

Project Number: 2
November 2006

Study on Intraregional Trade and Investment in South Asia

(Financed by the
Australia-ADB South Asia Development Partnership Facility
[RETA 6337: Development Partnership Program for South Asia])

ABBREVIATIONS

ADB	—	Asian Development Bank
FDI	—	Foreign Direct Investment
GDP	—	Gross Domestic Product
GTAP	—	Global Trade Analysis Project
IMF-DOTS	—	International Monetary Fund's Direction of Trade Statistics
NFP	—	National Focus Point
NTB	—	Nontariff Barrier
RCI	—	Regional Cooperation and Integration
RIS	—	Research and Information System for Developing Countries
SAARC	—	South Asian Association for Regional Cooperation
SAFTA	—	South Asian Free Trade Agreement
SAOC	—	Country Coordination and Regional Cooperation Division
SAPTA	—	South Asian Preferential Trade Agreement
SARD	—	South Asia Regional Department
T&C	—	Textile and Clothing

I. Basic Data	
1. Activity Title:	Study on Intraregional Trade and Investment in South Asia
2. Project Officer:	Naved Hamid, Principal Economist, SAOC / Alain Borghijs, Economist, SAOC
3. Request Date:	November 17, 2006
4. Executing Agency:	Asian Development Bank (ADB)
5. Implementing Agency:	Country Coordination and Regional Cooperation Division (SAOC), SARD-ADB
6. Types of Interventions:	General
7. Amount Requested:	\$320,000
8. Period this funding request will cover:	15 months (January 2007 – March 2008)
9. Region/Country (ies):	South Asia
II. Description of Executing and Implementing Agency(ies)	
<p>10. ADB will be the executing agency for this project. Within ADB, the Country Coordination and Regional Cooperation Division (SAOC) of its South Asia Regional Department will implement the project. As the region's leading development finance institution, ADB is well placed to facilitate regional cooperation and integration (RCI) in Asia and the Pacific. Since the adoption of its Regional Cooperation Policy in 1994, ADB has assisted various regional and subregional cooperation programs. ADB has also recently adopted an RCI strategy to guide its on-going and future RCI initiatives in a coherent way.</p> <p>11. In the context of South Asia, ADB's regional cooperation strategy has five key operational objectives to achieve its goal: (i) improve connectivity; (ii) facilitate trade and investment; (iii) develop regional tourism, (iv) facilitate cooperation in energy; and (v) promote private sector cooperation. The mandate to implement this strategy for the South Asia region lies with SAOC, in coordination with Resident Missions and Sector Divisions. Within SAOC, the proposed project will be implemented by Principal Economist and Economist, in close collaboration with SAOC's Regional Cooperation Unit, SARD country economists, and other concerned departments and offices. At SARD's 2005 Country Economists' conference, it was agreed to focus on trade and investment in South Asia as one of the priority research topics. SAOC's Economic Unit is currently conducting research on investment in South Asia and on informal trade.</p> <p>12. Throughout the entire implementation period, close collaboration will be ensured with the South Asian Association for Regional Cooperation (SAARC) Secretariat, as well as the National Focus Points (NFPs) of the SAARC Research Network to enhance ownership of the project.</p>	
III. Proposed Project	
A. Background and Rationale:	
<p>13. With its geographical contiguity and strong cultural, social and historical ties, South Asia has a good – but so far untapped – potential of emerging as a strong, efficient and dynamic region. Today, the South Asia region (including Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka) has about 23% of the world's population but accounts only for about 2% of global gross domestic product. In 2005, South Asia's share in world trade was only 1.5% or one quarter of Southeast Asia's share. Exports of goods and services account for 18.8% of South Asia's GDP in 2005. Of which, only 6.7% of its GDP is due to services while the services sector as a whole account for more than half of South Asia's GDP. Meanwhile, FDI in South Asia is only 1% of its GDP. In terms of intraregional trade and investment in goods and services, South Asia is also lagging far behind Southeast Asia. These figures indicate that there is indeed significant scope for further expansion of trade and investment within the region.</p>	

