Economic Reforms and India-Bangladesh Bilateral Trade: Can further liheraiization help in promoting cooperation?

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Abstract

The paper discusses the economic reforms carried out in India and Bangladesh towards liberalization of trade and hence enhancement of bilateral trade cooperation between these two countries. It compares the sequence of economic reforms carried out in India and Bangladesh with the theoretical "proper" sequencing of economic reforms and examines the differences in the maturity of frameworks in these two countries. On the basis of these discussions, the papers attempts to find if further liberalization can promote bilateral trade cooperation between India and Bangladesh, and to what further extent and in what directions further liberalization of trade policy is required to achieve bilateral trade cooperation.

Introdnction

The fundamental concept of economic liberalization as a strategy of policy reform is based on the well-known neoclassical result of the Pareto optimality of free trade. This view favors the free determination of market economy with government intervention restricted only to correct market failure resulting from external factors and shocks. During 1970's, a number of developing countries embarked on economic liberalization, aiming at removing any distortion to trade reducing barriers to capital movements, and increasing the role of market mechanism (Edwards, 1984). The reform process included the elimination and/or reduction of quantitative restrictions on trade and tariff levels along with the reduction of restrictions on domestic financial market and international capital movement. However, evidence shows that liberalization of economic policies of developing nations were failures as they were partially converted consequences of the reforms. Even if there were no clear

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arguments for the main reason behind the failure of the liberalization, inappropriate macroeconomic policies, particularly the timing of the reforms was argued to be a major problem (Edwards, 1984). In addition to the timing of economic reform, the sequence followed has also become a controversial issue among economists at present.

Since economic liberalization promotes a country's potential in pursuing regional, bilateral or multilateral cooperation in trade, the growing consensus of harvesting mutual gains by promoting interdependence and increasing degree of openness has also emerged in South Asia---a historically recognized trading hub explored by many European expatriates during the seventeenth and eighteenth century. Among the 'members' of South Asia, both Bangladesh and India have been rated as potential collaborators for promoting the consensus of regional economic cooperation. The Indian economy is predominantly manufacturing based resulting in a large volume of manufacturing exports and capital imports to and from every corner of the world. India exercises gradual economic liberalization process with major policy objective being market orientation and globalization. Bangladesh economy, on the other hand, stands in a transitional phase of shifting and reallocating productive resources from agriculture towards industrialization, and has identified sixteen priority sectors and industries with a view of giving them special incentives and support. Since 1990s, the government's policy objectives have been directed towards privatization and liberalization of trade, commerce and industry in order to globalize and optimize the benefits from interdependence and regional cooperation.

Though there has been no "formal bilateral trade cooperation agreement" between India and Bangladesh, the structural adjustments and policy cooperation required for such an agreement between the two countries has been high on the agenda since 1990s, and numerous state visits have shown promises for the future. However, bilateral trade practice between India and Bangladesh has not been equitable and has always been heavily skewed towards India (Chandra, 1991). Although both countries are promoting the macroeconomic consensus of policy reforms towards greater degree of liberalization, the barriers perceived to restrict bilateral cooperation in trade happens to be still in practice, and somehow escape the coverage of policy reforms towards openness in every step towards liberalization. Moreover, critics often argue that bilateral trade cooperation between these two countries are incompatible due to the two different framework of trade policy followed by the two countries. The purpose of this study, is thus to examine whether economic liberalization has in any way contributed in promoting the possibilities of trade cooperation between India and Bangladesh and identify areas where further liberalization may stimulate bilateral trade cooperation. In addition, it attempts to identify some structural as well as institutional adjustments (apart from economic liberalization) through which bilateral trade cooperation between India and Bangladesh can be promoted.

A brief overview of Indian and Bangladesh economy

The leading macroeconomic and social indicators of India and Bangladesh suggest similarity in the progress of development of these two countries, although maturity of developmental process differs to considerable extents. The following table 2.1 presents some leading macroeconomic and social indicators that may prove helpful for a comparative study of the macroeconomic performance and assessment of developmental status of these two neighbor countries.

