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BANGLADESH AND FREE TRADE AREA: REGIONAL AND BILATERAL ROUTES

Abstract

To achieve the benefits of globalisation, Bangladesh is engaging in bilateral and regional trading arrangements simultaneously. Two regional trading arrangements, SAFTA and BIMSTEC-FTA have already been finalised. At the same time, Bangladesh is considering three bilateral trading arrangements with India, Pakistan and Sri Lanka respectively. Now a number of pertinent questions are: What difference will it make for Bangladesh to sign bilateral FTA alongside regional FTA? Can bilateral FTA be a substitute for regional one? Which one will be beneficial for Bangladesh – bilateral trading arrangement, regional trading arrangement or some combination of bilateral or regional trading arrangement? Using the Global Trade Analysis Project (GTAP) model and data, the paper shows that welfare benefits of regional arrangements could be higher than bilateral arrangements. However, in regional arrangements, sometimes big economies may not offer handsome concession due to distinct interest with an individual country, and they offer large concessions in bilateral arrangements. In this respect a combination of bilateral and regional trading arrangements may be the viable policy options for Bangladesh.

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1. Introduction

Bangladesh has been liberalising trade regime gradually with the aim of integrating into the global economy and getting the benefits of globalisation. In recent years, one of the important elements in Bangladesh's trade policy is to promote trade in the South Asian region. Trade creation, poverty reduction and export led economic growth are the main objectives behind this policy. Keeping this view in mind, Bangladesh is striking some regional free trade deals with its neighbouring countries, namely, South Asian Free Trade Area (SAFTA) and Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) Free Trade Area. Other proposals have been raised, mainly from the business community, to initiate bilateral free trade arrangement with India, Pakistan and Sri Lanka.

The member countries of South Asian Association for Regional Cooperation (SAARC) signed the SAFTA agreement on January 06, 2004 in Islamabad and the agreement came in to effect from January 01, 2006 with a special grace period for the Least Developed Countries (LDCs) within the group. The agreement is expected to come into force on July 01, 2006¹. The meeting of the 'committee of experts' on SAFTA has been going on in order to resolve the issues of sensitive list, rules of origin, revenue compensation mechanism, non-tariff and para-tariff barriers etc. At the same time, Bangladesh has started negotiation on the issues for BIMSTEC-FTA and also some other bilateral trading arrangements with its neighbours. According to the official sources the initial round talks on free trade agreement between Bangladesh and India will take place in Bangladesh shortly. Contacts with Pakistan and Sri Lanka are also on for suitable dates to launch similar FTA negotiations with them.

¹ *The DAWN*, Online edition of National Newspaper in Pakistan, November 29, 2005.

The recent initiatives of Bangladesh to enter in to the various free trade arrangements have raised some debate regarding the impact and relevance of those arrangements. Though signing of the SAFTA agreement is a landmark in the evolution of the SAARC, the commodity-by-commodity negotiations under SAFTA proved highly labourious and time-consuming. On the other hand, when the Cancun Ministerial collapsed, the stakeholders are more interested to engage in bilateral free trade arrangement rather than regional. For Bangladesh a number of pertinent questions may be raised: What difference will it make for Bangladesh to sign bilateral FTA alongside regional FTA? Can bilateral FTA be substitute for regional one? Which one will be beneficial for Bangladesh – bilateral trading arrangement, regional trading arrangement or some combination of bilateral or regional trading arrangement? The main objective of this paper is to address these questions and suggest a road map for Bangladesh, i.e., how Bangladesh should go ahead to be involved in a free trade arrangements. The paper will also make a comparison between bilateral and regional trading arrangements in the context of Bangladesh.

The paper is organised as follows. Following the introduction, Section 2 provides the mechanism of bilateral and regional FTA and their complementarities. Section 3 provides the consistency of regional FTA under the existing World Trade Organization (WTO) discipline. Section 4 discusses the criteria for a successful Free Trade Area. Section 5 gives a brief picture regarding the progress of bilateral and regional approach to FTA. Section 6 provides the implication of bilateral and regional approach to FTA for Bangladesh while Section 7 draws the conclusion.

