

Nepal's Trade Promotion through SAFTA: Impediments and Possibilities

Dissertation

Submitted to

Department of International Relation and Diplomacy (DIRD)

Faculty of Humanities and Social Sciences

Tribhuvan University

In Fulfillment of the Requirement for the

Master's Degree

In

International Relations and Diplomacy

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April, 2020

LETTER OF RECOMMENDATION

I certify that this dissertation entitled "Nepal's Trade Promotion through SAFTA: Impediments and Possibilities ” was prepared by Yunesh Pratap Singh under my supervision. I hereby recommend this dissertation for final examination by the Research Committee Department of International Relations and Diplomacy, Tribhuvan University, in fulfillment of the requirements for the Degree of MASTER’S IN INTERNATIONAL RELATIONS AND DIPLOMACY.

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DECLARATION

I hereby declare that this dissertation is my own work and that it contains no materials previously published. I have not used its materials for the award of any other degree. Where other author's sources of information have been used, they have been acknowledged.

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Acknowledgements

I would like to express my sincere gratitude towards my supervisor Mr. Achal Raj Pandey for his continued assistance throughout the journey of this thesis. From helping to narrow down the area of research to a concrete subject to his interminable advice and remarks, his guidance was invaluable for the completion of the research.

I am also indebted towards the Program Coordinator of Department of International Relations and Diplomacy- Professor, Khadga K.C., PhD, for his unwavering patience, concern and guidance. His mentorship and encouragement has been a blessing.

I would be certainly be remiss if I did not specifically mention the names of Prajesh Raj Aryal and Prabal Poudel, for they have contributed profusely to bring this thesis into fruition. Further, I would like to express my sincere gratitude towards Garima Uprety for being so forthwith with her help in arranging the format of the thesis in line with the specifications. Likewise, I am immensely indebted towards Pratiksha Ghimire for her continued motivation and encouragement throughout the process.

Abstract

Nepal aspired to achieve trade diversification with countries of South Asia other than India through the agreement on SAFTA. This study analyzed the pattern of Nepal's trade post 2010 A.D. under the framework of SAFTA. Further, it delved deeper into the impediments encountered by Nepal in pursuance of the aforementioned objective and the prospects of expansion of trade in the region. Through various trade data and statistics, the research showed that Nepal has been left wanting in terms of achieving the stated objectives. However, there exists considerable potential to augment trade with countries of Rest of South Asia.

Key Words: SAFTA, Trade Diversification, Impediments, Trade potential

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- Sensitive List under SAFTA
- Growth in imported value of goods in countries of South Asia
- Trade Complementarity Index of Nepal with countries of South Asia
- Trade Potential with Countries in Rest of South Asia

List of Abbreviations

ADB	Asian Development Bank
ASEAN	Association of South East Asian Nations
CENTO	Central Treaty Organization
COE	Committee of Experts
ECOWAS	Economic Community of West African States
GATT	General Agreement on Tariffs and Trade
GCR	Global Competitiveness Report
LDCs	Least Developed Countries
MERCOSUR	Southern Common Market
MFN	Most Favored Nation
MNCs	Multi-National Corporations
NAFTA	North American Free Trade Agreement
NLDCs	Non Least Developed Countries
OAS	Organization of American States
OUA	Organization of African Unity
PTA	Preferential Trading Agreement
RSA	Rest of South Asia
S&D	Special and Differential
SAARC	South Asian Association for Regional Cooperation
SAFTA	South Asian Free Trade Area
SARC	South Asian Regional Cooperation
SEATO	South East Asia Treaty Organization
SMC	SAFTA Ministerial Council
SPS	Sanitary and Phyto-sanitary
TBT	Technical Barriers to Trade

Chapter One : INTRODUCTION

1.1 Background

Free trade is a policy of international trade which entails the free movement of goods for importation or exportation without any restrictive or distortionary interference from the government. Ever since Adam Smith and David Ricardo expounded the benefits of free trade, it has established itself as a norm rather than an exception in the last couple of centuries. Free trade took a form that we know today especially after the end of World War II with the establishment of General Agreement on Tariff and Trade (GATT) which provided a rule based platform for trade between states. However, as international trade under multilateral institutions grew in significance, states other than those considered as the economic powerhouses started growing increasingly disconcerted with the apparent benefits of multilateral trading regimes, and, thus resorted to creating regional trading blocs under regional trading agreements constituting states with shared geography and common economic interests. Regional trading bloc such as ASEAN is deemed to be an offshoot of the aforementioned problem of multilateral trading regime. South Asia witnessed its own version of regional intergovernmental organization with the establishment of South Asian Association for Regional Cooperation (SAARC) on December 8, 1985 A.D., comprising of Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka; with Afghanistan joining as the 8th member on 2007 A.D. SAARC was brought into being with the manifest objective of accelerating economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realize their full potentials. (SAARC Charter, 1985). A move towards greater trade liberalization

in the region was realized with the coming into force of South Asian Preferential Trading Arrangement (SAPTA) in 1995 A.D. which envisioned the creation of a Preferential Trading Area among member states. The aim was to prevent the marginalization of South Asia's trade in global market by the dint of improvement of the productive capacity of member states (Lohani, 2008). Although, SAPTA was a mildest form of integration, it provided the opportunity for greater forms of economic cooperation (Hossain, 2009,p.5). However, SAPTA could not produce the desired results as it was plagued by several flaws. Limited product coverage and tariff preferences rendered it ineffective in generating the expected level of economic integration among member states.(Sawhney and Kumar, 2008,p.2) This led to SAPTA being replaced by Agreement on South Asian Free Trade Area (SAFTA) which came into effect on July, 2006 A.D. with the ultimate objective of creating an economic union. With historical cultural and economic ties among the states in the region it was widely believed that SAFTA would serve as a stepping stone for the realization of much higher degree of economic integration within the region, wherein the Preamble to the agreement states that "preferential trading arrangements among SAARC Member States will act as a stimulus to the strengthening of national and SAARC economic resilience, and the development of the national economies of the Contracting States by expanding investment and production opportunities, trade, and foreign exchange earnings as well as the development of economic and technological cooperation"(SAARC Secretariat,2020) Unlike its predecessor, the agreement has been embedded with several features such as Trade Liberalization Program, Rules of Origin, Revenue Compensation Mechanism, Technical Assistance for LDCs and much else besides (Hossain, 2009, pp.6-7).

Nepal joined SAFTA with much optimism and with a view to diversify its exports to other countries in the region, which was hitherto primarily tilted towards its southern neighbor

India. Extant literature stand starkly divided on the merit of SAFTA in propagating regional trade and in aiding member states, including Nepal, to achieve destination wise export diversification. Nepal's stated aim in entering into trade agreements has been to secure better market access conditions for its exports, achieving product wise and destination-wise export diversification and reducing trade deficit, Nepal's Trade Policy, 1992 and Trade Policy, 2009 (as cited in Adhikari and Kharel, 2011, p.3). The actual performance in terms of SAFTA helping Nepal to achieve export diversification to Rest of South Asia (RSA) does not paint a pretty picture. It is argued that inconsistency between Nepal's trade policies with respect to SAFTA, supply side constraints, comparative advantage in similar items of export interest, among others; act as impediment to achieve greater regional economic integration. However there is also a degree of optimism surrounding the efficacy of SAFTA where the emergence of regional production networks and the attendant intra-industry trade within the region through the implementation of the provisions of the agreement could facilitate member states to achieve their objective of expanding their trade with other states in the region (Sawhney and Kumar, 2008, p.2).

In this light, the research will seek to delve into the issue of changes in pattern of Nepal's trade vis-à-vis Rest of South Asia, India and overall international trade post 2010 A.D. It will also be pertinent to look into the agreement in and of itself. Likewise, impediments in the realization of greater trade diversification under the agreement will be sought to be analyzed with a further enquiry into potential possibilities.

1.2 Statement of the problem

While there exists considerable amount of literature pertaining to the effectiveness of SAFTA with respect to expansion of trade in and among countries of South Asia, concrete research with regard to changes in pattern of trade of Nepal vis-à-vis South Asia, and in particular with Rest of South Asia is few and far between. The primary research problem of the research is to analyze the pattern of trade of Nepal with Rest of South Asia post 2010 A.D. and to explore existing hurdles and potential for the expansion of trade with Rest of South Asia.

1.3 Research Objectives

The primary objectives of the research will be:

- To assess the pattern of Nepal's trade with Rest of South Asia under SAFTA post 2010 A.D.
- To analyze the impediments in realizing the promotion of Nepal's trade with Rest of South Asia under SAFTA.
- To explore the possibilities for the expansion of trade with Rest of South Asia.

1.4 Research Questions

The research will seek to explore answers to the following questions:

- What is the pattern of Nepal's trade with Rest of South Asia under SAFTA post 2010 A.D.?
- What impediments exist in furtherance of Nepal's trade with Rest of South Asia?

- What are the possibilities for the expansion of Nepal's trade under SAFTA in terms of destination wise export diversification?

1.5 Significance of the Study

Though there are a considerable number of studies carried out on the subject of SAFTA and its efficacy in promoting intra-regional trade, research on the issue of Nepal's trade performance under the framework of the agreement is few and far between. Thus this research will contribute to fill the existing gap of knowledge in existing literature with regard to Nepal's trade performance under SAFTA. Likewise, it will also be useful to all those interested in discerning the pattern of Nepal's trade under SAFTA post 2010 A.D. and the impediment and possibilities thereof.

1.6 Definition of Key Terms

- Rest of South Asia: It comprises member states to the agreement other than India; namely Afghanistan, Bangladesh, Bhutan, India, Maldives, Pakistan and Sri Lanka.
- Impediments: It refers to structural drawbacks of Nepal that are inhibiting the exploitation of possibilities offered by the agreement.
- Pattern of trade: It represents the trend of trade, i.e. volume of import and export, of Nepal with the Rest of South Asia under the agreement.
- Possibility of export diversification: It refers to the potential offered by the agreement to diversify trade of Nepal to countries in the region other than India.

- Trade complementarity: It refers to the extent to which the exports of one country are compatible with the imports of its trading partner.

1.7 Limitations of the Study

In the research only the overall picture of trade is analyzed and an attempt has not been made to look into the pattern of trade in terms of products due to limitations in accessing relevant data. Likewise, the research has also been constrained by the dearth of literature available on the issue of Nepal's trade performance under the framework of SAFTA.

The lack of country wise trade data prior to 2010 A.D. has limited the scope of the research in making a comparison of pattern of trade before and after the coming into effect of SAFTA. Hence data from 2010 A.D. has been used.

1.8 Organization of the Thesis

Chapter 1: Introduction

The introductory chapter sets forth the background of the research and encompasses the statement of the problem, research objectives, significance of the study, delimitations, methodology and organization of the study.

Chapter 2 : Literature Review

This section of the research looks into the extant literature pertinent to the subject at hand including an analysis into current literature on regionalism and its history, SAFTA, Nepal's trade performance under SAFTA and the impediments and possibilities thereof. The section attempts to look into what has been said and what gaps exist in available literature.

Chapter 3: Conceptual Framework and Research Methodology

This section of the research will illustrate the conceptual framework of the study and the research methodology adopted to conduct the study and arrive at its conclusion.

Chapter 4: Regionalism: Concept and Evolutionary Practices

This section delves deeper into the concept of regionalism, its history, evolutionary practices and motivational factors of regionalism. Likewise it also includes a look into the subject of regionalism in South Asia and the pre-requisites of regionalism in South Asia.

Chapter 5: Regionalism in South Asia and the SAFTA Agreement

This section of the research looks into the subject of regionalism in South Asia and the pre-requisites of regionalism in South Asia. Likewise, it further goes into analyzing the various features of the SAFTA agreement.