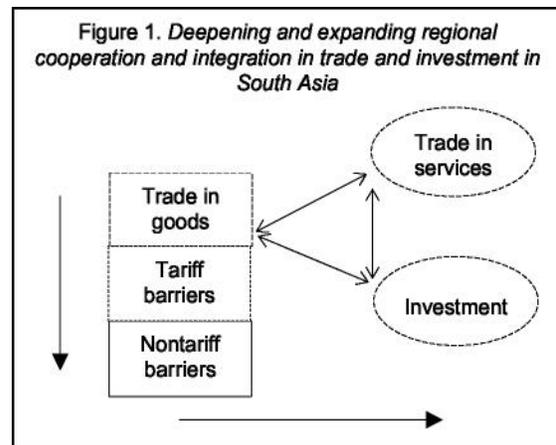
14. South Asia's economic performance during the last one and a half decade has been impressive and economic growth has contributed to significant reduction in poverty in the region. For South Asia to sustain economic and social development and achieve the Millennium Development Goals by 2015, economic growth needs to be further accelerated and ADB recognizes that RCI has a critical role to play in realizing this. Regional economic cooperation can help "unlock their vast economic potential, achieve sustained, rapid growth, and reduce poverty." As such RCI is an important platform to complement efforts at the country level in pursuing its vision of a poverty-free region. The goal of ADB's regional cooperation strategy for South Asia is to help the region realize its full potential in economic and social development and to enable South Asia to play an effective part in wider Asian integration.

15. Reduced poverty and closer regional and cross-regional integration will also help promote peace and security within South Asia and beyond. By further expanding markets for goods, services, and investment and encouraging better allocation and more efficient utilization of South Asia's production potential to achieve higher economic growth and potentially reduce poverty in the region. Regional economic cooperation will also contribute to improving political relations among South Asian countries, leading to more stable growth and economic development in the region.

16. To enhance the competitiveness of goods and services and accelerate regional integration in trade and investment in South Asia, ADB seeks to implement activities that will facilitate the reduction of trade and nontrade barriers in the region. The ratification of the South Asian Free Trade Agreement (SAFTA)¹ as of 1 January 2006 marks an important milestone for the South Asian Association for Regional Cooperation (SAARC) and a key step towards a greater regional integration vision of forming a South Asian Economic Union. Through the SAFTA, SAARC hopes to reduce custom tariffs for goods to 0–5% until 2016 and establish a free trade area in South Asia.

17. While the prospects for RCI in South Asia have improved, deeper and broader integration strategies must be pursued. In the past, SAARC has expanded the scope of tariff concessions among its members through the South Asian Preferential Trade Agreement (SAPTA) but it has not been very successful in realizing significant intra-regional trade expansion. At the 13th SAARC Summit in Dhaka in November 2005, the SAARC Member States expressed "determination to work towards significantly accelerating regional cooperation in economic areas.....underlined the need to accelerate regional cooperation through all possible means and mechanisms...."

18. With South Asia's growing interest in forging closer ties within and outside the region, SAARC can do more in bringing the desired expansion in trade by promoting deeper cooperation and integration in regional trade and investment in goods and services. To achieve this, three parallel initiatives are deemed necessary: (i) expanding the scope of SAFTA to include trade in services and investment; (ii) deepening SAFTA by reducing not only tariff barriers but also nontariff barriers; and (iii) focusing on key industries to demonstrate the process and benefits of reform (see Figure 1).



¹ The South Asia Free Trade Agreement (SAFTA) was agreed to among the seven South Asia countries that form the South Asian Association for Regional Cooperation (SAARC): Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

19. Firstly, SAARC Member States recognize that trade in services and investments are indeed crucial in promoting economic cooperation as it would complement the expansion of trade and investment in goods and take an active part in the global supply chain. Furthermore, South Asia has a strong comparative advantage in its services sector and it accounts for an outstanding and growing share in the region's total output (53.3% in 2005) mainly due to a combination of strong demand and effective reforms undertaken by South Asian countries. However, due to the lack of research on services trade policy and limited availability of data on international trade in services policymakers have therefore limited guidance as to how liberalization in trade in services and investment should proceed. Liberalization of trade in services is in many ways different from trade in goods. Barriers that restrict the cross-border movement of goods are rarely similar to the restrictions on cross-border mobility of services. For instance, many services transactions require physical proximity between the service provider and the user and therefore physical mobility of providers and users is very essential. Barriers to trade in services are often more complicated than tariffs and may take the form of regulations, standards, capital and labor restrictions, and other policy measures that are difficult to quantify. Because of the usual difficulties in quantification, most of the past studies on barriers to trade and other trade-restricting measures have focused on trade in goods. Therefore, against this backdrop and the "recognized [...] potential of trade in services," the SAARC Heads of State or Government "called for a study to see how services could be integrated into SAFTA process" (Dhaka Declaration, 2005).

