



NEXT STEPS TO SOUTH ASIAN ECONOMIC UNION

A STUDY ON REGIONAL ECONOMIC INTEGRATION (PHASE II)
COMMISSIONED BY THE SAARC SECRETARIAT

EXECUTIVE SUMMARY



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Report prepared for the South Asian Association for Regional Cooperation (SAARC) Secretariat

The views expressed in this report are those of the authors and do not necessarily reflect the views or policies of the SAARC Secretariat and the Asian Development Bank, or their Board of Directors, or the governments they represent.



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Arjun Bahadur Thapa
Secretary General
SAARC

The South Asian Association for Regional Cooperation (SAARC) is striving to more closely integrate the economies of its eight member countries (Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka). Globalization has helped spur progress and the Agreement on South Asian Free Trade Area (SAFTA), signed in 2006, marks an important milestone in regional cooperation and integration (RCI). However, despite these and other developments, South Asia is one of the least integrated regions in the world. Intra-regional trade continues to account for less than 5% of formal trade of the eight member countries.

SAFTA results to date have fallen short of expectations due to complex safeguard measures and non-tariff barriers (NTBs) among SAARC member countries. Global, regional and domestic turbulences have also complicated progress in liberalizing trade, investment and other dimensions of regional economic cooperation. Nonetheless, there has been progress and relationships among SAARC countries have improved. Increasingly, their mutual interest lies in accelerating and deepening their economic cooperation and integration. The Heads of State or Government reaffirmed their commitment to regional cooperation through SAARC and underscored the importance of annual Summit meetings in charting common strategies for the realization of the objectives and principles set out in the Charter of the Association. Meeting for the first time at the dawn of the new millennium, they solemnly renewed their pledge to strengthen the Association and make it more cohesive, result oriented, and forward looking, by adopting clearly defined programs and effective implementation strategies in line with popular expectations. To give effect to the shared aspirations for a more prosperous South Asia, the Leaders agreed to the vision of a phased and planned process eventually leading to a South Asian Economic Union (SAEU). Although non-tariff barriers, infrastructure constraints and other factors continue to hamper regional cooperation and integration in South Asia, reference by SAARC Leaders to SAEU indicates a willingness to consider bold action.

On the request of SAARC Secretariat, ADB supported to carry out Phase I of the SAARC Study on Regional Economic Integration (REI). Phase I of the study on REI proposed approaches of achieving REI through four pillars, namely market integration, cross-border connectivity, energy cooperation and private sector liberalization. The current second phase of the study on REI intends to provide a roadmap for achieving the SAEU.

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Genesis of SAEU

SAARC Council of Ministers has recommended the formulation of recommendations leading to SAEU. Steps toward a Union must draw upon international experience, notably the lessons learned by the European Union (EU), the Association of Southeast Asian Nations (ASEAN) and other prominent regional organizations. Drawing on this international experience, there is a need to adopt a highly pragmatic blend of RCI approaches:

- a top-down approach based on binding agreements, as illustrated by SAFTA;
- a top-down approach based on open-regionalism and voluntary principles, as practiced by SAARC and ASEAN;
- a bottom-up market-driven approach, based on global value chains and cross-border production and distribution according to the most cost and time effective locations;
- geographically-focused programs and projects to secure cross-border connectivity (e.g., transport corridors) and to resolve impediments to trans-boundary integration.

It is therefore needed to reinforce all four RCI approaches, with private and public sector business interests guiding coordinated initiatives. There is also a need to be clear by what is meant by SAEU. While the original call a decade ago included the possibility of a common currency and monetary unification, the Euro debt crisis has cautioned against going beyond what may be sustainable and of mutual benefit—especially in light of marked differences in the size and economic status of SAARC member countries. ASEAN provides the evolving model most closely aligned with the aspirations of South Asia. The ASEAN Economic Community (AEC) is scheduled to come into effect in 2015, characterized by open, outward-looking, inclusive and market-driven economies of its ten member countries. Sector roadmaps and rules-based systems are designed to ensure mutual benefits and effective compliance and implementation of agreed commitments. The AEC is essentially a Free Trade Area (FTA) Plus model, in which the barriers to movements of goods, capital, labor and services will be reduced as much as possible. ASEAN is designed neither as a customs union with common external tariffs, nor as an economic union with a common currency. ASEAN's FTA Plus model can help guide SAARC's conceptualization of SAEU, taking into account regional needs.

Goals, General Objectives, and Terms of Reference

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3.1 Goals

The goals of the Second Phase of the study are to provide a detailed road map for SAEU along with identification of specific priority steps to be taken under each stage of regional economic integration and quantification of potential gains from various phases of regional economic integration on priority sectors.

3.2 General Objectives and Terms of Reference

The objectives and Terms of Reference of the study are to:

- review and update the completed draft report of SAARC Study on REI along with country reports of Bangladesh, Bhutan, India, Nepal, Pakistan and Sri Lanka;
- prepare a road map for the identification of 2–3 priority sectors for trade liberalization under South Asian Free Trade Area (SAFTA), including the quantitative assessment of reducing tariff to 0–5 % and their implications to each individual SAARC country, especially on Least Developed Countries (LDCs);
- prepare a road map for reducing and removing Para-tariff Measures (PTMs) and Non-tariff Measures (NTMs) by carrying out the following tasks: (a) Examine the Notifications on NTMs/PTMs submitted by Member States; (b) Examine Responses and counter-responses on notifications/responses submitted by Member States; (c) Categorize each NTM/PTM mentioned in each Notification/Response/Counter-response in broad categories; (d) Examine whether each NTM/PTM mentioned in the Notifications is compatible with WTO provisions of not; (e) Suggest ways and means of reducing those identified NTMs/PTMs which are not compatible with WTO provisions; and (f) make suggestions on how to address the trade barriers;
- chart out a course of action on how to ultimately move towards SAEU including the action plan and/or suggestion for harmonization of customs schedules of countries in the region and identification of specific priority steps to be taken under each stage of regional economic integration;
- quantify potential gains from various phases of regional economic integration, including SAEU on priority sectors;
- assess implications of regional economic integration on SAARC countries, especially on LDCs and provide mechanisms to support LDCs;

- provide a detailed analysis on remittances;
- prepare a road map for cross-border connectivity in the region by considering road network both within and beyond neighboring countries, e.g. Nepal-Sri Lanka, Nepal-Bhutan;
- prepare a road map for energy cooperation by specifying projects and programs to tap on national resource endowment of SAARC countries, particularly in the development of hydropower, and power trading in the region;
- suggest measures and actions to be taken to achieve the goal of poverty alleviation and targets of Millennium Development Goals (MDGs) and SAARC Development Goals (SDGs); and
- assess the role of larger economies in the region, such as India and Pakistan, in facilitating regional economic cooperation and integration in South Asia.