Chapter 6: Nepal's Trade Performance through SAFTA: Impediments and Possibilities

This chapter of the research lays down the findings and results of the research. It analyzes the current trend of trade in South Asia, the pattern of Nepal's trade with Rest of South Asia post 2010 A.D., the impediments in the augmentation of Nepal's trade with countries of Rest of South Asia under the SAFTA agreement and the possibilities thereof.

Chapter 7: Summary and Conclusion

This section summarizes the findings of the study and proposes the steps that can be adopted moving ahead.

Chapter Two: REVIEW OF LITERATURE

For the purposes of the thesis it was apt to begin by looking into the idea of regionalism itself, and, then on delve deeper into the agreement on SAFTA, in and of itself. Regionalism is generally understood as a conglomeration of states of a particular geographical area pursuing common interest through collective action. However, the idea of what actually constitutes regionalism is still a contested issue. As noted by Fawcett (2012) "The concept of regionalism has had a complex history because of its essentially contested and flexible nature and because of a divergence of views as to whether or not regionalism is an effective or desirable organizing mechanism in international politics." (p.4). However it cannot be denied that regionalism has established itself as an integral component of International Relations literature, especially post World War II. Likewise in the study of regionalism, a distinction is also drawn in what is understood as a dichotomy between 'old regionalism' and 'new regionalism'. While old regionalism was primarily guided by state based regional organizations characteristic of the post-World War II era, new regionalism on the other hand is marked by both formal and informal relationships and interactions between states as well as non-state actors (Fawcett,2012, p.4) Thus in the domain of new regionalism, agency is also provided to non-state actors.

Moving on, in trying to understand the concept of regionalism, it is also pertinent to look into various theories that seek to describe the motivation behind cooperation between states. This in turn will help to broaden the understanding of regional cooperation. (Reed,1997,pp.236-239) has highlighted four major approaches to international cooperation: (a) realist or state centric approach which is based on the premise that states are the most important actors in international affairs and thus are the only relevant agency in relationship between states; (b)

economic or firm centric approach which posits that the end of the cold war politics has made the idea of a purely political basis of relation between states irrelevant, which has thus provided a room for firms to play a role in forging relation between states. It argues that regionalism becomes operational when the firms of the respective countries can acquire economic gains through collaboration; (c) institutionalist approach which views institutions as both the cause and effect of international relations and (d) political economy approach which asserts that neither states nor institution of themselves can play a determining role in interaction between states and provide primacy to the role of 'historical structures' in interaction between states, where historical structures represent a composite of material, ideological and institutional structures.

While discussing the subject of regionalism, it is also important to look into how regional geopolitical systems are viewed through the lens of International Relations theories. Much of the traditional literature on regional geopolitical system was centered on the realist state centric approach which accorded primacy to state sovereignty in any regional groupings. Viewed from this lens a regional arrangement comprised four primary actors: the hegemon or aspiring hegemon, bargainer, peripheral dependent and external challengers. Cantori and Speigel (as cited in Paranjpe, 1996, p.95). In this respect, Paranjpe (1996) contends that:

There has been no evidence of geopolitical systems being perceived on such idealist concerns like “the development of organized structures for peace or creation of a society of states for order in human society-as a whole.” Those initiatives having such concerns have usually addressed themselves to functionalist or philosophical concerns that transcend geopolitical boundaries of regions. Efforts at developing a “regionalistic” pan -Asian or Afro-Asian peace approach in 1940s and 1950s and the emergence of non-alignment may be classified as part of this approach. pp.95-96

In this light the fundamental approach to the understanding of regionalism in South Asia has been through the realist framework based on the premise of state centrism with the concept of national sovereignty at its core. This approach towards analyzing regionalism in South Asia, according to (Paranje, 1996, pp.96-97) revolves around four tenets:

- a) South Asia a conglomeration of geographically close states bound together by common history and culture;
- b) India by the dint of its economic and military might occupies central position in the region;
- c) South Asia, sans India, has two types of actor: bargainer and peripheral dependent;
- d) Other small states in the region such as Nepal, Bhutan and Maldives, still hold significance through their 'nuisance value' as they wield bargaining power in times of crisis.

However with the changes that occurred post-Cold War, the aforementioned basis of viewing regionalism has undergone a paradigm shift. The emergence of new actors in international relations, increasing establishment of multilateral platforms of international cooperation, advancement in information and communications technology and the increasing mobility of finance and human capital has rendered the notion of state sovereignty diluted. This has been brought about by both supra-national integration and sub-national disintegration.

(Paranje, 1996, p.101). Paranje (1996) further asserts that "The fundamental paradigm has shifted to multi-centricism. This approach to international relations can be described as trans-nationalist or complex interdependency." (p.101). He further goes on to argue that the paradigm has shifted towards multi-centricism which can be described as trans-nationalist or

complex interdependency which is more in line with the neo-liberal school of thought.

Likewise Paranje (1996) observes that:

Economic Integration appears to be the inevitable course for regional organizations today. The political implications of economic integration would mean the less of sovereignty for national governments. Economic integration with a harmonized monetary policy will encompass all aspects of commerce and public welfare', it will also dilute national sovereignty. p.101

Moving on, it is pertinent to look into how current literature views the prospects of SAFTA in augmenting intra-regional trade. To begin with, the success of SAARC in forging regional cooperation itself has been a matter of considerable polemic. Despite over three decades of existence, SAARC has not been able to deliver the expected results in terms of economic cooperation, information flows, value systems and ideas of security (Baral, 2003, p.265). In this respect Baral (2003) asserts that "There have been no signs of regional cooperation, neither in terms of the economic cooperation for which SAARC was established, nor in terms of promotion of understanding and peace." (p.266). Likewise he further argues that:

As far as economic activity is concerned, the South Asian states seem to be inclined more to continue a bilateral pattern than to create a regional economic entity. The negligible intra-regional trade and investment over the years suggest that South Asian states are less interested in developing a cooperative framework of economic cooperation. There has also been a marked tendency of South Asian states to develop their own individual relations with other regional groupings and individual countries.pp.267-268

SAFTA was brought into effect in supplantation of the earlier agreement pertaining preferential trading which was the South Asian Preferential Trading Arrangement (SAPTA). However the positive list based SAPTA could do little to enhance the extent of intra-regional trade. Through SAFTA the concerned member states sought not only to join the bandwagon of growing number of preferential trading arrangements throughout the world but also aimed to enhance the level of intra-regional trade, where South Asia had continuously remained one of the least integrated regions of the world. In this regard, a study by The Center for Policy Dialogue (CPD), Bangladesh (as cited in Moinuddin, 2008, pp.140-144) has identified some key pre-requisites for the effective functioning of a regional trading arrangement which are as follows:

- Geographical proximity
- High level of pre-PTA tariffs
- Some degree of pre-PTA intra-regional trade
- Trade complementarity and difference in economic structures
- Political harmony in the region

It has been noted that South Asia was endowed with geographical proximity and high level of pre-PTA tariff, but it lacked other essential preconditions.

The agreement on SAFTA itself sought to remedy some of the deficiencies of SAFTA where the agreement itself was embedded with features such as:

- Trade Liberation Program
- Sensitive List of Goods

- Institutional Framework
- Rules of Origin
- Dispute Settlement Mechanism (SAFTA Agreement)

The extant literature in the area stand starkly divided with respect to the prospects of SAFTA in facilitating the expansion of trade among members in the region, with most of the work being heavily skewed towards evincing pessimism with respect to the prospects of SAFTA. This pessimism primarily stems from factors such as inherent limitation of the agreement, limited export complementarities, supply side constraints and much else beside. SAFTA is not viewed as an ambitious free trade agreement with sincere aim of expanding regional trade as is evidenced by the large number of commodities kept in the negative list, i.e., outside the purview of concessional duty, by the member states and intermittent political hurdles, for instance the scrapping of the Most Favored Nation status India to Pakistan. The extensive negative list and the concomitant limited product coverage effectively eroded the prospects of intra-regional trade (Sawhney and Kumar, 2008, p.8). However, SAFTA has also witnessed bursts of enthusiasm. With regard to the low level of trade complementarities, Srinivasan as cited in (Sawhney and Kumar, 2008) has observed that it "reflects in part the barriers that countries have imposed on their trade, which were intended to change the trade pattern away from what would emerge were they to allow their true comparative advantage to dictate their trade." (p.13) Likewise, it has also been noted that models depicting the prospects of regional trade tend to overlook the possibility of expansion in intra-industry trade within the region as demonstrated by the members of

ASEAN. Further still (Sawhney and Kumar, 2008, p.15) note that four factors provide impetus for greater integration in South Asia:

- Pure economic gains through efficient use of capital and labor as well as distribution of goods and services across borders,
- other non-traditional gains from greater regional integration like increased flow of FDI,
- Strategic gains when the South Asian countries negotiate as a unified group in multilateral fora, and
- developmental and environmental efficiency gains arising from adopting a regionally integrated approach towards provision of regional public goods like environment, water conservation and other natural resources including the regional ecosystem and related bio-diversity,

With regard to the implications of SAFTA to Nepal in terms of its trade diversification towards Rest of South Asia, literature is few and far between. Extant literatures point to several impediments limiting the ability of Nepal from reaping benefits from SAFTA to the hilt, while at the same time also see potential from SAFTA as well. It is felt that countries in South Asia have a comparative advantage in similar products, and view themselves as competitors in the international market, thus limiting the possibility of intra-regional trade. Similarly, policy and structural factors such as tariff and non-tariff barriers, para-tariff, high transaction cost, transit difficulties and supply side constraints are also seen as an impediment in Nepal's trade expansion in Rest of South Asia.(Adhikari and Kharel, 2011) However, there are also grounds to be optimistic about Nepal's trade with Rest of South Asia under SAFTA. The successive reduction of the number of items in the negative list does provide much relief. Likewise a regional forum

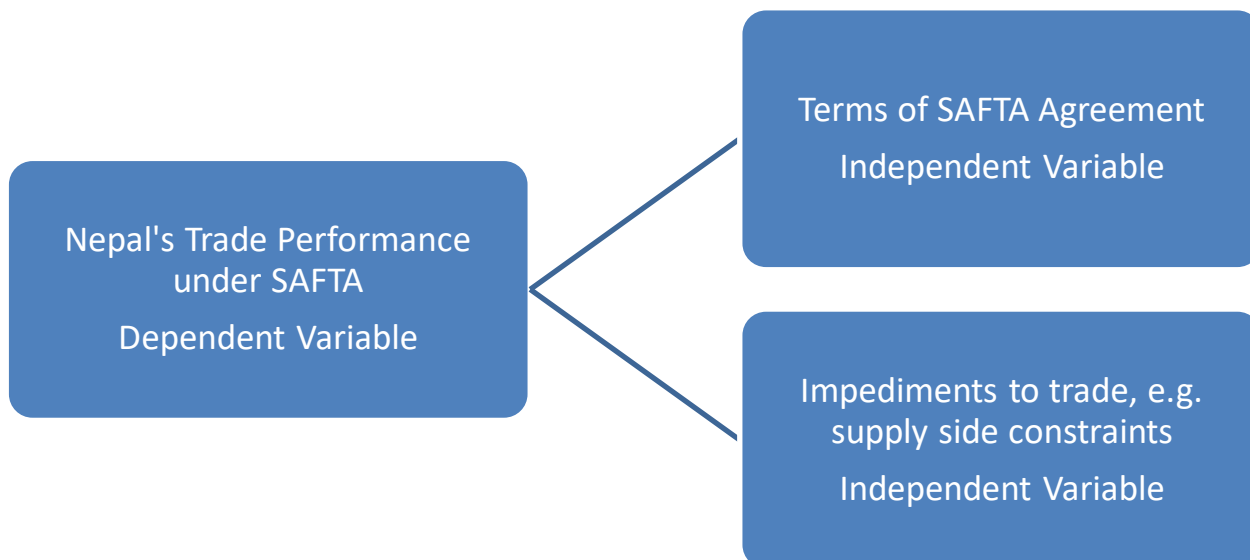
such as SAFTA also provides a much more predictable trading platform for small parties and can also be leveraged to resolve disputes under bilateral trade treaties (Adhikari and Kharel, 2011, p.8). In this respect Sawhney and Kumar (2008) have noted that:

the motivation for greater integration in the South Asian region follows from four distinct factors: first, pure economic gains through efficient use of capital and labor as well as distribution of goods and services across borders; second, other non-traditional gains from greater regional integration like increased flow of FDI; third, strategic gains when the South Asian countries negotiate as a unified group in multilateral forums; and fourth, developmental and environmental efficiency gains arising from adopting a regionally integrated approach towards provision of regional public goods like environment, water conservation and other natural resources. p.15

Chapter Three: CONCEPTUAL FRAMEWORK AND METHODOLOGY

3.1 Conceptual Framework

The conceptual framework of the research can be illustrated viz:



3.2 Research Methodology

A) Research Design

The research is both descriptive and analytical in nature. It makes use of both qualitative and quantitative data. The research specifically looks into how Nepal's trade pattern has changed post 2010 A.D. under the SAFTA agreement. Likewise the research will also take a longitudinal approach as it analyzes the trade data of Nepal as well of other countries in South Asia post 2010 A.D.

