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SANEM
Thinking Aloud

Editor's Desk

*SANEM is happy to present the second issue of **Thinking Aloud**. After the publication of the first issue on June 1, 2014, we have received huge appreciation and encouragement from all over the world. We are thankful to all the readers for their very constructive feedback. The current issue focuses on regional integration in South Asia. The first article underscores the importance of a new regime for regional integration in South Asia with emphasis on market integration, growth integration, investment integration and policy integration. The article on regional value chain emphasizes on the promotion of regional value chain in South Asia for deepening regional integration, and provides examples of cases of garments and leather products. The macroeconomic update focuses on the need for a new investment regime in Bangladesh for further growth acceleration and growth maintenance. The short interview of Dr. Saman Kelegama emphasizes on the significance of reaping low hanging fruits for a stronger regional integration in South Asia. A short story on the leather sector in Bangladesh shows how SANEM's intervention is helping this sector to drive to a positive direction, much needed for export diversification.*

Inside this issue

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Towards a New Regime of Regional Integration in South Asia

Selim Raihan

The current regime of regional integration in South Asia has primarily focused on the rise in intra-regional trade in goods. However, South Asia is at the verge of a new regime of regional integration which has to involve four integration processes: (i) *market integration:* integration in trade in goods and services; (ii) *growth integration:* integration in economic growth processes of the South Asian countries; (iii) *investment integration:* promotion of regional investment and trade nexus; and (iv) *policy integration:* harmonization of economic and trade policies. A new regime on regional integration in South Asia calls for these four integration processes through responding to four fundamental questions:

On the first question "***Why*** is there a need for a deeper regional integration in South Asia?" the answer is: there are now convincing evidences that deeper regional integration is needed for generating and sustaining economic growths in the South Asian countries, i.e. regional integration will be a critical factor in the future growth processes of these countries. This is required for larger employment creation and alleviation of poverty in a region which has the highest number and density of poor people. For the promotion of inclusive growth, regional integration will be an effective instrument. Ensuring food security is a challenging issue, and intra-regional trade in agricultural and food products will be immensely critical. Deeper regional integration through trade and transport facilitation will increase competitiveness of these countries to better participate in the global trade. Promotion of regional supply chain will be critical in developing dynamic comparative advantages of these countries. Finally, the peace dividends, through intra-country stable political relations, will be immensely high.

> **"..the new regime will require clear and visible leadership from India in taking the agenda forward. Other countries in the region should not be only at the receiving end but also have to take part actively and effectively. The new regime will call for all South Asian countries to balance what effectively they can offer and what they can expect in the deeper integration process."**

On the second question "***How*** to achieve deeper regional integration in South Asia?" the answer is: despite all shortcomings, SAFTA is a landmark achievement, and deeper integration has to take lessons from SAFTA. Intra-regional trade in South Asia has been low, but there are signs of huge potentials. There is a need to move beyond SAFTA; and the new regime has to put much weight on regional *investment and trade nexus*. Promotion of intra-regional investments and attracting extra-regional FDIs in goods and services sectors in general, and energy and infrastructural sectors in particular will be the key driver in the new regime.

On the third question "***What*** to do?" the answer is: a comprehensive assessment is needed on the achievements of SAFTA so far. For deeper market integration in goods, full implementation of SAFTA is needed with emphasis on further liberalization of intra-SAARC tariffs, reduction in sensitive list, relaxing the rules of origin, and establishing effective mechanisms to deal with the NTMs/NTBs. There is a need to link intra-regional liberalization with enhanced intra-regional investment in different services sectors. Regional and sub-regional efforts have to be promoted for different trade and transport facilitation measures, for cooperation in energy generation and transmission, and for linking energy cooperation and trade and transport facilitation with investment and growth processes of these countries. The focus should also be on the promotion of regional supply chains. The new regime will call for greater integration in trade, macro, financial and industrial policies with the aim for removing different policy and structural barriers. Short-term and medium term realistic targets should be spelled out. The new regime will re-emphasize on the importance of concrete regional efforts in the diversification of the export structures of the smaller and weaker countries for them to effectively integrate with the regional economy.