India happens to be one of the largest economies of the world with almost one fifth of the aggregate world population with a population density of 330 people living in per square kilometer (as of 1999). India recorded the second highest adult literacy rate in the region (55.7% as of 1999) with the government putting strong emphasis on Human Resource Development in its policy objectives (Economic Survey).

Table 2.1: Leading social and macroeconomic indicators of India and Bangladesh.

	India	Bangladesh
Population as of 1999-00 (Density of population)	980 Millions (330 per sq km)	126Millions (867 per sq km)
Population growth rate as of 1999-00	1.8%	1.6%
Life expectancy at birth as of 1999-00	63 years	59 years
Adult literacy rate as of 1999-00	55.7%	40.1%
GDP (PPP adjusted) as of 1999-00	US $2034 Bil.	US $171 Bil.
Per capita income as of 1999-00	US $439	US $341
Economic Growth Rate as of 1999-00	6.1%	5.1%
Current Account Balance as of 1999-00	US $-4984 Mil.	US $-253 Mil.
Gross International Reserves as of 1999-00	US $30647Mil.	US $1936 Mil.
FDI inflows as of 1999-00	US $2168 Mil.	US $150 Mil.
Total labor force as of 1999-00	431 Mil.	64 Mil.

Source: An Investment Guide to Bangladesh, CPD and Statistical Yearbook of Bangladesh, BBS; Economic Survey, India.

In early phases of underdevelopment of the Indian Economy (1950-65) 60 to 80 percent of the country's population, comprising mostly rural inhabitants were seeking employment in the agricultural sector. Savings mobilization rate was low and trade commerce remained limited with scarce credit facilities. There was a shift of surplus labor to industry as for the move towards industrialization in 1960, and as a result economy progressed towards the second phase of reforms. There were much emphasis on human resource and human development to address social issues as economic planning objectives. Population control was major agenda during 1970s, which brought in sustainable development in standards of livings (Shetty, 1978). Liberalization during the late 90s was designed to promote macroeconomic growth and stability through which reliance on traditional sources of external and internal revenue generation was reduced. In the sixth plan (late 1970s) the economic growth rate in India was negative for the first time in history. With a starting growth rate of 1.7% in the first plan (1950), the growth rate ranged between 2-3% till the fifth plan period of early 1970s. The negative growth rate of sixth plan period was recovered in the seventh plan, and eighth plan period of 1990 established a record growth rate of over 4% for the first time (Economic Survey).

Bangladesh is the world's ninth most populous country with a population density of more than 860 people per square kilometer and a population of 126 million growing at a rate of 1.6% per annum (as of 1999 data). Poverty alleviation is the government's primary objective for development with special emphasis placed on human resource development, which aims to raise the literacy rate to 70% by the year 2002 (which as of 1999 is 40.1%). The country's higher educational facilities include 11 public and 32 private universities, 4 engineering colleges, 13 public and 9 private medical colleges and 20 polytechnic institutes (BBS). In 1972, the government of newly independent Bangladesh ideologically committed itself to growth via public enterprises through the nationalization of all major industries. Widespread dissatisfaction with the poor performance of the public enterprises convinced the government that the public sector was unable to steer the country toward growth and development (Hassan, 1996). This conviction, along with the need to cut government expenses and reduce the role of the public sector, shifted the development policy towards market forces. Thus by the late 1970s the importance of private sectors was recognized and a new Industrial policy was introduced in

1982 with major objective to provide a new dimension and greater thrust for industrialization of the country. Government reforms following the new Industrial Policy (1982) aimed at transforming Bangladesh into a market-based economy has brought some positive results in macroeconomic indicators. Between 1990 and 1998, GDP growth rate increased to 5%. The acceleration in growth has been accompanied by a decline in poverty, but poverty reduction still has a considerable way to go.

Promotion of economic cooperation between Bangladesh and India is of vital importance as far as overall promotion of regional cooperation within South Asia is concerned. These two economies are historically popular as potential "gateways" to South Asia, having one of the best port and transit facilities. With a diverse but conformable cultural environment and rich natural as well as human resource base, India and Bangladesh are two adjacent centers of harvest for potential investors, traders and tourists.