2. Bilateral and Regional FTA: Mechanism and their complementarities

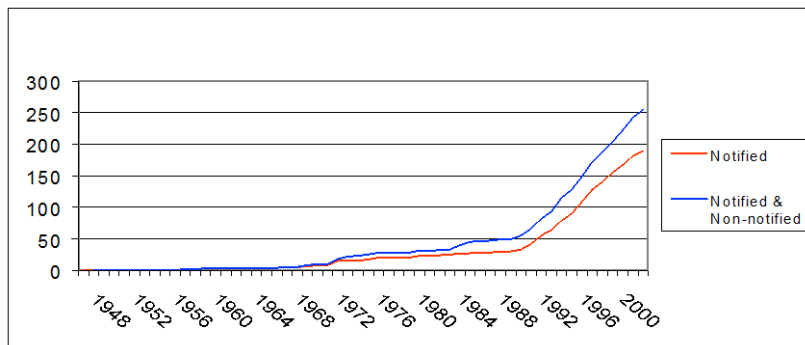
Recently, Bangladesh has been engaged in various bilateral and regional free trade arrangements in South Asian region and the negotiation is going on with the member countries. The private sector expert group urged the government to pursue bilateral FTA talks side by side with talks in regional levels. On the other hand, a section of the experts and civil society is opposed to FTA with India, Pakistan, Sri Lanka and other SAARC nations on bilateral basis arguing that such deals will overlap each other as proposed SAFTA and BIMSTEC-FTA cover preferential trade issues with those countries². With these concerns, two issues have been discussed in this section – i) is there any essential difference between bilateral and regional FTA mechanism? and ii) whether a regional approach to trade policy is necessarily in conflict with a bilateral approach.

Regarding the first issue, the instruments of a free trade talks does not differ substantially in case of bilateral and regional framework. Generally they include Trade Liberalisation Programme, Rules of Origin, Institutional Arrangements, Dispute Settlement Procedures, Trade Remedies, Special and Differential Treatments and any other instrument that may be agreed upon. Under the Trade Liberalisation Programme the components are Tariff, Para-Tariff, Non-Tariff Measures and Direct Trade Measures. So, there is no instrumental difference between bilateral and regional FTA mechanism. But the procedure to get a final accord varies between bilateral and regional FTA mechanism. In case of regional FTA negotiation interests of all the member countries are considered to get the accord while in the absence of any third countries bilateral FTA mechanism only concentrate the optimal interest of those two countries. Bilateral trade agreements differ considerably in scope,

² *The Daily Star*, Dhaka October 04, 2004.

varying from the exchange of preferences on a limited range of products between two, to include various trade-related provisions going beyond traditional tariff reduction or elimination. The new generation of bilateral arrangements tend to go far beyond traditional tariff-cutting exercises and often include rules on investment, competition, environment and labour which are beyond the scope of existing regional rules.

Chart 1 - RTAs notified to the GATT/WTO (1948-2003)



Source: WTO (2003)

Regarding the second issue, there are some debates about the extent to which bilateral agreements are complementary to regional agreements, or are a risk or a distraction to regionalism. In any case, the number of bilateral agreements is growing. Most of the world's major trading nations are already party to such agreements, and are actively engaged in negotiating further agreements. Whether a complement or a distraction to regionalism, virtually all trading nations appear to be pursuing bilateral and regional agenda at the same time. By the end of 2003, nearly 290 RTAs had been notified to GATT and subsequently to the WTO. Of these, more than 190 are estimated to be in force and another 60 or so are estimated to be

operational but not yet notified.³ The most common category is the free trade agreement (FTA) which accounts for 70 percent of all RTAs. Partial scope agreements and customs union agreements account for 23 and 7 percent, respectively. Among the type of arrangements bilateral agreements dominate in number. According to the WTO estimates, the three-fourths of world trade is currently conducted under bilateral or plurilateral agreements. So from these premises, bilateral arrangements are not complementary to regional one. Many bilateral arrangements are being negotiated or explored among major economic players in the region. These types of dual engagements are also permissible under the existing WTO framework.

Another thing should be mentioned here that free trade does not mean the free movement of all commodities within the member countries. Generally commodities are divided into two categories in any FTA, namely, sensitive list and free list. The commodities under the sensitive list do not get the benefits of tariff concession in the importing countries while the commodities of free list get the benefits of duty free access. Sometimes the time limit varies from commodity to commodity and country to country to get the duty free access. In these circumstances, one country can pursue bilateral and regional trade negotiation with the same countries if she thinks she will be able to achieve some extra benefits regarding the sensitive list and special and differential treatment. Since Bangladesh is an LDC, it is easier for her to achieve some extra benefits through regional negotiation but it may not be possible through bilateral negotiation. Similarly, in bilateral negotiation, some extra facilities can be achievable which is not possible in regional negotiation. Because in case of RTAs, one country will be bound to give the same facilities to all the countries of a certain group if she grants any

³ Chandrasekhar and Ghosh (2004)

facility to any particular country of that group. From this point of view, although there is no essential difference between the mechanism of bilateral and regional approach of FTA, country may be benefited through simultaneous negotiations of bilateral and regional framework with the same country or the group of country.