On the fourth question "***Who*** will do and what?" the answer is: the new regime will require clear and visible leadership from India in taking the agenda forward. Other countries in the region should not be only at the receiving end but also have to take part actively and effectively. The new regime will call for all South Asian countries to balance what effectively they can offer and what they can expect in the deeper integration process. Regional institutions, like SAARC Secretariat, have to be institutionally reformed and reoriented. Business associations and civil society organizations have to understand and take part in the political economy process of pursuing regional integration agenda in South Asia more than ever under the new regime.

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Volume I Issue 2 July 1, 2014

Macroeconomic Update

Bangladesh needs a new investment regime

Sophisticated econometric estimation suggests that the contribution to growth in Bangladesh, so far, has largely come from the factor accumulation effect and less from the factor productivity effect. During 1980s, average GDP growth rate in Bangladesh was 3.2% with an average investment-GDP ratio of 16.5%. During 1990s, the average growth rate in GDP increased to 4.8% with the rise in average investment-GDP ratio to 19.1%. During 2000s, the average growth rate in GDP became 5.8% with an average investment-GDP ratio of 23.9%. The first three years of 2010s witnessed the rise in average growth in GDP to 6.3% while the average investment-GDP ratio increased to 25.4%. The current investment regime, with its macroeconomic and investment policies and institutional structures, has been able to mobilize investment required to achieve 5-6% GDP growth rate. However, there are valid reasons to argue that the current investment regime can't sustain the economic growth process in the future and achieve a higher growth path; and there is a need to move towards a new investment regime in Bangladesh. A close look at the composition of investment during 1990s and 2000s suggests that the large contribution to the rise in investment came from the rise in private investment and the rise in its share in total investment. However, in recent years, the share of private investment in total investment has fallen with the rise in the share of public investment, which is unsustainable. Also the current investment regime has been less successful in diversifying the economy. The new investment regime calls for some substantial policy and institutional reforms aiming at considerable rise in private investment and its efficiency. What needed are: (i) a new paradigm of macro, trade and investment policies aiming at economic diversification, (ii) reform of the economic institutions tuned to further growth acceleration and growth maintenance, (iii) stability in the political institutions, (iv) efficient public investment in social and physical infrastructures facilitating further private investment, (v) attracting large FDIs, with emphasis on regional cooperation in South Asia, and (vi) improving the overall governance of the macroeconomic policy environment.

Selim Raihan

South Asia needs Regional Value Chains in Garments and Leather products

Rashmi Banga

South Asia as a region is losing out on its cost competitiveness, especially in their traditional export-oriented industries like textiles & garments and leather & leather products. Global imports of textile and leather products of the region increased by 70% and 300% respectively in the last decade. Not only are these industries losing out on their domestic markets, they are also losing out on their domestic value addition in their exports. Exports of textile products rose in Bangladesh by four times over the last decade, while it doubled in Sri Lanka. However, domestic value additions in these industries have declined in both the countries, as imports of raw material and semi-finished products in these industries have risen steadily. In Sri Lanka domestic value addition in exports of textile products declined by 4 percentage points and is now 48% while in Bangladesh it declined by 5 percentage points and is now 67%. Decline in domestic value addition in exports of textiles products is also striking in Pakistan, where it declined by 14 percentage points to reach 78%. Exports of finished leather products from India and Pakistan are experiencing a similar *hollowing-out* as domestic value addition declined in these products from 77% to 60% in India and from 85% to 74% in Pakistan. The importance of domestic value-addition in exports cannot be ignored as a fall would mean losing out on the commensurating production-linked gains of exports.

"..if a RVC is formed within South Asia and leather products are exported by Bangladesh and India and tanned leather imported from Pakistan, not only tanneries in Pakistan will benefit but the finished leather product industry will also benefit from falling costs of tanned leather due to rising scale of production."