The political economy view of economic reform

In order to promote the so-called "long awaited" trade cooperation between India and Bangladesh, it is therefore, important to examine the sequencing and timing of the process of liberalization through economic and institutional reforms in these two countries. For the convenience of discussion, the different phases of economic reforms undertaken to promote liberalization in these two countries will be discussed in the following section. The section after that will discuss the political economy view of the sequencing of economic reforms undertaken in India and Bangladesh.

Economic reforms towards liberalization in India and Baugladesh:

During the late 1970s the idea and the process of trade liberalization and introducing increased degree of openness was emerging in the South Asian region, with India and Bangladesh taking the lead role of this transition. Dismantling of trade barriers, denationalization and introducing increased degree of privatization in all sectors, financial ownership reforms, promotion of private sector participation and foreign direct investment in strategically selected "thrust sectors" and other issues were high on the agenda of political campaigns, institutional initiatives and macroeconomic research during the last twenty years. In most sectors, incentives were generated to promote the consensus of globalization through opening up borders, removing barriers against trade and investment, mobilizing domestic savings, integrating capital and financial markets and removing control over prices to allow markets function smoothly.

Before discussing in more detail the sequencing of economic reforms carried out in India and Bangladesh, the two conceptual approaches that were adopted and argued broadly among economists and policymakers should be defined. One of the central questions concerning the liberalization program is the choice between a gradual and a rapid approach. Without externalities and distortions, the problems of speed and order would be simple. In order to achieve the first best equilibrium, all markets should be liberalized immediately and simultaneously (Edwards, 1984). This is the so-called "Big Bang" or rapid or drastic approach to reform. But when many factors are taken into account, the speed and the order would not be that simple. One policy measure should precede the others. Reform processes are put in order or steps. This is known as "Gradualist Approach" to reform. In the debate about sequencing of economic reform, it seems unfair to add credibility to the gradualist approach just because of the simplicity of the Big Bang. While the supporters of gradualism may point out the failure of Chile's reforms in the first phase when rapid approach was adopted, those who argue for rapid approach may show the unsuccessful story of Indonesia's reform where the proper sequencing did not take place. The process of economic policy reform in India and Bangladesh can be presented sequentially as it occurred. Table 3.1.1 will discuss the phases and sequencing of economic reforms towards greater degree of liberalization that occurred in India.

Table 3.1.1: Sequeuce of economic reforms carried out in India.

Reforms	Sequence of reforms
Trade policy reforms in first phase	During the first phase of trade policy reform during 1955-70, the government adopted the objective of rapid industrialization with particular emphasis on import substitution of heavy/large scale industrial products with the declaration of 300 commodities, which were completely substituted by domestic production, and a more liberalized act of import of raw materials required for enhancing domestic production.

Trade policy reforms in second phase	To promote export and diversify export base, India adopted extensive export promotion measures by establishing a number of organizations dealing with foreign trade with definite sets of objectives during the Sixth Five-Year Plan (1977-82). During this phase of trade policy reform, the Sixth Plan document emphasized the creation of a stable policy environment (Nambiar, 1977). It envisaged maximum attention need to be given in removing disadvantages from which the exporters suffer and obstacles to the expansion capacity for exports and maintaining adequate links with technological developments abroad. The Seventh Plan (1982-87) highlighted the importance of service exports, particularly earning from tourism. Six Free Trade Zones were established to ensure increased incentives to export production. The overall reform process during this phase was completed during the Eighth Five-Year Plan in the early 1990s, which actually was the first phase of trade liberalization. The Eighth Plan highlighted deregulated measures of export promotion by decontrolled export of over hundred items, introduction of the Export Processing Zones (EPZs) scheme, 100% Export Oriented Unit (EOU) scheme with duty free enclaves and simplification of advance licensing system for exporters. In case of imports, a large part of administered licensing of imports was replaced by import entitlements. The fixed exchange rate regime was changed into a managed floating exchange rate regime.
Trade policy reforms in the third phase	In the third phase of trade policy reform, India announced a five-year (2002-07) medium term export strategy for the manufacturing sector to boost up exports and create a more export-friendly environment. The process of trade liberalization in India is exhibited in the chronology of India's removal of quantitative restrictions, with a total of 1429 reductions in tariff lines under preferential treatment to SAARC countries in 1998. on march 2002, the government of India ended virtually all quantitative restrictions on exports in a bid to raise overseas sales (Jalan, 1992). The liberalization process also includes special incentive features for export promotion and import substitution. Besides, there has been a significant institutional reforms to promote trade liberalization and continuous monitoring of trading practices to ensure sustained growth in trade surplus is also noteworthy. The policy emphasized, among others, the need for an effective and responsive trade defense mechanism to provide protection against unfair trade practices.

