ORF ISSUE BRIEF

AUGUST 2007 ISSUE BRIEF # 10

Time to Boost India-Bangladesh Trade and Economic Relations

By Jayshree Sengupta

Among India's neighbours, Bangladesh occupies a special position—not only because of India's role in its liberation but because geographically, too, it surrounds Bangladesh from three sides.

The beginning of close economic relations between the two countries can be traced back to 1971. After its independence, Bangladesh's requirements of consumer goods, especially food, came from India. Over the years, the country has sought easier access to Indian markets for its own products. It has been active in seeking duty reduction and elimination of non-tariff barriers that India imposes on imports from across the border.

There already exists a bilateral trade agreement between Bangladesh and India which was signed in 1980 and later amended and signed in March 2006; this came into force on April 1, 2006 and is valid till March 2009. This agreement provides for expansion of trade and economic cooperation, making mutually beneficial arrangement for the use of waterways , railways and roadways, passage of goods between two places in one country through the territory of the other, exchange of business and trade delegations and consultation to review the working of the agreement at least once a year. Implementation of this agreement has the potential to aid trade and investment between the two countries.

India, on its part, has committed itself to progressively reducing tariffs and non-tariff barriers at the various SAARC summits.

At the 14th SAARC summit held in New Delhi in April 2007, India announced that it would grant duty-free access to Bangladeshi imports that are on the `positive' list. India has also agreed to slash import duty on the `negative' list (Sensitive List) from 45 per cent to 10 per cent.[1] In fact, India decided to grant zero tariff access for products in the positive list to all the Least Developed Countries (LDCs) of SAARC. While India, Pakistan and Sri Lanka are categorized as Non-Least Developed Countries (NLDCs), Bangladesh, Bhutan, Maldives and Nepal are categorized as the LDCs. This unilateral gesture by India is in keeping with the trade liberalization and investment enhancing measures that SAFTA embodies towards the LDCs of the region, and it has come much before the scheduled date of 2009.[2]

Article 7 of the SAFTA Agreement provides for a phased tariff liberalization programme and covers all tariff lines except those kept in the Sensitive List by the member states. SAFTA was signed by all the member states of SAARC—India, Bangladesh, Bhutan, Maldives, Nepal, Pakistan and Sri Lanka—during the 12th SAARC Summit held in Islamabad in January 2004 and came into force from January 1, 2006.

India's unilateral move should aid in easing trade relations with all the LDCs of the region, and in particular boost economic relations with Bangladesh. Geographical proximity and cultural affinity between the people of Bangladesh and West Bengal, who speak a common language, would also greatly enhance bilateral trade. A huge amount of illegal border trade, amounting to more than $1 billion, already takes place between the two countries.

Among its neighbours, India shares the longest land boundary with Bangladesh—stretching 4,096 km. At many places, the border is porous, making it easy for people to cross over and return to their place of domicile frequently. India and Bangladesh could be natural trade partners due to geographical proximity and ethnic ties; there exists a certain degree of trade complementarity between the two. However, Bangladesh's imports from India are much higher than India's from Bangladesh. This is obviously because it has a much smaller resource and industrial base as compared to India. However, certain types of goods from Bangladesh are increasingly finding a ready market in India. Now Bangladesh's exports to India are rising much faster than India's exports to Bangladesh. India's exports to Bangladesh were valued at $ 1,631 million in 2004-05 and rose to $ 1632.4 million in 2005-2006.

During the same period, imports from Bangladesh rose from $59.3 million in 2004-05 to $ 118.7 million in 2005-06 which is almost double. Bangladesh has also increased its trade with Singapore and China in recent times. The trade volume between China and Bangladesh was US $3.2 billion in 2006 which was an increase of 29 per cent over the previous year. The trade surplus that India has had with Bangladesh over the years, however, is a sore point in the relations between the two countries and has been the cause of much adverse comments in Dhaka.

India has been giving Bangladesh extensive tariff preferences under SAPTA, which is a precursor of SAFTA, and many of the tariff barriers applicable to other countries have not been faced by Bangladeshi exporters.

