Should Bangladesh Sign a Bilateral Free Trade Agreement With Pakistan?

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[***Abstract:*** *The paper examines the rationale for establishing a bilateral free trade agreement (FTA) by Bangladesh with Pakistan as means of enhancing trade and economic cooperation between the two countries. The experience in regional economic integration in SAARC, lessons drawn from the prevailing bilateral FTAs in the South Asian region, and the opinion of civil society groups, comprising academics, researchers, and leaders of business chambers and trade bodies of the two countries, strongly indicate that both the countries will benefit from the FTA by way of increased flows of trade and investment. Long term benefits of the FTA and the accompanying trade liberalization measures will be more significant than the immediate short term gains.]*

I. Introduction

Bangladesh and Pakistan have a shared history and culture, and commonality of interest in a wide range of regional and international issues, which provide a sound basis for building cordial and mutually beneficial relationship between them. These two countries have already developed close cooperation in their dealings with such multilateral bodies as SAARC, OIC, WTO, NAM, D-8, the United Nations and its specialized agencies.

During the past three and a half decades that elapsed since the break-up of Pakistan and the emergence of Bangladesh as a sovereign independent country, both these countries extended their trade links with the industrial countries because of their growing requirements of technical know-how, equipment, raw materials and intermediate goods. Bilateral trade between them has therefore remained low.

There is, however, a growing realization at both official and private sector levels in the two countries of the need to expand trade and investment between them. At the official level, the desire is reflected in the formation, first, of SAARC, then SAPTA, and more recently the SAFTA. The two countries have also a Joint Economic Commission (JEC), which is responsible for promoting cooperation in trade and other economic matters.

At the private sector level, the growing realization among trade and industry circles of these two countries of the need to intensify efforts at expanding both way trade is reflected in the strong links that have been established between the national federations of chambers of the two counties - FBCCI in Bangladesh and FPCCI in Pakistan - as also between the Karachi Chamber of Commerce and Industry (KCCI) and the Dhaka Chamber of Commerce and Industry (DCCI) to achieve the trade promotion objective. There are also regular business exchanges through visits of business delegations and seminars organized from time to time by the trade bodies of the two countries.

Of late, the political leadership of the two countries has initiated efforts to sign a bilateral FTA to strengthen trade and economic relations between them. The business community of the two countries, too, has been showing keen interest in the planned FTA as means of expanding mutual trade. They believe that the FTA could be a stepping stone to achieve the goals of the recently established SAFTA, to which both these countries are deeply committed.

The paper is purported to assess the feasibility of the proposed FTA between Bangladesh and Pakistan. Section II outlines the trend and pattern of Bangladesh's trade with Pakistan and examines the reasons behind the smallness of trade between them. Section III examines the prospects of

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establishing a bilateral FTA between the two countries in light of the lessons drawn from the experience of the prevailing regional and bilateral trade agreements in South Asia, and also discussions held with economists, researchers, and leaders of industry and business of the two countries. Section IV discusses the likely benefits of the bilateral FTA and associated concerns for Bangladesh. Section V makes some recommendations to the Government about the position it may adopt on the planned FTA. Major conclusions of the paper are summed up in the sixth and final section.

II. Commodity Pattern of Trade (Export, Import and Trade Balance)

Bangladesh's export to Pakistan is very small. In 2005-06 it was as small as $58 million, which is just 0.5 percent of her total exports. Bangladesh's import from Pakistan is small as well. In 2005-06 imports from Pakistan were about $150 million, or just over 1 percent of Bangladesh's overall imports.

Bilateral trade between these two countries is not only very small but also has been growing very slowly over the past years (Table 1). During the ten-year period between 1996-97 and 2005-06, Bangladesh's exports to Pakistan grew at an annual rate of 4.47 percent and imports from Pakistan grew at the rate of 9.33 percent. The total value of trade (export plus import) between the two countries in 2005-06 was just about $200 million.

It is also worth noting that Bangladesh has always had a deficit trade balance with Pakistan. Although the size of the trade deficit is small, it has been increasing every year. The deficit rose to $92 million in 2005-06 from $28 million in 1996-97.The ratio of imports to exports in Bangladesh's bilateral trade with Pakistan rose from 1.73 to 2.60 during this period.

As of now, trade between the two countries is concentrated on a very few items. Raw jute, fertilizer and tea constitute about 90 percent of Bangladesh's exports to Pakistan (Figure 1). As regards imports, cotton and manmade fibers alone accounts for over 60 percent of Bangladesh's total imports from Pakistan. Cotton fabrics, machinery, plastic products, vehicles, vegetable products (mainly cereals) and prepared foodstuff add another 21 percent to Bangladesh's total imports from that country (Figure 2).

Table 1:
Bangladesh's Trade with Pakistan (Exports, Imports and Trade Balance)

Million US$

Year	BD's Total Export	Export to Pak	(2) as % of (1)	BD's Total Import	Import from Pak	(5) as % of (4)	Trade Balance	Ratio of Bilateral Imp/Exp
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]
1996-97	4427	38.97	0.87	7162	67.26	0.94	-28.29	1:1.73
1997-98	5172	44.67	0.86	7524	80.03	1.06	-35.36	1:1.79
1998-99	5324	38.13	0.72	8018	82.79	1.03	-44.66	1:2.17
1999-00	5752	31.75	0.55	8387	83.72	1.00	-51.97	1:2.64
2000-01	6467	32.08	0.50	9364	95.30	1.02	-63.22	1:2.97
2001-02	5986	28.60	0.48	8540	67.32	0.79	-38.72	1:2.35
2002-03	6548	31.51	0.48	9658	68.68	0.71	-37.17	1:2.18
2003-04	7603	45.11	0.59	10903	112.62	1.03	-67.51	1:2.50
2004-05	8655	64.09	0.74	13147	138.92	1.06	-74.83	1:2.17
2005-06	10526	57.74	0.55	14746	150.12	1.02	-92.38	1:2.60
Growth Rate (%)*	10.10	4.47	-	8.35	9.33	-	11.42	-

Note: *Average annual growth rate 2005-06 over 19996-97 calculated on the base of end-year values.

Sources: Export Promotion Bureau (EPB); Bangladesh Bank (BB). Minus signs denote deficit.