Overview of Intra-Regional Trade in South Asia

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Figure 1 outlines the regional market shares in 2011 for SAARC countries. Regional market shares represent the relative importance of each SAARC member country in the intra-regional trade bloc; the larger the share, the greater the importance of the country in question. Intra-regional exports were heavily dominated by India and Pakistan, which together accounted for over 86% of total intra-regional trade. However, Sri Lanka had the largest share (24%) of intra-regional imports; in contrast, it accounted for just 5% of intra-regional exports. India accounted for only 13% of total intra-regional imports but for 73% of total intra-regional exports. Afghanistan, Bhutan and the Maldives accounted for less than 1% of intra-regional exports and between 1%–5% of total intra-regional imports.

Table 1 records regional exports as a percentage of a country's total exports. The shares varied widely, from 82% in the case of Bhutan to only 2% for Bangladesh and 4% for India. Like Bhutan, intra-regional exports accounted for 67% and 71%, respectively, of Afghanistan's and Nepal's total exports. Similar to exports, there were wide variations in the relative importance of intra-regional imports for SAARC countries. Approximately 50% of Afghanistan imports and 44% of Nepal's imports were from SAARC countries. In sharp contrast, only 1% of India's

Figure 1 Country Shares (%) of Intra-SAARC Imports and Exports, 2011

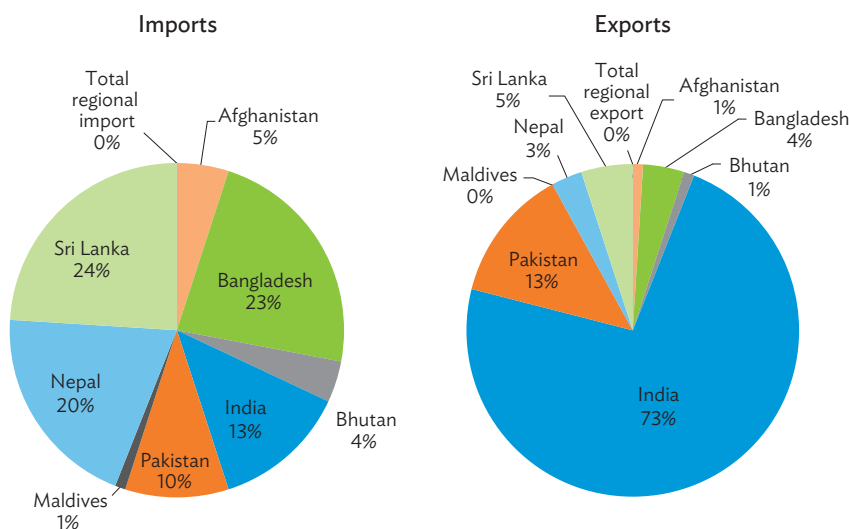


Table 1 Intra-regional Trade in South Asia

Row Labels	Column Labels									
	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	Total Intra regional Export	Total export
Afghanistan	0	0	0	70,438	0	0	180,650	0	251,088	375,851
Bangladesh	1,227		3,658	579,125	925	19,385	82,734	24,348	711,403	33,098,384
Bhutan	0	26,403		343,018	0	1,639	0	0	371,060	452,963
India	504,566	3,405,516	21,9077		118,293	2,559,910	1,678,131	4,452,043	12,937,535	301,483,250
Maldives	0	0	0	1,773		0	0	9,755	11,529	83,279
Nepal	117	26,037	3,209	614,379	22		2,641	208	646,613	907,634
Pakistan	2,656,391	946,700	0	272,495	5,477	1,275		347,708	4,230,045	25,140,082
Sri Lanka	3,075	46,308	112	521,264	55,204	642	75,231		701,837	10,011,282
Total exports		19,861,109	371,552,724	5						
Total intra-regional imports	3,165,376	4,450,963	226,057	2,402,493	179,922	2,582,850	2,019,387	4,834,062	19,861,109	
Total Imports	6,390,311	39,190,326	1,051,747	462,402,791	1,411,701	5,915,923	43,542,006	19,696,480	579,601,286	
Regional imports as % of country's total imports	50	11	21	1	13	44	5	25	3	

Source: Data compiled from WITS and calculated for 2011.

imports were from other SAARC member countries; low intra-regional dependency was also evident for Pakistan, where imports from other SAARC member countries accounted for only 5% of total imports.

Total exports of a SAARC member country as a percentage of total exports of all eight SAARC member countries is another measure of their relative trade openness and size. India accounts for 65% of the region's combined total exports. Pakistan accounts for 21% while Afghanistan and the Maldives together account for only about 1%. In terms of imports, Sri Lanka accounts for 24% of total intra-regional imports, followed closely by Bangladesh at 22%. Bhutan and Maldives account for only 1% of total imports by SAARC member countries.

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Overview of Chapters

Chapter I is the introductory chapter of this report. It presents the major issues for consideration for the movement toward the SAEU. This chapter provides an overview of the literature on regional integration in South Asia. This chapter presents an analysis on the definition of the approach for SAEU.