3. Consistency of Regional FTAs under the Existing WTO Disciplines

There are some questions regarding the legal entity of FTAs under the existing WTO disciplines. The creation of FTAs may be attributed to difficulty in the multilateral negotiations conducted at the WTO. FTAs, being an agreement to eliminate trade barriers among member countries only, have a discriminatory aspect against non-member countries. The General Agreement on Tariffs and Trade (GATT) prohibited discrimination and required each member country to give most favoured nation (MFN) treatment to the other member countries. Therefore, FTAs violate at least the spirit of GATT. However, under some specific situation the WTO member countries are permitted to formulate such arrangements. The three sets of rules are:

- i. Article XXIV of GATT, which provide for derogation from the MFN clause and offer the provision for the formation and operation of customs unions and FTAs;
- ii. The enabling clause of GATT which provides the opportunity to the preferential trade arrangements among the developing country members; and
- iii. Article V of GATS which governs the conclusion of FTAs in the area of trade in services.

Bilateral and Regional FTAs among South Asian countries could be set up under these rules. To examine these regional groups and assess their consistency with WTO rules a Committee on Regional Trade Agreements (CRTA) has been created by the WTO general

council⁴. The effect of FTAs on regional trading system and their relationship with regional arrangements are also examined by CRTA.

4. Criteria for a Successful Free Trade Area

Theoretically, success of a free trade area depends on fulfilment of some criteria. If those criteria have been fulfilled then the probability is higher for an economically viable FTA. In trade related theories and literatures, the economists agreed to set up some common necessary conditions. Bandara and Yu (2003) and Krueger *et al* (2004) have described the following conditions for the successful completion of an FTA.

4.1 Geographical Proximity: Geographical proximity had always been a key issue for trade between two countries. Around the world one of the major determinants of bilateral trade is transport cost. Evidently, for reduced transport and communication cost neighbouring countries could get advantage while countries far away are disadvantaged. Regional trading arrangements should be undertaken on the basis that it is natural for neighbours to indulge in trade with each other. Goods from neighbouring countries may also be more compatible with local factors of production than those from farther away. While regional trading arrangements follow this pattern, bilateral trading arrangements may take place between distant partners. Although these FTAs do not benefits from transport cost savings, they benefit on other counts, as they would have traded in any case.

4.2 High Pre-FTA Tariff Rates: High pre-FTA tariff rates increase the probability that trade will be created among members, rather than diverted from non-members to members.

⁴Visit World Trade Organization (WTO) website for detail.

4.3 High Degree of Bilateral Trade: High degree of bilateral trade is an encouraging sign for establishing an FTA. Benefits from FTA would be higher among the countries having high degree of bilateral trade while trade agreement with little prior trade would be unsuccessful.

4.4 Presence of Trade Complementarities: Free Trade Areas are likely to succeed in strengthening bilateral trade if the trade structures of member countries exhibit strong complementarities. When the commodities of one country have a considerable demand to other country the potential benefits of trade are higher. If the commodities of an FTA member countries are same in nature, member countries would not be able to touch the envisaged levels of trade due to low level of trade complementarities.

4.5 Differences in the Pattern of Comparative Advantage: Countries having different competitiveness among different commodity groups would be able to create a successful free trade area. Prospects of trade expansion are likely to be weak for countries that have comparative advantage in similar products.

4.6 Little Political Tensions: Political tensions have also undermined efforts to foster trading arrangements. Political conflicts hamper the negotiation and implementation of any trading arrangement. Absence of or little political tensions create a friendly environment among the member countries to reach the final decision smoothly.

Now the question is whether Bangladesh's engagement with its neighbouring countries to form a free trade area meets the above preconditions or not? The criteria of geographical proximity are present in SAFTA and BIMSTEC member countries. With all these countries, Bangladesh enjoys relatively low transport cost compared to other trading partners. Despite the recent effort to liberalise trade, the member countries of SAFTA and BIMSTEC have long been maintaining high tariff rates. Bandara and Yu (2003) show that

average regional tariff rate in South Asia is higher than other trading blocks. The third criteria high degree of bilateral trade with the member countries is totally absent in SAFTA and BIMSTEC block. Table 1 and Table 2 show the share of bilateral and regional export and import as a percentage of world exports and imports. The export share of Bangladesh with SAFTA and BIMSTEC members is 1.75 and 1.26 percent respectively while individually with all the member countries it is less than 1 percent of world export. In case of import Bangladesh is a big trading partner for India. Bangladesh's import share with India is about 16 percent while with other countries it is less than 1 percent. Bilateral trade of other countries in these sub-regions is not significantly high. The other two criteria trade complementarities and differences in the pattern of comparative advantage have been analysed by Kemal (2004). The paper shows that strong trade complementarities are absent in all South Asian countries with other member countries. This paper also argues that SAFTA member countries have an almost identical pattern of comparative advantage in some products. The last criterion, little political tension, is not present in South Asia. Political tension between two large member countries in SAFTA, India and Pakistan is always a problem for creating cooperation. The relationship between Bangladesh and India is also not so satisfactory.

