



Transit and Trade Barriers in Eastern South Asia: A Review of the Transit Regime and Performance of Strategic Border-Crossings

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Executive Summary

In recent years, South Asia has received growing attention as a region that is integrating successfully into the world economy. South Asia has successfully converted preferential trading agreement (SAPTA) into a free trade agreement (SAFTA) in July 2006. However, intra-subregional transit trade volume is still miniscule in eastern South Asia (Bangladesh, Bhutan, India and Nepal), compared to its extra-subregional transit trade. About 2 percent of transit trade of eastern South Asia is conducted within the subregion, whereas the rest 98 percent is extra-subregional.

With SAFTA, South Asian countries are now looking toward deeper integration of the region. However, in reality, South Asia is far from realising its full potential. One of the critical factors prohibiting South Asia in achieving its full potential is absence of regional transit trade. Unlike European Union, South Asia does not have a regional transit arrangement, although partial transit exists for landlocked countries like Afghanistan, Bhutan and Nepal. India and Bangladesh do not have transit arrangement even though they are adjacent and share a common border. At the same time, India has bilateral transit arrangement with Bhutan and Nepal, two landlocked countries with which India share an international border.

The present squishy transit arrangement in South Asia is disappointing, as the greater benefits of SAFTA and multilateral free trade are contingent upon full regional transit. Therefore, the scope and issues covered under the GATT Article V (Freedom of Transit) have become extremely important since regional trade in South Asia has expanded. A regional transit arrangement will help South Asia to better integrate the region and also to strengthen the globalisation process.

The econometric evidences of this paper strengthen the existing linkage of trade costs, transit, and trade flows: higher the transaction costs between each pair of partners, less they trade. In our particular case, it is seen that a 10 percent fall in transaction costs at border has the effect of increasing country's exports by about 3 percent. The analysis of this paper shows that a regional transit arrangement would perhaps enhance the regional trade, controlling for other variables. At the same time, implementation of e-governance at border is found to be significant determinant of trade flows thus indicating e-filling of Custom formalities has been helping the trade to grow in eastern South Asia. This is also not to deny that many of the border Customs stations surveyed in this study are yet to be equipped with modern ICT. Nevertheless, this study holds out, among others, the importance of transit as a major source of advantage for the regional as well as international trade. Hence, an important means of promoting the regional trade could be accepting to full transit in South Asia, which will not only enhance regional trade but will also strengthen the globalisation process, being pursued by the WTO.

The efficiency of border corridors is also a critical factor for a region's competitiveness and its trade prospects. Using Data Envelopment Analysis (DEA), we have evaluated efficiency of the border crossings in eastern South Asia. We have found that among the nine Land Customs Stations (LCSs), Raxual in India is relatively an efficient border, while rest eight LCSs are relatively inefficient. However, average performance of nine LCSs has improved over time pointing to the fact that there has been a positive development in border Customs stations.

To improve performance, border corridor management authorities (here, government) need to constantly evaluate operations or processes related to providing, marketing and selling of services to the users. Since present trade flow is very much uneven between the border corridors, a full regional transit arrangement in South Asia would likely redistribute the regional trade and traffic among the existing corridors.

Therefore, in order to maximise the benefits of trade liberalization in view of SAFTA and in anticipation of full regional transit arrangement either under GATT Article V or under SAFTA, South Asian countries should give utmost importance to inefficient border Customs stations for making them efficient. If the objective is to achieve equitable growth of trade and traffic in South Asia, all the border corridors have to improve their efficiency over time. The requisite policy agenda extends broadly to stimulating the evolution of border corridor services, promulgating new performance standards, and encouraging their implementation.

I. Introduction

Countries that depend on transit trade, notably the landlocked countries, are confronted with a variety of practical constraints that increase the transportation costs of their international trade (UNCTAD, 2004, 2007).¹ It is estimated that landlocked developing countries have to bear, on average, 50 percent higher international transport costs than their neighbouring transit/coastal countries (UNCTAD, 2004). The specific constraints are related to Customs and border procedures and also to the fact that cargo and transport services have to adapt a different sets of administrative, legal, commercial and other conditions when passing through a third country. Transit arrangements that aim at diminishing these constraints need to take new developments into account, notably concerning trade facilitation, new technologies, multimodal transport, and transport security.

In recent years, South Asia has received growing attention as a region that is integrating successfully into the world economy. South Asia has successfully converted preferential trading agreement (SAPTA) into a free trade agreement (SAFTA) in July 2006. With SAFTA, South Asian countries are now looking toward deeper integration of the region. This FTA would lead to growth in intra-regional trade from US\$ 6 billion to US\$ 14 billion by 2010 (Government of India, 2006).² However, in reality, South Asia is far from realising its full potential. One of the critical factors prohibiting South Asia in achieving its full potential is absence of regional transit trade.³ Unlike European Union, South Asia does not have regional transit arrangement, although partial transit exists for landlocked countries like Afghanistan, Bhutan and Nepal. The present squishy transit arrangement in South Asia is nonetheless disappointing.