Chapter II provides an analysis of the trade performance and potential in South Asia, including indicators related to overall economic conditions, the sectoral composition and direction of trade, and tariff and non-tariff protection. The pattern of intra-regional trade is analyzed and comparisons made with other regions.

Chapter III provides an overview of the main features of SAFTA, including sensitive lists, rules of origin, treatment of non-tariff barriers, and the compensation and dispute resolution mechanisms. SAFTA is compared to ASEAN's FTA, so as to identify the policy measures and timelines needed for greater progress toward SAEU.

Chapter IV analyzes bilateral trade agreements in South Asia and investigates how these agreements could be harmonized with SAFTA.

Chapter V analyzes the importance of informal trade in South Asia. The methodologies for estimating informal trade flows in South Asia are outlined, together with an analysis of their composition and the reasons for informal rather than formal trade practices. The differentiating characteristics between formal and informal traders are identified.

Chapter VI examines the status of trade in services in South Asia, with a view to understanding the prospects for and challenges to deeper integration of the service sector. Brief overviews are provided on service sector trends in the SAARC member countries and in the region as a whole. The key features and modalities of negotiations under the SAARC Agreement on Trade in Services (SATIS) are outlined, together with the opportunities and challenges of trade liberalization for a representative set of services (energy, telecommunications, tourism and health).

Chapter VII examines recent developments in labor mobility and remittances in South Asia and provides a comparative analysis with other regions, leading to policy recommendations for greater integration and harmonization consistent with progress toward the SAEU. Focus is given to facilitating the movement of professionals and skilled workers, as barriers to their movement are easier to remove, or at least reduce, under trade agreements.

Chapter VIII discusses the broad similarities and differences of FDI regulatory regimes of SAARC member countries and provides a review on SAARC's perspective on investment cooperation. Recommendations are made regarding formulation of a road map for investment cooperation under the SAEU.

Chapter IX discusses the key policy and infrastructure priorities for development of economic corridors in South Asia, and their importance in networking with regional and global value chains (RVCs and GVCs).

Chapter X addresses trade facilitation measures consistent with creation of SAEU and reviews the performance of SAARC member countries in promoting trade facilitation.

Chapter XI analyzes how regional integration in trade in goods and services and in investment and other areas could help reduce poverty in South Asia. This chapter includes a theoretical and empirical analysis of the interrelationship between regional integration and poverty reduction.

Chapter XII outlines the methodology for identifying priority products for fast track trade liberalization in South Asia, focusing on non-tariff measures (NTMs). Export capacity is compared to actual export performance, and the NTMs identified 50 products where bilateral exports are zero despite large export potential.

Chapter XIII quantitatively assesses the implications of full implementation of SAFTA (with and without the sensitive lists) and the impact of deeper degrees of regional integration in South Asia. The analysis is based on use of a global general equilibrium model.

Chapter XIV discusses strategic interventions required at national and local levels in support of RVCs in South Asia and their link to GVCs. Estimates are made of the untapped potential for regional trade in South Asia, based on a gravity model, and sectors are identified suitable for development of RVCs.

Chapter XV examines issues related to integration of capital markets in South Asia. It provides cross-regional analysis of the size of capital markets in South Asia and the regulations governing them.

Chapter XVI analyzes energy demand and supply in South Asia and the prospects for cross-border energy trade.

Chapter XVII reviews the development of regional institutions in South Asia and outlines broad recommendations on how to improve the overall institutional architecture for SAEU.

Finally Chapter XVIII presents an overall summary of the report and its main conclusions.

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Recommendations¹

6.1 Elements of SAEU

Advancement of SAEU should entail four pillars of initiative (Table 2):

- Pillar 1, Market Liberalization (Trade Liberalization Program under SAFTA and SAARC Agreement on Trade in Services [SATIS], Reduction of Sensitive List, Rules of Origin, Non-tariff Barriers [NTBs], services trade, investment);
- Pillar 2, Sector Liberalization (priority sectors are identified for fast-track liberalization);
- Pillar 3, Economic Corridors (promoting integration into global and regional value chains);
- Pillar 4, Cross-border connectivity (especially transport and energy).

Cross-cutting issues should include building and strengthening institutions, capacity building and financing.

SAEU's main features are summarized in Table 3, highlighting its FTA, common market, and growth area elements, supported by efficient regional institutions and funding mechanisms.

Table 2 Pillars of SAEU

Pillar 1: Market Integration	Pillar 2: Sector-based Integration	Pillar 3: Economic Integration	Pillar 4: Cross-Border Connectivity
Expedite implementation of SAFTA, SATIS (trade in goods and services)	Priority sectors for fast track liberalization for trade in goods and services	Policy coordination, promoting integration into global and regional value chains	Focus on transport and energy, facilitating hydro-power development and sharing of natural gas and other energy resources
Cross-Cutting Issues <ul style="list-style-type: none"> • Building and Strengthening Institutions, Capacity Development • Financing 			

¹ An Action Plan recommended in the Study is provided in the Appendix.

Table 3 Elements of SAEU

Elements	SAEU
Freer flow of goods (FTA)	Yes (SAFTA)
Freer flow of services, labor and capital	Yes (Agreements on services liberalization under SATIS; and the Draft Agreement on Investment to be finalised)
Efficient cross-border infrastructure (Sub-regional growth areas)	Yes (Transit and energy agreements)
Integration of regional production network (Sub-regional growth areas)	Yes (Regional industrial policies)
Efficient regional institutions	Yes (SAARC Secretariat, South Asian Regional Standards Organisation [SARSO]; SAARC Arbitration Council [SARCO], etc.)
Sufficient financial resources for regional cooperation	Yes (SAARC Development Fund)
Common external tariffs (Customs Union)	No
Common currency (Economic Union)	No
Harmonization of economic policies	Yes (with incremental approach)

6.2 Trade Potential of SAEU

Intra-regional trade in South Asia accounts for only 5% of the total trade of SAARC countries, underscoring their stronger trade ties—in most cases—with other countries. Only 4% of India's total exports are to SAARC member countries and only 2% in the case of Bangladesh. Bhutan, Afghanistan and Nepal, however, are heavily dependent on exporting to SAARC member countries. These same countries are also heavily dependent on imports from SAARC member countries. The FTA between Sri Lanka and India prompted a surge in trade between the two countries, illustrating trade potential through trade liberalization. Reflecting their size and economic development, India and Pakistan account for more than 86% of total intra-SAFTA export trade, but a significantly smaller share of total intra-SAFTA import trade. Only 1% of India's imports are from the region, and only 5% in the case of Pakistan.