So it is clear that member countries of SAFTA and BIMSTEC do not meet all the preconditions which are required to create a successful free trade area in this region. But it is not mandatory to satisfy all the criteria in all the cases. Because after formation of an FTA the demand of products will change and the member countries may be able to diversify its products. Same situation may be occurred in case of comparative advantage, with increased demand situation and large scale of production countries will obtained difference in comparative advantage.

5. Progress with Regard to Regional and Bilateral Approaches to FTA

5.1 Progress in Regional Approach to FTA

At Male Summit in 1997, the regional approach of Free Trade Area in South Asian region was first initiated by the member countries of SAARC. At that time the member countries intended to establish the SAFTA by 2001. But due to the political instability among the member countries, the enforcement of SAFTA within its scheduled time was delayed. However, at the Colombo Summit in 1998, a 'committee of experts' was set up to draft a comprehensive treaty regime for creating a free trade area in South Asian region. The 'committee of experts' prepared the framework of the proposed SAFTA and the member countries agreed in principle to it. In 2004 at the 12th Summit of the regional forum in Islamabad, the SAARC foreign ministers signed the framework agreement to establish SAFTA for better economic cooperation among the South Asian nations. According to the agreement on SAFTA, the member countries agreed to the following schedule of tariff reduction (Table 3)

In the first phase, India, Pakistan and Sri Lanka (developing countries) will reduce tariff to 20 percent and Bangladesh, Bhutan, Maldives and Nepal (least developed countries) will reduce to 30 percent if the actual tariff rates are higher than this limit. If the actual tariff rates are below this limit, there will be an annual reduction on a Margin of Preference basis of 10 percent for developing countries and 5 percent for least developed countries on actual tariff rates for each of the two years. In the second phase, the subsequent tariff reduction by member countries from 20 percent or below to 0-5 percent will be done within second timeframe of 5 years by India and Pakistan within 6 years by Sri Lanka and within 8 years by Bangladesh, Bhutan, Nepal and Maldives. The member states are

encouraged to adopt reductions in equal annual instalments, but not less than 15 percent annually.

Table 3: Schedule of Tariff Reduction under SAFTA

Countries	Existing Tariff Rates	Tariff Rates Under SAFTA Agreement	Time Schedule
SAFTA First Phase			
India, Pakistan and Sri Lanka	More than 20%	Reduce to 20%	2 Years
	Less than 20%	Annual reduction of 10%	2 Years
Bangladesh, Bhutan, Maldives and Nepal	More than 30%	Reduce to 30%	2 Years
	Less than 30%	Annual reduction of 5%	2 Years
SAFTA Second Phase			
India and Pakistan	20% or below	0-5%	5 Years
Sri Lanka	20% of below	0-5%	6 Years
Bangladesh, Bhutan, Maldives and Nepal	30% of below	0-5%	8 Years

Source: SAFTA Agreement

The other important issues such as rules of origin and the commodities under sensitive list and revenue compensation mechanism have been discussed and finalised in the meeting of the ‘committee of experts’. In this meeting, all the seven member countries reached a consensus on having a common rule of origin. Regarding the sensitive list, all the member countries agreed to make their respective sensitive lists of products smaller. It is expected that the negotiation would be concluded by June 2006 so that the member countries can reduce tariff under the SAFTA treaty from July 2006.

In terms of new potentials for increasing trade and investment year 2004 was very encouraging for the South Asian countries.

Within a span of one month time two free trade agreements were signed in 2004. The first one is SAFTA and second one is BIMSTEC-FTA. Both the agreements are expected to come into force in July 2006. The BIMSTEC framework agreement is not merely for trade in goods, but it includes services, investment and other issues of economic importance as well. According to the agreement of BIMSTEC-FTA the member countries have agreed to the following schedule of tariff reduction.

Table 4: Schedule of Tariff Reduction under BIMSTEC-FTA

Countries	Fast Track Commodities	Normal Track Commodities
India, Sri Lanka and Thailand	0 tariff by 2009	0 tariff by 2012
Myanmar, Bangladesh, Bhutan and Nepal	0 tariff by 2011	0 tariff by 2017

Source: PROACT (2004)

For the purpose of trade in goods, the BIMSTEC-FTA treaty has stipulated tariff reduction to zero percent by 2017 under two different tracks – fast track and normal track (Table 2). However, the timeframes for tariff elimination under fast track and normal track differ, and so does that for developing and least developed members. The three developing members – India, Sri Lanka and Thailand – will reduce tariffs to zero percent on each others’ goods and services by July 2012. The three least developed members – Myanmar, Bangladesh, Bhutan and Nepal – will have another five-year grace period to tear down tariff walls. Tariffs would begin to be reduced in mid-2006 with products designated for ‘fast-track’ treatment to be traded on a zero-tariff basis by mid-2009 for the three developed members and by mid-2011 by the other countries. The last reduction under the normal track would be done before 2017.