B) Nature and Scope of Data

The research is based on secondary quantitative and qualitative secondary data. With regard to the change in pattern of Nepal's trade with Rest of South Asia, secondary quantitative data and statistics present in different platforms of government agencies such as the Department of Customs, Ministry of Finance and Ministry of Industry, Commerce and Supplies is analyzed. Data and statistics included in the annual Foreign Trade Statistics published by the Department of Customs was the primary source of data analyzed. Likewise, data available in online platforms such as World Integrated Trade Statistics was also used.

C) Tools and Techniques of Data Analysis

Change in the pattern of trade was sought to be discerned by looking into the change in trade, both in terms of absolute volume and in terms of comparative percentages. Graphical tools such as line graphs were used to give a pictorial representation of the trend of trade with Rest of South Asia. Likewise, assessment was also made of the average rate of change in pattern of trade over a period of 2010-2018 A.D.

In order to explore impediments to intra-regional trade and the possibility of expansion thereof, assistance was sought of qualitative secondary data present in different journals, published articles and books pertinent to the subject.

D) Unit of Analysis

The unit of analysis of the research is Nepal's trade performance under the framework of SAFTA agreement.

Chapter Four: REGIONALISM- CONCEPT AND EVOLUTIONARY PRACTICES

4.1 The concept of regionalism

It is indeed an arduous task to limit the concept of regionalism in a specific definitional bracket given its highly flexible and evolving nature. In this regard Danesh Sarooshi (as cited in Fawcett,2012,p.4) observes that " The United Nations Charter contributes to this flexibility, avoiding precise definitions of regional agency, to allow for the possibilities of multiple partnerships. "Likewise, the fluidity of the concept of regionalism is further compounded by what different scholars have observed as a dichotomy between "Old Regionalism" and "New Regionalism". While Old Regionalism was characterized by the preponderance of the role of states as the principle agents, New Regionalism, on the other hand, is a more diverse concept with the involvement of actors other than states. Thus, with regard to the scope and nature of the two types of regionalism mentioned above Fawcett(2012) states that " Old regionalisms were focused (mainly) around examples provided by a European/North American core, new regionalisms have a more global reach and greater autonomy from the core, embracing regions from the former 'South'" p.4. Taking this into account scholars agree that it is important to devise a definition of regionalism that is broad enough to accommodate the changing nature of regionalism and at the same time narrow enough to lend itself to academic cohesion and analytical rigor. Thus with this in mind regionalism can be understood as a conglomeration of states of a particular geographical area collectively pursuing a set of common goals. It can be viewed as a set of policies and practices pursued by state based permanent organizations, the

membership of which is confined to a limited geographical area (Fawcett, 2012, p.3). Further, Joseph Nye (as cited in Fawcett, 2012) posits that "region is a limited number of states linked by geography and interdependence and regionalism a formation of and policies pursued by inter-state groups based around a region" p.5. Thus, the effects of globalization and the effects of the role played by non-state actors in regionalism notwithstanding, state remain the principle actors in the operations of regional organizations.

4.2 History of Regionalism

Although regionalism, per se, has existed in one form or the other at different stages, the kind of regionalism that we have come to be accustomed to germinated principally after the Second World War. Through different stages of evolution and modifications, today regionalism has firmly established itself in the discourse of international relations and trade, wherein Fawcett (2012) opines that " By the start of the 21st century, if not before regionalism was well established in the vocabulary of International Relations Scholars and practitioners such that it would be hard to imagine a world without it." p.2

While it is the European countries that have been the primary protagonist of the story of regionalism, other regions too have now come to make their presence felt through active participation in platforms of regional collaboration. It is pertinent to highlight that South American states were also early advocates of regionalism post their independence in the nineteenth century, where it was later intertwined with the wider notion of Pan- Americanism. Likewise, the African states too have been vigorous advocates of regionalism, where, in the 21st century they devised various elaborate schemes of regionalism and are deemed to be the path-breakers in the journey of regionalism with their adoption of the principle of "Responsibility to

protect." Thus it can be gauged that regionalism as a concept and praxis has not followed a linear path and has rather sprang up in different stages by being shaped by a myriad of external and internal factors (Fawcett, 2012, p.8). In this respect Micheal Barnett (as cited in Fawcett, 2012) goes on to point that:

Though 1945 is often taken to be a starting point in the development of formal organization, there are significant prior histories of regionalism which deserve mention since these informed early institution building and arguably continue to inform regional processes today. For example Arabism, born of the late Ottoman and European colonial experiences, has closely informed the development of regional institutions, notably the League of Arab States, but also the GCC. Hence Arab Congresses predated formal organization. Though constitutionally the League (and the GCC) was an organization that placed state sovereignty first, the influence of Arabism in decision and alliance making was marked, particularly in respect of Arab-Israel relations and the question of Palestine.

The Americas, notes Fawcett, developed a unique brand of regionalism with its characteristic 'regional idea' primarily based on the notions of anti-colonialism and independence. The late nineteenth century saw the conflation of different ideas of regionalism with the concept of Pan-Americanism, which is also attributed to the rise in US ascendancy. However, post 1945, different American state started to advocate of different avenues of regionalism of which the Southern Common Market (MERCOSUR) and most recently the Union of South American Nations (UNASUR) and the Bolivarian Alternative for the Americas (ALBA) can be cited as primary examples. Likewise, the period after 1945 provides a sturdy stepping stone for the analysis of contemporary regionalism, in that, the period witnessed the novelty of formal international institutions, the expansion of international arena through decolonization and

the first attempt to set out the parameters for a regional-multilateral relationship in the United Nations and other bodies (Fawcett,2012, p.8). In this light Fawcett (2012) further notes that "However, it is the case that the post-Cold War expansion of regionalism, across different regions and issue arenas had a powerful impact on its status in International Relations and International Law" (p.9)

Fawcett has categorized the early post war regionalism in three main clusters: security based regionalism such as NATO, SEATO, CENTO, trade based regionalism such as NAFTA, EC, PAFTA and multipurpose regional organizations such as OAS and OAU. He further points that the performance of early regionalism, other than the European experiment and the quasi-regionalism of NATO, were not deemed to be particularly successful when gauged through security and economic parameters. However, despite the aforementioned situation, the concept and indeed the practice of regionalism did become firmly embedded in international relations. This can be attributed as (Fawcett, 2012, p.9) opines, to the limitations of the United Nations where peace, security and economic development were rendered by regionally based institutions. The period of Cold War provided further impetus to the growth of regional organizations primarily because of the changing security and economic priorities of states and the desire among regional actors to better manage their own affairs. Thus, regional organizations sprang up in different quarters of the globe such as ASEAN, SAARC, ECOWAS and GCC. This burgeoning of regional organizations, Fawcett notes, is deemed as the first wave of regionalism with the second wave to occur after the end of the cold war.

The kind of regionalism witnessed post-Cold War evinced some novel features, particularly in terms of its scope and multi-dimensional nature, while at the same time retaining essential features of the earlier era. Here, Barry Buzan and Ole Waever (as cited in Fawcett,

2012) remark that "International system change, as in the early Cold War, in particular the removal of 'superpower overlay' transformed the international security environment making regions more vulnerable and regionalism more attractive." p.10.

Thus the period bore witness to growing importance of regional organization where a number of new institutions such as the Asia Pacific Economic Conference (APEC), the ASEAN Regional Forum (ARF), the Arab Maghreb Union (AMU), and the Commonwealth of Independent States (CIS), while older organizations expanded their memberships as well as taking on different tasks and activities.

4.3 Theories of International Cooperation

While delving deeper into the concept and history of regionalism, it is pertinent to look into the various theories of international cooperation which will help in understanding the driving factors of regionalism. Various studies in international relations have classified the theories of international cooperation into four broad categories, which are discussed viz:

- **The realist or state centric approach:** This approach broadly posits that states being the primary actors in international relations, they themselves are the primary drivers of international cooperation. In this regard, Reed (1997) states that:

It proceeds from the Hobbesian premise that states are essentially self-interested in that they seek to maximize their economic and political security with an international system which has no central government, and, therefore, is anarchical. The interest of every state is to prevent poverty and war. International relations, in this view, can at best comprise a network of arrangements on a quid pro quo basis which is mutually beneficial for the participants on clearly defined economic/political grounds. p.236

- **The economic or firm centric approach:** This theory is based on the contention that the end of cold war has provided room for firms to play a decisive role in guiding foreign policy of states. Busch and Milner (as cited in Reed, 1997, p.236) argue that regional instrument of collaboration will develop between countries if firms in those countries deem that they can avail the benefit of economies of scale by collaborating on a regional basis rather than through a multi-lateral platform. They further go on to state that:

firms are likely to prefer regional cooperation under three kinds of conditions: (1) where firms are export-dependent; (2) where strong multi-nationality of firms exists; and (3) where the possibility of intra-industry trade exists. Assuming there is such demand for regionalization; Busch and Milner ask if the state will supply the necessary institutions that facilitate regionalization. Busch and Milner suggest conditions under which states will respond positively to the demands for regionalization put forward by firms. For example, in economies where multinational corporations (MNCs) and exports contribute to a large share of national income, states would be willing to respond to their requests for specific trade arrangements. Similarly, where a strong potential for intra-industry trade within a region exists, states would be more inclined towards regional integration. p.236

Other theorists such as Balassa (as cited in Reed, 1997, p.237) contend that regionalization occurs between countries producing the same type of products and having similar resource base. However, others such as G. Gereffi (as cited in Reed, 1997, p.237), argue that for the above model to be functional it requires different countries to specialize in different components of the same product where these require different degrees of technical sophistication. Gereffi further states that "This has traditionally been the pattern

of exchange between the "core" and "periphery," where the periphery has exported primary commodities or semi-processed products and the final assembly, labeling and marketing was done in the "core" countries." p.237

- **Institutional approach:** This theory contends that relations between states tend to be strained due to the inefficacy of institutions, thus states should look towards institution building in order to augment the level of cooperation between states. However, authors such as Reed (1997) argue that "While institutions are obviously necessary to provide a material basis to international relations, I wish to argue that they in and of themselves cannot engender an enduring international arrangement." (p.238)
- **Political-economy approach:** Political economist contend that neither states nor firms in and of themselves can induce inter-state relations and give a greater prominence to the role of historical structures- structures being a composite of material structures, ideological structures and institutions (Cox,1981). Reed (1997) asserts that:

One important element of this approach is the notion of structural power of capital, which primarily determines state-capital and interstate relationships. It is this structural power of capital that is being manifest through the rise of global finance, and has brought about what some political economists have called the "new diplomacy" of the post-cold war era. The parties to this new arrangement are states, domestic capital and transnational capital, where the structural power of transnational capital is the greatest at present. p.238

4.3.1 The universalism and regionalism debate

There exists considerable polemic among scholars on the merits of universalism, i.e. multilateral platforms of international cooperation, as compared to the merit of regional organization, and regarding which among the two is preferable in guiding international political and economic affairs. This debate can be traced back to the very foundations of modern regionalism where Fawcett (2012) notes that "Regionalism has been judged in terms of its relationship with other multilateral institutions notably those relating to trade and finance (the Bretton Woods institutions) and security (the United Nations system)." (p.5)

The architects of the post-World War II world order were decidedly in the favor of a universal rather than a regional approach towards guiding the world affairs. This early aversion towards regionalism primarily stemmed from the ignominy acquired by regionalism, where the period was characterized by expansionist politics of the then powerful states like Germany, Japan and Italy with their Pan-European and Pan-Asian authoritarian ambitions. Thus it was widely held that only by the dint of a universal conglomeration of states could the international world order be restored to its normalcy (Fawcett, 2012, p.5). However, there was still a glimmer of hope for regionalism. In this regard Fawcett (2012) further elaborates that:

However, there was also recognition that states would wish to conduct their economic, political and security affairs within defined regional and geographical contexts, as already evidenced in the Americas, in the Inter American system, and indeed in Europe itself where a so-called 'concert' of powers had regulated 19th century regional relations. The UN's own organization clearly reflects this, for example in the establishment of regional economic commissions and voting procedures. p.5

The space for the role to be played by regional organization is also provided by the United Nation its Charter, Article 51-54 elaborate various provisions regarding regional organizations and their relationship with the United Nations. Article 52, for example, provides an avenue for regional arrangements to execute a formal role in contributing towards world peace and security. However, as Fawcett (2012) has stated "The tone, unequivocally, is UN-first with insistence on reference and deference to Security Council decision making. Hence Article 53 asserts that 'the Security Council shall, where appropriate, utilize such regional arrangements or agencies for enforcement action under its authority" (p.6). Likewise, with regard to the role of regional organizations in trade and commerce Article 24 of the General Agreement of Tariff and Trade provides for the creation of regional trading arrangements to establish a free trade area.

4.4 Theoretical premise of economic integration

That free trade based on the principles of comparative advantage is desirable had been established ever since the benefits of the same were expounded by pre-eminent economists such as Adam Smith and David Ricardo. In this regard various theories exist highlighting the desirability and characteristics of economic integration between states. Thus the literature on economic integration developed primarily as a product of neo-classical welfare economics with its emphasis that states should concentrate on the production and export thereof of product in which they have a comparative advantage and the attainment of increased welfare through freeing of trade by eliminating barriers to trade among partner countries. Likewise, functionalist and neo-functionalist theories of integration are primarily based on the notion of customs union with the famous typology propounded by Bela Balassa, namely of free trade area, customs union, common market, economic union and complete economic integration (Haq, 2004, p.68). The

aforementioned typology represent varying degree of integration wherein as Haq (2004) has elaborated:

in a free trade area, tariffs and other restrictions are abolished among the participating states. A customs union adopts a uniform tariff for trade with the non- members, in addition to suppression of discrimination. Common market is a customs union in which restrictions on factor movements are abolished. Labor and capital can move freely within the participating system without any sort of restriction. Economic union includes the characteristics of a common market with a degree of harmonization of monetary, fiscal and social policies. Total economic 'integration' would add complete unification of economic, fiscal and other policies including the adoption of common monetary system. It would also include the setting up of a supranational authority whose decisions would be binding upon participating countries. p.69

Bela Belasa (as cited in Haq, 2004, p.69) deems economic integration as both a process and state of affairs. Regarded as a process, as noted by Haq (2004) "it encompasses various measures abolishing discrimination between economic units belonging to different national states: viewed as a state of affairs it can be represented by the absence of various forms of discrimination between national economies."(pp.69-70). Thus in theories in economic integration it is widely acknowledged that there is a comprehensive consensus on three key issues, viz- (i) economic integration primarily refers to division of labor between states, (ii) it involves the mobility of goods or factors or both, and (iii) it is related to discrimination or non-discrimination among factors and goods. (Haq, 2004, p.70). In this respect, Balasa (as cited in Haq 2004) attributes the lackadaisical progress of economic integration in developing countries to:

- item-by-item negotiations on tariff reduction encounter considerable difficulties because of the power of special interests ;
- differences in the level of industrial development have made agreements on trade liberalization difficult;
- in view of the distortions in relative prices due to protection, it has been difficult to determine the benefits to be derived from integrations and there has been a tendency to consider changes in the trade balance as a sign of gains or losses;
- governments of individual countries have been reluctant to proceed with integration because they are anxious to safeguard their sovereignty; p.70

He further opines that a fundamentally different rationale should be sought in order to pursue economic integration of less developed states.

Chapter Five: REGIONALISM IN SOUTH ASIA AND THE SAFTA AGREEMENT

5.1 Regional Trading Arrangement in South Asia

With the continuous deadlock in negotiations for greater multilateral free trade under the erstwhile General Agreements on Tariff and Trade (GATT), states began to look towards furtherance of regional trade under regional trading instruments. Thus the latter half of the twentieth century saw an increase in the number of preferential trading agreements (PTAs) and Regional Trading Agreements (RTAs). The accelerated progress of a freer multilateral trading regime in Europe, and the creation of ASEAN in south-east Asia is widely acknowledged as an offshoot of the aforementioned phenomena. Thus, it was only a matter of time that South Asia too considered joining the bandwagon through a regional trading instrument of its own in the form of the agreement of South Asian Free Trade Area (SAFTA). The region was endowed with the bare essentials for the creation of a regional trading block such a close geographic proximity, a semblance of cultural similarity and similar structural characteristics of economies of the respective countries. The creation of a regional trading arrangement of its own in the form of SAFTA was motivated by a host of considerations. First and foremost, as has been mentioned earlier, the proliferation of preferential trading arrangement around the world created a sense among the leaders of South Asia that it too had to join the bandwagon. Likewise as Moinuddin (2008) has noted "the creation of FTAs in the Americas and EU and South Asia's neighbors generated adverse trade diversion effects on South Asia. In response to this, the leaders of the region sought to form FTAs of their own." (p.149). The opportunity of fostering political

harmony through economic cooperation was also another reason for the creation of SAFTA. As the creation of the European Economic Community aided the thawing of relations between Germany and France, it was believed that a platform of economic cooperation would also serve as an instrument in improving the relations between the countries of the region and in particular between India and Pakistan (Moinuddin,2008, p.149)

5.1.1 SAARC the Foundation of a Regional Trading Regime

The genesis of regional economic cooperation in South Asia can be traced back to the early 1980s when Bangladesh took the initiative for the establishment of an operational regional cooperation resulting in the first foreign secretaries' meeting of South Asian countries in 1981 A.D. The meeting decided on cooperation in non-contentious issues such as agriculture, telecommunication, rural development, health and meteorology. The gradual institutionalization of ad-hoc arrangements of technical cooperation, the Integrated Programs of Action (IPA) was formally launched with the adoption of South Asian Regional Cooperation (SARC) in 1983 (Moinuddin, 2008, p.134). Successive rounds of meetings and negotiations ultimately led to the formation of South Asian Association for Regional Cooperation (SAARC) in 1985 A.D. with Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka as the founding members where the membership was increased to 8 with the addition of Afghanistan in 2007 A.D. The SAARC Charter was adopted with the express objective " to accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realize their full potentials."(SAARC Charter, 1985)

5.1.2 SAPTA a precursor to SAFTA

In the early part of the 1990s the cooperation within the framework of SAARC was limited to non-economic fronts. A move towards economic cooperation was initiated with the study on Trade, Manufactures and Services (TMS) based on the recommendation of which the Council of Ministers formed a High Level Committee on Economic Cooperation which then institutionalized the framework of South Asian Preferential Trading Arrangement (SAPTA) in 1991 A.D (Moinuddin, 2008, p.135). The agreement on SAPTA came into effect on 1995 A.D. However the intra-regional trade under SAPTA failed to go in the desired direction largely owing to inherent limitations of the agreement such as limited product coverage and extensive tariff preference (Sawhney and Kumar, 2008, p.2).

5.2 Agreement on South Asian Free Trade Area:

Agreement on South Asian Free Trade Area (SAFTA) is an agreement among the member states of SAARC which came into effect on 2006 A.D. with an explicit aim of promoting fair and increased trade among contracting states. In consonance with the principles of the Marrakesh Agreement establishing the World Trade Organization, SAFTA is based on the principle of " overall reciprocity and mutuality of advantages in such a way as to benefit equitably all Contracting States, taking into account their respective levels of economic and industrial development, the pattern of their external trade and tariff policies and systems" and that "it shall involve the free movement of goods, between countries through, inter alia, the elimination of tariffs, para tariffs and non-tariff restrictions on the movement of goods, and any other equivalent measures" (SAFTA Agreement). Likewise, SAFTA has been adopted with the manifest objective of facilitating " the free movement of goods, between countries through, inter

alia, the elimination of tariffs, para tariffs and non-tariff restrictions on the movement of goods, and any other equivalent measures" and of " promoting conditions of fair competition in the free trade area, and ensuring equitable benefits to all Contracting States, taking into account their respective levels and pattern of economic development". (SAFTA Agreement). The agreement primarily seeks to augment regional trade among contracting states through the elimination of tariff, non-tariff barriers and para-tariffs, adoption of trade facilitation measures in par with international standards and harmonization of customs and trade related laws affecting regional trade. The agreement envisages the creation of a free trade area eventually culminating into an economic union.

5.2.1 Features of SAFTA

In pursuance of the aforementioned objectives the agreement on SAFTA has been embedded with the following features:

- **Trade Liberalization Program:** The trade liberalization program under the agreement aims at the gradual phasing out of tariff and non-tariff barriers effective from the date of entry into force of the agreement, where least developed and non-least developed countries have been given different timeframes for the reduction. In this regard the agreement has the following provision:
 - The tariff reduction by the Non-Least Developed Contracting States from existing tariff rates to 20% shall be done within a time frame of 2 years, from the date of coming into force of the Agreement. Contracting States are encouraged to adopt reductions in equal annual installments. If actual tariff rates after the coming into

force of the Agreement are below 20%, there shall be an annual reduction on a Margin of Preference basis of 10% on actual tariff rates for each of the two years.

- The tariff reduction by the Least Developed Contracting States from existing tariff rates will be to 30% within the time frame of 2 years from the date of coming into force of the Agreement. If actual tariff rates on the date of coming into force of the Agreement are below 30%, there will be an annual reduction on a Margin of Preference basis of 5 % on actual tariff rates for each of the two years.
- The subsequent tariff reduction by Non-Least Developed Contracting States from 20% or below to 0-5% shall be done within a second time frame of 5 years, beginning from the third year from the date of coming into force of the Agreement. However, the period of subsequent tariff reduction by Sri Lanka shall be six years. Contracting States are encouraged to adopt reductions in equal annual installments, but not less than 15% annually.
- The subsequent tariff reduction by the Least Developed Contracting States from 30% or below to 0-5% shall be done within a second time frame of 8 years beginning from the third year from the date of coming into force of the Agreement. The Least Developed Contracting States are encouraged to adopt reductions in equal annual installments, not less than 10% annually.
- The above schedules of tariff reductions will not prevent Contracting States from immediately reducing their tariffs to 0-5% or from following an accelerated schedule of tariff reduction.