Figure 1

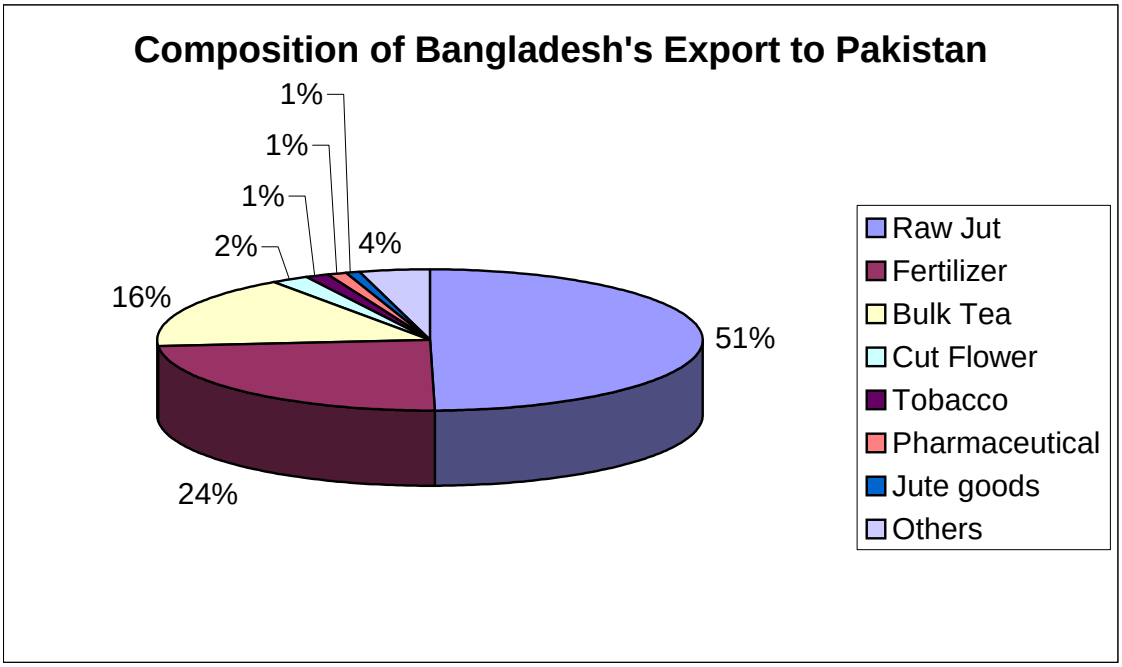
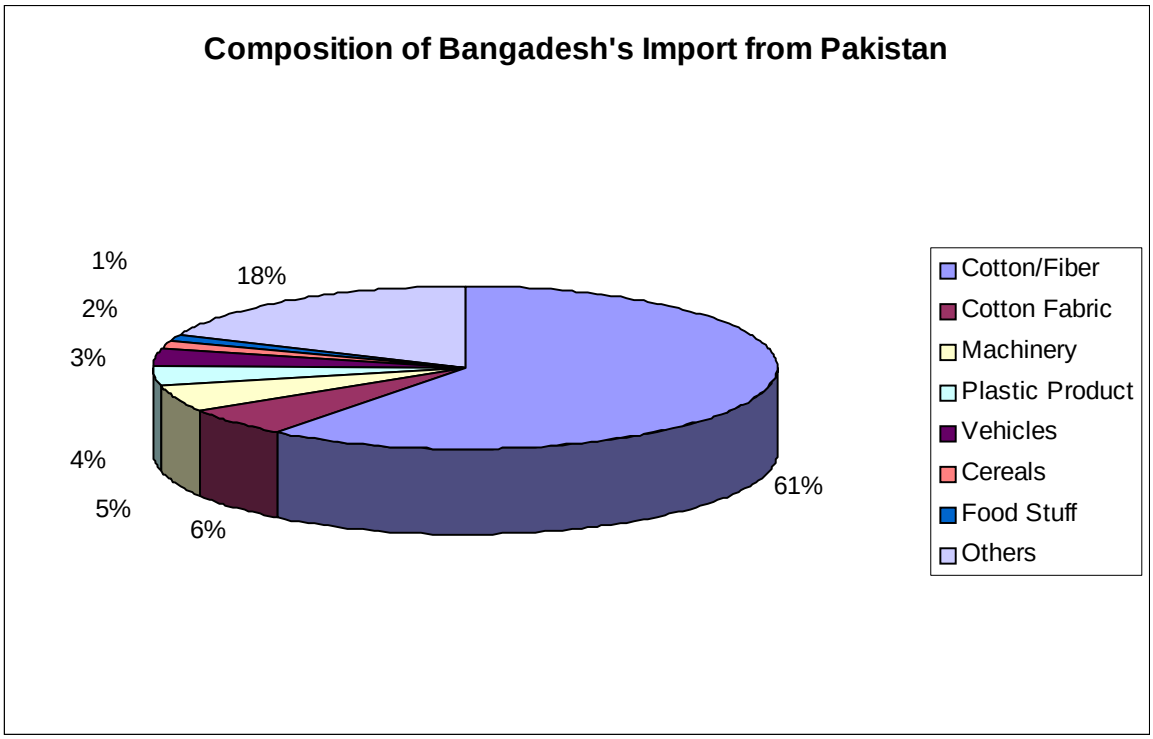


Figure 2



2.1 Reasons behind the Smallness of Bangladesh's Exports to Pakistan

Insufficient Product Diversification

A major reason behind the low volume of Bangladesh's exports to Pakistan is the country's undiversified production and export base. The country's industrial sector is in a rudimentary stage of development and its manufacturing production involves simple processing of raw materials and intermediate goods, most of which are imported.

Most of the products that Bangladesh is able to produce and export are the very ones in which Pakistan has significant domestic production (e.g., RMG). Demand for these products is therefore necessarily low. Some of the products that are believed to have good demand in Pakistan's domestic market are either in short supply (e.g., tea) or cannot compete there because of high transport cost and, to some extent, tariff barriers.

Tariff Barriers

Average tariff rates in Pakistan are low relative to Bangladesh (Table 2). However, the products Bangladesh can export face higher rates of customs duty in Pakistan. Because of its backward and undiversified industrial base, Bangladesh is not able to manufacture capital machinery or spares. It can offer only simple consumer goods like readymade garments, hosiery products, knitwear, leather shoes, fruit juices, jams and pickles, fish and fish products etc. These products face much higher rates of duty in Pakistan than intermediate and capital goods.

Table 2:
Simple Average of the Tariff Rates: Pakistan and Bangladesh

	Pakistan		**Bangladesh**	
	1998-99	**2004-05**	**1998-99**	**2004-05**
All tariff lines				
Customs duties (CD)	21.3	16.8	20.0	16.3
Other general protective taxes		0		3.9
Other selective protective taxes		0		6.3
Total		**16.8**		**26.5**
General maximum CD	35.5	25.0	40.0	25.0
Other general protective taxes		0		4.0
General maximum: CD+ other		25.0		29.0
Non-agricultural tariffs				
Customs duties		16.6		15.6
Other general protective taxes		0		3.9
Other selective import taxes		0		5.8
Total		**16.6**		**25.4**
General maximum: CD+ other		25.0		29.0
Agricultural tariffs				
Customs duties		18.1		19.6
Other general protective taxes		0		3.7
Other selective import taxes		0		8.8

	Pakistan		Bangladesh	
	1998-99	**2004-05**	**1998-99**	**2004-05**
Total		**18.1**		**32.1**
General maximum CD		25.0		25.0
Other general protective taxes		0		4.0
General maximum: CD+ other		25.0		29.00

Note: The averages are of non-preferential MFN rates as given in official tariff schedules and do not allow for SAPTA or other preferential rates. The "general maximum" Customs duty rate is defined as a rate which includes at least 5 percent of total tariff lines, and above which there are no more than 10 percent of total tariff lines.