5.2 Progress in Bilateral Approach

Bilateral approach to FTA in the South Asian region is not a new concept. India has already signed bilateral FTAs with Sri Lanka and Nepal. India-Sri Lanka Free Trade Arrangement (ILFTA) was signed on December 1998. The Sri Lankan experience with India over the FTA is very encouraging. India-Sri Lanka FTA has brought down the trade deficit of Sri Lanka with India from 8.6:1 to 4.9:1 in just two years⁵. Under India-Sri Lanka FTA, India has granted duty free access for 1351 items by 6-digit Harmonised Code immediately on implementation of the Agreement. For Textile 25 percent reduction of tariff for 528 items has been granted. For the rest, except 429 items included in the sensitive list, across the board duty free access would be given in 2 stages within 3 years from the date of implementation of the Agreement⁶. There is a tariff rate quota on tea for 15 million kgs. and on garments for 8 million pieces. Among the 8 million pieces of garments a minimum of 6 million pieces should contain Indian fabrics. No category of garments could exceed 1.5 million pieces per annum. The items in the sensitive list of 429 tariff lines at 6 digit level of Harmonised Code are from various sectors like rubber and rubber products, paper and paper boards, plastics and products thereof, coconuts, alcoholic beverages and textile items, etc. From Sri Lankan duty free access for 319 items by 6-digit Harmonised Code has been granted on the date of operationalisation of the Agreement. In addition, it has given 50 percent tariff concessions on 839 items on the date of operationalisation of the Agreement which has been deepened to 100 percent as on today. For the remaining 2724 items, Sri Lanka would reduce tariffs to zero percent over a period of 8 years in three phases. Sri Lanka's sensitive

⁵ *The Hindu*, Online Edition of National Newspaper in India, January 05, 2004.

⁶ Department of Commerce, Ministry of Commerce and Industry, Government of India.

list comprises of 1180 items. The rules of origin have been specified by three criteria – (i) the local value addition should be 35 percent. In case of cumulative rules of origin local value addition should be 25 percent; (ii) non originating materials to undergo substantial transformation at 4 digit HS level and (iii) a list of operations like simple packing, cutting and assembly etc. have been defined which would not qualify for duty free market access.

On the other hands, India-Nepal Trade Treaty was signed in 1996 which offers far more liberal terms to Nepal than does the India-Sri Lanka FTA. Under the Treaty India provides, on a non-reciprocal basis, duty free access, without quantitative restriction, to the Indian market for all Nepalese-manufactured articles with the exception of a short sensitive list. Such imports from Nepal are facilitated through a simple procedure of Certificate of Origin. The absence of provisions relating to origin-rules under the India-Nepal FTA raised concerns about imports from Nepal into India, thereby having adverse implications for some Indian domestic sectors. The problem was finally tackled by setting these rules in place during subsequent negotiations. A low value addition criterion has been agreed to by India of a local value addition requirement of only 25 percent for the first year and 30 percent thereafter.

Bangladesh is considering three bilateral Free Trade Arrangements with India, Pakistan and Sri Lanka respectively. The Free Trade talks are going on among the respective officials of these countries. A round of talk on the proposed Free Trade Agreement with India was held on October 2003 at the Joint Secretary level. In that meeting the two countries have agreed to remove tariff and non-tariff barriers to strengthen trade between them. India declined to grant LDC status to Bangladesh and agreed to grant certain trade facilities without granting it concessions as LDC. It, however, agreed to grant special facilities like waiving the necessity for Bangladesh cement exporters to obtain a Bureau of Indian Standards (BIS)

certification if they already had one from Bangladesh Standards and Testing Institute (BSTI). India and Bangladesh have already exchanged a list of para tariff and non-tariff barriers with a view to removing impediments on securing easy access of their exports to other. As per standard practice, the trading partners of a bilateral FTA either maintain a list of goods favourable to each other or follow a sensitive list restricting the export and import of these products. Bangladesh has prepared a 968-item list of goods that will not be traded under a Bangladesh-India Free Trade Agreement (FTA). The list contains seven categories of products, which are agriculture, textile, plastic products, pharmaceuticals, steel and iron, vehicles and electronics. Recently on March 21, 2006 Bangladesh's Finance Minister and Indian Commerce Minister signed the trade agreement between India and Bangladesh⁷ where both the countries formally agreed to start negotiations to form a bilateral FTA between them.