Sector intra-industry trade indices show considerable degrees of complementarity among the imports and exports of SAARC member countries. There is, though, a great deal of variation in the degree of complementarity—underscoring the need to carefully tailor facilitation of intra-regional trade. The companion document provides country-by-country complementary values for exports and imports. For Bangladesh, Bhutan, India, Nepal and Sri Lanka the intra-industry trade indices are relatively higher for manufactured goods, while for Afghanistan, the Maldives and Pakistan intra-regional trade appears to be more primary oriented.

Economic analysis provided in the companion document indicates that full implementation of SAFTA would generate significant increases in intra-regional trade and income gains for all SAARC member countries. In volume terms, the largest trade gain would accrue to India; in terms of boosts to GDP, the largest gain would accrue to Nepal. All SAARC countries

would experience measurable increases in their total exports, with the largest increase by Nepal (32%) followed by Bangladesh (5%), Pakistan (5%), Sri Lanka (3%) and India (1.3%). It is estimated that intra-regional trade could triple over current levels, providing more than a \$30 billion boost to the region annually.

6.3 Full Implementation of SAFTA

SAARC member states should agree that a common agenda to transform the region into a much more highly integrated market and production base must include clear targets and specific timelines.

Full implementation of SAFTA should be accelerated, notably through tariff liberalization. More effective progress should be made in reducing the number of tariff lines in Sensitive Lists and in reducing the number of sectors protected under the Sensitive Lists. While Article 7.3 (b) of SAFTA stipulates revision after four years or earlier, the stipulation is not mandatory. The first 20% reduction in the Sensitive Lists took nearly four years to complete and discussions for the next round of reduction has just begun. SAARC member states have agreed to reduce their respective Sensitive Lists and agreement must now be reached as to the degree and in which sectors.

Two measures should be adopted:

- **Reduction Based on Priority Sectors:** Based on trade potential, 29 priority sectors have been identified, with the highest numbers of tariff lines protected under the Sensitive Lists relating to textiles, electronic equipment, iron and steel, and plastic and rubber products. Following further analysis, it is recommended that member countries agree on annual reduction in tariff lines in priority sectors by non-least developed countries (NLDCs) and least developed countries (LDCs) by 20% and 10% respectively by 2016, and having not more than 100 tariff lines in the Sensitive List by NLDCs and LDCs by 2020 and 2025, respectively.
- **Reduction Based on Tariff Structure:** Tariffs for the priority sectors range from 5%–50%. Following further analysis, it is recommended that member countries adopt Tariff Liberalization Programs for Sensitive Lists whereby, by 2016, peak tariff will be reduced to 30%, and by 2020, peak tariff will be reduced to 20% with some flexibility for highly sensitive products.

A High Level Task Force should review the legal, technical, institutional and administrative features of SAFTA, identifying changes needed to accelerate full implementation of SAFTA. The review will include not only the Sensitive Lists and Non-Tariff Barriers but also the Rules of Origin, Compensation Mechanism and Dispute Resolution. The Rules of Origin should be liberalized, so as to take account of the changing business environment and bilateral agreements in the region. Combined value addition requirements and the issuance of origin certificates should be facilitated through better use of technology. The scope and jurisdiction of the Dispute Resolution Mechanism should be strengthened, thereby providing greater confidence that SAFTA is being implemented as intended.

6.4 Reducing Non-Tariff Barriers

SAARC's capacity to deal with core non-tariff barriers (e.g., sanitary and phytosanitary standards, technical barriers to trade, port entry restrictions and para-tariffs) should be strengthened. The SAARC Secretariat must be able to deal effectively with the reports and complaints received by the SAARC Chamber of Commerce and Industry and apex trade bodies. Greater harmonization is required concerning technical barriers to trade and sanitary and phytosanitary standards, particularly for animal and plant products. Harmonization of non-tariff barriers will enable acceptance by importing countries of certificates issued by an exporting country, reducing the need for inspections at border points.

Mutual Recognition Agreements (MRAs) for specific products or sectors will greatly expedite intra-regional trade. Adequate funds should support the human and financial resources needed to make the South Asian Regional Standards Organisation effective. The process of accreditation and certification should be advanced by more ready acceptance of certificates issued by competent laboratories in SAARC countries. National treatment is to be accorded to all products in respect to registration, labeling and testing, together with charges and fees thereof. SAARC countries should expedite automation of their customs clearance procedures under the Automated System for Customs Data (ASYCUDA) system.

6.5 Integrating SAFTA and Bilateral Trade Agreements

SAFTA will endeavor to match the tariff reduction and other provisions of the bilateral FTAs (notably of the India/Sri Lanka and the Pakistan/Sri Lanka FTAs), harmonizing the commitments and eventually eliminating any differences.

SAFTA's rules of origin provisions, notably the 30% value-addition provision, should be adjusted so as to better facilitate intra-regional export trade expansion in South Asia. Value-additions of most LDC export products are very low, hence the current 30% value-added provision acts as a barrier to export trade. SAFTA rules of origin should also better align with the Pakistan/Sri Lanka and other bilateral FTAs regarding tariff headings and shifts in headings following processing (e.g., final product classification at the first four digit level vis-à-vis non-originating materials). Trade diversion in South Asia will be minimized by reducing the absolute level of external tariffs of SAARC member countries and narrowing inter-country differences in their external tariff rates.

