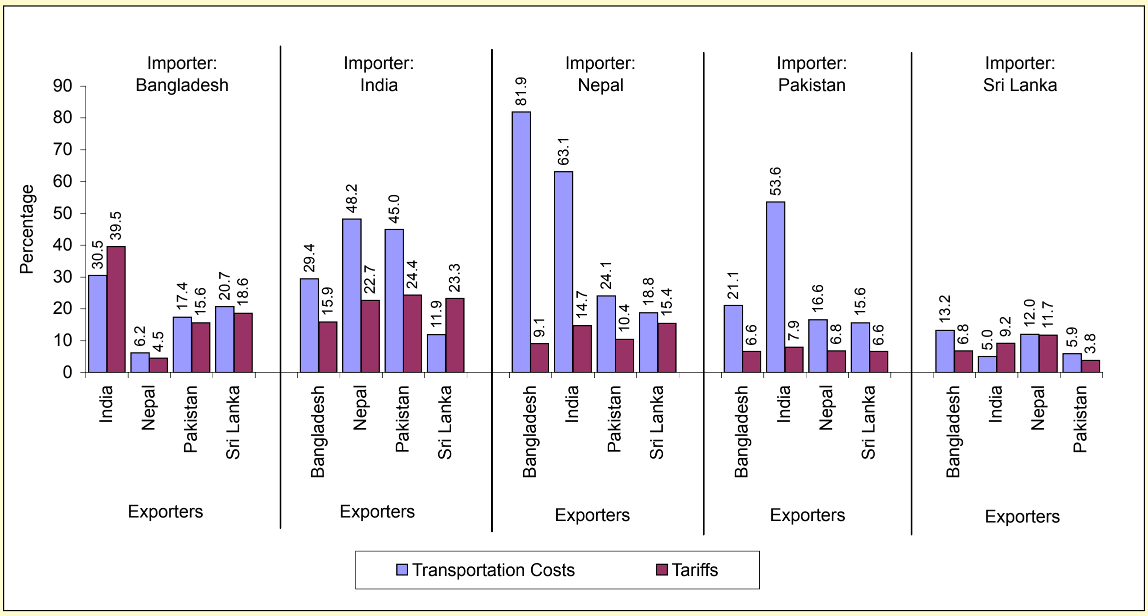
South Asian economies have made substantial gains in output during recent years, with expansion rates that have far exceeded the global averages.[1] This acceleration of growth, in which international trade has played an important role, has helped South Asian economies make impressive strides in human development. However, the region still contains about 47 per cent of the world's poor earning US$ 1 per day[2], of which a majority is living in least developed countries and in border areas of other South Asian countries. Apparently, people in border areas and landlocked countries in South Asia are among those most affected by a lack of adequate access to trade-led globalization. The welfare of South Asia's poor strongly depends on how trade at borders benefits the local economy including landlocked areas, where the concentration of the poor is comparatively high. This policy brief discusses some emerging issues concerning trade facilitation and pro-poor growth in South Asia, many of which are also relevant to other developing Asian subregions.

High transportation costs heavily tax trade in South Asia

The importance of tariffs as barriers to trade has gradually declined in South Asia. However, high tariffs still exist for certain sensitive products, and there is a strong presence of non-tariff barriers (NTBs) including high border transaction costs in South Asia. In particular, high transportation costs act as a serious constraint to enhancing merchandise trade flow in the region. There is strong empirical evidence to support the concept that trade costs components, namely, infrastructure quality, tariffs and transport costs are important to international trade patterns.[3] Indeed, as product differentiation, vertical specialization and international outsourcing have become more prominent in world trade, the relative importance of these costs as a determinant of international trade has increased in Asia (see D. Hummels, 2008).