Between 1980 and 2004, while trade between the two countries grew, the rate of growth of India's exports to Bangladesh was much higher. In 2004, India's exports to Bangladesh (officially recorded) were worth about $1.7 billion but its imports were valued only at $78 million. Since 1996-97, India's exports to Bangladesh have been growing at 9.1 per cent per annum, slightly above the average rate of export growth of its merchandise exports (8.4%).

However, India's imports from Bangladesh over the same period have grown at an average rate of just three per cent annually compared to the average growth rate of its total imports at 9.2 per cent. The trade gap has risen for Bangladesh, an average of 9.5 per cent annually since 1996/97.[3] While India's share in Bangladesh's imports rose from 3.6 per cent in 1980 to 18.5 per cent in 2004, Bangladesh exports to India in the entire decade of 1990s remained less than one per cent of India's total imports. The trade gap rose from $88 million in 1980 to over $1 billion in 2004.[4]

The rise in India's exports to Bangladesh was facilitated by the opening up of the latter's economy and reforms initiated in 1982. The appreciation of the real Taka/Rupee exchange rate by about 50 per cent between the mid-1980s up till 1999 also contributed to the expansion of both formal and informal Indian exports to Bangladesh and retarded the growth of Bangladesh exports to India. The exchange rate trend was reversed after 1999 but Bangladesh's exports to India continued to stagnate. Bangladesh has often complained of various trade barriers, especially non-tariff barriers that India has imposed in the past. That is why the demand for 'special treatment' has dominated the talks between the leaders of the two countries. Reduction of trade barriers, especially non-tariff ones, would go a long way in boosting Bangladesh's exports to India.[5]

Bangladesh began exporting basic manufactures, including leather, rubber, paper and chemicals in the 1980s. Gradually, the list has grown and Bangladesh today exports medicines, textiles, iron and steel, metals, raw jute, Jamdani sarees, medical appliances and clothing accessories. These have found a growing market in India. Bangladesh imports from India food grains, fabrics, cotton yarn, machinery, instruments, glass and glassware, ceramics and coal.

Whether the trade between the two countries after the duty free access would be enhanced will depend on various factors, including better transport facilities and other additional trade facilitation measures. Much will also depend on whether Bangladesh's exports have a real comparative advantage and whether there is trade complementarity between the two countries.

Prospects for bilateral trade to rise are greater when one country has a clear comparative advantage in products that figure prominently in the import structure of another country. India has a 'revealed comparative advantage' in many goods which is why Indian imports to Bangladesh have been growing over the years. Bangladesh, on the other hand, has relatively limited scope for enhancing its exports because it lacks a similar `revealed comparative advantage'.[6]

Complementarity between the two countries is also limited. Trade complementarity exists when the supply capability of a particular country matches well the demand capability of its trading partner and the supply capability of the trading partner matches well with the demand potential of the former. It is possible that the supply capability of a particular country matches well with the demand potential of its trading partner but not vice-versa. Thus, there could exist between the two countries a situation of partial complementarity. In the case of India, it has a strong potential to meet Bangladesh's import demands but there is a major lack of such potential on the part of Bangladesh. Studies have shown that India's exports match Bangladesh's imports fairly well but there is a clear lack of complementarity in Bangladesh's exports to India. It is a clear case of partial complementarity. India, perhaps, needs to help Bangladesh in achieving a higher degree of complementarity by encouraging greater Indian investment in Bangladesh.[7]

The duty free entry of Bangladeshi goods into India will mean a significant reduction in the informal trade that is taking place between the two neighbours. The pattern of informal trade follows the pattern of formal trade as large volumes of goods are being smuggled from India into Bangladesh but much smaller volumes are being smuggled in the other direction. There is thus a substantial Indian trade surplus in the informal account as well. Apart from cross-border smuggling, the practice of over and under-invoicing in formal trade makes a significant contribution to the volume of informal trade.[8]

Bangladesh's exports to India, however, have not been constrained by tariff protection. India has been giving Bangladesh extensive tariff preferences under SAPTA (South Asian Preferential Tariff Arrangement, which was a precursor of SAFTA) and many of the tariff barriers applicable to other countries have not been faced by Bangladeshi exporters. This shows that India's trade policy has not been discriminatory towards Bangladesh and that the slow growth of the latter's exports to India is due to other factors like lower degree of complementarity and weak comparative advantage.