- **Rules of Origin:** Rules of origin refers to rules to ascertain the country of origin of a product and to determine their "economic nationality." Such rules play a vital role in the application of preferential trading arrangements. The agreement of SAFTA provided for the rules of origin to be negotiated among member states in due course of time and to be incorporated in the agreement as an integral component. Subsequently, Rule of Determination of Origin of Goods under the Agreement on South Asian Free Trade Area has come into force.
- **List of Sensitive Products:** The agreement provides room for the non-adoption of trade liberalization of program for products considered sensitive in view of national interest, public morals, health and historic values. Although the agreement provides for the list of sensitive goods to be reviewed every four years, the agreement does not however limit the size and scope of the list, thus going against the spirit of World Trade Organization (Moinuddin, 2008, p.137). In this regard the agreement states that:

Contracting States may not apply the Trade Liberalization Programme as in paragraph 1 above, to the tariff lines included in the Sensitive Lists which shall be negotiated by the Contracting States (for LDCs and Non-LDCs) and incorporated in this Agreement as an integral part. The number of products in the Sensitive Lists shall be subject to maximum ceiling to be mutually agreed among the Contracting States with flexibility to Least Developed Contracting States to seek derogation in respect of the products of their export interest" and " The Sensitive List shall be reviewed after every

four years or earlier as may be decided by SAFTA Ministerial Council (SMC), established under Article 10, with a view to reducing the number of items in the Sensitive List." (SAFTA Agreement)

- **Institutional Framework:** For the effective implementation of the provisions of the agreement, the agreement has established two institutions namely, the SAFTA Ministerial Council (SMC) and the Committee of Experts (COE). The SMC is the apex decision making body comprising ministers of trade or commerce of contracting states and is responsible for the administration and implementation of the agreement and decisions and arrangements made within its legal framework. The council has been mandated to meet once every year or more often as and when deemed necessary. Likewise, The SMC is supported by the COE comprising one nominee of each contracting state and is mandated to monitor, facilitate and review the implementation of the agreement and execute tasks assigned by the SMC.

- **National treatment:** Article 5 of the agreement of SAFTA states that " Each Contracting State shall accord national treatment to the products of other Contracting States in accordance with the provisions of Article III of GATT 1994." (SAFTA Agreement)

- **Additional measures:** For the effective implementation of the agreement and to support and complement the agreement of SAFTA the agreement provides avenues for the adoption of various trade facilitation measures such as:
 - Progressive harmonization and simplification of customs procedures of contracting states;
 - Harmonization of Harmonized Systems of Commodity Classification;
 - Cooperation between customs agencies of contracting states to facilitate smooth customs clearance;
 - Simplification of banking procedures;
 - Transit facility, especially for contracting land-locked states, for the enhancement of intra-regional trade;
 - Removal of barriers in intra-regional investment;
 - Rules for the promotion of fair competition;
 - Development of communication system and transport infrastructure;
 - Simplification of procedures pertaining to business visas.

- **Special and Differential Treatment for Least Developed Contracting Members:** The agreement provides for the provision of according Special and Differential (S&D) treatment to the Least Developed Contracting States. Rahman (as cited in Moinuddin, 2008)" notes that:

One of the salient features of the SAFTA Framework Agreement was that it accorded the LDCs an explicit recognition as a separate group of countries among contracting states; the framework mentions that the LDCs in the SAARC will be provided with Special and Differential (S&D) treatment" p.137. The special and differential treatment accorded to the Least Developed Contracting states includes inter-alia

- Special consideration in the application of anti-dumping and countervailing measures;
 - Greater flexibility in the application of quantitative or other restrictions provisionally on import of goods from other member states;
 - Direct trade measures by other contracting states to promote the exports of least developed contracting parties;
 - Technical assistance and cooperation to the least developed member states to avail the benefits of the agreement;
 - Establishment of an appropriate mechanism in order to compensate the least developed contracting states for the loss of revenue incurred as a result of application of trade liberalization program.
- **Measures Relating to Balance of Payments:** The agreement provides a room for the provisional suspension of concessions under the agreement by contracting states in the event of them facing grave balance of payment difficulties. Such suspension once adopted should be immediately notified to the Committee of Experts. The Committee of

Experts then monitor the situation and require the concerned member state to phase out the suspension once the balance of payments situation improves.

- **Non-tariff barriers:** Another salient feature of the agreement is that it requires quantitative restrictions that are not in accordance with the rules of WTO to be done away with for products not included in the sensitive list. Likewise, the contracting states are also required to notify to the SAARC Secretariat all non-tariff and para-tariff barriers on an annual basis.
- **General exceptions:** Article 14 (a) of the agreement provides that " Nothing in this Agreement shall be construed to prevent any Contracting State from taking action and adopting measures which it considers necessary for the protection of its national security." Likewise Article 14 (b) further states that " Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the similar conditions prevail, or a disguised restriction on intra-regional trade, nothing in this Agreement shall be construed to prevent any Contracting State from taking action and adopting measures which it considers necessary for the protection of :
 - public morals;
 - human, animal or plant life and health; and
 - articles of artistic, historic and archaeological value."
- **Consultation and Dispute Settlement:** The agreement provides for bilateral consultation among contracting states for the purpose of resolution of disputes that may

arise between contracting states in the course of application or in the interpretation of the provisions of the agreement. The procedure for settlement of disputes involves bilateral consultation to be initiated by the complainant state in writing upon the receipt of which the respondent should furnish a reply within 15 days. Where such consultation fails, the matter can be taken to the Committee of Experts. If the matter continues to remain unresolved then it can be taken to the SAFTA Council of Ministers for resolution.

5.2.2 Pre-requisites of an effective Preferential Trading Agreement and SAFTA

Given that SAFTA thus far has not been able to yield the results expected of it in terms of augmentation of intra-regional trade, various scholars have come to question the efficacy of SAFTA and wondered whether the regional had inherent conditions conducive for the proliferation of intra-regional trade in the first place. It is widely acknowledged that a roll-back to pre-SAFTA era is a wishful thinking and that the region should endeavor to make the most out of the existing agreement by fine-tuning its provisions and the implementation thereof. Thus, in this light it is pertinent to delve into what scholars have deemed to be the pre-conditions for an effective Preferential Trading Agreement and whether such conditions can be discerned within South Asia.

The Center for Policy Dialogue (CPD), Bangladesh, through a theoretical analysis of growth zones in South Asia came up with the following as being the pre-requisites of a successful Preferential Trading Agreement:

- **Geographical Proximity:** As per the natural trading bloc argument of Paul Krugman and Frankel's gravity model of international trade (as cited in Moinuddin, 2008, p.141),

countries in close geographical proximity to one another naturally engage in a high degree of international trade with one another. This feature is inherent in South Asia too. However, it does not behave in consonance with its geographical characteristic where a majority of the countries engage in a greater quantum of international trade with countries outside the region than with countries in the region. The trend in trade of South Asia can be better illustrated with the following table:

South Asia's Export to: (\$ '000)	Volume	Percentage of total export
South Asia	29009757	8.34
East Asia and Pacific	83641931	24.04
Europe and Central Asia	76344699	21.95
USA	55449679	15.94

Source: World Integrated Trade Solution' 2018

It can be gauged from the table above that South Asia's exports to countries within the region remains meager as compared to its exports to other regions of the world.

(Moinuddin, 2008, p.142) points out several factors contributing to this small scale of intra-regional trade such as:

- A limited export basket of member states;
- A relatively inefficient and unproductive production structure;
- Large degree of cross-border illicit trade;

- Political tension among member states, most significantly that between India and Pakistan;
 - High barriers to investment;
 - Poor cross border trading infrastructure.
-
- **High level of pre-PTA tariffs:** A high level of pre-PTA tariffs is considered another important pre-requisite for success of a PTA and this condition did exist in South Asia where countries prior to early 1990s pursued a protectionist trade policy of import substitution and export promotion marked by high tariff walls.
 - **A certain degree of intra-regional trade:** There should be certain degree of intra-regional trade between aspiring participants of a PTA to facilitate the effective furtherance of intra-regional trade after entering into a regional preferential trading arrangement. However, South Asia continues to remain one of the least integrated regions in the world even after adoption of a preferential trading arrangement as has been demonstrated earlier and is a definitely a concerning issue. This low level of intra-regional trade among members of SAFTA as compared to high level of trade with other regions does not bode well for the successful implementation of preferential trading arrangement under SAFTA (Moinuddin, 2008, p.141).
 - **Trade complementarity, difference in economic structures and competitiveness:** The existence of pre-PTA trade complementarity between contracting states and difference in the nature of comparative advantage and export potential is vital for the success of a PTA. However, these attributes seem to be lacking in South Asia as compared to other successful regional preferential trading arrangements. Kemal et al. (as cited in

(Moinuddin, 2008, pp.142-143) points to the fact that the expansion of regional trade among countries that have comparative advantage in similar products or have existing economic structures exhibiting low degree of trade complementarity are likely to be minimal. In their study they have emphasized the fact that the exports of countries like Nepal, Bangladesh and Sri Lanka have limited compatibility with Indian imports. Based on various studies Moinuddin (2008) asserts that "The low complementarity ratios give a rather discouraging picture with regard to prospects of South Asian regional integration."(p.142).Likewise, it has also been observed that countries in South Asia have a comparative advantage in identical and limited range of products thus encumbering the prospects of a full-fledged regional integration to take shape.

- **Regional political harmony:** Political harmony among states within the region is *sine qua non* for the effectiveness of any regional preferential trading arrangement as exhibited by several successful PTAs around the world. However, this vital ingredient has frequently been conspicuous by its absence in the region. This largely stems from the persistent political acrimony between India and Pakistan, the two largest economies in the region, thus severely hindering the progress of the agreement. The success of the whole arrangement delicately hinges on the thawing of relations between the two largest economies mentioned above.

Thus it has been observed that South Asia is bereft of many of the preconditions mentioned above required for the effective implementation of a successful preferential trading agreement.

Chapter Six: NEPAL'S TRADE PERFORMANCE UNDER SAFTA: IMPEDIMENTS AND POSSIBILITIES

Based on the study of available literature pertinent to the issue under discussion and the analysis of different data, the results and findings of the research are presented as follows:

6.1 Trend of Nepal's Trade with Rest of South Asia post - 2010 A.D.

Given the historical ties subsisting between Nepal and India and the open border between the two, Nepal has always been heavily dependent on India with respect to its trade, i.e. both imports and exports. This evident from the fact that India accounts for over 90% of exports and imports of Nepal in the region, where the portion of exports to India is minute in comparison to imports from India. Consequently, Nepal faces significant trade deficit vis-à-vis India which is rising at an alarming rate over time. Thus one of the principal aims of Nepal in joining the agreement on SAFTA was to mitigate this burgeoning trade deficit and dependence with India and ensure geographical and commodity wise diversification in its trade. Thus it is fitting to look into how the pattern of Nepal's trade has changed with respect to its trade with India and Rest of South Asia over the years. Likewise, it is also pertinent to probe into the impediments encountered, if any, in the pursuance of the aforementioned objective and the possibilities thereof.