Figure 1. Estimated ad valorem transportation costs and tariffs in 2005



Notes: (1) Ad valorem transportation costs are represented by total transportation costs (inland and international) as a percentage of import value, taken from P. De, 2009. (2) Weighted average tariff, drawn from WITS (World Bank, 2008)

[1] During 2003-2007, average GDP of South Asia grew by an annual average of 8.3 per cent, compared with a world average of 4.6 per cent (calculated based on World Economic Outlook Database 2008, International Monetary Fund, Washington, D.C.)
[2] Refer, Table 2.1 of Human Development in South Asia 2007: A Ten-year Review (Human Development Centre, 2008)
[3] See, for example, P. De, 2007, and D. Brooks and D. Hummels, 2009.

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South Asia provides a classic example of an area where transportation costs seemingly outweigh tariff incidence. Figure 1 shows that the estimated ad valorem transportation costs at bilateral levels in 2005 exceeded the applied customs tariffs for most of the South Asian countries, except in three cases: (a) imports by Bangladesh from India; (b) imports by India from Sri Lanka; and (c) imports by Sri Lanka from India. In addition, Figure 1 shows that South Asian countries are paying more towards trade transportation costs – compared with customs tariffs – where the costs of trade transportation increase when the country is landlocked (e.g., Nepal). The variability of transportation costs in South Asia pivots around the performance of the region's inland and international transportation infrastructure and services, particularly at borders.

Crossing borders is a costly affair in South Asia

A large portion of South Asia's merchandise trade is carried overland through land borders such as those between India and its neighbouring countries. However, there is no direct cross-border road or rail transportation in South Asia. For example, between India and Bangladesh, and between Pakistan and India, direct movement of goods and vehicles is not allowed. At the Bangladesh-India and Pakistan-India borders, goods are required to be transhipped as direct through-road transport movement across the border is prohibited.

Cross-country land border movements among South Asian countries continue to be unsatisfactory due to various impediments. A series of empirical findings show that some land borders in South Asia are overcrowded and need special attention to reducing time delays and costs of transaction.[4] For example, the border delay in terms of time for India's exports to Bangladesh (Petrapole India, and Benapole, Bangladesh) was not reduced between 1998 and 2005. On the one hand, delays in terms of time at the border increased from 2.5 days in 1998 to 3.92 days in 2005. On the other hand, the costs of transaction at the border also increased from 10.38 per cent in 2002 to 16.80 per cent in 2005.[5]

Procedural complexities very often work as deterrents to India-Bangladesh trade.[6] The customs offices in eastern South Asia still require excessive documentation, especially for imports, which must be submitted in printed copy form. According to De and Ghosh (2008), Indian exporters to Bangladesh have to obtain up to 330 signatures on 17 documents at several stages. While most of these documents are standard for international trade, the two Governments have added many others of a purely local nature. As problems are systematically "solved" by adding new procedures and regulations to existing ones – rather than rethinking the entire trade control system – pilferage continues to rise. This often not only changes the composition and direction of trade in South Asia, but also attracts a considerable number of unemployed people due to the opportunities for earning large amounts through informal channels, which later becomes their full-time formal employment.

Similar situations – albeit less dramatic – exist at most other land borders in South Asia.[7] All this leads to a rise in transaction costs and to rent-seeking informal economies in South Asia. Ultimately, the welfare loss on account of trade transaction costs and time delays is considerable and possibly wipes out the benefits of trade liberalization in the region.

In a recent ARTNeT study, P. De, A. R. Khan and S. Chaturvedi (2008) showed that a 10 per cent fall in transaction costs at the border had the effect of increasing a country's exports by 3 per cent.[8] The study indicated that e-filing of customs formalities had helped trade to grow in eastern South Asia. The same study also showed that current transit arrangements had not played a significant role in enhancing regional trade flow, primarily in the context of eastern South Asia. Unlike the European Union, South Asia does not have a regional transit arrangement, although limited bilateral transit arrangements exist for landlocked countries such as Afghanistan, Bhutan and Nepal.[9] Therefore, the cost of transportation and time delays at borders in South Asia are greatly penalizing trade in the same way as do high tariffs.