Realising the urgent need for enhancing South Asian trade, the Heads of South Asian Association for Regional Cooperation (SAARC) countries have been harping on the potential of an integrated transport and transit system for the region.⁴ They have emphasized that higher intra-regional trade would not be achieved until and unless the physical infrastructure and appropriate Customs clearance and other facilitation measures, including multimodal transport operations, are in place. They have also pointed out that in this effort, uninterrupted overland connectivity is equally important. In order to reduce regional and multilateral trade transportation costs, the South Asian leaders aim to integrate the region through an improved connectivity including a regional transit arrangement. The need for regional transit arrangement in South Asia is long standing. However, challenges are numerous. A full regional transit means a stronger multilateral transit. A set of studies show that the economies with geographical contiguity could potentially benefit substantially from higher trade, provided the trade and transport barriers are removed through a regional transit arrangement (e.g. EU).⁵ Some earlier studies identified several challenges related to

¹ For example, UNESCAP (2008) commented that while relaxing regulations and tariffs is a way to help least developed landlocked countries (LLDCs) to achieve prosperity, the physical distance from sea ports remains a major obstacle. Building roads, railway lines and other transport infrastructure is therefore required to help these countries to find new markets for their goods.

² Countries in South Asia are planning to enhance intra-regional trade from 5 percent to 12 percent within next five years due to SAFTA (Government of India, 2006).

³ See, for example, Ray and De (2003), World Bank (2004), ADB (2005), to mention a few.

⁴ Refer, the Declaration of 14th SAARC Summit, New Delhi, 3-4 April 2007.

⁵ See, for example, Polak and Heertje (1993)

the implementation of GATT commitments in transit and trade facilitation in context of South Asia.⁶ But, none so far attempted to best design a regional transit transport arrangements in context of South Asia.⁷

A regional transit arrangement will help South Asia to better integrate the region and also to strengthen the globalisation process. The scope and issues covered under the GATT Article V (Freedom of Transit) have become extremely important since regional trade in South Asia has expanded. The GATT Article V addresses traffic in transit. It regulates the conditions a member may impose on goods transported through its territory by another party to a foreign destination.⁸ Quite naturally, in order to operationalise a South Asian transit system, WTO offers several solutions. Therefore, a study on WTO rules on transit and its developmental implications for South Asian countries is highly significant because all South Asian countries, except Afghanistan and Bhutan, are members of WTO, and South Asian countries have accorded an FTA in accordance with WTO rules in 2006 and are aiming to form a Customs Union by 2013 and an Economic Union by 2020.

In view of above, the objective of this paper is to assess potential gain of a regional transit with special emphasis on eastern South Asia subregion, namely, Bangladesh, Bhutan, India and Nepal. The profile of intra-regional transit trade and related transit arrangements are presented in the next section (Section 2). Section 3 discusses the transit arrangement mechanisms in eastern South Asia subregion. WTO rules on transit (GATT Article V) and its development perspectives on eastern South Asia are discussed in Section 4. Section 5 presents the results of a field survey, which was carried out on selected border crossing corridors in the subregion. We also discuss the constraints of transit trade in the subregion and the potential gaps in the transit arrangement in the subregion. Econometric results are presented in Section 6. Finally, conclusions and policy recommendations are given in Section 7.

II. Transit Trade in Eastern South Asia: Profile and Arrangement

The importance of tariffs as barriers to trade has gradually come down, however, high-tariffs still exist for certain sensitive products, and there is a strong presence of Non-Tariff Barriers (NTBs) including high border transaction costs in the region.⁹ High transportation costs are also penalising trade in South Asia (De, 2008a). However, poor institutions (e.g. lack of e-filing of trade documents), inadequate infrastructure (e.g. lack of modern warehouse or container handling facility at border), and absence of a regional transit trade (virtually in the entire region) are prohibiting the trade to grow in South Asia.¹⁰

In South Asia, Afghanistan, Bhutan and Nepal are landlocked countries and solely depend on transit through neighbouring countries. They confront with a variety of practical constraints that increase the logistics costs of their international trade

⁶ See, for instance, UNESCAP (2006, 2007)

⁷ Except perhaps ADB (2005), which was the first comprehensive study for establishment of regional transit in South Asia.

⁸ See, WTO (2005a and 2005b)

⁹ See, for instance, Das and Pohit (2006), Taneja (2007), to mention a few.

¹⁰ See, for example, Subramanian (2001), Arnold (2007), Wilson and Ostuki (2007), De (2008b).