6.1.1 Current Status of Nepal's International Trade

The current status of Nepal international trade can be illustrated as follows:

Table 1: Top 10 import partners		
S.N.	Country	Import Value(NRs '000)
1	India	917,922,211
2	China	205,518,640
3	UAE	35,366,448
4	France	19,853,451
5	Indonesia	18,206,545
6	Thailand	14,401,893
7	Canada	13,554,991
8	United States of America	13,428,381
9	Switzerland	12,658,637
10	Malaysia	12,545,362
	Overall Imports	1,418,535,343

Source: Annual Foreign Trade Statistics, 2018-2019, Department of Customs

Table 2: Top 10 export partners		
S.N.	Country	Export Value (NRs '000)
1	India	62,731,840
2	United State of America	10,848,862
3	Germany	3,158,873
4	Turkey	2,964,858
5	United Kingdom	2,629,478
6	China	2,109,799
7	France	1,295,225
8	Bangladesh	1,293,475
9	Italy	1,180,986
10	Japan	1,061,183
	Overall Exports	97,109,521

Source: Annual Foreign Trade Statistics, 2018-2019, Department of Customs

Table 3: Trade deficit with partner countries (NRs '000)				
S.N.	Country	Imports	Exports	Trade Balance
1	India	917,922,211	62,731,840	-855,190,371
2	China	205,518,640	2,109,799	-203,408,841
3	United Arab Emirates	35,366,448	325,417	-35,041,031
4	France	19,853,451	1,295,225	-18,558,226
5	Indonesia	18,206,545	16,130	-18,190,415
6	Thailand	14,401,893	48,547	-14,353,346
7	Canada	13,554,991	895,983	-12,659,008
8	United States	12,658,637	453,434	-12,205,203
9	Switzerland	12,545,362	215,779	-12,329,583
10	Malaysia	10,969,083	346,200	-10,622,883
	Overall Trade Balance	1,418,535,343	97,109,521	-1,321,425,822

Source: Annual Foreign Trade Statistics, 2018-2019, Department of Customs

As can be seen from the tables given above India is the main source of imports into Nepal and has continuously remained so. China, United Arab Emirates, France and Indonesia are the other major sources of imports. For the table given above it can be analyzed that India alone accounts for nearly 2/3rds of the imports into Nepal. Likewise, in terms of exports, India again is the primary destination of Nepal's exports accounting for roughly 2/3rds of total exports from Nepal. Besides India, United States of America, Germany, Turkey and the United Kingdom represent other major destination of Nepal's exports. In terms of balance of trade, Nepal faces adverse trade deficit with almost all of its major trading partners with India accounting for nearly 2/3rds of Nepal's overall trade deficit. Alarmingly, the ratio of imports to exports of Nepal currents stands at 14.6:1 meaning that for every export of goods worth 1 Rupees it imports goods of Rupees 14.6 representing severely skewed trade balance.

6.2 Pattern of Nepal's Trade with Rest of South Asia post 2010 A.D.

As has been touched upon to earlier, Nepal's stated aim of joining Preferential Trading Arrangements, SAFTA in particular, was to move away from its trade dependence and look for new avenues of international trade in countries of South Asia other than India. Cognizant of the myriad of problems that dependence on trade with a particular country can pose, Nepal has sought to diversify its trade, both in terms of geography and commodities, to other areas as well. In this regard, the extent to which Nepal has been able to leverage the possibilities offered by SAFTA in diversifying its trade to Rest of South Asia can be illustrated viz:

	2010	2011	2012	2013	2014	2015	2016	2017	2018	Average Annual Growth Rate
Afghanistan	255	58	8,543	785	7,628	88,610	1,235	1,950	8,573	2086.692
Bangladesh	1,104,150	1,517,633	2,301,107	1,646,266	2,730,605	1,206,848	4,226,665	4,791,034	4,242,246	40.35
Bhutan	112,234	250,028	279,843	314,181	429,224	152,615	531,412	1,637,784	1,673,272	72.21
India	259,162,277	319,147,296	396,478,432	471,973,645	507,561,578	483,307,764	641,423,632	814,101,622	917,922,211	17.69
Maldives	927	71	92	11	13,652	50	9	172	687	15723.4
Pakistan	293,747	274,700	367,503	355,599	429,631	43,490	435,714	6,301,492	640,683	264
Sri Lanka	151,788	85,186	152,695	129,254	196,895	3,343	172,150	309,663	275,520	636.55
Total SA	260,825,378	321,274,972	399,588,215	474,419,741	511,369,213	484,802,720	646,790,817	827,143,717	924,763,192	17.74
Total RSA	1,663,101	2,127,676	3,109,783	2,446,096	3,807,635	1,494,956	5,367,185	13,042,095	6,840,981	50.26
Share of RSA(%)	0.63763	0.66226	0.778247	0.515597	0.744596	0.308364	0.829818	1.5767629	0.739755	
Share of India (%)	99.36237	99.33774	99.22175	99.4844	99.2554	99.69164	99.17018	98.423237	99.26025	

Source: Annual Foreign Trade Statistics, Department of Customs

It is quite evident from the table given above that despite the coming into effect of SAFTA, Nepal still is almost completely reliant on India in terms of its imports from South Asia. It can be seen from the table that post 2010 A.D., almost the entirety of imports from South Asia has been from India in each successive year. Likewise, during the period under consideration, total imports from India grew at 17.69 percent while total imports from Rest of South Asia grew by 50.26 %. While this increase from Rest of South Asia is significant in and of itself, the sheer volume of imports from India completely eclipses the gains made by Rest of South Asia. Within the Rest of South Asia category, Bangladesh was the main source of imports into Nepal accounting for almost 62 percent of imports from Rest of South Asia in 2018 A.D, followed by Bhutan with a share of 24.45 % and Pakistan with 9.3 % of total imports. However, not a single country from the Rest of South Asia features among the top import partners (out of 158 countries) of Nepal in 2018 A.D.

	2010	2011	2012	2013	2014	2015	2016	2017	2018	Average Annual Growth Rate
Afghanistan	4394	97572	606660	1520371	1603346	1520371	103	20893	22865	2860.892
Bangladesh	3471938	2391865	2851519	1951019	1084415	1951019	1047913	1083024	1293475	19.43
Bhutan	425484	530179	333879	94626	120603	94626	77406	75872	161973	113.48
India	42868108	50356238	51083407	58919632	55675107	58919632	41640226	46719757	62731840	34.27
Maldives	461	1280	22577	4750	8599	4750	461	559	6886	1131.84
Pakistan	142338	229195	149886	86836	28733	355599	155478	37316	53798	120.86
Sri Lanka	7598	20408	4859	2203	38845	2203	2550	8955	8172	233.1
Total SA	46920321	53626737	55052787	62579437	58559648	62848200	42924137	47946376	64279009	5.69
Total RSA	4,052,213	3,270,499	3,969,380	3,659,805	2,884,541	3,928,568	1,283,911	1,226,619	1,547,169	-4.54
Share of RSA(%)	8.636371	6.098635	7.210135	5.848255	4.925817	6.250884	2.991117	2.5583143	2.406958	
Share of India (%)	91.36363	93.90136	92.78987	94.15175	95.07418	93.74912	97.00888	97.441686	97.59304	

Source: Annual Foreign Trade Statistics, Department of Customs

The pattern of exports of Nepal to Rest of South Asia vis-à-vis India paints the same picture as pattern of imports. Nepal's exports to countries in South Asia again is heavily skewed in favor of India with over 90 percent of Nepal's exports to South Asia being accounted for by India. While exports to India have grown by an average rate of 34.27 percent since 2010 A.D., exports to Rest of South Asia has witnessed an average decline of 4.54 percent over the period under observation. Within the Rest of South Asia category, Bangladesh, Bhutan and Pakistan represent the major export destinations accounting for 83 percent, 10.46 percent and 3.4 percent of the total export to Rest of South Asia respectively. Thus, among the countries in Rest of South Asia, Nepal's exports are heavily skewed in favor of Bangladesh, with other countries representing a meager share of Nepal's exports. Except for Bangladesh, not a single country from the Rest of South Asia features among the top import partners (out of 158 countries) of Nepal in 2018 A.D.

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Afghanistan	4139	97514	598117	1519586	1595718	1431761	-1132	18943	14292
Bangladesh	2367788	874232	550412	304753	-1646190	744171	-3178752	-3708010	-2948771
Bhutan	313250	280151	54036	-219555	-308621	-57989	-454006	-1561912	-1511299
India	-	-	-	-	-	-	-	-	-
	216294169	268791058	345395025	413054013	451886471	424388132	599783406	767381865	855190371
Maldives	-466	1209	22485	4739	-5053	4700	452	387	6199
Pakistan	-151409	-45505	-217617	-268763	-400898	312109	-280236	-6264176	-586885
Sri Lanka	-144190	-64778	-147836	-127051	-158050	-1140	-169600	-300708	-267348
Total RSA	2389112	1142823	859597	1213709	-923094	2433612	-4083274	-11815476	-5293812

Source: Annual Foreign Trade Statistic, Department of Customs.

The status of trade balance, again, is not favor of Nepal. Though Nepal's overall trade balance with Rest of South Asia was positive for most part of the period under consideration, having trade surplus with Bangladesh, Afghanistan and Bhutan for a significant period, the situation has meteorically deteriorated in recent years. While Nepal has always witnessed a huge trade deficit with India, the trade balance with countries like Bangladesh and Bhutan, with whom it used to have a favorable trade balance has now taken a turn in the wrong direction. India accounted for nearly 2/3rd of the share of overall trade deficit of Nepal in 2018 A.D. During the same period Nepal had trade deficit with all but two countries from Rest of South Asia, namely- Afghanistan and Maldives, with whom Nepal has a negligible amount of trade interest. Likewise, among the countries in Rest of South Asia, Bangladesh accounted for the highest portion of Nepal's trade deficit at around 55.7 percent.

Thus, it an quite clearly be discerned that Nepal, for one reason or another, has not been avail the expected benefit from the agreement on SAFTA as its trade, both in terms of exports and imports are still heavily reliant on India. Worse still, its trade deficit with India has been ballooning with the passing of each year and its trade balance with Rest of South Asia too started

to go against its favor. Whether this situation has come about due to the problems in the agreement itself or due to limitations inherent in Nepal's trade competitiveness and economic structure will be probed in the chapters to follow.

6.3 Impediments in the furtherance of Nepal's Trade with Rest of South Asia

A host of factors are limiting the ability of Nepal in augmenting its trade with Rest of South Asia under the framework of SAFTA. This part of the research will look into in detail the factors encumbering Nepal's furtherance of trade with Rest of South Asia.

6.3.1 Supply side constraints

One of the fundamental problems faced by Nepal in exploiting the potential offered by SAFTA relates to its own supply side constraints. Overcoming such constraints is paramount in order to avail the market access opportunities offered by SAFTA and in order to improve its dismal export performance.

Based on the growth diagnostics developed by Hanusmann et al, ADB et al as cited in (Adhikari and Kharel, 2011, p.26) the following have been identified as a group of pressing constraints that are limiting the social returns to investment and in turn are having a detrimental effect on Nepal's export competitiveness : a) limited and low quality infrastructure such as electricity, transport network, irrigation); b) weak governance as in rampant corruption; poor industrial relations climate and labor market rigidities; and c) market failures such as information and learning externalities and coordination failures, as evidenced by the low technological quality of domestically manufactured goods.

(Adhikari and Kharel, 2011, p.27) further go on to list the following as supply-side constraints encumbering Nepal's competitiveness in the regional market:

- Inadequate infrastructure for efficient production and transportation of goods;
- Lack of competitive human resources with the requisite skill to process exportable products;
- Largely conservative financial system that still relies on collateral than on the inherent feasibility of projects;
- Limited use of modern technology limiting the prospects of moving up the value-chain ladder;
- Incipient adoption of trade facilitation measures causing delays in customs processing of exportable goods.

Likewise, based on different studies as noted by (Adhikari and Kharel, 2011, p.27), use is also made of the Global Competitiveness Report (GCR) published by the World Economic Forum in order to gauge the level of competitiveness and the constraints impeding such competitiveness of different countries. Four indicator, namely- Transport Infrastructure, Human Capital, Trade Openness and Financial System; for the year 2019 A.D. of Nepal, India, Sri Lanka, Pakistan and Bangladesh (report does not include data of Maldives, Bhutan and Afghanistan) in order to analyze the relative competitiveness of each country.