Trade between the two countries has also been constrained by the lack of transhipment facilities. If these were granted, trade between India and its own North East could become a major source of revenue gain for Bangladesh.

India has dismantled most of its tariff protection regime in industrial goods.[9] It has also brought down its general tariff level and Indian markets are full of imported goods from all over the world. Bangladesh will have to compete with foreign goods in the Indian markets, which could prove difficult even with zero duty access. As for agricultural goods, India still maintains a protectionist regime which is in accordance with WTO rules.

Although Bangladesh has been the main beneficiary in the recent move by India to reduce tariffs in most goods, in garments, which comprise the bulk of Bangladesh's exports, the duty reduction has not been drastic as it remains in the negative list.[10] The 'rules of origin' clause embodied in SAFTA acts as a non-tariff barrier in the case of garments from Bangladesh. For giving preferential access to the member countries under SAFTA, it is important that goods should have undergone a substantial manufacturing process in the exporting countries. Value content has to be 30 per cent for LDCs. This means that the import content of made ups should not be more than 70 per cent of the fob price or the landed price and if it is so, it can disqualify many products with less than value addition of 30 per cent in Bangladesh.[11] The 'rule of origin' clause, however, could give an incentive to Bangladeshi exporters to source the fabrics from India.

India has also offered Bangladesh market access for eight million pieces of garments; three million pieces with the condition of sourcing fabrics from India. An additional three million garments have been granted access with the condition of using fabrics of either Indian or Bangladesh origin and a further two million pieces without any condition. India could set up industries in Bangladesh that have a high intra-industry trade and trade index. The goods produced when exported back to India could reduce the trade imbalance.[12]

Better transport links would help bring about an increase in trade between the two countries. The problem of traffic congestion can be handled with check-posts undertaking expeditious clearance. India is planning to establish state-of-the-art integrated check-posts on the border with Bangladesh. The check-posts will give clearance to goods, services and even people; India plans to give passports to truckers to operate across the India-Bangladesh border. It would also reduce transaction costs.

This move by the Indian government may reduce the serious administrative constraints faced by exporters in Bangladesh because 38 out of the 42 customs posts along the border with India have only restricted custom clearance. Only four land border posts are presently there to clear all imported goods. In terms of volume, the most important customs posts with comprehensive customs clearance are at Benapole in Bangladesh and Petrapole in India, located on the main road linking Kolkata with Jessore and Dhaka.

There is the additional problem of sea-borne trade as certain products have to go to specific ports for customs clearance. This problem faced by exporters has given rise to bootleg smuggling which bypasses customs posts altogether or even "official smuggling" involving bribes to customs and other officials on both sides of the border.[13]

Trade between the two countries has also been constrained by the lack of transhipment facilities between Bangladesh and India. If such facilities were granted, trade between India and its own North East could become a major source of revenue gain for Bangladesh.[14] For example, tea from Assam travels 1,400 km to the Kolkata port whereas the distance could be curtailed by 60 per cent if access to Chittagong port was available. Secondly, goods from Agartala travel 1,645 Km to Kolkata, while the direct distance would be 350 km if Bangladesh allows through movement. Opening up access through Chittagong port could provide an incentive to exploit natural resources in North-East India as well as northern Myanmar, for mutual benefit. Bangladesh could pick up containers from Kolkata and deliver to the North-East in India. This would lead to possibilities of increased investment by India. Promoting investment in telecommunications and Internet Communications Technology sector between the two countries would enhance economic relations further.[15] ICT could be used to alleviate poverty. The Bangladesh experience of Grameen Phone could be used in this regard and NGOs could play an important role for providing connectivity to the rural area to reduce the digital divide.