Source: World Bank, 2004. *Trade policies in South Asia: An Overview*, Washington, D.C. (three volumes); Central Board of Revenue (Pakistan).

Non-Tariff Barriers

Pakistan has removed many of the NTBs over the past years but, as is reported by traders, traces of NTBs still remain. Some of the commonly used NTBs in Pakistan are:

1) Quantitative restrictions such as quotas, and prohibitions
2) Imposition of arbitrary health and quality standards, which favour domestic producers over foreign producers
3) Government monopoly in importing through state trading agencies

Strict Rules of Origin under SAPTA

Strict rules of origin disqualify most of Bangladesh's manufactured exports for entry into the Pakistan market. The SAPTA rule of origin, which applies to Bangladesh as an LDC, is 30% as against 40% for non-LDC members. However, because most Bangladesh manufacturing industries depend very heavily on imported inputs, even the liberal rule of origin requirement of 30% granted under SAPTA has proved too high to enable these products access to the regional market.

Ineffective SAPTA Mechanism to enhance trade

The SAPTA measures adopted since 1995 have had little impact on the bilateral exports and imports of the two countries. In the four successive rounds of SAPTA negotiations that were conducted till December 2002, Pakistan offered tariff concession on 543 products exported by LDC member states (Bangladesh, Bhutan, Maldives and Nepal).

Bangladesh, on the other hand, offered tariff concession on 835 items in the four rounds, of which 650 are non-LDC and 185 LDC products. Bangladesh has thus offered more concessions to Pakistan under SAPTA than it has received in return (Table 3).

All the same, the SAPTA concessions did not produce any perceptible impact because most products on which concessions were exchanged are irrelevant for both these countries. Some of these products are not traded between them at all. In respect of products that are actually traded or have some export potential, the margin of preference (MOP) granted under the four rounds proved too small to allow any meaningful improvement in the access to each other's market (Table 4).

Table 3:

Number of Products in which Bangladesh and Pakistan offered Concessions to each other under the SAPTA Rounds

Country	Round 1	Round 2	Round 3	Round 4	Round 1-4
Bangladesh:					
To Non-LDCs	11	215	338	86	650
To LDCs	1	11	143	30	185
Total	**12**	**226**	**481**	**116**	**835**
Pakistan:					
To Non-LDCs	20	227	24	-	271
To LDCs	15	131	271	126	543
Total	**35**	**358**	**295**	**126**	**814**

Source: SAARC Secretariat (compiled from National Schedules of Concessions)

For example, the 10-30 percent duty concession on basic customs duty offered by Pakistan under SAPTA provisions has not helped Bangladesh in raising her exports to Pakistan. This is evident from the data presented in Table 1, which shows a stagnant, in fact, a declining trend in exports in the recent years. Imports from Pakistan, too, have remained stagnant, albeit at a level higher than exports to Pakistan. Some increase in imports from Pakistan has, however, been observed since 2002-03.

Table 4:
MFN Tariff Rates and Tariff Reductions (%) Negotiated under SAPTA

Country	MFN Tariff (%)	Concession in SAPTA 1 (%)	Concession in SAPTA 2 (%)	Concession in SAPTA 3 (%)	Concession in SAPTA 4 (%)
Bangladesh:					
To Non-LDCs	0-40	10	10	10	10, 15
To LDCs	-Do-	10	10	10-15	10, 15, 20
Pakistan:					
To Non-LDCs	0-45	10	10	20	-
To LDCs	-Do-	15	15	30	10,15,20,30

Source: As for Table 3.

Lack of Direct Shipping Facility

The volume of trade is low because there is no facility for direct shipment of merchandise between the two countries. Bangladesh's export cargo is transported from Chittagong to Karachi through transshipment via Singapore. Main line operators stopped their services to Pakistan from Colombo due to war risk. It is estimated that a minimum of 21 days and a maximum of 35 days are required for the transportation of cargo from Chittagong to Karachi through transshipment in Singapore.

It is obvious that Bangladesh's export can be more competitive if transportation time can be reduced. Special shipping arrangements could help solve the problem. Both countries may make efforts in this regard and cooperate with each other to find a solution. Expanding the facilities of air freighting of perishable commodities that are commercially viable for such cargo may also be considered.

III. The Case for a Bilateral Free Trade Agreement with Pakistan

3.1 Lessons from the Experience of Existing Regional and Bilateral Free Trade Agreements

Prospects of SAFTA

Other than adopting a negative list approach, SAFTA has not addressed the many other shortcomings of its predecessor, the SAPTA that had made it ineffective in stimulating intra-regional trade. These include long Sensitive Lists (SL) that leave out the most actively traded goods, and non-removal of NTBs. Intra-regional trade is unlikely to expand if these problems are not duly addressed.

There is also no commitment in SAFTA to eliminate quantitative restrictions (QRs) on products receiving tariff preferences. Nor does the Treaty have any provisions relating to anti-dumping duty, subsidies and countervailing duties, and technical barriers to trade. The trade enhancing potential of SAFTA may be weakened as a result.

Although SAFTA officially took off on 1 July 2006, four of the seven member countries (Bhutan, Maldives, Nepal and Sri Lanka) have not yet issued notifications about the implementation of the tariff reduction deal.

SAFTA is likely to encounter problems in several other areas. One is the separation of the tariff reduction procedure for LDC and non-LDC member countries, which may create disputes in the trade liberalization programme.

The product coverage of the sensitive lists is another problem. Although the number of tariff lines in the individual member country's SL is not very large, they include the most actively traded goods, which are rendered ineligible for tariff reduction. Some 80 to 90 percent of SAARC's intra-regional imports may thus remain outside the SAFTA process. Thus, most products of export interest to Bangladesh are in the sensitive lists (SL) of partner countries. Fish, vegetables, pharmaceuticals, garments, footwear are in India's SL. Pakistan's SL includes items like jute fabrics, woven and knitted garments, special woven fabrics, made-up textiles, and footwear. The SL of Sri Lanka includes fish, leather, and footwear. Tea is in Bhutan's sensitive list. Major export items such as fish, jute fabrics, woven and knitted garments, made-up textiles and footwear are in the SL of Nepal. Fish, T-shirts and jute bags are in the SL of Maldives.

Moreover, the use of two separate lists, one for LDCs and the other for non-LDCs, by some of the members may lead to an abuse of the sensitive lists. For example, if a particular Sri Lankan export is in India's SL but not in Bangladesh's, that item from Sri Lanka may be routed to the Indian market via Bangladesh (Kelegama, 2004).