Source: Sen and Das, 1992, CPD working papers, Misra and Puri, 1994, Economic Survey, India, Jalan 1992.

Undoubtedly, the speed and sequencing of economic reforms towards liberalization in India has been gradual where an order of changes has been consistently followed. The basic strategy of trade liberalization in India since its independence was the one, which attempts to strengthen the domestic economy first and introduces outward-orientation as the next phase. During the first phase of economic reforms, in order to protect the domestic economy's interests, India adopted the objective of rapid industrialization with particular emphasis on import substitution of heavy/large scale industrial products. To achieve the desired level of import substitution, the government liberalized the import of raw materials that are needed for producing heavy/large scale industrial products. This was the first step of export promotion, as most of these large scale industries were potential suppliers of inputs to manufacturing industries. During the second phase of reforms, the Sixth Plan document emphasized particularly on export promotion through enhanced manufacturing activities. It also emphasized the creation of a stable policy environment, and assurance of maximum attention in removing obstacles from which exporters suffer. By the time India adopted export promotion of manufacturing goods, the prerequisite industrial set up was already existing. This phase also took rigorous measures in developing tourism industry, decontrolling exports, removing quantitative restrictions on exports and establishing institutions that were especially designed to assist export promotion. India adopted a managed floating exchange rate regime to ensure increased competitiveness in world market. The consensus of export promotion and boost manufacturing exports continued during the third phase of reforms. Complete removal of quantitative restrictions on exports was done in 2002, and a chronology of large reductions in import barriers was also recorded during the last decade.

The reforms in the investment and financial sectors of India were also gradual keeping compatibility with strategic concerns of trade policy reforms. The first phase of investment policy reform of India towards liberalization preceded trade policy reform. There was, however, a marked array of restrictions on foreign investment and MNCs applied during the second phase of reform. These included prohibition of import of technology, reduction in normal permissible period of agreements and administrative interference in making decisions regarding foreign investment in some particular industries. With the introduction of FERA in 1974, foreign equity participation in non-banking foreign branches and subsidiaries was also restricted to 40% with a permission requirement (Swamy, 1994). During the 1990s, a large number of steps were taken to liberalize the investment regime, that included, among others, introduction of automatic approval routes for FDI proposals, allowance of increased foreign equity participation, allowance of trade marks and brand names and removal of restrictions on transfer of shares. The financial sector reform in India took place at a relatively later stage of economic reforms, when trade and investment policy reforms already had passed the first and second phases. These included removal of entry restrictions imposed against foreign banks, partial convertibility of capital account and partial liberalization of the capital markets to foreign institutional investors. Table 3.1.2 discusses the phases and sequencing of economic reforms towards greater degree of liberalization that occurred in Bangladesh.

Table 3.1.2: Sequence of ecouomic reforms carried out in Bangladesb.