Harmonizing SAFTA preferences with those of bilateral FTAs should be addressed through easing the rules of origin:

- a 'de minimis' rule, where a specified maximum percentage of non-originating materials is allowed without affecting the determination of origin; and
- easing the regional cumulative rule concerning domestic value added.

6.6 Integrating Formal and Informal Trade

Informal trade among SAARC member countries is substantial, in part because of the extensive Sensitive Lists under SAFTA and the relatively tight rules of origin. Further, export restrictions (e.g., on food exports) and non-tariff factors (e.g., trade-restrictive product standards) are additional impediments to formal trade.

Lack of proper transport and transit facilities, cumbersome customs procedures, excessive paperwork and poor infrastructure at border areas prompt traders to rely on informal rather than formal channels. While SAARC member countries have made important progress in facilitating cross-border trade and in reducing the associated transaction costs (including time), further improvements are urgent. Customs procedures and paperwork need to be simplified and connectively improved through improved cross-border infrastructure and transport protocols. Easier visa processes, cellular services and courier facilities are further measures for spurring formal trade.

The trade information base should be upgraded, including through increased communication among export and import traders in SAARC member countries. Greater dialogue among traders will contribute to a more active and amenable business environment, along with filling gaps in information concerning trade regulations and procedures. SAARC on-line networks, trade fairs and exhibitions will be further means for promoting intra-regional trade.

Streamlined border security is another step toward SAEU. Security checks, payment of bribes, and harassment by border officials discourage formal trade. Border officials must be better able to differentiate between legitimate trade and informal or illegal trade. Information concerning legitimately traded goods, routes, correct standards and bonafide trading partners should be improved.

The payment process for formal trade transactions need to be streamlined. Establishment of cross-border banking facilities will facilitate traders throughout the region. Easier access to credit and banking systems will encourage informal traders to gradually switch to formal trade, although ethnic trading networks are expected to continue.

6.7 Facilitating Trade in Services

The SAARC Agreement on Trade in Services (SATIS) should be advanced through a number of initiatives, including the following:

- **streamlining of investment regulations**, through fast track procedures for regional investors and for selected commercial services; also, improved information on the investment regulatory framework in SAARC member countries and on the bidding processes for service contracts; a regional investment treaty addressing investment-related SATIS concerns will be formulated, harmonized with the India-Pakistan bilateral investment treaty currently under discussion; a SAARC investment treaty will address investment facilitation, investor protection,

dispute settlement and contract enforcement; double taxation treaties will also be developed;

- **greater institutional and regulatory cooperation**, notably through harmonization of financial services regulations and standards, thereby facilitating remittances and investment flows through formal banking and capital market channels; additional steps will include the reduction of exchange restrictions, adoption of common standards and strengthening regulatory enforcement of the financial sector;
- **improvements in the business environment**, including through improved transport connectivity and transit trade agreements; standards and regulatory principles for the service sector will be established; and
- **an incremental, phased approach to liberalization of trade in services**, focusing first on the least contentious services, such as tourism and information technology services; negotiations concerning service trade liberalization will proceed on issues, sectors and sub-sectors where there is a minimum core group of three or more interested members, following ASEAN's open approach; bilateral and multilateral agreements (e.g. BIMSTEC) will also serve for advancing trade in services; SAARC member countries will consider a request and offer approach to liberalizing the movement of natural persons for selected categories of service providers; SATIS discussions will be linked with those on trade facilitation.

Implementation of SATIS should involve four critical steps: first, improving information on the service sector so as to better understand its importance and the barriers to trade in services; second, focus regional discussions on regulatory and institutional issues critical to trade in services; third, development of the regional transport and trade facilitation infrastructure; and fourth, capacity building, including selected services such as healthcare, environment, education, renewable energy, and tourism.

6.8 Labor Mobility

SAARC member countries should take short- and long-term measures to facilitate the movement of skilled- and highly-skilled labor in the region:

- member countries should work together to design an agreement which facilitates the movement of certain categories of professionals and specialized skills under a common framework;
- a special visa category should be issued for business travel, including an easier entry process;
- barriers to Mode 4 trade under SATIS should be phased out;
- standards and qualifications should be harmonized by universities, professional bodies and research institutes;
- member countries should set timelines for entering into MRAs for selected sets of professions;
- member countries should provide the supporting technology and infrastructure (e.g., visa counters) to facilitate labor mobility; and
- member countries should reduce the cost of remittances, following the 5 percentage point reduction in 5 years being implemented by the G8 and G20 countries.

In recognition of its sensitivity, SAARC member countries should focus on non-controversial and achievable labor mobility measures. SAARC member countries recognize that they must work together to create a skilled, mobile workforce.

6.9 Investment Cooperation

SAARC member countries should advance investment cooperation under the framework of open regionalism, appropriate home and host country measures, progress toward a common market, harmonized regulatory provisions, and country-specific priorities for building regional supply chains. Accordingly, SAARC member countries should undertake the following measures:

- draw from the ASEAN model for investment cooperation, while adjusting in recognition of conditions in South Asia;
- simplify and harmonize procedures for investment applications and approvals;
- widely disseminate investment-related rules and regulations;
- harmonize guidelines for investment in specific sectors;
- strengthen institutional capacity for regulating investment, including foreign direct investment;
- facilitate investment transactions through improved financial and banking networks;
- coordinate investment and trade liberalization; and
- simplify cross-border customs regulations.

SAARC member countries should take measures to facilitate public-private investment partnerships for the development of regional or sub-regional energy and infrastructure projects, and to facilitate regional value chains in the apparel, other industries, and the service sector. SMEs should be accorded special supports. Member countries may consider reducing corporate and personal income taxes to incentivize foreign investment in high priority sectors, subject to limits to avoid counterproductive regional competition.