Bangladesh was offered a proposal to enter into a free trade agreement with Pakistan during the visit of Pakistani Commerce Minister in 2002. After that the Free Trade talks were held on November 2003 at Dhaka at Joint Secretary level. Bangladesh raised the issue of special and differential treatment of the Bangladeshi goods on the ground of being a least developed nation. Bangladesh proposed free access to Pakistani products after 12 years of signing the FTA, while it wanted Pakistan to open its market one year after the deal. But Pakistan did not agree on this. The major points in the negotiations related to relaxed rules of origin, reduction of direct tariffs, elimination of non-tariff barriers, longer phase-out period of tariff withdrawal and anti-dumping and countervailing measures. Bangladesh persisted with its sensitive list approach in the

⁷ *The Financial Express*, National Daily Newspaper in Bangladesh, March 22, 2006.

negotiations for the pact in a bid to avert a possible adverse impact on its local industries. This approach meant allowing duty-free movement of all products between the two countries save the items incorporated in the list. Pakistan has agreed to give Bangladesh special and differential treatment under the bilateral trade deal and both countries will have sensitive lists. In view of its status as a least developed country, Bangladesh will enjoy a longer phase-out period and have a longer sensitive list of products than Pakistan. Besides, there will be two separate lists under which one category of products will enjoy immediate tariff concession and another category will see tariffs withdrawn in phases. Recently on February 2006 both Bangladesh and Pakistani Prime Ministers agreed to finalise the bilateral free trade arrangement within the shortest possible time. A Pakistani delegation led by its Commerce Minister visited Bangladesh to make a successful FTA deal.

Bangladesh and Sri Lanka also agreed in principle to strike a comprehensive deal as their first round of talks on Free trade agreement (FTA) held on November 2003 in Dhaka. In this meeting both sides had agreed to go for a comprehensive agreement. They signed agreed minutes expressing their intent to sign the FTA and listing the issues with regard to format of the talks and other matters that they agreed during the meeting. Bangladesh and Sri Lanka both agreed to accommodate each other's sensitive list of products to give protection to some of their domestic industries. The talks basically dealt with the framework of the forthcoming agreement and basic issues that needed detailed discussions in the next meetings.

So, bilateral trading arrangements already exist between India and some other South Asian countries. The contracting countries are getting benefits from such arrangements. Now India is becoming more active in seeking out bilateral trade agreements within and outside the region. To enhance trade in South Asian region

Bangladesh is also getting involved in bilateral trading arrangements with its neighbours.

6. Implications of Bilateral and Regional Approach to FTA for Bangladesh

In this paper, Global Trade Analysis Project (GTAP) model and data have been used to find out the implications of bilateral and regional approach to FTA for Bangladesh. GTAP is a multi-regional Applied General Equilibrium (AGE) model, which captures the global economic activity⁸. This is a linearised comparative static model which provides a standard modeling framework and a common database for AGE analysis which gives researchers the opportunity to focus on policy implementation problems. The researchers and policy makers of different organisations frequently use GTAP to quantify the impact of FTA.⁹

6.1 Overview of GTAP Model¹⁰

In GTAP model each region has a single representative household. The regional household income is generated through factor payments and tax revenue. Expenditure by this household is governed by an aggregate utility function that allocates expenditure over private consumption expenditure, government consumption expenditure and savings. For the private household consumption CDE (Constant Difference of Elasticities) expenditure function is applied. The government consumption is described by Cobb-Douglas function over composite commodities. Substitution possibilities between domestically and foreign produced goods of the same category are represented by a CES (Constant Elasticity of

⁸ See, Hertel (1997)

⁹ GTAP related papers are available in GTAP website.

¹⁰ For details, see, Brockmeier (2001)

Substitution) function. The aggregate utility is also described by Cobb-Douglas function with constant expenditure shares.

In GTAP model, producers operate with constant returns to scale production functions where the technology is described by Leontief and CES functions. Producers maximise profit function by choosing two broad categories of inputs to production, namely, intermediate inputs and primary factors. In each sector, it is assumed to allocate inputs to minimise total cost for a given level of output. Intermediate inputs are produced domestically or imported but movement of primary factors is not allowed in the model.

The GTAP database covers all the bilateral trade, transport and protection data that link 66 regional economic databases. The version-5 of the GTAP database has 66 regions, 55 commodities and 5 factors of production.

6.2 Region and Commodity Aggregation

The main objective of this paper is to assess the implications of various bilateral and regional FTA in South Asian and BIMSTEC region and to provide policy suggestions for Bangladesh. Keeping this view in mind each member countries have been separated as much as possible such as – Bangladesh, India, Sri Lanka, Rest of South Asia¹¹, and Thailand. In addition, USA, Canada and EU have been separated because Bangladesh and its FTA partners have significant trade relationship with these countries. All other countries are combined as Rest of the World (ROW).

In case of commodity aggregation, 66 commodities are aggregated as 11 commodities. The main strategy for this aggregation is to separate the major traded commodities of the FTA

¹¹ The version 5 of GTAP database did not separate Pakistan, Nepal and Maldives. They are considered jointly as Rest of South Asia.

member countries (both in case of intra-regional trade and trade with rest of the world) and aggregate the rest (see, appendix Table.A1).