The SAFTA agreement does not contain any mechanism to reconcile the tariff reduction measures adopted by the already existing bilateral and multilateral treaties, such as FTAs between India and Sri Lanka, India and Bhutan, India and Nepal, and Sri Lanka and Pakistan, Bangkok Agreement, and the BIMSTEC-FTA. It may be noted that the SAFTA is set to be fully operational in 2013 for non-LDC members and in 2016 for LDC members. By that time the bilateral FTAs within the region and other South Asia-related regional trading arrangements (RTAs) will come into full force. The India-Sri Lanka FTA will be in full operation in 2008 and the Pakistan-Sri Lanka FTA in 2012. Moreover, under the fast track liberalization, the BIMSTEC-FTA will come into full operation by 2011. Because of the longer time frame for tariff reduction under SAFTA compared to bilateral FTAs and other South Asia-related agreements, SAFTA may lose much of its relevance as a regional integration scheme.

The SAFTA treaty does not provide for liberalization of trade in services, which account for about a half of the region's GDP. It has also excluded investment from its agenda. Trade flows these days are

inextricably linked with investment flows. In SAARC, the trade-investment nexus is of particular importance because of limited production and export capabilities of its member countries. If the region does not undertake measures to promote investment, the full potential of intra-regional trade expansion is unlikely to be realized.

The most important prerequisite for the success of an FTA is a strong political will to maintain the continuity of commitments. However, this prerequisite does not seem to exist yet, as Pakistan's refusal to grant MFN treatment to India would indicate. SAFTA cannot become a realistic proposition unless bilateral economic issues are properly addressed (Sobhan, 2004).

To sum up, unless SAFTA widens the product coverage for tariff reduction by narrowing down the members' sensitive lists, remove NTBs, incorporate investment and service liberalization, and settle bilateral economic issues, the outcome in terms of intra-regional trade expansion will be less than expected (Kelegama, 2004).

Experience of Bilateral FTAs in the South Asian Region

The slow progress of wider regional cooperation in enhancing trade within the region led most South Asian countries to use the bilateral route to boost trade with neighbours. India was the pioneer in this regard. The India-Sri Lanka FTA has resulted in a significant increase in trade between the two countries. Sri Lanka's trade deficit with India fell drastically. India's trade treaty with Nepal, too, has yielded larger trade. Moreover, these bilateral agreements led to a large increase in India's investment in Sri Lanka and Nepal. In fact, India has now become the third largest investor in Sri Lanka. The Pakistan-Sri Lanka FTA, too, is expected to promote trade and investment between the two countries.

The experience of major South Asian countries thus reveals that bilateral free trade agreements have shown a better record of success in expanding bilateral trade and investment than regional or sub-regional integration schemes. All this provides a strong rationale for Bangladesh to form a bilateral FTA with Pakistan. Bilateral FTA can offer the country certain concessions which may not be possible under multilateral or regional trading arrangements.

3.2 Exploiting the Advantages of Prevailing Complementarities

The close trade relation that had existed between Bangladesh and Pakistan in the 1950s and the 1960s was disrupted in the early 1970s and the trade volume has not increased even under the regional framework of SAARC/SAPTA. However, there are indications that trade complementarity still exists between the two countries in a wide range of areas (see, for example, Shah, 2006).[2] A bilateral free trade agreement will enable the two countries exploit the advantages of these complementarities. Two-way trade will increase as a result.

3.3 Position Adopted by Bangladesh-Pakistan Joint Economic Commission

The Eighth Meeting of the Bangladesh-Pakistan Joint Economic Commission (JEC) held on 12-13 September 2005 set a target to enhance bilateral trade to 1 billion dollars by 2007 for facilitating implementation of a free trade agreement (FTA). To achieve this target, the two countries signed several agreements to promote bilateral trade and investment and agreed upon a detailed plan of action. They decided to set up a Joint Working Group (JWG) to monitor the progress of the agreements and implement the targets on trade and investment. Agreement reached in different areas of cooperation includes, among others, the following:

- To enhance flights between the two countries and improve trade and economic relations

[2] Products in which trade complementarity is believed to exist are: Textile, Leather, Rice/Wheat, Fruits, Jute, Tea, Sugar, Milk, Fresh water pearls, Bamboo products, Cement, C.I. Sheets, Fish, Engineering goods, Coconut products, Natural rubber, Solar lamps, Surgical instruments, Ceramic table ware, and Rock salt.

- Pakistan offered to enhance duty free import of 15000 metric tons of tea per annum from Bangladesh

- To ensure participation in each other's trade fairs and holding of single-country exhibitions
- To promote joint ventures in sectors such as ICT, telecommunications, cotton textiles, jute goods, electronics, light engineering, leather, agro-based industries, agricultural machinery, and tourism

- To establish a direct shipping link between the two countries

- To create a Joint Fund to undertake investment promotion activities in both countries

- To establish institutional linkages between export processing agencies of the two countries

- To promote private sector interaction by encouraging the exchange of business delegations

3.4 MOU between FBCCI and FPCCI to Enhance Cooperation in Trade and Investment

The Federation of Bangladesh Chambers of Commerce and Industry (FBCCI) and the Federation of Pakistan Chambers of Commerce and Industry (FPCCI) signed an MOU on 22 July 1992 with the objective of enhancing trade between the two countries and formed a Joint Business Council (JBC) to achieve that end. The MOU was renewed on 30 July 2002, and again on 30th April 2004.
Under the MOU, both the Federations of Chambers have intensified their effort to bring the private sectors of the two countries much closer to each other in exploring the potentials of trade expansion and joint industrial collaboration. Both the Federations laid stress on the need for signing a free trade agreement (FTA) under which the two countries could offer zero or preferential tariff to each other on reciprocal basis for providing greater market access.

3.4.1 Bangladesh-Pakistan Joint Business Council (JBC) Meeting

The Bangladesh-Pakistan Joint Business Council (JBC) held its first meeting in Dhaka on 27 August 2006. In the meeting the Federations of Chambers of the two countries (FBCCI and FPCCI) agreed to raise bilateral trade to the level of $1billion between Pakistan and Bangladesh as envisaged in the Eighth JEC meeting held in Dhaka in September 2005. They expressed optimism that the target could be reached by tapping the potential sectors on both sides (Financial Express, 28 August 2006).

In a joint communiqué, the two sides emphasized the need for early signing of the proposed Free Trade Agreement (FTA). They also agreed on easing the Rules of Origin (ROO) and to remove all tariff and non-tariff barriers for augmenting import and export between the two countries. The joint communiqué identified a number of Bangladeshi and Pakistani products for export to each other countries.[3] It also identified potential sectors in which Pakistani entrepreneurs could invest in Bangladesh.[4]

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[3] The identified export products of Bangladesh are: Textiles, Readymade Garments (RMG), Knitwear, Leather, Jute yarn, Diversified Jute Products, Jewellery and Pearl, Pharmaceuticals, Bamboo and Cane Products, Cement, C.I. Sheets, Fish, Light Engineering Goods, Rubber, Ceramics, Food and Agricultural Items, Battery, Chemical Fertilizer, Cut Flowers and Foliage, Toiletries, PVC bags, Tea, Melamine, Herbal Medicine, Hard Board and Particle Board, and Cable. Products of Pakistan identified for export to Bangladesh are: Textiles, Leather and Leather Products, Sport Goods, Chemical Products, Marble and Granite, Engineering Goods, Surgical Equipments, Plastics, Pulp of Wood, Cereals, and Fruits.