Country/ Economy	Transport infrastructure		Human Capital		Trade Openness		Financial System		Overall
	Rank	Index	Rank	Index	Rank	Index	Rank	Index	Rank
Bangladesh	100	42.1	123	41	119	49	90	32.5	105
India	28	66.4	64	52.9	131	43.9	40	69.5	68
Nepal	91	44.1	110	43.9	110	42.3	51	66.4	108
Pakistan	69	51.1	67	52.4	138	41.5	99	55	110
Sri Lanka	50	57.7	54	54.3	140	38.4	87	56.9	84

Source: Global Competitiveness Report-2019 A.D., World Economic Forum

From the table given above it can be quite clearly be discerned that Nepal has a lot of room for improvement in order to enhance its competitiveness and thus avail the opportunities offered by SAFTA. Based on the available data, Nepal with an overall rank of 108 out of 141 countries remains one of the least competitive economies in the world. Likewise, in South Asia, only Pakistan has fared worse than Nepal with Bangladesh, India and Sri Lanka securing better ranking than Nepal. Though it has made considerable improvement in the area of Financial Systems, it has not been accompanied by improvement in other area vital for the enhancement of the competitiveness of an economy. In this regard Adhikari and Kharel (2011) go on to state that "Nepal continues to produce and export "poor country goods" and it efforts at enhancing its competitiveness and achieve export diversification have neither produced satisfactory results, nor are targeted at moving up the value chain ladder." (p.27)

Likewise, Adhikari and Kharel also analyze the state of Research & Development as indicated by the state of scientific publications, patent applications, Research and Development

Expenditure and Research Institution's Prominence, in the Global competitiveness Index, to probe into the potential of each economy to move up the value-chain ladder. This indicator again paints a grim picture for Nepal, where, with a rank of 103 it fares worse than all other countries in comparison.

Country/ Economy	Scientific Publications (score)		Patent Application (number)		Research and Development Expenditure (% of GDP)		Research Institutions Prominence (1- 100 best)		Overall
	Rank	Index	Rank	Index	Rank	Index	Rank	Index	Rank
Bangladesh	66	76	104	8.8	--	--	52	6.0	82
India	21	92.7	63	16.8	52	20.7	8	98.4	26
Nepal	88	70.7	112	0.5	80	10.1	87	1.1	103
Pakistan	53	80.0	105	0.8	87	8.2	35	15.2	68
Sri Lanka	76	74.1	87	3.8	111	3.6	71	2.3	96

Similarly another indicator used by Adhikari and Kharel is the Logistic Performance Index (LPI) published by the World Bank. Under LPI six different indexes are used to evaluate the level of logistics performance of countries. The indexes are:

- The efficiency of customs and border management clearance (“Customs”).
- The quality of trade and transport infrastructure (“Infrastructure”).
- The ease of arranging competitively priced shipments (“Ease of arranging shipments”).
- The competence and quality of logistics services—trucking, forwarding, and customs brokerage (“Quality of logistics services”).
- The ability to track and trace consignments (“Tracking and tracing”).
- The frequency with which shipments reach consignees within scheduled or expected delivery times (“Timeliness”).

Table 10 : Logistics Performance Index for the year 2018 A.D.

Country/ Economy	Customs		Infrastructure		International Shipments		Logistics Compliance		Tracking & Tracing		Timeliness		Overall
	Rank	Index	Rank	Index	Rank	Index	Rank	Index	Rank	Index	Rank	Index	
Afghanistan	158	1.95	158	1.73	158	1.81	152	2.11	158	1.92	159	1.7	160
Bangladesh	121	2.3	100	2.39	104	2.56	102	2.48	79	2.79	107	2.92	100
Bhutan	135	2.14	150	1.91	160	1.8	115	2.35	130	2.35	146	2.49	149
India	40	2.96	52	2.91	44	3.21	42	3.13	38	3.32	52	3.5	44
Maldives	105	2.4	71	2.72	94	2.66	125	2.29	104	2.6	64	3.32	86
Nepal	122	2.29	123	2.19	129	2.36	105	2.46	98	2.65	89	3.1	114
Pakistan	139	2.12	121	2.2	97	2.63	89	2.54	136	2.27	136	2.66	122
Sri Lanka	79	2.58	85	2.49	112	2.51	109	2.42	78	2.79	122	2.79	94

Source: Logistics Performance Index, 2018 A.D., The World Bank

From the table given above it can be seen that Nepal has an overall ranking of 122 out of 160 countries under observation. Likewise, in South Asia, Nepal ranks 5th out of the 8 countries with Afghanistan, Bhutan and Pakistan faring worse than Nepal in terms of Logistics Performance. Hence, there certainly is a lot of room for improvement for Nepal to improve its

overall logistics performance and hence enhance its competitiveness along the way. Thus based on the available literature and globally accepted indicators it is evident that Nepal faces a myriad of supply side constraints limiting its ability to fully avail the market access opportunities granted to it under SAFTA.

6.3.2 Sensitive List under SAFTA

The provision regarding Sensitive List is provisioned in Article 3 of the SAFTA agreement wherein Article 3 (a) states that:

Contracting States may not apply the Trade Liberalisation Programme as in paragraph 1 above, to the tariff lines included in the Sensitive Lists which shall be negotiated by the Contracting States (for LDCs and Non-LDCs) and incorporated in this Agreement as an integral part. The number of products in the Sensitive Lists shall be subject to maximum ceiling to be mutually agreed among the Contracting States with flexibility to Least Developed Contracting States to seek derogation in respect of the products of their export interest.

Article 3 (b) further goes on to state that " The Sensitive List shall be reviewed after every four years or earlier as may be decided by SAFTA Ministerial Council (SMC), established under Article 10, with a view to reducing the number of items in the Sensitive List." Thus unlike its predecessor SAPTA, SAFTA is based on a negative list of goods or the sensitive list, the goods incorporated under which are not subject to tariff reduction/exemption under the agreement.

As per the provision of the agreement, each country maintains two sets of negative list- for least developed countries and the other for non-least developed countries. This provision of a negative list was thought to be better than the provision of a positive list under the erstwhile SAPTA. However, member states have included a vast number of products under the sensitive list thereby defeating its very purpose. A number of products of export interest of partner trading country and in which they have a revealed comparative advantage have been denied tariff concession by including them in the sensitive list. The current status of the number of products included in the sensitive list by member states is as follows:

Member State	Number of products in the earlier sensitive list	Number of products in the revised sensitive list (Phase II) w.e.f January 1,2012
Afghanistan	1072	858
Bangladesh	1233(LDCs) 1241(non-LDCs)	987 (LDCs) 993(Non-LDCs)
Bhutan	150	156
India	480(LDCs) 868(Non-LDCs)	25(LDCs) 614(Non-LDCs)
Maldives	681	154
Nepal	1257 (LDCs) 1295(Non-LDCs)	998(LDCs) 1036(Non-LDCs)
Pakistan	1169	936

Sri Lanka	1042	837 (LDCs) 963 (Non-LDCs)
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Source: SAARC Secretariat

The resulting effect of the high number of products in the sensitive list is that countries have to face a higher rate of tariff in items of export interest. For example, in 2016 the average range of tariff in South Asia was 13.6 %, which is significantly higher than 7.3% average rate of tariff of East Asia and the Pacific and 6.3% average world tariff. Furthermore, almost 35% of the total intra-regional trade in value is subject to tariff prescribed by the sensitive list, where in countries like Bangladesh and Sri Lanka almost 45% of the imports from other SAARC members fall under the sensitive list (Kathuria and Mathur, 2018). The problem is further compounded by the fact that the agreement itself does not provide a clear guideline with regard to phasing out of the sensitive list. Although there exists a working group for the phasing out of the sensitive list and the agreement provides for the revision of the sensitive list every four year, the results have not been satisfactory (Kathuria and Mathur, 2018).

The high number of goods in the sensitive list and the resultant increase in average tariff reduces the competitiveness of Nepali goods in the markets of Rest of South Asia, which is already plagued by a host of supply side constraints. Even products identified by the Nepal Trade Integrated Strategy, 2016 as having high export potential have been kept in the sensitive list of other member states. For example ginger has been included in the sensitive list of India, thus encumbering its export potential. Hence the long list of goods included in the sensitive list by other member states has impeded on the potential of Nepal to exploit the market access opportunities afforded by the agreement of SAFTA.

6.3.3 Non-Tariff and Para-Tariff Barriers

Non-Tariff and Para-Tariff barriers refer to measures, other than tariff, which have an effect on hindering the free movement of goods across borders. UNCTAD has classified Non-Tariff Measures (NTM) into three broad categories:

- technical measures, which include measures related to product standards and quality specifications and largely comprise sanitary and phyto-sanitary standards (SPS) and technical barriers to trade (TBT)
- nontechnical measures, which include measures such as import licensing, price control measures, import subsidies, and rules of origin;
- export-related measures, such as export subsidies, prohibitions, and quotas (ADB and UNCTAD, 2008)

As a rule, countries can impose a certain degree of NTMs to safeguard their interests so long as it does not cause any distortionary effect on trans-national trade. However as Kathuria and Mathur (2018) have stated "NTMs become nontariff barriers if they are more burdensome than necessary to achieve a legitimate goal, for example, if customs officials behave arbitrarily and do not apply rules uniformly, or if border testing of imports takes inordinate amounts of time. "In the case of South Asia, much of the NTMs pertain to SPS and TBT measures where SPS and TBT account for 85 percent of all non-tariff barriers in South Asia (ADB and UNCTAD 2008). Para Tariffs in South Asia range from supplementary duty and regulatory duty in

Bangladesh, port and airports development levy in Sri Lanka, testing and certification in India to regulatory duty in Pakistan.

Nepal is also mired by several non-tariff and para-tariff barriers while exporting goods to countries in South Asia. According to a study titled " Launching of National Sector Export Strategies and Non-Tariff Measures" conducted by Ministry of Industries, Commerce and Supplies in 2017 A.D. half of Nepali exports are subject to non-tariff barriers like regulatory and procedural obstacles in foreign markets. Likewise almost 2/3rds of the obstacles faced by Nepali exports relate to SPS and TBTs. The situation is even more dire with respect to India, where Nepali exports encounter a host of barriers such as countervailing duty on garments, separate license requirements for the export of ginger and agro-products, anti-dumping duty, quarantine issues, documentary hassles and the like. A study titled "Potential Exports and Non- Tariff Barriers to Trade- Nepal National Study,2019" conducted by the South Asian Sub-Regional Economic Cooperation- Asian Development Bank has highlighted the major non-tariff barriers encountered by Nepali exports in some the major trading partners in South Asia, which can be illustrated viz:

- **Barriers encountered while exporting to Bangladesh:**
 - Radio-activity level requirements that are not addressed by Nepali standards have affected the exports of products such as meat of bovine animals and fats and oils derived from milk.
 - Standards pertaining to added melamine have affected the export of products such as oil cake and other solid residue of linseed.

- The export of wheat flour and fixed vegetable fats and oils has been stunted by mandatory certification requirements.
- **Barriers encountered while exporting to Bhutan:**
 - Nepal does not face significant non-tariff barriers in the Bhutanese market however the only stumbling block could be the authorization requirement applicable in case of exports of plastics and articles of plastic.
- **Barriers encountered while exporting to India:**
 - Nepali faces significant SPS and TBT requirements with respect to the export of agricultural products that have severely hindered the free movement of goods from Nepal to India. Nepali agricultural exports have to fulfill various requirements such as labeling requirements, pre-shipment certification and special authorization requirement for the presence of GMOs, among others.
 - Similarly Nepali textile and clothing exports face extremely strict testing requirements. In most instances, the testing is carried out in laboratories that are located at a significant distance from all major customs point, and hence are especially problematic in case of perishable goods.
 - Another major obstacle cited by traders is the arbitrary application of procedures, regulations and the system of classification of goods by Indian Customs authorities.
- **Barriers encountered while exporting to Sri Lanka:**
 - Stringent irradiation requirements have affected the exports of agricultural products such as cinnamon, big cardamom and ginger.