Reforms	Sequence of reforms
Trade policy reforms in first phase	During the first phase of trade policy reforms during 1970s, Bangladesh had a fairly protected tariff structure, with imports being restricted and/or prohibited through provision of 'restricted' list and/or 'negative list', and exports not being encouraged with adequate provision of direct or institutional incentives. The process of privatization of industries emerged with a major policy reform towards deregulation (NIP 1982), and with growing concern of sustained trade deficits, export promotion was an addressed issue in the mid 1980s.
Trade policy reforms in second phase	During the second phase of trade policy reform, (during the late 1980s) Bangladesh pursued import- substitution program of industrialization with emphasis on the local production of final consumer goods for which a ready market was presumed to exit. The government rapidly liberalized its trade regime towards a more open economy with removal of quantitative restrictions on exports. National Tariff Commission was established in November 1992 to examine the various anomalies is custom duty structure. The tariff commission was established to devise a plan to compress the tariff rates further leading to the evolution of a nominal maximum rate of 50% in 1993-94. Along with the program of nationalization of tariffs that continue to limit or remove anti export bias, the government started designing many new incentive schemes and improved the existing wide array of export incentives. In case of imports, the "negative list" and 'restricted list' were abolished and replaced by one 'control list' introduced in July 1988.

Trade policy reforms in the third phase	The EXIM policy 1997-02 of Bangladesh was also designed to further liberalize trade and build a more open and globally competitive economy. In the process of trade liberalization, custom duty rates were compressed to arrange of 0.0-40.0%. The 2.5% import permit fee, along with 15% value added tax (VAT) is the only other protective device being employed to restrict trading practices. Import permit system has been made automatic, and cumbersome procedure for opening letters of credit has been simplified. Moreover, the present structure of tariffs and the import policy are being regularly reviewed by the government to identify areas where further actions are called for. Among the recent reforms, removal of custom duties on imports of raw cotton, textile, machinery, irrigation equipment and animal feeds used by poultry and dairy industries, and certain drugs, deserve special attention. Regulatory procedures for import have also been simplified with a view to minimize bureaucratic delays. Effective direct and institutional incentives were designed especially for export oriented units and industries in the EPZs.

Source: Islam, 1996, CPD Working Papers, Hassan, 1996.

As compared to the speed and sequencing of economic reforms carried out in India, Bangladesh adopted a more drastic approach towards liberalizing its trade and investment regimes. In most policy objectives of early stages of economic reforms of Bangladesh, macroeconomic stabilization and liberalization programs tended to be introduced together. In fact, reforms towards liberalization in trade, investment and financial regimes were carried out together in early 1980s. Since the economy did not achieve the preconditions of desirable macroeconomic stabilization before embarking on financial sector reform, the stabilization and liberalization programs had to be pushed together. In the case of trade policy reforms towards liberalization, import substitution and export promotion policies were adopted together in line with (among others) privatization of financial institutions, allowance of up to 100% foreign equity participation, simplification of duty drawback schemes and introduction of current account convertibility. These were followed by further reductions in tariff rates, removal of several non-tariff barriers, establishment of Board of Investment for streamlining administrative procedures needed for investment approvals, offering fiscal, institutional and indirect incentives for promoting outward orientation. Thus, as far as the economic reforms towards liberalization in Bangladesh is concerned, the rapid approach involved rapid trade and price liberalization, quick movement to current account convertibility, early adoption of market based monetary controls and simultaneous liberalization of the domestic financial system. Such an approach, as argued by Johnston (1997), can be termed as a "Big Bang" approach, although the speed of reform does not completely resemble to that carried out in Chile during early 1970s.

"Proper" sequencing of economic reform in theory

Generally, it is difficult to decide the approach that will prove to be the best for a country. Before adopting reforms, the important factors that should be taken into account may not be the supremacy of one approach over the other. Different characteristics of each country in terms of social, political and economic contexts may be more important issues to address. However, if there is a need to choose between the two, the costs and risks of both approaches have to be considered carefully. As argued by Johnston (1997), the costs and risks of a gradualist approach can be low savings, capital flight, lack of monetary control and inefficient resource allocation. The risks of Big Bang, however, can be market failure and instability resulting from inadequate market infrastructure such as law and regulations.