[4] The identified sectors for investment are: Apparel and related backward linkage industries, Textiles, Oil and Gas, Chemicals, Energy, Telecommunications, Light Engineering, Information Technology (IT), Construction,

The two sides agreed to explore the possibility of establishing a direct shipping line between the two countries to boost trade, especially exports of tea and jute from Bangladesh to Pakistan. They also agreed to expand air links between the two countries for further increasing the volume of exports from both sides.

Pointing out that Bangladesh is currently privatizing a number of state-owned jute mills, textile mills and engineering enterprises, the Bangladesh team urged upon the Pakistani entrepreneurs to avail of these opportunities.

3.5 MOU between KCCI and DCCI on Expanding Trade and Exchange of Business Visits

Efforts at the level of the Federations of Chambers to enhance trade and economic cooperation between Bangladesh and Pakistan are also complemented by the close collaboration between individual business chambers of the two countries. The Dhaka Chamber of Commerce and Industry (DCCI) and the Karachi Chamber of Commerce and Industry (KCCI) have been exchanging trade visits on a regular basis to each other's country and organizing meetings and seminars to explore strategies to boost two-way trade and enhance cooperation in other areas.

The two sides signed an MOU on 4 February 2005 to undertake studies for specific purposes, exchange and share market information, and assist each other for display of their products through fairs and exhibitions.

Quickly following up with the MOU signed in the preceding month, the KCCI led a business delegation to Dhaka on 30 March 2005. More recently, a large KCCI delegation made a week-long visit to Bangladesh (3-8 June 2006) and expressed their trading interest in several areas like agricultural and food products, chemicals, pharmaceuticals, automobiles, glassware, textiles, cotton, readymade garments, jute twine and backing products, handicrafts, and service providers such as shipping.

The DCCI team expressed interest in developing linkages between the two countries in textiles and garments, and also in pharmaceuticals. They mentioned that Pakistan had an advantage in textiles and Bangladesh had expertise in RMG and, as an LDC, it also enjoys some benefits in the form of concessions in the developed country markets. The Pakistani entrepreneurs expressed keen interest to set up joint venture textile units and high value added apparel industry.

The two Chambers extended full support to the proposal for signing a bilateral FTA. Both the sides agreed that the potential for trade expansion exists between the two countries. What is needed for that purpose is the exchange of information, trade delegation and match making between the businessmen of the two countries. The KCCI chief suggested that after the lists of products, which can be traded between the two countries, are drawn, the KCCI will be organizing visits of product-wise trade delegation so that business to business meeting can be arranged to derive better results.

The KCCI leader also pointed out that improper shipping service between the two countries was a major obstacle to enhancing bilateral trade. He stressed that the businessmen should lobby with their respective governments to find a viable solution to this problem. Also, he was of the opinion that the private sector should devise strategies to improve the shipping service arrangement to save time and money in transporting goods from Chittagong to Karachi and vice versa.

Jute Goods, Leather and Footwear, Fertilizer, Paper, Food Processing, Livestock Breeding, Agriculture and Agro-products, and Fisheries.

3.6 Interest Shown by the Two Governments in FTA

The possibility of establishing a free trade agreement (FTA) between Pakistan and Bangladesh was raised for the first time during the Pakistan Commerce Minister's official visit to Dhaka in January 2002. The idea gained ground in June 2003 when both countries had shown willingness to sign an FTA (Shah, 2006). Official level talks began in November 2003 but did not gain much momentum till February 2006, when the Bangladesh Prime Minister visited Pakistan, and the two governments agreed to sign a bilateral FTA before 30 September. Negotiations on the FTA resumed on 19 April 2006 in Dhaka, and Pakistan proposed a draft of the proposed Agreement.

In the April meeting it was decided that the technical level negotiations would continue till end-May 2006 and be completed by July 2006 and the FTA would be signed by September 2006. However, the progress in the talks has been very slow so far, and the September deadline for signing the agreement has obviously not been met.

Pakistan's offer to sign an FTA with Bangladesh is in line with country's recently adopted strategy to enter into bilateral free trade agreements with a number of countries and regional groupings. The rationale for FTA from Pakistan's point of view is that because of the proliferation of preferential trading arrangements around the world, whether in the form of Regional Trading Arrangements (RTA) or bilateral Free Trade Agreements (FTA), Pakistan's exporters were increasingly finding themselves at a disadvantage vis-à-vis their competitors. The Government of Pakistan, therefore, decided to initiate a series of preferential trade negotiation designed to neutralize this disadvantage for their exporters. While negotiations with a number of countries are at various stages, some of them have either already begun to yield benefits or are on the verge of doing so (GOP, 2006).[5]

It is thus quite natural that Pakistan will want to forge a bilateral free trade agreement with Bangladesh as well, which is a prominent member of SAARC, and with which there are strong historical and economic relations. On the basis of this author's briefing of the Government officials in Pakistan and relevant papers made available by them, the objectives behind Pakistan's proposal for signing an FTA with Bangladesh are understood to be the following:

- Cementing closer ties and reviving the old business relations;
- Taking advantage of each other's complementarities, and establishing joint ventures;
- Preparing jointly for greater global competition;
- Utilizing each other's experience in research and development;
- Pakistan being a larger country would help build infrastructure and development of resources of Bangladesh;
- Pakistan can give special preference and SAFTA plus status in the FTA.

3.7 Opinion of the Civil Society on the Desirability of FTA

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Ever since the idea of establishing an FTA between Bangladesh and Pakistan was floated, the issue has been widely discussed and commented upon by civil society groups – academics, researchers, newspaper columnists and the country's business and trade bodies. Opinion expressed in numerous

[5] Pakistan's first FTA to become fully operational was with Sri Lanka that became effective since June 2005. It has recently concluded negotiations on a Preferential Trade Agreement (PTA) with Iran and signed a framework agreement with MERCOSUR countries (Brazil, Argentina, Paraguay and Uruguay). Its negotiations for full-fledged FTA with China and Malaysia are progressing at a rapid pace, and an Early Harvest Programme with both these countries has become effective since January 2006. Pakistan is also expecting to conclude FTA negotiations with Singapore and the Gulf Cooperation Council (GCC) by the end of 2006. Finally, Pakistan has initiated talks with several other countries – Russia, Mauritius, Morocco and Thailand – for preferential market access arrangements. Additionally, multilateral negotiations are taking place with the Organization of Islamic Countries (OIC) and the Group of Developing Eight (D-8). Further, a joint consultative study group for a potential PTA with the Association of Southeast Asian Nations (ASEAN) has also been agreed (GOP, 2006)

seminars and newspaper articles has generally been receptive of the idea of FTA. Potential benefits of freer trade after FTA have been recognized and highlighted in various seminars.