Regional transit is a key challenge to South Asian countries

Transit is an intrinsic element of any cross-border movement of goods and vehicles and is one of the central challenges facing the South Asian countries. Afghanistan, Bhutan and Nepal are the landlocked countries of South Asia and depend solely on transit through neighbouring countries. The United Nations Conference on Trade and Development (UNCTAD) has pointed out that those countries dependent on transit trade, notably the landlocked countries and areas, are confronted with a variety of practical constraints that increase the transportation costs of their international trade.[10] It has been estimated that landlocked developing countries have to bear, on average, 50 per cent higher international transport costs than their neighbouring transit/coastal countries (UNCTAD, 2004). Landlocked developing countries are among the poorest developing countries, have limited capacities and depend on a very limited number of commodities for their export earnings.

Trade in South Asia is now conducted on a most favoured nation basis between all countries except between India and Pakistan, and the South Asian Free

4 See, for example, P. De, 2008 and 2009.
5 See P. De and B. Ghosh, 2008.
6 This particular subject has been dealt by several authors in the literature on WTO trade facilitation. See, for example, S. Chaturvedi, 2006.
7 See, for example, N. Taneja, 2007.
8 In other words, the higher the transaction costs between each pair of partners in eastern South Asia, the less they trade.
9 For example, Afghanistan has bilateral transit arrangements with Pakistan, as do Maldives and Sri Lanka. India and Bangladesh do not have a transit arrangement even though they share a common border. India also has bilateral transit arrangements with Bhutan and Nepal, two landlocked countries with which India shares an international border. See P. De, A. R. Khan and S. Chaturvedi, 2008, for further details.
10 See, for example, UNCTAD, 2004. ESCAP (2008) also noted that while relaxing regulations and tariffs was one way of helping least developed, landlocked countries to achieve prosperity, the physical distance from seaports remained a major obstacle. Constructing roads, railways and other types of transport infrastructure is therefore required in order to help such countries find new markets for their goods.

Trade Agreement (SAFTA) is steering the region towards free trade.[11] At the same time, most of the South Asian countries have yet to ratify international conventions on cross-border movements of goods and vehicles and the goods carried by road and rail in South Asia are largely subject to transhipment at the borders.[12] South Asia has yet to reach an agreement on a regional transport and transit arrangement for the cross-border movement of goods and vehicles.[13] While most countries in the region have entered into bilateral agreements of mutual understanding on transit, such agreements do not exist between either India and Bangladesh, India and Pakistan, or Bhutan and Nepal. Surprisingly, transit agreements are absent where the trade volume is comparatively high.

As the South Asian countries tackle the challenge of transit, the standardization and enforcement of laws and regulations related to transportation, maintenance of transit corridors, and security need to be taken into consideration. Indeed, secure trade is as important as free trade. The promise of transit will be realized only if it generates economic and social benefits not only for landlocked countries and least developed countries but also in border areas within South Asia.

Border areas contain a higher concentration of poor in South Asia

In South Asia, transportation costs and transit are not, however, the only problem faced by border areas and landlocked countries. Their lack of direct access to seaports and markets entails additional expense because the costs of transporting goods through a transit country result in less than competitive international trade.

Growth in South Asia has, so far, been centred around the core of a country (or economic bloc). The States (or provinces) at the outer periphery tend to be poorer than those at its centre.[14] Contrary to popular belief, despite unprecedented economic growth in South Asia, the total number of people living in poverty – particularly rural poverty – has not declined, and there has been a rise in income inequality, particularly within countries.[15] On average, the ratio of income of the richest 20 per cent to the poorest 20 per cent increased from 4.3 per cent during 1990-1996 to 5.5 per cent in 2000-2005 (Human Development Centre, 2008). This rise in income inequality is a serious concern for South Asia.