While it can be argued that rising import-content of exports indicates linking into global value chains (GVCs), it is important to pause and rethink whether falling domestic value-addition of exports can be in any way gainful for an economy. While the entire emphasis of policy makers has been on linking into GVCs, there is a need to refocus policies on "*gainfully*" linking into GVCs, whereby not only exports rise but also domestic value-added content of exports. While it may be difficult to climb up the GVCs given the structure of GVCs- where the lead firms capture maximum value created in GVCs through providing pre and post manufacturing services- forming Regional Value Chains (RVCs) in these industries can offer much higher to South Asian countries in terms of domestic value-addition.

A RVC differs from GVC, as in RVCs the end product (finished product) is exported by a country from the region, while sourcing its intermediate products and raw materials from within the region. This will create demand for raw materials and semi-finished products within the region offering higher scale economies to other South Asian countries. For example, if a RVC is formed within South Asia and leather products are exported by Bangladesh and India and tanned leather imported from Pakistan, not only tanneries in Pakistan will benefit but the finished leather product industry will also benefit from falling costs of tanned leather due to rising scale of production. RVCs therefore offer opportunities to the countries within the region to link into value chains by using the region for boosting their competitiveness and increasing the domestic value added content of their exports. Linking into GVCs at higher end can also become easier if there are well established RVCs, as this will improve countries' bargaining power vis-à-vis the lead firms in GVCs. Sri Lanka and Bangladesh have acquired the necessary skills for producing world class quality garments and have well trained workforce. Establishing their brands is the need of the hour.

The region has rising demand and supply of both the inputs and outputs of textile and clothing industry and therefore provides a fertile ground for forming the RVC. Similar potential exists in the region's leather industry.

However, RVCs will not form automatically given the political economy of the region. There is a need to develop targeted policies and strategic interventions by both the policymakers as well as private sector in the region. Setting up industry-specific regional associations, regional design studios, regional R&D centers, promoting regional brands and prioritizing regional infrastructure are needed to improve the global competitiveness of the regional products. The region can also benefit from having an intra-regional investment agreement and deepening trade agreement. With the new governments in place in some of the countries in the region, new mindsets need to be promoted which emphasizes on collaboration and not competition.

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"Work on the *low hanging fruits*"

SANEM interviews Dr. Saman Kelegama to talk about regional integration in South Asia. Dr. Saman Kelegama is the Executive Director of the Institute of Policy Studies of Sri Lanka (IPS). He is the co-editor of the South Asia Economic Journal. He is an eminent expert on regional trade issues in South Asia.

SANEM: What is your view on the benefits of deeper regional integration in South Asia?

SK: Benefits of deeper integration will lead to flow of investments that in turn will stimulate trade in South Asia. More investment is essential to stimulating the investment-trade nexus – thereby promoting more intra-regional trade. Deeper integration will lead to higher growth. Deepening economic integration under a regional framework has been noted to be one of the most effective ways of addressing poverty. There are 'direct' and 'indirect' linkages through which regional integration can affect poverty. The direct link relates to the impact of regional integration on economic growth through increased levels of income while the indirect linkages are via channels such as trade, foreign direct investment, migration and other routes like regional social infrastructure programs.

SANEM: What are the major impediments?

SK: The first impediment is regional politics which fluctuates up and down and this has an impact on the economic integration process. South Asia has still not found a formula to insulate the economic integration process from regional politics. Second, although the Track II activities in South Asia are far ahead of the Track I (or the official SAARC process), the two tracks do not meet effectively and seem to be moving in parallel. The Track II is yet to find an entry point to Track I. Third, non-tariff barriers (NTBs) are an impediment but some of them can be overcome by wise entrepreneurship. Fourth, the SAARC Secretariat does not have adequate powers to move the economic integration agenda in-between SAARC Summits.

SANEM: Non-tariff barriers are considered as major hindrances; Is this somehow an exaggeration?