The private sector industry and business, although apprehensive of increased trade deficit for Bangladesh, are supportive of the proposed FTA. They expect that the FTA will ultimately lead to higher exports, reduce the trade deficit, and bring benefits in the long run. They have also come up with various suggestions for the success of the FTA.

Regarding tariff reduction in the FTA, the private sector's opinion is overwhelmingly in favour of reducing tariffs on Bangladesh products to 0-5% right at the time of coming into force of the FTA. They also suggest that Bangladesh, as an LDC, should be allowed differential treatment in maters of tariff reduction.

A widely expressed view is for keeping a short Negative List of products by both countries. In particular, products of export interest to Bangladesh should not be included in Pakistan's Negative List. The rules of origin (ROO) should also be made simple and more liberal than under SAPTA/SAFTA.

The business community strongly feels that all NTBs and para-tariffs should be completely dismantled along with the elimination of tariffs. Moreover, Bangladesh's exports should not be subjected to anti-dumping, countervailing, and safeguard actions as long as the country's exports in individual products do not exceed 5% of the total market share of Pakistan.

It has also been emphasized that there should be a Mutual Recognition Agreement (MRA) whereby assessment certificates on Technical Regulations and Standards issued by designated national agencies will be accepted by both countries.

The private sector also suggests that the FTA should not merely cover the trade in goods but it should also be extended to cover trade in services and investment.

The absence of direct shipping service has been generally recognized as a major trade-inhibiting factor. The trading community wants the two governments to devise ways and means to introduce direct shipping service between the two countries.

Pakistan is urged upon to invest in Bangladesh in sectors like textiles and jute, readymade garments, agro-processing, pharmaceuticals, light engineering, and leather. Pakistani investment in backward linkage industries will promote Bangladesh's industrialization and exports, not only to Pakistan but also to the rest of the world.

There have been suggestions that the FTA with Pakistan will enable Bangladesh access to markets of Afghanistan, Western and Central Asia, and CIS countries. Bangladesh may also be a springboard for Pakistan's exports to ASEAN countries and beyond. The consensus of the general public thus seems to be generally in favour of forming an FTA.

A section of economists and some former civil servants have expressed yet stronger views, suggesting that there is no choice now for Bangladesh other than signing bilateral FTAs because SAFTA is not being effective. In their opinion, SAFTA is a non-starter because of a long implementation period (2013 to 2016). Bilateral agreements are likely to be more effective in expanding trade. However, they maintain that while the proposed FTA with Pakistan will enhance trade, reduce prices, and generate competition, to actually make it so, the Negative Lists will need to be very short, the rules of origin made very simple, and NTBs fully eliminated.

IV. Likely Advantages of the Bangladesh-Pakistan FTA for Bangladesh

Given the very low volume and absence of any clear trend in bilateral trade between Bangladesh and Pakistan, it will be hazardous to make any projection about the growth of bilateral exports and imports following the establishment of the FTA. However, on the assumption that the major structural impediments and policy barriers to trade will be removed, the paper makes a qualitative assessment of the potential effects of the FTA on Bangladesh's exports to and imports from Pakistan.

4.1 Effects on Bangladesh's Exports to Pakistan

Table 5 presents data on some selected items of Bangladesh's exports to Pakistan, the share of these exports in Bangladesh's total exports in these products, their share in Pakistan's import market, and the average annual growth of these exports to Pakistan in the most recent years (2001-02 to 2004-05).

Table 5:
Bangladesh's Major Exports and their Share in Pakistan's Market
(2004-05) Thousand US$

Commodity	BD's Exp. to World	BD's Exp. to Pak	Exp. to Pak as % of BD Exp	Pakistan's total IMP	BD share in Pak market	Growth Rate *
Grand Total	**8654520**	**64093**	**0.74**	**20598100**	**0.31**	30.85
Raw jute	96190	31807	33.06	46200	68.84	11.96
Chemical fertilizer	130270	15417	11.83	427900	3.60	New product
Tea in bulk	15840	10547	66.58	27000	39.06	68.38
Cut flowers	7340	1576	21.47	-	-	119.19
Tobacco	17920	843	4.70	1500	56.2	149.89
Pharmaceuticals	21260	652	3.06	187800	0.34	-4.93
Jute mfrs.	139460	632	0.45	-	-	53.71
Iron chain	30830	312	1.01	-	-	1318.18
Soap	3070	247	8.04	98100	0.25	311.67
PVC bags	25650	226	0.88	-	-	100.89
Woven garments	3598200	164	.004	8900	0.25	95.34
Other Eng. goods	85020	163	0.19	543333	0.0003	73.89
Leather	220930	148	0.06	66800	0.22	-49.48
Plastic hanger	5200	138	2.65	-	-	94.37
Cosmetics	108150	101	0.09	-	-	High
Polythene sheet	4860	92	1.89	-	-	New Product
Cotton waste	3860	84	2.18	-	-	128.94
PVC pipe	147900	76	0.05	-	-	New Product
Carbon Rod	380	71	18.68	-	-	58.00
Cast Iron articles	7740	61	0.79	-	-	238.89
Stainless Steel ware	5800	42	0.72	-	-	100.00
Vegetables	43330	37	0.08	58600	0.06	233.22
Frozen fish	54920	33	0.06	1200	2.75	-19.51
Ceramic products	28750	33	0.11	82800	0.03	725.00
Fruits	3080	14	0.45	58600	0.02	New Product
Home Textiles	220930	08	0.003	-	-	25.99
Footwear (leather)	5951	01	0.01	21600	0.004	-

*Average annual growth rate based on end year values: 2001-02 to 2004-05
Source: Export Promotion Bureau; State Bank of Pakistan

First, a fairly good export prospect seems to lie in the few traditional products like raw jute, tea and jute goods, which at present account for the bulk of the country's exports. Then there are products, which, although of low value, have shown high growth rates in the most recent years. These products

are vegetables, PVC bags, certain engineering products, tobacco, carbon rod, home textiles, cut flowers, ceramic products, soaps, plastic hanger, iron chain, stainless steel ware, cast iron articles, chemical fertilizer, electric and electronic products, PVC pipes, polythene sheet etc.

There are again certain products, which are not currently exported to Pakistan but which are believed to have good export potential in Pakistan, as the business community there seems to indicate. Fruit juices, jams and jellies, telephone cables, tents, leather footwear, sports footwear, glass and glassware are some of these products. If only Bangladesh can generate adequate export surplus, the share of these products in Pakistan's import is likely to considerably increase after the FTA.

4.2 Effects on Bangladesh's Imports from Pakistan

Data on selected products currently imported from Pakistan are presented in Table 6. Import in most of the products constitutes a very tiny proportion of Bangladesh's total imports, and also a small fraction of Pakistan's global export in these products.