There are several bilateral issues with India, according to Bangladesh, that need to be resolved. These include India's proposed river-linking mega project involving common rivers, sharing the waters of common rivers, implementation of the 1996 Ganges Treaty, Implementation of land boundary demarcation under the 1974 Land Demarcation Agreement, delimitation of maritime boundary, India's fencing of the international land boundary and the 'illegal' presence of millions of Bangladeshis in India.[16]

Opening up of trade further by giving duty-free access to Bangladesh's exports is one important way of bringing about closer economic ties that could help in tackling other bilateral issues. Politically, Bangladesh remains a very important country to India and its potential of becoming an important trade and investment partner in the future could be initiated by exchanges and dialogue between prominent members of civil society in the two countries. Finally, for SAFTA to be really effective, it has to offer much more than what other competing regional arrangements are offering to countries like Bangladesh. It should also pave the way for greater regional cooperation in vital areas like energy, infrastructure, human development and poverty alleviation.

ABOUT THE AUTHOR

Jayshree Sengupta is a Visiting Fellow at ORF.

1. Under the SAFTA (South Asian Free Trade Area) Agreement, each contracting state is required to prepare a Sensitive List of items on which trade liberalization will not apply. India's Sensitive List comprises mainly of primary products, including live animals, animal products, vegetable products, prepared foodstuffs, fats and oils, rubber products, textiles, marble and ceramics, second hand motor cars etc. Source: Indra Nath Mukherjee: Research and Information System for the Non-Aligned and Other Developing Countries; Discussion Paper #86/2004
2. According to Article 7 of SAFTA Agreement, the NLDCs will have to bring down all tariffs to 20 per cent while LDCs would bring down tariffs to 30 per cent. NLDCs will then bring down tariffs from 20 percent to 0-5 per cent in 5 years (Sri Lanka 6 years).The LDCs are required to do so in 8 years. NLDCs will reduce their tariffs for LDC products to 0-5 per cent in 3 years.
3. World Bank, Dhaka: India –Bangladesh Bilateral Trade and Potential Free trade Agreement (Bangladesh Development Series, Paper No.13)
4. Chandrima Sikdar: Prospects of Bilateral Trade Between India and Bangladesh in 'Foreign Trade Review' 41(1): April-June 2006
5. The Non-Tariff Barriers can range from the past compulsory 'canalisation' through parastatals such as FCI (removed in April 2001) and protection granted to agricultural and consumer products that are WTO compatible.
6. Chandrima Sikdar: Prospects of Bilateral Trade Between India and Bangladesh in 'Foreign Trade Review' 41(1): April-June 2006
7. Panchamukhi V.R.: (1990), Economic Cooperation in the SAARC Region: Potential, Constraints and Policies, Interest Publication, New Delhi
8. World Bank, Dhaka: India –Bangladesh Bilateral Trade and Potential Free trade Agreement (Bangladesh Development Series, Paper No.13)
9. About 90 per cent of industrial tariffs are between 12 to 5 per cent now
10. In 2000, ad volarem tariffs were supplemented by the introduction of high specific tariffs to protect fabrics, garment producers. World Bank, Dhaka: India –Bangladesh Bilateral Trade and Potential Free trade Agreement (Bangladesh Development Series, Paper No.13)
11. India's Current Engagement to RTAs (http://commerce.nic.in/India_rta.htm)
12. Ibid
13. World Bank, Dhaka: India –Bangladesh Bilateral Trade and Potential Free trade Agreement (Bangladesh Development Series, Paper No.13)
14. Indo-Bangladesh Dialogue on Trade , Investment and Connectivity, Dhaka August 2005, Centre for Policy Dialogue, Dhaka and India International Centre
15. RIS policy Briefs: Facilitating India's Overland Trade in the Eastern Neighbourhood (No. 29, December 2006) by Prabir De
16. Harun ur Rashid in 'Holiday', February 20, 2004

20, Rouse Avenue, New Delhi-110 002
Phone: +91-11-43520020
Fax: +91-11-43520003
www.orfonline.org
email: orf@orfonline.org