- Fulfillment of sufficient labeling and special authorization requirement in the case of exports of GMOs or foods containing GMOs.
- The Food (Labeling and Advertising) Regulations 2005 lay out a series of labelling requirements for packaged foods that go beyond the ones specified by Nepal's Food Act.

Thus Nepal faces significant barrier to trade in the form of Non-Tariff Measures in South Asia which is hindering its export potential in the region. The matter is further exacerbated by the fact the mechanism under SAFTA to deal with such barriers is not as effective as expected. (Adhikari and Kharel, 2011, p.22). As per the agreement, contracting parties are required to notify to the SAARC Secretariat any non-tariff and para-tariff barriers faced in their exports on an annual basis. Such measures are then reviewed by the Committee of Experts (CoE), in order to assess their compatibility with relevant WTO measures. The COE then recommends the elimination or the implementation of such measures in a manner that is least restrictive on trade. Thus the CoE acts as a dispute settlement body under SAFTA but its efficacy has always been an issue of contention (Adhikari and Kharel, 2011, p.22-23).

6.3.4 Transit Related Issues

Problems related to transit is another major stumbling block for Nepal in realizing its export potential in Rest of South Asia. Given its landlockedness, Nepal is heavily dependent on the transit facility provided by India to avail trade opportunities with countries in Rest of South Asia. Adhikari and Kharel (2011) note that "A host of transit restrictions is in place, causing delays, raising the landed prices of imports and eroding export competitiveness. The restrictions

operate at two levels: transit to access Indian sea-ports and transit through Indian territory to access Bangladeshi markets and sea-ports."

Nepali traders face issues such as highly cumbersome transit related procedures, issuance of unilateral notifications on transit and customs matters by Indian officials, hassles related to multiple checking agencies, cumbersome documentary requirements and the like. (Adhikari and Kharel, 2011, p.23).

Hence it stands to reason that given the myriad of problems both internal to Nepal such as its supply side constraints and the anomalies in the SAFTA agreement itself, it has been difficult for Nepal to expand its trade in countries of Rest of South Asia. The result being that it is still significantly dependent on India in terms of its international trade and this dependence continues to deepen despite several measures taken by Nepal.

6.4 Potential for the expansion of Nepal's exports to Rest of South Asia under SAFTA

As has been stated earlier, Nepal's stated aim of joining the agreement on SAFTA was to enhance its exports to countries in Rest of South Asia thereby reducing its dependence on trade with India. However, due to various impediments Nepal has not been able to exploit the opportunities of market exploitation under the agreement. Nevertheless the potential for market exploitation still remains. One of the simplest ways to gauge the potential existing in the markets of Rest of South Asia is to see the increase in the value of imports of each country overtime.

Table:12 Growth in imported value of goods in countries of South Asia	
Country	Growth in imported value of goods between 2014-2018 (% p.a.)
Afghanistan	18
Bangladesh	9
Bhutan	25
India	3
Maldives	11
Pakistan	8
Sri Lanka	6

Source: International Trade Center

The table given above clearly shows that there exists significant opportunities for Nepal to tap into in the markets of Rest of South Asia. The imports of most of the countries in Rest of South Asia have witnessed a significant increase over the period of 2014-2018 A.D. with large increment in the rate of import of Bhutan, Afghanistan and the Maldives. Nepal could look into increasing its share of exports in these countries. Thus with timely improvements in its production capacity and competitiveness Nepal can be exploit the opportunities present in the region.

Likewise, another way to probe into the export potential of a country in a regional trading arrangement is through what is known as the Trade Complementarity Index developed by the World Bank. The index shows the extent to which the export profile of a country complements

the import profile of its trading partner, with a high index score representing high export potential.

Table 13: Trade Complementarity Index of Nepal with countries of South Asia			
Country	1999	2003	2009
Afghanistan	-	-	60.97
Bangladesh	-	34.50	31.41*
Bhutan	75.40	-	80.73
India	41.77	38.59	42.50
Maldives	36.56	27.11	32.49
Pakistan	71.56	70.69	80.11*
Sri Lanka	-	29.33	28.78
*Figures of 2007			
Source: WITS as used in Adhikari and Kharel,2011			

Though the data pertains to time period from 1999 A.D to 2009 A.D., it still helps us to understand the potential existing in different markets for Nepali exports. From the table given above it can be discerned that Nepali exports enjoys appreciable amount of complementarity with the imports of most of the countries in Rest of South Asia. While complementarity with Indian imports has remained somewhat consistent, the degree of complementarity with partners like Bhutan and Pakistan is quite high and in an increasing trend. Likewise, Nepali exports also enjoy significant complementarity with imports of Bangladesh, which the Nepal's major export destination in South Asia after India.

The trade potential existing with the countries of Rest of South Asia that Nepal can exploit can be further highlighted as follows:

Table:14 Trade Potential with Countries in Rest of South Asia	
Country	Untapped Trade Potential (\$)
Afghanistan	4600
Bangladesh	15000000
Bhutan	650100
Maldives	13000
Pakistan	280100
Sri Lanka	14700

Source: International Trade Center, 2019

From the table given above, it can be seen that Nepal can tap into the potential for exports in most the countries in Rest of South Asia. Though the figure given above indicate a small value of export potential in countries like Afghanistan and Maldives, it can still look into making use of the vast potential in countries like Bangladesh, Bhutan and Pakistan.

Hence, it can be inferred from the data given above that market opportunities are there in the offing. Nepal now needs to find the appropriate policy mix to ensure that it exploits these market access prospects by improving its competitiveness in the market.

Chapter Seven: SUMMARY AND CONCLUSION

With the proliferation of regional preferential trading agreements across the globe, South Asia to desired to join the bandwagon and reap the potential of enhancing regional trade within the region through a preferential trading agreement of its own. Guided by different political motives as well, it was hoped that the coming into force of agreement on South Asian Free Trade Area would unleash the trade potential inherent in the region and integrate the economies of the member states, which was hitherto deemed to be one of the least integrated regions in the world.

With various provisions such as trade liberalization program under which member states were required to gradually reduce import tariffs, institutional mechanisms to deal with any disputes between member states, the provision of sensitive list to protect products/ industries deemed vital for the preservation of genuine economic interest of member states, harmonization of customs procedures, gradual phasing out of Non-Tariff Measures that are not consistent with WTO provisions and much else besides, unlike its predecessor SAPTA, the agreement on SAFTA was embedded with several salient features with a view to enhance intra-regional trade, remove barriers to trade and gradually move towards the realization of a free trade area. Likewise, the region itself was endowed with certain pre-requisites that scholars have identified as being important for a functioning preferential trading agreement. The countries in the region are located at a close geographical proximity to one another and there existed a high pre-preferential trading agreement tariff wall in the member states. However, the agreement has not been able to produce the desired result as the agreement in itself and in many ways, has provided a room for member states to adopt provisions which is not in keeping with the spirit of free trade. Similarly, as different scholars have identified, the region itself lack certain pre-requisites vital

for the furtherance of free trade, such as, member states having a competitive advantage in similar group of products such as agricultural goods, low-level of pre-existing intra-regional trade and the persistent political discord between certain member states, especially India and Pakistan. Due to these reasons, SAFTA has not been able to give the desired level of lift to intra-regional trade as certain other regional trading arrangements such as ASEAN has been. This is evident from the fact that South Asia still remains one of the least integrated regions in the world with the share of intra-regional trade being significantly lower than the share of trade of the region with rest of the world.

However, amidst all the pessimism in the current literature and, in truth, in practice as well, the region does hold potential to realize its cherished ambition of an enhanced level of intra-regional trade. As noted earlier, though countries in the region exhibit comparative advantage in similar range of products and the estimates pertaining to trade complementarity are not so encouraging, they only are a reflection of the status quo and do not fully capture the unexploited potential in the region (Sawhney and Kumar, 2008, p.13). It is important to remember the very factors that provided an impetus for a regional trading agreement in the region and build on it. Likewise, certain measures should be expeditiously adopted to make the agreement itself more conducive for the furtherance of regional trade. First and foremost the long list of sensitive goods should be curtailed so that more products enjoy tariff concessions. The long list of sensitive goods adopted by member states has effectively defeated the very purpose of the agreement where a vast portion of goods traded are shielded from tariff liberalization measures. Hence priority should be accorded to the expeditious reduction in the number of goods kept in the sensitive which is in keeping with the economic interests of member states. Likewise, the currently prevailing high MFN tariff rates for the goods kept in the sensitive list should also

be gradually reduced. Similarly, steps should be taken to make the SAFTA Rules of Origin less stringent in order to grant greater access to domestic produce in the regional market.

Moving on, Nepal hoped to achieve country wise and product wise export diversification through SAFTA, given that it was largely dependent upon India in its international. However, the pattern of trade shows that far from realizing this ambition, Nepal has come to be even more reliant of India in terms of its trade with South Asia. India still is Nepal's largest trading partner where Nepal's trade deficit with India for the past couple of years has witnessed an upward trajectory. The only silver lining has been the increased economic integration with Bangladesh where the volume of trade with Bangladesh has seen significant progress. However, in this area as well, Nepal has not been able to use this increasing trend to its advantage as trade deficit with Bangladesh too is in an increasing trade, which previously used to be in Nepal's favor.

That Nepal has significant export potential in countries of Rest of South Asia has been established. However, Nepal has not been able to tap into this vast unutilized prospect. Nepal's own supply side constraint has proven to be a major stumbling block in realizing its potential. From low quality infrastructure for production and transportation of goods, issues of governance, inadequate quality human capital to issues of finance, supply side constraint has been a major hindrance in exploiting the market access opportunities in Rest of South Asia. Thus in order to truly realize its potential it is paramount to reduce these supply side constraints through effective promotion of domestic production, rapid improvement in state of infrastructure, providing proper skills and training to the human resource and the like.

Likewise, Nepal's export potential is also marred by the large number of products in the sensitive list kept by trading partners. Hence Nepal should advocate for the pruning of such an

extensive list especially in respect of goods that are of its primary export interest. However, in order to do this, Nepal should also look into reducing its own long sensitive list, as Nepal has one of the highest number of goods under its sensitive list. Similarly Non-Tariff Barriers in various forms are also encumbering Nepal's export potential. As Nepal has almost done away with all of its para-tariff barriers, it should advocate for the same with other countries as well. Nepal should also push for a regional mutual recognition agreement on SPS measures and technical standards with the ultimate aim of harmonization of such standards (Adhikari and Kharel, 2011, p.31). Furthermore, Nepal should also push for making the Rules of Origin of SAFTA less burdensome, especially for LDCs.

Nepal should also push forward the idea of exploiting the synergies in production among the member states in areas where they have a comparative advantage. As (Sawhney and Kumar, 2008, p.19) have pointed out given the fact that the countries in the region have a comparative advantage in common areas such as agriculture and textiles, further liberalization would help to enhance competition in these areas thereby leading to geographical specialization across the region in specific segments within these areas. This would not only help Nepal to enhance its competitiveness but would also shield it from competition from other areas.

Reverting back to the pre-SAFTA days cannot be imagined at the moment. Thus Nepal should look to bolster its export potential within the framework of the agreement itself. With the right steps taken at the right time, it certainly can improve its trade performance with countries in Rest of South Asia.

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