SK: They are certainly a hindrance to trade but if you master the art of overcoming them, then they will not be major barriers to trade. For example, take China's trade with India, where China's exports to India increased from US$ 1.5 billion in 2001 to US$ 70 billion by 2013 without any FTA between the two countries in place. Now, many entrepreneurs in South Asia complain about NTBs in the Indian market and the difficulty in penetrating it. But then, one has to ask how China is exporting to India with the same NTBs in place and how they overcame them to increase their exports by 47 times in a twelve year period? Therein lies the answer. It is a barrier but its impact is sometimes over-exaggerated.

SANEM: What should be done to promote intra-regional trade in South Asia?

SK: If countries could unilaterally liberalize trade, then intra-regional trade can be increased but then, unilateral liberalization is a political economy issue in regional trading agreements and it does not happen in practice. So what we need to do is to work on the "low hanging fruits" and implement trade facilitation (TF) measures as per the agreement of the WTO Bali package. TF can reduce transaction costs by an average of 10% and is as effective as tariff reduction in moving trade. Since TF is a non-controversial area, implementing it would not be difficult. But implementation should be based on binding commitments and also should be time bound. The SAARC Development Fund can allocate funds to implement some of the required TF measures. We should also start dismantling some Non-Tariff Measures (NTMs) that have become barriers to trade. Selim Raihan has done an excellent study recently on identifying NTMs in South Asia. This should be a starting point to begin this exercise. I suggest that the SAARC Secretariat should create a Director post for a representative of the SAARC Chamber of Commerce and Industry so that the trade and investment issues are effectively addressed in Track I using such studies.

SANEM: Thank you so much for your time.

SK: Pleasure.

The interview was conducted by Ahmed Tanmay Tahsin Ratul, Research Associate at SANEM.

SANEM's Intervention in the Leather sector in Bangladesh

M. Abu Eusuf

The leather industry accounted for more than $980 million exports in 2012-13. It has huge potentials in generating employment and growth by increasing export of higher value added products. However, the sector has not yet reached its full potential primarily due to operating constraints stemming from its production base in Hazaribagh of Dhaka city where there are minimal waste management systems and inadequate industrial layout planning. Out of more than 200 tanneries in Bangladesh, majorities are located in Hazaribagh. Following legal orders of the High Court, the government and the leather associations signed a MoU in 2003 to relocate all the tanneries from Hazaribagh to a new tannery estate. However, the implementation of the first MoU was stuck for many difficulties with unresolved decisions on cost sharing of various components (e.g. CETP) of the new industrial estate. SANEM, in partnership with the Asia Foundation, formed a coalition and began working with the leather associations and BSCIC in December 2012, in an effort to facilitate an acceptable agreement among all parties that would speed-up the relocation process. The coalition helped leather entrepreneurs and policy makers signing of a revised MoU in October 2013. As a result, the Hazaribagh-centric tannery industry is now legally bound to relocate all the factories to a new environmentally compliant tannery estate at the outskirt of Dhaka city. In resolving these binding constraints, the coalition maintained relentless liaison with all the relevant parties including leather associations, BSCIC, Ministry of Industry, and Ministry of Finance. Moreover, the coalition also organized several back-to-back meetings, roundtable discussions and seminars with leather sector entrepreneurs and government representatives during February 2013 and May 2014. Since then, the coalition has been addressing issues like initiation of CETP construction, drafting of compensation guidelines, advocating for 'soft loans' at lower/subsidized interest rate, and submission and approval of layout plans. Around 150 tannery owners out of 155 plot-owners in the new tannery estate already submitted their layout plans to BSCIC by May 2014. The coalition will continue to oversight the construction of the CETP; help formation and operation of a new company, jointly owned by the government and the leather associations to operate the CETP after it is set up; develop policy mechanism for the shifting of mortgages from land in Hazaribagh to the plots in Savar; and advocate for 'soft loan' for the entrepreneurs who will start shifting to the Savar Tannery Estate.