Although there is no empirical evidence so far to show that the border areas are adversely affected by trade in South Asia, it can be said that costlier trade at borders is negatively affecting the local economy in the border and landlocked areas, converting it into a rent-seeking informal economy. Table 1 provides average per capita incomes and poverty rates (rural) of the border provinces/states of selected South Asian economies. It is clear that a vast majority of the South Asian population living in border and landlocked areas are comparatively poor and mostly depend on agriculture. The poverty incidence is very acute in eastern South Asia, particularly in landlocked Nepal, Bangladesh and India's north-eastern region.

Table 1. Income per capita and poverty rate in bordering States in South Asia

Country	Bordering states	Bordering with	Income per capita (US$), 2006 (avg.)	Rural poverty rate (%), 2004-05 (avg.)	Country HDI 2005
India	North-eastern states (7), West Bengal	Bangladesh	690 (860)	34 (22)	0.619
	Western and North-western states (4)	Pakistan	800* (860)	32 (22)	
Bangladesh	All states** (4)	India	450	53	0.547
Pakistan	Eastern provinces (2)	India	890 (800)	36 (32)	0.551
Nepal	Southern and eastern states (5)	India	300 (320)	48 (46)	0.534

Sources: National Sample Survey Organisation and Economic Survey 2007-2008, for India; World Development Indicators, CD-ROM 2008; World Bank and Bangladesh Economic Review, 2007-2008, for Bangladesh; Pakistan Economic Survey, 2007-2008, for Pakistan; Economic Survey, 2007-2008, for Nepal; and country HDI taken from Human Development in South Asia 2007: A Ten-year Review (Human Development Centre, 2008).
* Excluding Punjab State of India. Numbers in first parentheses are national averages. **States in Bangladesh officially termed Divisions.

[11] In South Asia, all countries except Bhutan are members of the World Trade Organisation.
[12] There are seven United Nations Conventions that set out a basic framework for the cross-border movements of goods and vehicles (see ESCAP, 2007).
[13] However, in recent years, there have been some important developments in regional transportation in South Asia. As per the directives of the fourteenth SAARC Summit held in New Delhi in April 2007, the Ministers of Transport of SAARC countries for the first time met in New Delhi on 31 August 2007. Taking note of the recommendations of the SAARC Regional Multimodal Transport Study, the SAARC Transport Ministers began negotiating a Regional Transport and Transit Agreement as well as a Regional Motor Vehicles Agreement in 2008.
[14] A strong literature exists on this issue (see, for example, R. Capello, 2007).
[15] See, for example, Human Development Centre, 2008.

Therefore, people living in border areas and landlocked countries are largely left untouched in relative term by the globalization process in South Asia. The exact causes of the slow growth remain unknown and are a matter for detailed analysis. However, informal economy at border areas arising from rising transportation costs and border delays are certainly disincentives to trade-led industrialization, thereby widening the income gap between the benefiting regions and the deprived border areas. Facilitating intraregional trade and economic integration would provide an opportunity for many of these people and provinces (states) to benefit as they would be closer to the centre of the economy (rather than remaining at the outer periphery of their own national economy). In the short term, greater developmental efforts have to be focused on the border areas, in order to deepen national integration and also attune their production structure to international demands.

Concluding remarks

Reducing trade costs and facilitating transit is two of the key approaches to achieving a more inclusive growth through trade, i.e., one that will reduce the gap between the economic core and the outer periphery of each of the South Asian economies. Doing so will encourage economic activity at and across borders, eventually generating employment through industrialization as well as benefiting the poor of the border areas and landlocked countries. However, governments will also need to provide adequate education and capacity-building opportunities for the people living in such areas so that they can effectively engage in trade.

The rise of trade as a share of national output is inexorable in the era of globalization. Attempting to resist this process by keeping the cross-border trade costly and congested will merely escalate poverty and strengthen inefficient rent-seeking informal economies in border areas and landlocked countries. The ongoing global economic slowdown and its adverse effect on trade may escalate poverty and lead to the further rise of informal economies in the border areas and landlocked countries. Therefore, South Asian countries need to make coordinated efforts to integrate the border areas and landlocked economies with the export-led growth process in order to effectively tackle the downside risks of globalization.

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