Table 6:
Bangladesh's Major Imports from Pakistan and Pakistan's Share in Bangladesh's Market (2004-05) Thousand US$

Commodity	BD's IMP from the World	BD IMP from Pak	Imports from Pak as % of BD's IMP	Pakistan's total Exports	BD's IMP as % of Pak Exp
Grand Total	**11305441**	**138920**	**1.22**	**14391100**	**0.96**
Fish	816	3	0.36	111700	-
Fruits & Nuts	57680	770	1.33	90500	0.85
Cereals	629966	193	0.03	934000	0.02
Sugar	226344	394	0.17	115400	0.34
Tobacco	14591	221	1.51	11400	1.94
Animal Food	111680	405	0.36	4300	9.41
Mineral Fuels	975850	813	0.08	479500	0.17
Inorganic Chemicals	124549	2053	1.65	8000	25.67
Pharmaceuticals	41251	565	1.37	63600	0.89
Fertilizers	331547	1095	0.33	6200	17.67
Paints & Varnishes	132566	852	0.64	4900	17.39
Plastic products	477851	5598	1.17	271500	2.06
Leather	10412	2518	24.18	310700	0.81
Wood and cork	37417	25	0.06	12600	1.98
Paper and paperboard	243590	424	0.17	17400	2.43
Cotton	1499956	71687	4.77	3067200	2.33
RMG	133928	1905	1.42	2723000	0.07
Woven Fabrics	48136	1942	4.03	10900	17.82
Knitted Fabrics	256690	8022	3.12	85400	9.39
Footwear (Leather)	10093	35	0.35	140700	0.02
Glass & glassware	49503	335	0.67	44500	0.75
Precious stones	1238	16	1.27	23800	0.06
Base metals	683092	313	0.04	164800	0.18
Machinery	1203369	7174	0.59	61100	11.74
Transport equipment	716224	5366	0.74	41500	12.92
Surgical instruments	9465	374	3.95	186800	0.20
Arms & ammunition	22039	1533	6.95	2300	66.65
Misc. Mfrs.	83580	302	0.36	488400	0.06

Source: Bangladesh Bank; State Bank of Pakistan

The shares of different products in the mutual trade of the two countries as depicted in Table 6 are very small indeed, particularly if one recalls that these countries have been members of SAARC for over two decades and nurturing trade cooperation under the preferential trading arrangement under SAPTA for more than a decade now, but in a free trade environment under the FTA, the import of these and many other new products from Pakistan is likely to increase considerably.

4.3 Effect on Investment

The FTA is very likely to attract direct investment from Pakistan and also encourage joint venture investments with Pakistani entrepreneurs. During the recent visits of Pakistan business delegations to this country, Pakistani entrepreneurs expressed keen interest to invest in Bangladesh either as direct investment or in joint ventures in various sectors like textiles, jute, RMG, sugar, leather, footwear, chemical fertilizer, pharmaceuticals, food processing, gas exploration, and power generation.

Pakistani entrepreneurs have already invested in Bangladesh, and four Pakistani companies are operating in BEPZA with an investment of $3.00 million (KCCI, 2006). These investments are in sectors like textile, food and allied industries, and service industries (GOB, 2002). The other sectors where Pakistani enterprises could invest are leather, chemicals, fertilizer and light engineering (KCCI, 2006). It can be expected that in an FTA, Pakistan's investment in the country will increase further. The prevailing environment also appears conducive. Bangladesh and Pakistan have an Investment Promotion and Protection Agreement under which Pakistani investments enjoy full protection and security in Bangladesh. There is also an Agreement for Avoidance of Double Taxation between the two countries (GOB, 2002).

Investment by Pakistan in textiles, leather and leather goods, agro-processing, food and allied industries and information technology (IT) for purpose of export to the European Union and other developed country markets could be highly lucrative in view of the privileged market access that Bangladesh enjoys as a least developed country under GSP schemes of the developed countries (GOB, 2002).

4.4 Likely Benefits of the FTA and Areas of Concern for Bangladesh

From the foregoing discussions, the likely benefits of FTA and the areas of concern for Bangladesh are summed up in the following:

Benefits	Concerns
a) Exports of both traditional products like jute and jute goods and newer items that have depicted high growth rates in the most recent years will increase.	a) The highly protected sectors may become uncompetitive. Some safeguard measures may be needed to protect the country's genuine infant industries from import competition.
b) Increased imports of raw materials and intermediate industrial inputs will boost industrial growth.	b) Revenue from import duty will come down. However, overall government revenue will increase, e.g., VAT and excise duty, because of more industrial production.
c) Duty free or low duty imports of essential inputs will make these imports cheaper, bring down production costs, and make Bangladesh SMEs competitive in both domestic and international markets.	c) Bigger nations often go back from the agreed terms when their local industries are affected.

d) Increased exports will enable fuller utilization of production capacity, exploitation of economies of scale, and generation of additional employment.	d) Rules of origin are a major constraint to Bangladesh's export growth. These should be simplified, and the value addition requirement should be brought down from the current level to the range of 20 to 25%.
e) FDI from Pakistan will increase especially in areas of textile, pharmaceutical, leather, food processing, rubber, ceramic products etc.	e) Non-tariff barriers will remain a concern unless these are completely eliminated.
f) Increased FDI and joint ventures with buy-back arrangements in certain areas will enhance the country's industrialization and provide easier access to the Pakistan market for products of the newly established industries.	f) There is no mutual recognition at the moment of the national institutions that issue certificates on product quality, standards, technical specifications etc. Mutual accreditation of the designated institutions/organizations of each country is essential to facilitate mutual trade.
g) Backward linkage industries will be established in FDI and joint venture projects. h) Bangladesh will be able to avail of the GSP benefits and exploit the LDC nation advantage to a greater extent than is currently possible. i) FTA will enhance trust and confidence among the business community of the two countries. j) FTA will offer wider choice and better quality of products and thus enhance consumer welfare.	g) Absence of direct shipping facility and the consequent high transportation cost that impedes trade are a major concern. Unless this problem is solved, trade between the two countries will not expand even if all commercial policy barriers are removed.

V. Recommendation to Government about the FTA

The foregoing discussions provide a strong rationale for forming an FTA with Pakistan. Some pertinent recommendations to the Government in this regard are made in the following:

1. Sign the FTA. Bangladesh has little to lose but much to gain from the FTA. Opinion of experts, the business community and the general public is overwhelmingly in favour of signing an FTA with Pakistan. Government should not therefore hesitate to sign the Agreement immediately.