20. Secondly, it is recognized that increasing trade and attracting investment require liberalization policies on but not limited to tariff barriers. Deeper integration in trade and investment in goods would also require liberalization policy on non-trade barriers other than quantitative restrictions such as import restraints, technical requirements, inconsistent and lengthy customs procedures, and complicated documentation requirements, which prevent the easy flow of goods and services in the region. South Asia has been identified to have high non-tariff barriers. SAARC recognizes this and emphasizes that "parallel initiatives for dismantling of non-tariff and para-tariff barriers" are necessary, thus calling for "expeditious action on conclusion of agreements on mutual recognition of standards, testing and measurements with a view to facilitating intra-regional trade" (Dhaka Declaration, 2005).

21. Lastly, to bring the policy reform process at a more manageable pace and level, it may be necessary to initially focus on exploring the potentials of priority industries where more immediate and specific interventions such as removal of non-tariff measures can be implemented. Such focused reforms have higher chances for success and can be used to demonstrate economic benefits of trade and investment liberalization among South Asian countries. Since both the textile and clothing (T&C) and the automobile industries involve multiple production stages that require varying degrees of skill and labor intensity, these industries are among the industries that have high potential for intensified intra-industry trade within the region. Also, most South Asian countries are large exporters of intermediate and finished T&C goods, making South Asia's comparative advantages on T&C strong. Meanwhile, as the manufacturing giants continue to heavily specialize on high-tech automobiles, there is an emerging niche in the developing markets for specializing in the production of simple and low-cost automobiles. Having a large pool of skilled but cheap labor and a strong potential domestic demand, South Asia has a good potential in expanding an automobile industry production chain within the region.

B. Objectives:

22. The goal of this project is to facilitate regional cooperation and integration in South Asia. Specifically, it aims to (i) contribute to the regional policy debate on trade in goods and services and investment in South Asia and (ii) respond to the expressed needs of the SAARC Secretariat for an expert advice on the liberalization of trade in services and investment policies in South Asia.

C. Scope of Work/Description of Proposed Approaches:

The objectives of this project will be carried out by executing the following set of activities:

Regional Cooperation and Integration Capacity enhancement	<p>1.) Study on trade in services. To guide SAARC member countries in their plan to expand SAFTA from goods trade to cover trade in services, a study on the potential for and constraints in trade in services under SAFTA will be conducted for the SAARC Secretariat by the Research and Information System for Developing Countries (RIS) in collaboration and consultation with the national institutions in each of the SAARC countries including the National Focal Points (NFPs) of the SAARC Research Network of the SAARC Secretariat.</p>
	<p>2.) Industry studies. To maximize project impact, more detailed studies will be conducted on a number of priority industrial sectors such as the textile and the automobile industries which can serve as catalysts for expanding intra-industry trade and investment in South Asia. These studies will provide sector-specific strategies that will guide and accelerate trade policy reform within each target sector</p>
	<p>3.) Investment/Country studies. To enhance the relevance and applicability of region-wide policy conclusions from other project components, 5 parallel country studies will be conducted in the five major South Asian economies (Bangladesh, India, Nepal, Pakistan, Sri Lanka). Building on the region-wide recommendations of the industry studies (see 2.), these country studies aim at deriving sector-specific policy recommendations for enhancing trade and investment in South Asia. The country studies will examine key opportunities and barriers to investment in the said economies, both at the general level, as well as specific opportunities and barriers related to the priority industry studies. The country studies will also consider the importance of policies to enhance labor mobility as a complement to capital mobility.</p>
	<p>4.) Study on the impact of SAFTA and the role of nontariff barriers (NTBs) on intraregional trade. This study will focus on demonstrating the economic benefits of reducing barriers to trade and investment in goods and services in South Asia in terms of growth and (women's) employment by identifying and quantifying the impact of SAFTA and the role of nontariff measures on South Asia's intra-regional trade. The study will also focus on a feasible action plan for SAARC to reduce the barriers to trade.</p>
Information dissemination	<p>▪ To promote the adoption of key policy recommendation and strategies that the project aims to provide, the project will use various dissemination schemes. These include: (i) the production and distribution of dissemination materials consisting of a series of policy brief and studies and (ii) the conduct of a series of workshops among key policy officials.</p>

D. Workplan and Reporting

23. The project will require about 8 person-months of international consulting services and 50 person-months of national consulting services. All the consultants will be engaged by ADB in accordance with its *Guidelines on the Use of Consultants*. For the Study on trade in Services, single source selection will be used to recruit RIS. Given the unique expertise of RIS as a leading regional research institute and its strong ties with the SAARC Secretariat, the Study on Trade in Services component will not only benefit from the high quality of RIS and its research network of national focal points, but also ownership of the component by the SAARC Secretariat – crucial for ensuring actual implementation of the findings of the Study – will be ensured. Consultants for the other project components will be recruited on an individual basis. The outline terms of reference for consultants can be found in Appendix 2.