6.10 Economic Corridors

SAARC member countries will develop economic corridors to more closely integrate the region (including with ASEAN) and to facilitate participation in GVCs. To this end, the following steps should be undertaken:

- preparation of a master plan of South Asian Economic corridors, together with time lines for their completion;
- effective coordination among key stakeholders (public and private) in formulating the master plan;
- identification of the infrastructure (e.g., physical infrastructure, logistics networks, maintenance) necessary for development of the economic corridors;
- mobilization of the necessary financial resources, including through partnerships with multilateral financial institutions and the private sector;

- identification of industries and sectors for the designated economic corridors;
- identification of the policy and regulatory (software) measures needed in support of the industries/sectors intended as the focus of investment in the economic corridors;
- clarification and harmonization of the rights of passage for goods, people and vehicles, and of the associated permits, licenses and other measures;
- accession to the seven international transport conventions, especially the Customs Convention on the International Transport of Goods under Cover of Transit International Routier Carnets, the International Convention on the Harmonization of Frontier Controls of Goods, and the Convention on the Harmonization of Frontier Controls of Goods; and
- identification of the logistics requirements for effective economic corridors and coordinated action in response.

6.11 Trade Facilitation

Supplementary to trade liberalization, the reduction of non-tariff barriers and other measures outlined above, SAARC member countries should undertake a number of trade facilitation measures:

- establishment of national trade facilitation committees;
- adoption of the World Trade Organization Trade Facilitation Agreement, with the support of the Asian Development Bank, World Bank, United Nations Economic and Social Commission for Asia and the Pacific, and other organizations;
- targeted measures by both the governments and private sectors to reduce the time and transaction costs of cross-border trade;
- active involvement of chambers of commerce and industry associations in simplifying and automating documentation, certificates of origin, and other steps in the import/export process;
- progress in aligning national procedures and documents with international standards and conventions;
- tailoring trade facilitation measures in support of cross-border production networks, especially in support of SMEs;
- identification of backend production opportunities in South Asia and the steps needed to realize these linkages, possibly led by a project development facility to facilitate planning and implementation of cross-border projects;
- establishment of single-window border facilities for processing of trade-related information and documents, modelled after successful single-window border facilities (e.g., Republic of Korea);
- increased use of information and communication technology and development of paperless trade (e.g., acceptance electronically of cross-border Bills of Lading); and increased use of e-filing of documents;
- streamlining and harmonization of inspection and testing procedures and improved risk management systems;
- harmonization of hours of operation of customs facilities;
- improvements in multimodal connectivity; and
- introduction of trade facilitation performance monitoring systems.

6.12 Poverty Eradication

SAARC member countries should demonstrate that regional integration addresses the interests of the poor. Accordingly, SAARC member countries should:

- document and widely communicate how regional integration has spurred economic growth in their countries, generating new and better paying jobs for low income workers, including those in remote and slow growth areas;
- document and widely communicate how regional integration has spurred increased trade, foreign direct investment, regional infrastructure investments, migration and other benefits;
- ensure labor adjustment programs and other forms of support (e.g., social safety nets) for low income workers and others that may be adversely impacted by trade liberalization;
- strengthen infrastructure, health, education and other services in poor areas, so as to strengthen the ability of workers in these areas to respond to new employment opportunities arising from trade liberalization and other economic integration steps;
- improve access to credit and other financial services to assist the poor to take advantage of new investment and job opportunities; and
- ensure that the legal and regulatory system (e.g., contract enforcement) is accessible to the poor and exercised in a fair manner.

6.13 Regional and Global Value Chains

SAARC member countries should collaborate in promoting and facilitating regional and global value chains in South Asia, a fundamental building block for strengthening business competitiveness in key sectors. Regional value chains in the textile, clothing, leather, food processing and other sectors provide opportunities for businesses in South Asia to gain higher value for their exports and to participate in global value chains. To promote and facilitate regional and global value chains, SAARC member countries should collaborate in the following:

- identification of strategic policy interventions needed at the regional and national levels (e.g., preferential trade agreements, cluster formations);
- formation of regional industry associations;
- establishment of regional design centres;
- joint research and development in support of target industries;
- acceleration of trade facilitation;
- improvement of transport and other critical infrastructure, and of telecommunications services;
- harmonization of industrial support policies;
- capacity building regarding relevant institutions and regulations; and
- capacity building regarding technical innovation, and skills development.

6.14 Integration of Capital Markets

SAARC member countries should integrate their capital markets at a pace that reflects their respective levels of development and the challenges they face. Integration will be guided by pragmatism, recognizing the different starting points and different speeds but with a common goal. Integration of capital markets will be a bottom-up process, and accompany integration of the goods and services markets. Integration should be achieved incrementally though step-by-step harmonization of standards, led by industry participants and building on the considerable degree of regulatory similarity. A SAARC agreement on capital markets is viewed as the logical result of the bottom-up process of harmonizing standards under a common goal.

Integration of capital markets in SAEU includes the following measures:

- SAARC Expert Group on Development of Capital Markets needs to meet regularly to guide the integration/harmonization process;
- in depth analysis of capital markets in SAARC member countries as a foundation for establishing common standards, including analysis of market volatility, demutualization, pension fund management, new products, bond markets and other capital market issues;
- wide consultation with stakeholders concerning integration of capital markets;
- wide dissemination of baseline common standards and support for their implementation;
- rules requiring prospectuses and specifying their contents;
- rules on capital adequacy and staff training of brokerage firms;
- corporate governance codes based on international best practices;
- rules for trading transparency and standards for clearing and settlement;
- accounting standards based on international standards;
- strengthening of regulatory skills and statistical measures of enforcement;
- capacity-building on financial literacy and the stock exchange business;
- support for small capital markets, including possible outsourcing of settlement and other functions subject to economies of scale; and
- guidance from central bankers concerning exchange rate policy and management of capital markets.

6.15 Energy Cooperation

In recognition of their collective extensive energy potential and requirements, SAARC member countries should intensify their cooperation in developing and sharing the region's energy potential, including renewable energy.

Policy initiatives for the development and sharing of the hydropower potential in Bhutan, Nepal and other areas of the region should include:

- encouraging and facilitating expanded participation of the private sector;
- providing assistance for detailed feasibility studies, financing mechanisms, and PPP investments;
- developing a regional data base on possible cross-border power transmission connections; and
- determining interconnection modalities (HVAC or HVDC), their operational feasibility and economic viability.