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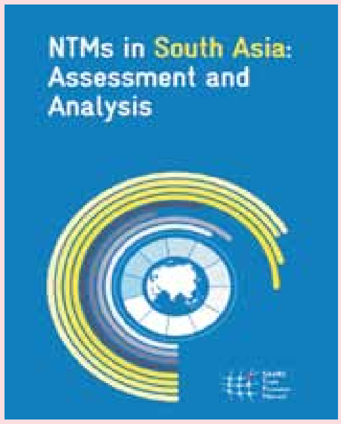
SANEM Updates

Ongoing Research Projects

SANEM's research team is currently working on the following issues:

- Gravity models on South-South trade: For Commonwealth Secretariat, UK
- Randomized control trial experiment in a research project on "Reducing Extreme Poverty through Skill Training for Industry Job Placement": For IZA, Germany and DFID
- Quasi-experiment in a research project on "Employment Effects of Different Development Policy Instruments": For World Trade Institute of Bern, and Swiss National Foundation
- Preparing technical papers on labor market, growth and poverty in Bangladesh: For IDRC-Canada

Review



Raihan, S., M. A. Khan and S. Quoreshi (2014), "NTMs in South Asia: Assessment and Analysis", SAARC-TPN, Kathmandu

This book provides an inventory of NTMs for each SAARC country at the 6-digit HS code level and also specifies country specific lists of products for which the country has export capacity but actual regional export is limited or non-existent, and identifies the relevant NTMs on those products. Using the GTAP model, the study also presents a simulation of possible gains from reduction in transaction costs in regional trade in South Asia. A monitoring and reporting template for NTMs has been developed and a framework for monitoring and reporting of NTMs has been proposed using the template as a tool. Finally, the study comes up with a set of recommendations that addresses the policy making at the functional levels.

Thinking Aloud

Volume I Issue 2 July 1, 2014

SANEM Hosts Regional Workshop on "WTO and Post-Bali Work Program for Asia"


With the mission to discuss and identify the issues of interest to Asian LDCs and countries with special needs, SANEM hosted the regional workshop on "WTO and Post-Bali Work Program for Asia" which was held on 5th and 6th May, 2014 at the Ruposhi Bangla Hotel premises in Dhaka, Bangladesh. Other organizers of the workshop included the Commonwealth Secretariat, Bangladesh Foreign Trade Institute (BFTI), African EXIM Bank and Center for WTO Studies, New Delhi.

Dr. Selim Raihan (Executive Director, SANEM) commenced the inaugural session with his warm welcome address on May 5, 2014. Among others, Prof. Abhijit Das (Head, Center for WTO Studies, New Delhi), Dr. Md. Mozibur Rahman (CEO, BFTI, Dhaka) and Dr. M. A. Razzaque (Adviser and Head, Economic Affairs Division, the Commonwealth Secretariat) embellished the inaugural session with their special remarks.

The workshop consisted of nine technical sessions on diverse trade issues and each session ended up with a lively open house discussion where the participants came up with their feedback, comments and recommendations. The major presentations on the first day included "Key Issues in negotiations on industrial tariffs", "NAMA Issues: Development Implications for LDCs and low income countries in Asia", "Recent developments regarding NAMA issues", "Key Issues in Agriculture for LDCs and low income countries in Asia", "Implications of Bali Decision on Public Stockholding for food security purposes", "Green Box Support: Development Implications", and "Key Issues in negotiations on Services" where the panelists discussed on the current state of play and implications for developing countries. Panelists for the first day included Dr. Saman Kelegama (Executive Director, IPS, Sri Lanka), Dr. Mustafizur Rahman (Executive Director, CPD, Dhaka), Prof. Abhijit Das, Dr. Rashmi Banga (Economist, UNCTAD, Geneva), Mr. Puspa Sharma (Research Director, SAWTEE, Kathmandu), Dr. M. Asaduzzaman (Professional Fellow, BIDS, Dhaka), Dr. Georgios Mermigkas (Trade and Food Security Officer, FAO, Geneva), Dr. Md. Mozibur Rahman, Dr. Selim Raihan and Dr. Nazneen Ahmed (Senior Research Fellow, BIDS, Dhaka).