Activity	Resources (refer to Appendix)	Completion Time (15 months)														
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Study on trade in services	Services consultant															
Industry studies	Industry consultants															
Country studies	5 Country consultants															
Study on NTBs	modeling Consultant															
Compilation of studies	Project coordinator and assistant															
Information dissemination	Publication consultant															
Project monitoring & evaluation	Project coordinator and assistant															

E. Expected Outputs and Outcomes

24. The intended impact of this project is to guide SAARC’s policy formulation and enhance regional cooperation and integration in South Asia. The expected outcome is an enhanced understanding by SAARC policy makers and relevant SASEC working groups of the viable policies on trade and investment in goods and services for South Asia bringing regional cooperation and integration forward in South Asia. This outcome will be supported by a set of outputs: (i) country-specific policy recommendations on enhancing trade in services and promoting investment in South Asia, (ii) framework for exploring potentials of and addressing constraints in trade in services under SAFTA, and (iii) trade policies for key industries (textile and automobile).

25. Unfavorable political events in the region are a possible external risk that cannot be directly addressed by the project, but that may hinder the success of this project.

F. Project Evaluation and Information Dissemination

26. The outputs of the project will be disseminated through publication of policy briefs and studies and through high-level policy workshops targeted at policy makers.

G. Scope of Replication/Use in other DMCs

27. To minimize the risk of non-adoption of expert policy recommendations, appropriate participatory interventions and active dissemination activities to inform public opinion are incorporated in the project. Studies will be conducted by experts in close consultation with the stakeholders of this project — SAARC Secretariat, SAARC Network of Researchers, high-level policy officials of SAARC member countries.

IV. Cost Estimate and Disbursement Schedule

Item	Requested (\$)	Total (\$)
Country studies	85,000	85,000
Study on trade in services	60,000	60,000
Industry studies	45,000	45,000
Study on NTBs	30,000	30,000
Information Dissemination		
- Publications	5,000	5,000
- Policy Workshop	20,000	20,000
Monitoring and Evaluation	25,000	25,000
Auditing	2,000	2,000
Contingency	48,000	48,000
Total Expenses	320,000	320,000

Cost estimate in TA format can be found in Appendix 3.

V. Proposed Project Management System

28. Principal Economist and Economist, SAOC will coordinate the project and will oversee the general implementation of the project and its activities. Also, to facilitate the management and monitoring of the project, a Project Assistant will be recruited to assist the project coordinators in (i) implementing the overall study framework that will integrate the different components of the study and (ii) quality control and review of the outputs for each of activities of the project.

Appendix 1

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets/Indicators	Data Sources/ Reporting Mechanisms	Assumptions and Risks
Impact Enhanced regional economic cooperation and integration in South Asia	Expansion of trade and investment in goods and services within South Asia Key policy recommendations adopted and implemented by SAARC members	Data from IMF- DOTS and government trade and investment statistics Proceedings of the SAARC Ministerial Meetings and press reports	Assumptions Sustained commitment by SAARC members to enhance regional cooperation and integration in South Asia
Outcome SAARC's policy formulation process guided to enhance RCI on trade and investment in goods and services	Agreement by SAARC policymakers on the next steps toward enhancing regional policies on trade and investment in goods and services	Government statements; workshop proceedings; media reports	Assumptions Sustained interest in cooperation and active participation from high-level officials Risks Unfavorable political events that may increase tensions between countries
Outputs 1. Framework for exploring potentials of and addressing constraints in trade under SAFTA 2. Country-specific policy recommendations on enhancing trade in services and promoting investment in South Asia for SAARC member countries 3. Trade and investment policy options for textile and automobile industry 4. Policy workshops on the above topics	Informational materials published and disseminated among high-level policy officials Policy workshops organized	Progress and study reports; policy briefs and studies; media reports	Assumptions Expert consultants are readily available Government officials available to attend workshops
Activities with Milestones 1. Study on trade in services by 3 rd quarter of 2007 2. Industry studies 2.1. Intraregional trade in textile industry by 2 nd quarter of 2007 2.2. Intraregional trade in automobile industry by 2 nd quarter of 2007 3. Investment/Country Studies (BAN, IND, NEP, PAK, SRI) by 4 th quarter of 2007 4. Assessing the impact of SAFTA and the role of nontariff barriers on intraregional trade by 3 rd quarter of 2007 5. Dissemination of outputs 5.1 Production and dissemination of policy briefs and studies by 1 st quarter of 2008 5.2 Policy workshops by 1 st quarter of 2008			Inputs ADB: Consulting services = \$245,000 Monitoring & Evaluation, Auditing = \$27,000 Contingency = \$48,000