Policy initiatives concerning development of a regional power market should include:

- analysis of the power structures in the member countries, their legal and regulatory frameworks, their security and stability standards, and their compatibility;
- analysis of the power generation scheduling and dispatch procedures, energy accounting systems, financial settlement systems and of the institutional, regulatory and commercial requirements for cross-border power trade; and
- development of a framework for regional power exchanges linking the power systems of SAARC member countries.

Policy initiatives concerning large-scale power generating stations should include:

- analysis of their competitiveness based on imported coal and natural gas;
- analysis of the infrastructure and policy initiatives needed to facilitate establishment of large-scale power generating stations; and
- formulation of commercial risk mitigation strategies for the proposed Turkmenistan-Afghanistan-Pakistan-India and the Iran-Pakistan-India pipelines.

Policy initiatives concerning renewable energy should include:

- assessment of each country's renewable energy potential (wind, solar, biogas, biofuel) and development to date;
- sharing of experience in promoting and facilitating renewable energy investments; and
- collaborative research in adapting the technologies to local conditions.

Conclusion 7

The commitment to SAEU should be a commitment by key stakeholders throughout the region, including—in addition to the governments—the private sector, civil society, academe and think tanks. The economic agenda presented here is neither exhaustive nor conditional on all the elements being agreed to. As an agenda, it addresses four broad areas of interest:

(i) **Why is there a need for deeper regional economic integration in South Asia?**

To be more competitive and to participate more effectively in global value chains, the region must become more integrated. Success in reducing poverty and in opening up new and better job opportunities for workers in SAARC member countries will importantly depend on reducing the barriers to trade, investment and other forms of integration.

(ii) **How to achieve deeper regional integration in South Asia?**

In short, by building on success. While implementation of SAFTA has been slow, it nonetheless represents a landmark achievement. In many respects, private sector cooperation and business initiatives are leading the way, providing a course for further steps by SAARC Summits.

(iii) **What to do?**

What to do is extensive. Full implementation of SAFTA is perhaps the first order of business but other major steps—such as effective and faster implementation of SATIS and progress in an investment agreement—should also be priorities.

(iv) **Who will do what?**

SAARC Summits should pave the way. SAARC's full institutional structure must be mobilized in making SAEU a reality. In turn, SAARC's vast population needs to be mobilized in support of this vital challenge.

APPENDIX

Action Plan Recommended in the Study

Strategic Action	2014–2016	2017–2020	2021–2025
Tariff Liberalization	<p>Reduce tariff on all products except for those in SL to 0%–5% by LDC.</p> <p>Reduce tariff on all products except those in SL to 0% by NLDC.</p> <p>Harmonize the SAFTA tariff reduction scheme with Bilateral Free Trade Agreement (BFTA) tariff reduction schemes by introducing regular review and monitoring process to keep track of rapid modifications in the BFTAs.</p>	<p>Reduce tariff on all products except those in SL to 0% by LDC.</p>	
Reduction in Sensitive Lists (SL)	<p>20% annual reduction in tariff lines in priority sectors by NLDC.</p> <p>10% annual reduction in tariff lines in priority sectors by LDC.</p> <p>Reduce peak tariff to 30%.</p> <p>Harmonize the SAFTA SL with BFTA SL by introducing regular review and monitoring process to keep track of faster amendments in the BFTAs.</p>	<p>Not more than 100 tariff lines by NLDC.</p> <p>10% annual reduction in tariff lines in other sectors by LDC.</p> <p>Reduce peak tariff to 20% with some flexibility for highly sensitive products.</p>	<p>Not more than 100 tariff lines by LDC.</p>
Elimination of Non-Tariff Barriers (NTBs)	<p>Setup reporting, evaluation and monitoring mechanism.</p> <p>Enhance transparency by abiding to notification requirement.</p> <p>Reduce NTBs by 50% in Priority Sectors by NLDC.</p>	<p>Reduce NTBs by 50% in Priority Sectors by LDC.</p>	<p>Full Elimination of NTBs by LDCs and NLDCs with flexibility on some products.</p>
Rules of Origin (ROO)	<p>Review all bilateral ROO in the region and explore possible cumulation mechanism.</p> <p>Reform ROO to respond to changes in global production process to develop value chains in the region.</p> <p>Simplify procedure for Certification through EDI.</p>		

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Appendix Table *continued*

Strategic Action	2014–2016	2017–2020	2021–2025
Consultation and Dispute Settlement	Identify the bottlenecks/downsides of the existing dysfunctional settlement mechanism.	Making the system more effective by disseminating significant adjustments to the imperfections of the current system. Promote mutually agreed rules for enhanced implementation of the facilities.	
Investment facilitation	Set up a task force to discuss speedier clearances and approvals and fast tracking of investments in the region, for regular updating of information on the regulatory framework governing investment in different services. Initiate discussions for including an investment chapter in SATIS.	Implement fast track procedures for selected investors and selected services. Start discussions for a regional investment treaty and double taxation treaties among the countries. Continue discussions on an investment chapter in SATIS.	Design a regional investment framework that addresses issues of investment facilitation, investor protection, dispute settlement, contract enforcement. Add an investment chapter in SATIS.
Financial integration	Set up a committee to discuss financial integration through harmonization of financial services regulations and standards, easing the flow of remittances, payments and investment flows through formal banking and capital market channels. Ensure regular dialogues between financial sector regulators in the SAARC region under the SAARC Finance network.	Take steps to ease the cross border establishment of banks within the region. Take steps to remove exchange restrictions.	Arrive at harmonized financial services regulations and standards.
People mobility	Set up a task force to identify categories of movement for which visa procedures and requirements can be eased.	Implement recommendations of the task force by streamlining visa procedures and requirements for selected categories of persons within the region. Initiate discussions for mutual recognition of qualifications.	Develop a regional template for recognition of qualifications and for immigration requirements for a selected set of professions and categories of movement. Mutual recognition of qualifications for some selected professions among the member countries.

