## Free Trade with India

# Assessing Indian gains from a Bangladesh perspective

***By Sajjad Zohir***

When two parties negotiate, it is desirable to strike a deal which will bring benefits to both parties. Theories of economic exchanges, including international trade, have often considered that to be a basic premise; and these theories also try to prove that exchanges and trades can be mutually gainful. As in any case of exchange, one of the parties may be cheated, unknowingly engage in a contract detrimental to its own cause, or, be forced to accept an unfair deal. The worst may, however, arise when the parties representing the negotiating countries sell out the interest of the countrymen for personal gains. None of these need to be assumed at first, even though we often engage in such speculation and thereby facilitate such actions by refraining from positive engagements in discourses. We also assume here that our political representatives are sincerely pursuing the interest of the nation; and they welcome all perspectives on specific policy issue. It is also important to recognise that a deal that is not mutually gainful eventually leads to uncertainties, making investments risky and raising the cost of production and exchanges of goods and services. Obviously, a move towards free trade between Bangladesh and India from the current trade regime will involve benefits and costs to both the countries. It is important to identify these for both the countries and define the contractual arrangements, which will ensure net benefits to both. The game of diplomacy requires that each party comprehends the benefits and costs of a deal to the other party. Here, only the gains that may accrue to India from a free trade arrangement, in addition to those arising out of commodity trade between the two countries is being primarily focused. There are, of course, many other - often more important - dimensions involved in negotiating a free trade arrangement. Anticipated Indian gains from a free trade deal with Bangladesh: When asked about the possible implications of a free trade, there seems to be a consensus among the general observers in both countries that the Indian goods will flood the Bangladeshi market. Such responses appear to be naive on at least two grounds. First, the Bangladesh border is porous enough to let Indian goods get into its market through informal routes. Thus, a significant part of the potential gains from a ‘free trade’ is already realised. While there is no readily available estimate on additional gains to be made, such gains are likely to be confined to be in commodities (e.g., machinery and equipments), which normally are outside the jurisdiction of informal trade. Second, there are Bangladeshi commodities, which hold equal (if not more) potential to gain access to the Indian market if games are played on level grounds. One such case has been the dry battery cell. Another potential item is believed to be ceramic, which is possibly too fragile to be handled through informal routes. It is also alleged that the nominal concessions offered to the Bangladeshi exports to India under South Asia Preferential Trade Arrangement (SAFTA) will effectively increase only if other non-tariff barriers are removed. It is quite possible that the net gains from free trade, perceived in the aforementioned ways, may not be of much significance for India. This, however, needs to be assessed separately in a comprehensive manner. There are two additional gains that India is likely to realise, which are not necessarily mutually exclusive. Firstly, there will be demand for Transit embedded in the demand for free trade. It is, thus, expected that import of Indian goods through the western borders and re-exporting these goods to the north-east India through the eastern borders will be generally acceptable under the free trade arrangement between the two countries. In a way, this tantamounts to providing transshipment facility to India. Transit, transshipment and provision for re- exporting are perceived to be generically similar with variations in cost and differential benefits. In this context, possible gains to make the deal attractive to the Indian side would require that the cost of transporting a commodity from the west to the east through Indian territory under current arrangement is higher than the transportation and other costs of moving the commodities through Bangladesh; coupled with the various duties imposed by the Bangladesh government on trade flows of these commodities. This may be interpreted to suggest that Bangladesh may benefit by ensuring a minimum duty on this kind of flows, which should be as far as possible close to the various duties imposed by its government on related trade flows of such commodities but the same ought to be less than the latter. Setting no restriction on the trade flows will imply zero price for the transit facility offered under the free trade arrangement. It is important to recognise that increase in the flow of commodities will put extra pressure on transportation services, and will adversely affect the existing services. While the market will respond to increased demand (arising from transit needs) through increased prices, there will be additional cost to be borne by the society, and this should be fully recovered under any arrangement. In a way, this cost sets the minimum level of duty to be imposed on all trade flows between the two countries. The latter assertion holds when one assumes that the internal transport prices adequately recoup the expenses on roads and highways in Bangladesh. This is, however, not true in most developing countries, including Bangladesh and its neighbour. The presence of subsidy on building and maintenance of roads and highways in Bangladesh implies a higher cost incurred by the country to facilitate trade flows, which ought to be recovered. In contrast, presence of such subsidy in the neighbouring country implies that India can save on such expenses if alternative routes (such as, through Bangladesh) are found to transport goods from its western states to the north-east. One may reformulate here the earlier-noted requirement. But it does not require extra ingenuity to conclude that a person may gain by closing its wall and availing neighbour's entrance to get the car into the garage. The person, however, runs the risk of facing unanticipated contempt from the neighbour; and a fair deal reduces such risk! Similar arguments would apply for imports of goods from north-east India, which are re-exported to a third country (or, to Indian ports) by sea. In such cases, ports in Chittagong will be the sought-after transit routes; and one can extend the analyses to capture the additional costs that may arise due to increased congestion! Instruments of pricing the transshipment service, embedded in the free trade agreement, raise some difficulties. An import duty is easy to administer, but the idea runs contrary to that of (eventual) free trade. It is difficult to administer taxes on selective exports, nor is it ideologically saleable. The choice may be worked out once the numbers are well understood. It is difficult to monitor hidden subsidies provided by the Indian government in carrying out such activities. It is also difficult to enforce clean monitoring by a Bangladeshi agency. Thus, there may be two alternatives for Bangladesh aspiring to engage in free trade with India: (i) set the (import) duties right, if it does not adversely affect total trade flows; or (ii) make re-export legal and make it mandatory for trading agency to declare such activity (with provision for severe penalty in case of failure) and make the registered firms pay an additional service charge. The second one may also be difficult to monitor. Secondly, promoting investment in the North-East India is another important additional gain for India. That is partly rooted in the politics of that country. Ensuring economic growth and bringing political stability in its north-eastern states is likely to be a priority for India. Such investments will be attractive if they find a market either in Bangladesh or in the rest of the world (including rest of India) through Bangladesh's land and seaports. It is quite probable that India will have reasons to subsidise such investments in the northeast. For a thorough analysis, one needs to identify the areas of potential investments. One possible area may be the limestone-based cement factory, which will have adverse effects on Bangladesh's clinker-based cement factories. Ideally, a workable deal would need to involve Bangladesh as a partner in such investments, who in return, would be too keen to facilitate access of the north-eastern goods to the outside market. Unfortunately, the guardians of politics in this region had failed to appreciate the natural entities and nurture their healthy development! To sum up here, a "free trade" arrangement between two countries has many operational dimensions, and does not necessarily imply zero tariff on all commodities. Moreover, realising smoother trade flows requires adoption of common commodity classification at operational levels in the two countries and removal of other (non-tariff) trade barriers. More importantly, rational choices ought to be made by both negotiating parties, each having informed appreciation of the benefits and costs of other party. Here, one aspect of a larger canvas capturing the implications of a free trade arrangement between Bangladesh and India has only been alluded to. In this particular context, our policymakers may find appropriate to consider the following issues during their negotiation:

- Similar to rules stipulated under the WTO agreements, Bangladesh may find it desirable to ensure parity in domestic support (including export subsidy) provided to traded goods in the two countries.
- It is important to appreciate the needs as well as the difficulties in linking investment with trade. Should we negotiate trade without tagging it with investment? Ideally, we need to ensure certain production activities to be left to Bangladesh, where Indians may participate as well.
- It is important to recognise that Bangladesh will provide transit facilities to India under the umbrella of a free trade arrangement. While there is nothing wrong with it, the costs and service charges need to be realised.
- If nobody wants to openly acknowledge the linkage mentioned above, it is likely to surface in the context of defining an acceptable clause on Rules of Origin (RoR). If the required value addition, stipulated in the RoR, is specific to a country, Bangladesh will not legally be able to re-export to India the goods that are imported from India. In contrast, if the formula of regional accumulation is tabled, the motive behind a free trade will be too obvious. The concept of regional accumulation is a theme, rather alien to the context of bilateral trade agreement!

- Can bilateral free trade ensure Bangladesh’s interest without it being preceded by a transparent agreement on transit/transshipment, which accommodates transfer of payments to Bangladesh on account of the additional costs it incurs? If this cannot be negotiated bilaterally, wouldn’t the interests of both countries be better accommodated under a multilateral free-trade arrangement?

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