IMF-DOTS – International Monetary Fund's *Direction of Trade Statistics*; SAARC – South Asian Association for Regional Cooperation; RCI – Regional Cooperation and Integration; SAFTA – South Asian Free Trade Agreement; GTAP – Global Trade Analysis Project

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

- A. Consultant for the Study on Trade in Services²** (16 person months, national)
1. The consultant will be an expert on trade and investment policy in developing countries, especially in South Asia. In consultation with SARD, the SAARC Secretariat, and the SAARC Research Network, the consultant will:
 - i) outline the importance of the services sector in SAARC and its sectoral composition;
 - ii) outline in detail the logic and imperatives of regional cooperation in trade in services under SAARC;
 - iii) assess the potentials for services trade expansion in the SAARC region;
 - iv) identify intra-SAARC barriers and constraints on services trade and investment;
 - v) provide recommendations on a framework for intra-regional arrangement for trade in services, including suggestions on devising policy-instruments to address the prevailing barriers and constraints; and
 - vi) list and discuss required policy decisions and measures to enhance effective cooperation and integration in services and their sequence to be considered by the Member States in order to integrated Trade in Services with SAFTA.
- B. Consultants for the Industry Case Studies** (3 person months, international)
2. The consultants will be trade and investment policy experts on the identified industry in the area of trade in developing countries. In consultation with SARD and the SAARC Secretariat, the consultant for each case study will:
 - i) provide an analytical framework and rationale for expanding intra-industry trade under SAARC;
 - ii) assess the potentials and identify possible constraints for trade expansion in the identified industry within the SAARC region; and
 - iii) list and discuss general sector-specific policy recommendations to enhance intra-industry trade and encourage FDI in South Asia and their sequence.
- C. Consultants for the Country Investment Case Studies** (5 studies, 3 person months each, national)
3. The consultants will be trade and investment policy experts from South Asia. In consultation with SARD and the SAARC Secretariat, the consultant for each case study will:
 - i) identify and assess sector-specific investment policies and constraints at country-level;
 - ii) list and discuss general sector-specific policy recommendations to encourage FDI in South Asia and their sequence; and
 - iii) Consider the complementarity of capital and labor mobility in the promotion of trade and investment in South Asia.
- D. Consultants for the Study on the assessment of the impact of SAFTA and the role of nontariff barriers (NTBs) on intraregional trade** (5 person months, international)
4. The consultants will have substantial experience in the area of trade modeling in developing countries. In consultation with SARD, the consultants will:
 - iv) develop a model for South Asia with nontariff measures consistent with the objectives of the study;
 - v) outline the analytical framework for the model, including its assumptions and limitations;
 - vi) develop policy scenarios and simulate their effects on income / growth and (women's) employment; and

² The consultant will be engaged thru the single-source selection method in accordance with project administration instructions (PAI) No. 2.03E, para 16.

vii) assess the distribution of the effects of various policy scenarios across different countries and sectors in the region; and list and discuss general policy recommendations.

E. Consultants for Publications (4 person months, national)

5. The consultants will be publications experts on developing dissemination materials. In consultation with the Project Coordinator and the consultants of the studies, the publications consultants will:
- i) review and edit study reports and provide technical support on the development of dissemination materials such as policy studies and policy briefs; and
 - ii) develop high-impact publications designs for each of the dissemination materials.

F. Project Assistant (15 person months, national)

6. In consultation with the Project Coordinator, the project assistant will:
- i) assist in the development of an overall study framework that will integrate the different components of the study;
 - ii) assist in the quality control and review of the outputs for each of activities of the project; and
 - iii) provide support to meetings of the network/team working on the study (such as writing minutes, etc.).

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Total Cost
Asian Development Bank Financing	
1. Consultants	233.8
a. Remuneration and Per Diem	172.5
i. International Consultants	57.0
ii. Domestic Consultants	115.5
b. International and Local Travel	44.3
c. Reports and Communications	17.0
2. Training, Seminars, and Conferences	25.0
Training Program, Reports	25.0
3. Miscellaneous Administration and Support Costs	13.2
4. Contingencies	48.0
Total	320.0