There are five factors of production – land, unskilled labour, skilled labour, capital and natural resources.

6.3 Policy Simulation Scenarios

In this paper six simulation scenarios have been derived related to bilateral and regional FTA. Since the version 5 of GTAP database has combined Pakistan, Nepal and Bhutan as Rest of South Asia, simulation has been done on Bangladesh-Rest of South Asia FTA instead of Bangladesh-Pakistan FTA. In the Rest of South Asia group Pakistan is the dominating country and this simulation will provide the fairly accurate result of Bangladesh-Pakistan FTA. In case of regional FTA, two simulations have been done viz. SAFTA and BIMSTEC-FTA. To perform the simulation of bilateral and BIMSTEC-FTA all tariff and non-tariff barriers have been completely eliminated and only Bangladesh, India, Sri Lanka and Thailand have been considered to perform the BIMSTEC-FTA simulation. Other countries of the BIMSTEC-FTA – Myanmar, Nepal and Bhutan - are not separated in GTAP database. To perform the SAFTA simulation according to the agreement, tariff has been reduced to 5 percent if it is greater than 5 percent. The last simulation performs the combination of bilateral and regional FTA in this region. The policy simulation scenarios are summarised in the Box below.

Box :Policy Simulation Scenarios

Six policy simulation scenarios have been drawn in this paper. They are described in below

Simulation 1: Bangladesh-India Free Trade Area. All tariff and non-tariff barriers are completely removed between Bangladesh and India.

Simulation 2: Bangladesh-Sri Lanka Free Trade Area. All tariff and non-tariff barriers are completely removed between Bangladesh and Sri Lanka.

Simulation 3: Bangladesh-Rest of South Asia Free Trade Area. All tariff and non-tariff barriers are completely removed between Bangladesh and Rest of South Asia. The objective behind this simulation is to find a fairly accurate result of Bangladesh Pakistan Free Trade Area.

Simulation 4: South Asian Free Trade Area (SAFTA). The tariff is eliminated to 5 percent if it is greater than 5 percent. All the non-tariff barriers are completely eliminated.

Simulation 5: Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) Free Trade Area. All tariff and non-tariff barriers are completely eliminated within the member countries

Simulation 6: Combination of Bilateral and Regional Free Trade Area. This simulation combines the Simulation 1 to 5.

6.4 Simulation Results

In this section, the results of the different policy simulations are presented and analysed. The welfare results of various bilateral and regional FTA are shown as Equivalent Variation (EV) and presented in Table A.2. The table shows that the total welfare gain in regional FTA is bigger than bilateral FTA. All the member countries experience a sufficient welfare gain in regional and combination of bilateral and regional FTA. But in case of bilateral approach

Bangladesh gains sufficient welfare only in Bangladesh-India FTA. In this case the amount of welfare for Bangladesh is bigger than SAFTA. But it is only achieved through the endowment effect and other components of welfare such as allocative efficiency, terms of trade effect and investment-savings effect are significantly negative for Bangladesh. Bilateral FTA with Sri Lanka and Rest of South Asia experiences a small welfare gain for Bangladesh only 3.7 million US dollar and 2.2 million US dollar respectively. In all the cases India is the biggest gainer among all the member countries. For Bangladesh the total welfare gain is biggest in BIMSTEC-FTA and combination of bilateral and regional FTA which is around 109 million US dollar.

Table A.3 represents the commodity decomposition of allocative efficiency. Allocative efficiency refers the changes in efficiency as a result of resource reallocation. The gain from the resource reallocation among the agricultural products, processed rice, sugar, food products, wearing apparel and leather is positive in almost all the cases. This is because after arranging the FTA, the mentioned sectors have efficiently reallocated the scarce resources. In terms of allocative efficiency, Bangladesh experiences more gain from SAFTA than other FTA approach.

Industry output of commodity, export sales from Bangladesh and import by Bangladesh are shown in Tables A.4 to A.6 respectively. In case of industry output of commodity regional approach to FTA gives better outcome for Bangladesh. The percentage change of output increases in most of the Bangladeshi industries. Among them textile, wearing apparel, leather, natural resources, extracts agricultural products and service sectors experience significant increase in production. The other manufacturing industries, rice, and

sugar experience production loss. In case of bilateral approach to FTA, Bangladesh-India FTA experience better position rather than Bangladesh-Sri Lanka and Bangladesh-Rest of South Asia FTA. The increasing trends of the mentioned industries indicate that after arranging FTA the domestic and/or export demand of those commodities will increase. As a result Bangladesh's export and import in the South Asian countries increases in most of the commodities. This increasing trend is a sign of the trade creation among the South Asian region. But trade with other member countries outside the region will decrease slightly. This is because in the short run, the Bangladeshi industries will not be able to supply big amount of commodities to all the trade partners. But in the long run, the supply capacity may be adjusted. In Tables A.5 and A.6, in some cases the regional export and import represent a huge amount of change in percentage term. This is because the base value of export and import in this region of those particular commodities is very small.