The second day started off with a special address on "WTO Trade Negotiations and post-Bali Agenda: Issue of importance for LDCs and low income countries" by Mr. Amitava Chakrabarti (Director General, WTO cell and Secretary, Ministry of Commerce, Government of Bangladesh). Other presentations of the second day were on "Key issues in trade facilitation", "Trade Facilitation Agreement: Implications for LDCs and low income countries in Asia", "Single Undertaking: Implications and Options focusing specifically on LDCs and low income countries in Asia", and "Other Development Issues for LDCs: DFQF". The representatives from the participating countries expressed their observations and recommendations from individual country perspective. The distinguished panelists on this day were Dr. Selim Raihan, Mr. Jeff Procak (Regional Cooperation Specialist, ADB Manila), Prof. Abhijit Das, Dr. Mostofa Abid Khan (Director, BFTI, Dhaka), Dr. Cuong Minh Nguyen (Senior Economist, ADB Manila), Dr. M. A. Razzaque, Mr. Manzur Ahmed (Advisor, FBCCI, Dhaka) and Mr. Shaquib Quoreshi (Secretary, MCCI, Dhaka).

The concluding session was chaired by H.E. Mr. Pan Sorasak (Secretary of State, Ministry of Commerce, Cambodia), Dr. Rashmi Banga and Dr. M.A. Razzaque presented the first draft of the summary of the workshop. The workshop ended successfully with sharing of ideas, perceptions, expectations and recommendations from distinguished academics, researchers and practitioners.

Roundtable Meeting on "SAARC Regional Economic Integration"

Asian Development Bank (ADB) organized a two day long round-table meeting, on 24-25 March 2014 in Manila, Philippines, focusing on priority areas for South Asia's regional cooperation and integration. The meeting was attended by eminent scholars from this region presenting and discussing on the first drafts of the papers under the ADB-SAARC Secretariat Study on "A Roadmap for South Asia Economic Union". Dr. Selim Raihan, Executive Director of SANEM and the team leader of the study, presented the outline of the study and made presentations on two papers: "Identification of priority sectors for fast track liberalization" and "Quantitative assessment of phases of regional economic integration". Dr. Farazi Binti Ferdous, Fellow from SANEM, was a discussant for the study on "Informal trade in SAARC". The study is now in the process of being finalized, and Dr. Selim Raihan will make the final presentation at the ADB-SAARC Secretariat workshop on 21 July 2014 in Thimphu, Bhutan.

What Readers Say on June 1, 2014 issue

"It's great - the interview story is truly fascinating... "- Dr. M. A. Razzaque, Commonwealth Secretariat, London.

"The articles read really well with a good mix of data and policy analysis... the macroeconomic update section is also very useful."- Mr. Fazle Rabbani, DFID, Dhaka

"...wish all the very best for its continuation and betterment in every subsequent issue!" – Mr. Puspa Sharma, SAWTEE, Kathmandu

"A laudable initiative. Looking forward to read its future issues."- Mr. Bipul Chatterjee, CUTS International, Jaipur

"Wonderful read!"- Dr. Vaqar Ahmed, SDPI, Islamabad

e-version: http://sanemnet.org/thinking-aloud/

SANEM is a non-profit research organization registered with the Registrar of Joint Stock Companies and Firms in Bangladesh. Launched in January 2007 in Dhaka, it is a network of economists and policy makers in South Asia with a special emphasis on economic modeling. The organization seeks to produce objective, high quality, country- and South Asian region-specific policy and thematic research. SANEM contributes in governments' policy-making by providing research supports both at individual and organizational capacities. SANEM has maintained strong research collaboration with global, regional and local think-tanks, research and development organizations, universities and individual researchers.

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