2. Trade Liberalization Programme. The trade liberalization programme should be based on three separate lists.

a) Fast Track Liberalization. The first list is for immediate liberalization of trade in the so-called "fast track" items by eliminating all tariff and other barriers. This list will cover such items as have a greater degree of trade complementarity between the two countries. Withdrawal of trade barriers can be expected to lead to a significant expansion of trade in these products.

b) Normal Track. The second list will cover products in which withdrawal of trade barriers could be phased out over an agreed timeframe. Pakistan should eliminate all tariff, non-tariff, and para-tariff barriers in a shorter period of not more than 2 years, whereas Bangladesh, being an LDC, should be allowed a longer phase-out period of 10 years.

c) Negative List. The third list is the Negative List, which will contain products that the two countries may consider to be most sensitive. The Negative List should, however, be kept as short as possible. Products of export interest to Bangladesh should not appear in Pakistan's Negative List.

3. NTBs and Para-Tariffs. All non-tariff and para-tariff barriers should be completely eliminated.

4. Safeguard Provisions. The Agreement should provide for safeguard action to protect a partner country from injuries caused by increased imports post-FTA. Bangladesh exports shall not, however, be subjected to anti-dumping, countervailing and safeguard actions as long as the country's export share in individual products does not exceed 5% of the total market share of Pakistan.

5. Sector Coverage of the Agreement. In addition to trade in goods, the FTA should cover trade in services and investment as well.

6. Rules of Origin. The FTA shall provide for simple and liberal Rules of origin (ROO) for Bangladesh's export products to enter the Pakistan market. The provision should be more favourable than under SAFTA (SAFTA+) and the Pakistan-Sri Lanka FTA (Pak-Sri Lanka FTA+). The value addition norm for Bangladesh should not be more than 25 percent.

7. Improve Trade Facilitation. The FTA should provide for a set of trade facilitation measures such as the adoption of common tariff nomenclature, harmonization of customs procedure and evaluation methods, and harmonization and mutual recognition of standards that directly affect trade transactions, such as weights and measures, technical specification of goods etc.

8. Remove Procedural Constraints. Procedural constraints include lengthy and complicated customs clearance procedures that cause delays at ports, thereby disrupting delivery schedules and increasing costs. These constraints, which are responsible for the low volume of trade and also breed corruption, should be removed.

9. Establish Direct Shipping Service and Improve Infrastructure. The need for introducing direct shipping facilities has been emphasized in Section II of the paper. Equally important is the presence of a well-developed physical infrastructure such as power, telecommunication facilities, and efficient port services. In the absence of these facilities, bilateral trade flows would not increase, even if all trade policy impediments were removed.

10. Payments Arrangements. The FTA should provide for an efficient payments mechanism for settling mutual trade imbalances of the two countries. At present Bangladesh and Pakistan settle their trade transactions in hard currencies. In order that the scarcity of hard currencies does not obstruct their bilateral trade, they should agree to settle their mutual claims, up to a certain limit, in their respective home currencies.

11. Expand the Production Base. Even in a completely free trade situation, exports will not increase, if production and export supply capabilities do not expand. Top priority should therefore be given to augmenting the country's production capacity and generating adequate export surplus in products having export potential. Special attention should be given to develop the core-sector industries like steel, fertilizer, and textiles as they support many other industrial activities. In particular, the country will need to develop backward linkage industries in textiles, both yarn and fabric manufactures, so that its export-oriented clothing industry does not starve of essential input supplies. Direct and/or joint venture investment by Pakistan should be important in this regard.

12. Reform the Export Incentive Structure. Government incentives for promoting non-traditional exports at the present are limited to some specific industries, e.g., RMG and leather. These incentives should be targeted to encourage new exports as well.

13. Joint Ventures. Joint venture projects may be encouraged in specific areas with a view to exporting to Pakistan under buy-back arrangements. While studies will be needed to identify actual opportunities for joint venture projects, the following industries seem to have good potential: Textile, Food Processing, Pharmaceuticals, Sugar, Chemicals, Footwear and Rubber Products, Oil and Gas Exploration, Power, Construction of Infrastructure, Telecommunications, Fertilizer, Paper and Newsprint, Fisheries, and jute goods.

14. Direct Investment and Technology Flows. Apart from encouraging joint venture arrangements, Bangladesh should attract direct private investment in sectors in which Pakistan has acquired significant technological superiority and managerial expertise. The textile industry is a case in point. The traditional technology in the textile industry is now a thing of the past. The industry has now become highly capital-intensive. Bangladesh may ask Pakistan to build textile mills with up-to-date equipment and modern technology.

15. Integration of Capital and Financial Markets. The two governments may encourage integration of capital and financial markets of the two countries. Such integration will facilitate movement of capital for direct investment. The integration of capital markets could be encouraged, as a first step, by listing firms in each other's stock markets. Such a process would encourage a freer flow of portfolio investment between the two countries.

VI. Summary and Concluding Observations

Trade between Pakistan and Bangladesh is low, but the balance of trade is slightly tilted in favour of Pakistan. Major factors that have kept the volume of trade at a low level are inadequate production capacity, insufficient product diversification, tariff and non-tariff barriers, strict rules of origin applied under SAPTA, and the absence of direct shipping facility between the two countries.

For purpose of enhancing bilateral trade and promoting economic cooperation in other areas, discussions on the possibility of establishing a bilateral free trade agreement (FTA) between the two countries are currently underway.

A review of relevant documents regarding the progress of inter-governmental talks, deliberations among the National Federations of Chambers as well as between reputed Chambers and trade associations, and opinion of academics, researchers, government officials, and business leaders of the two countries reveals that there are plenty of opportunities for enhancing bilateral trade and investment between the two countries under the framework of an FTA.

For strategic and economic reasons, Pakistan has started to negotiate bilateral free trade agreements with a number of countries and regions. It has already signed an FTA with Sri Lanka, which has been found beneficial for both these countries. Pakistan has now shown interest in forming an FTA with Bangladesh, too, which it believes will promote deeper integration of the economies in South Asia.

In light of the experience of various bilateral free trade agreements within the SAARC region, it appears that the proposed free trade agreement between Pakistan and Bangladesh should bring benefit to both these countries. This paper makes some positive recommendations to the Government in that regard.

The proposed FTA may not by itself be sufficient to raise Bangladesh's exports to Pakistan. Additional measures on a number of fronts will be needed to achieve that objective. The most important is the need to expand the country's production and export base. Various policy-related and structural impediments that limit exports will need to be removed. Opportunities for entering into joint venture agreements with Pakistan, and attracting direct investment by Pakistani entrepreneurs in the country should also be explored.

Given the very low initial volume of Bangladesh's exports to Pakistan, the instantaneous effect of trade liberalization under the FTA on Bangladesh's exports will be necessarily small. However, the implementation of trade liberalization measures accompanied by steps to remove the many bottlenecks that impede exports will create favourable conditions for expanding export to Pakistan in the medium term.

What is more important for Bangladesh, however, is that the free trade environment that will be created by the FTA will induce the Bangladesh entrepreneurs to raise investment in both new and existing export activities, paving the ground for expansion of exports in the future. The long term dynamic benefits of the FTA will thus be more significant than the once-for-all static gains to the country.

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