Table A.7 represents the percentage change of employment in Bangladesh. It shows that the labour employment in Bangladesh both unskilled and skilled category increases in textile, wearing apparel and leather sectors. The demand for labour in wearing apparel increase significantly in all the scenarios and it is bigger in BIMSTEC-FTA around 8 percent and 7 percent in unskilled and skilled category. In case of SAFTA, Bangladesh India FTA and combination of bilateral and regional FTA the demand for labour is also expected to increase in most of the sectors. Bangladesh is a country where a large amount of labour is unemployed. So it is more crucial for Bangladesh to generate employment through FTA and it will be a major achievement for our poor people.

Earlier we have seen that from various FTA arrangements, Bangladesh experience is positive regarding production, trade and employment generation. Now the question is how it will effect on real GDP and household utility. Tables A.8 and A.9 shows the value of real GDP and per capita Household Utility respectively. In most cases Bangladesh experience increase in real GDP and Household Utility. The value of GDP increases significantly in case of SAFTA which is around 0.15 percent.

7. Conclusion

This paper has examined some bilateral and regional FTA options for Bangladesh within the South Asian region. It also tried to forecast the possible impact of those FTA arrangements. The analytical tool used in this paper is a static general equilibrium model which cannot capture all the features of an FTA. This model also cannot capture the dynamic effects of trade liberalisation. So the special and differential treatments for tariff reduction cannot be included in the performed simulation. Two other important instruments – sensitive list and rules of origin also cannot be considered in the simulation. With these shortfalls the modelling tool is very useful to compare different policy options.

The paper shows that most of the bilateral and regional FTA approaches generate benefits in terms of welfare, trade and employment. According to the performed simulation Bangladesh may achieve more from regional FTA approaches rather than bilateral FTA approaches. Considering the present situation and analysis of this paper, perhaps it is more viable for Bangladesh to engage in regional FTAs first to get the benefits of trade liberalisation. But in regional FTA, sometimes big economies may not offer handsome concession due to distinct interest with an

individual country and they offer large concession in bilateral FTA. So, if this type of additional benefit is achieved, then regional and bilateral FTAs need to go together to get maximum benefits. In case of bilateral FTAs being an LDC it can get extra benefits from developing countries within the region beyond the benefits from regional FTAs. Whether this type of additional benefits can be achievable or not would mainly depend on geo-political situation between the two countries. Since geopolitically Bangladesh is in no disadvantageous position in the region it can achieve more through bilateral negotiations. In this respect a combination of bilateral and regional FTA may be the optimal policy options for Bangladesh.

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Appendix Tables

Table A.1: Regional and Commodity Aggregation

Regional Aggregation		
No.	New regions	Comprising old regions
1	Bangladesh	Bangladesh.
2	India	India.
3	Sri Lanka	Sri Lanka.
4	Rest of S. Asia	Rest of South Asia.
5	Thailand	Thailand.
6	USA	United States.
7	Canada	Canada.
8	EU	Austria; Belgium; Denmark; Finland; France; Germany; United Kingdom; Greece; Ireland; Italy; Luxembourg; Netherlands; Portugal; Spain; Sweden.
9	ROW	All Other Countries of the World
Commodity Aggregation		
No.	New sectors	Comprising old sectors
1	AgPrd	Paddy rice; Wheat; Cereal grains nec; Vegetables, fruit, nuts; Oil seeds; Sugar cane, sugar beet; Plant-based fibers; Crops nec.
2	Rice	Processed rice.
3	Sgr	Sugar.
4	Fsh	Fishing.
5	OFood	Cattle,sheep,goats,horses; Animal products nec; Raw milk; Wool, silk-worm cocoons; Meat: cattle,sheep,goats,horse; Meat products nec; Vegetable oils and fats; Dairy products; Food products nec; Beverages and tobacco products.
6	NrExt	Forestry; Coal; Oil; Gas; Minerals nec.
7	Tex	Textiles.
8	Wap	Wearing apparel.
9	Lea	Leather products.
10	OMnfcs	Wood products; Paper products, publishing; Petroleum, coal products; Chemical,rubber,plastic prods; Mineral products nec; Ferrous metals; Metals nec; Metal products; Motor vehicles and parts; Transport equipment nec; Electronic equipment; Machinery and equipment nec; Manufactures nec.
11	Svces	Electricity; Gas manufacture, distribution; Water; Construction; Trade; Transport nec; Sea transport; Air transport; Communication; Financial services nec; Insurance; Business services nec; Recreation and other services; PubAdmin/Defence/Health/Educat; Dwellings.