(Box 1). Landlocked developing countries, as a group, are among the poorest of developing countries, with limited capacities and dependence on a very limited number of commodities for their export earnings. About 38 countries are presently landlocked with no access to sea (Upreti, 2006). Lack of territorial access to the sea, remoteness and isolation from world markets have contributed to their relative poverty, substantially inflating transportation costs and lowering their effective participation in international trade (UNCTAD, 2005). For example, Bhutan and Nepal heavily rely on Indian eastern coast for their international trade. Due to several bottlenecks including those are visible at border crossings and transit ports, Bhutan and Nepal face substantial trade costs, which, otherwise could have been avoided if a regional transit trade regime is restored in South Asia. The trade-reducing effect is strongest for transport-intensive activities. Most, if not all, landlocked countries in South Asia are commodity exporters. The very high transport costs which they must bear constrain export development since that burden limits the range of potential exports and markets in which goods can be competitively and profitably traded. The price of imports tends to increase because of high transit transportation costs.

In eastern South Asia, Nepal and Bhutan depend on India for their regional and international trade. In particular, Nepal is increasingly dependent on India for its 68 percent of exports and 62 percent of imports in a year (Table 1(a)). The relatively bigger country like Bangladesh sources about 13 percent of global imports from Bhutan, India, and Nepal, but its export to these countries is low, compared to import (Table 1(b)). The interesting development is that Bangladesh's trade with Bhutan has witnessed a steep rise in recent years, where this entire trade is carried overland using the India – Bangladesh – Bhutan transit corridor. India's trade with adjacent countries like Bhutan and Nepal have also gone up, which is again carried overland (Table 1(c)), where India has bilateral transit agreements with both of them. India's trade with Bangladesh has witnessed a phenomenal rise, despite the fact that they do not have any bilateral transit arrangement. The trade between Bangladesh and Nepal witnessed a marginal rise between 2000 and 2006. About US\$ 4.50 million was the bilateral total trade between the two countries, carried overland in 2006 through a tiny corridor between India, Nepal and Bangladesh.¹¹ A trilateral transit understanding between Bangladesh, India, and Nepal is in place in order to facilitate the overland trade between Nepal and Bangladesh. Bhutan's trade is again India-centric. Bhutan sources about 75 percent of its import from India and sales almost 88 percent of its exports to that country (Table 1(d)). However, trade among the countries in eastern South Asia subregion is not always a transit trade. For example, India's bilateral trade with Bangladesh, Bhutan and Nepal can not be termed as transit trade, whereas the same between Bangladesh, Bhutan and Nepal through India can be seen as transit trade since the trading countries in this particular case are not geographically adjacent. Similarly, the trade of Bhutan and Nepal with rest of the world through another country (here, India) can also be termed as transit trade. We discuss the profile of this transit trade in context of eastern South Asia next.

A. Transit Trade Profile of Eastern South Asia

Until recently, transit trade in South Asia was not in the forefront of regional and multilateral cooperation. However, increasing trade volume in recent years has forced the countries in South Asia to be more lenient on transit trade – regional and

¹¹ Refer, Chapter 5 (corridor 3) of this paper, and also see Map 1 in Appendix 3.

otherwise. The transit trade in eastern South Asia subregion can be grouped in two categories: (i) intra-subregional and (ii) extra-subregional. Tables 2(a) and 2(b) present the volume of intra-subregional and extra-subregional transit trade for three countries, namely, Bangladesh, Bhutan and Nepal, passed through India. Following observations are worth noting.

Table 1(a): Nepal's Trade with India and Bangladesh

	1991	2000	2006
	(US\$ million)		
<i>Exports to</i>			
Bangladesh	0.12	1.90	3.24
India	17.45	307.20	562.98
Total (above 2)	17.57	309.10	566.22
Share in global export (%)	6.83	42.89	68.25
<i>Imports from</i>			
Bangladesh	12.70	8.10	1.45
India	85.01	574.20	1481.51
Total (above 2)	97.71	582.30	1482.96
Share in global import (%)	19.54	37.08	61.85

Source: Calculated based on IMF (2007)

Table 1(b): Bangladesh's Trade with India, Nepal and Bhutan

	1991	2000	2006
	(US\$ million)		
<i>Exports to</i>			
Bhutan	0.30	0.90	4.08
India	22.8	50.13	146.93
Nepal	11.54	1.32	1.32
Total (above 3)	34.64	52.35	152.33
Share in global export (%)	2.05	0.94	1.19
<i>Imports from</i>			
Bhutan	3.90	4.53	12.95
India	189.49	945.45	2230.77
Nepal	0.14	3.98	3.16
Total (above 3)	193.53	953.96	2246.88
Share in global import (%)	5.66	10.60	12.56

Source: Calculated based on IMF (2007)

Table 1(c): India's Trade with Bangladesh, Bhutan and Nepal

	1991	2000	2006
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