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Appendix Table *continued*

Strategic Action	2014–2016	2017–2020	2021–2025
Connectivity	<p>Set up a committee to identify bilateral and sub-regional projects to develop road and rail transport links and joint investments.</p> <p>Provide transit facilities for the landlocked nations of Bhutan and Nepal.</p>	<p>Implement these projects.</p> <p>Sign open skies agreements between countries in the region.</p>	<p>Integrate the regional transport network.</p> <p>Create land corridors through member countries.</p> <p>Develop transit hubs in the region.</p>
Data and information exchange	<p>Set up mechanisms to regularly exchange and update information among governments, regulatory bodies, professional associations, industry associations, research institutions, civil society in the region.</p> <p>Set up a taskforce to examine data on regional and bilateral trade in services.</p>	<p>Work toward a regional database on services trade, investment and regulations.</p>	
Regulatory harmonization	<p>Set up a group on regulatory harmonization- discuss a set of regulatory principles for the service sector under SATIS.</p>	<p>Develop a cross-cutting “Services Reference Paper” which specifies pro-competitive principles applicable across all services.</p>	
Fast track sectors	<p>Identify services where fast track liberalization is possible, examine scope for pilot projects in these services, take up already existing initiatives on priority basis.</p>	<p>Implement the pilot initiatives and deepen commitments in these sectors under SATIS.</p>	
Sub-regional platforms	<p>Create sub-regional task forces on issues where a core of 3 or more countries interested in liberalization.</p> <p>Identify existing bilateral agreements and other plurilateral agreements among countries in the region and build on these platforms.</p>	<p>Implement sub-regional projects and initiatives.</p>	<p>Expand the sub-regional groups to a larger number of member countries.</p>
Synchronizing deficit and surplus in agriculture production and ensuring food security	<p>Identify priority food and agriculture products where there is export surplus and potential to trade.</p> <p>Sufficient allocation of resources for agricultural research and development (R&D).</p> <p>Effective utilization of the Regional Food Reserve.</p>	<p>Further reduction of tariffs and non-tariff barriers applied to these products.</p> <p>Synchronizing the identified deficit and surplus in agriculture production.</p> <p>Joint agricultural research, i.e. to develop high yielding crops.</p> <p>Sharing of experiences and best practices in agriculture R&D.</p>	

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Appendix Table *continued*

Strategic Action	2014–2016	2017–2020	2021–2025
	<p>Increasing the pledges made by member countries in order to have a sufficient reserve amount in the SAARC Food Bank to effectively address a large scale food shortage.</p> <p>Capacity building within SAARC to produce uniform and useable data to ensure the effective functioning of the SAARC Food Bank—e.g. food security information system.</p>	<p>Improve the coordination among member countries to effectively manage the SAARC Food Bank.</p> <p>Managing of stockpiles and monitoring of stock releases.</p>	
Enhancing intra-industry trade and promoting intra-regional investment	<p>Identify areas where regional supply capacities can be improved given the clear division of labor in terms of the region's sectoral composition and specialization in exports, i.e. in the textile and clothing Sector.</p> <p>Consult and involve the private sector in developing a regional strategy.</p> <p>Identifying specific instruments to promote regional investment.</p> <p>Improving the investment climate.</p> <p>Relaxation of restrictions related to outward FDI at country level.</p>	<p>Develop regional supply capacities to enhance vertical specialization and economies of scale.</p> <p>Develop sourcing relations through regular meetings of stakeholders, i.e. through the SAARC Chamber of Commerce and Industry.</p> <p>Undertaking measures to reduce bureaucratic red tape, energy and transportation costs.</p> <p>Establish working groups at the regional level to focus on key areas of trade and investment, i.e. rules of origin, customs, agricultural trade and subsidies, standards, investment and services, cross-border movement of business people and dispute settlement.</p>	Regulatory harmonization in identified key sectors.
Regional migration strategy	<p>Embark on a clearly defined migration management policy, at the country level.</p> <p>Identify impediments to ratifying ILO conventions and provide adequate information on the implications of ratifying; assisting countries to develop/make necessary changes to national laws which are in line with the provisions of the conventions.</p> <p>Developing effective support systems in the region to reduce irregular migration, i.e. financial assistance, insurance.</p> <p>Improving access and information of banking and financial services, and improving financial literacy.</p>	<p>Having a system at the regional level which can provide legal assistance and coordinate enforcement on cases related to fraud and exploitation of workers.</p> <p>Developing multilateral mobility agreements within the region.</p> <p>Adopting and implementing best practices of member states.</p> <p>Designing better financial and investment products for migrants.</p>	

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Appendix Table *continued*

Strategic Action	2014–2016	2017–2020	2021–2025
Promoting energy co-operation and development of a regional power market	<p>Identifying energy endowments and surpluses in the region for potential energy trade.</p> <p>Identifying areas of energy infrastructure that need to be developed.</p> <p>Identifying energy related projects at the sub-regional level.</p>	<p>Committing to a common agreement to promote energy trade.</p> <p>Developing crucial energy infrastructure at the regional level.</p> <p>Promoting FDI and private sector participation in the power sector.</p>	Harmonization of legal and regulatory framework in the energy sector of each SAARC member state.
Trade facilitation measures	<p>Facilitating vehicles crossing the border areas.</p> <p>Simplifying visa requirements.</p> <p>Lower and more transparent fee payment for formal trade.</p> <p>Automated system for handling clearances.</p> <p>Dissemination of trade related information through enquiry points and through trade related information.</p>	<p>Mutual recognition of standards.</p> <p>Improving infrastructure at borders.</p> <p>Cross border banking facilities.</p> <p>Simplification or reduction of documentation requirements.</p> <p>Single window for lodging of all trade related documents.</p> <p>Harmonization of documentation requirements and formalities for import clearances.</p> <p>Single form for customs clearance.</p>	