However, there are many reasons and philosophies supporting both approaches. In favor of gradualism given by Frenkel (1984), one argument is that there is a difference in the speed of adjustment between goods and asset markets. According to the new expectation and information, asset markets, particularly the financial sector, adjust faster than goods market (or real sector). So, the reforms should be carried out gradually by putting the priority in goods market in order to enable them to catch up with the asset markets when they are embarking in reform process. Another reason, in terms of political economics is, gradualism helps to build general agreement among parties involved in the reforms process by bringing them into the debate, working through their concerns and convincing them to accept the changes that will be introduced (Harwood, 1997). If this consensus is built, it creates the strong base for a successful reform.

Some of the reasons supporting Big Bang as a reform approach are summarized in the works of Johnston (1997). At first, as we know, the objective of financial reform helps to improve the mobilization of financial resources and to achieve greater efficiency in their allocation. The early adoption of financial liberalization in the reform process could fill the investment and saving gap and support the growth oriented strategies that are adopted in trade liberalization. The mobilization of financial resources, hence, is the reason to liberalize the financial sector especially the capital account of the balance of payments early in the reform process. Secondly, Big Bang could add credibility to the government's commitment to carry out reform and overcome the different interests to reform. Johnston (1997) argued that in terms of political economics, it is easier for authorities to start reforms in financial sector rather than in other areas. Then, the liberalization in this area can stimulate broader reforms in other areas. Moreover, the speed of reforms shows the willingness of the government to carry out reforms. Thirdly, Big bang could create the corrective adjustment in the macroeconomic policies, force parties with vested interests to adjust to the new reality and push through dislocation quickly. According to the sequencing literature, more gradualist approaches to reform have been followed in the countries with high saving ratios such as Japan and Korea, because these countries can afford the inefficiency of resource allocation and repression period of economic reforms. On the other hand, Big Bang has been part of growth-oriented strategies in the transition economies and the countries with low domestic savings. Nevertheless, economic theory does not provide a clear answer for the choice between gradual and drastic treatments, and we cannot approach to any of these issues dogmatically (Frenkel, 1984).

Liberalization and bilateral cooperation in trade

The notion of liberalizing a policy regime is often based on a future intention towards promoting regional, bilateral and/or multilateral trade cooperation with neighbor countries. In most cases, regional, bilateral and/or multilateral trade cooperation agreements include developing custom unions, reaching preferential trade agreements, establishment of free trade zones and signing trade contracts with strategic concerns. A few examples of reaching such cooperation agreements through liberalization of policies are NAFTA, SAPTA, ASEAN and APEC. Developing regional cooperation in trade among countries that belong to the same region (South Asia, Asia Pacific, North America, and BENELUX etc.) has been a very popular concept that emerged during the 1980s, when countries were opening up their borders to neighbors and adjacent countries in anticipation of higher gains from international trade. Evidence shows that in many cases, large and small economics have successfully embarked on trade agreements through liberalization and regional trade agreements on the basis of trade and resource complementarities (e.g. Germany and Spain under EU, India and Nepal under SAARC etc.), and have harvested mutual benefits from preferential trade agreements. Bilateral trade, as compared to other forms of trade cooperation agreements, is more intense in nature. It may be envisioned as a microform of preferential trade arrangement that may arise from potential partnership between two adjacent or neighboring countries within a regional trade agreement (Harwood, 1997).

Whatever the form of trade cooperation may be, it cannot be established without a practice of steady or drastic liberalization of economic policies. The manifest objective of steady or drastic liberalization of trade for any two neighbor countries indicate, in principle, their intention to trade with each other. However, in case of forming a "formal" bilateral cooperation, apart from the speed and sequencing of reforms, other important aspects of liberalization, namely, the strategy of reform and issue of coherence of policies during post-reform period deserve special attention. For each phase of economic reforms, it is therefore, important to note the strategic direction in which the reform is or will take the economy, and whether or not coherence of macroeconomic policies is ensured following a package of reforms. In case of promoting bilateral trade cooperation between India and Bangladesh, all aspects of economic reforms as discussed above (speed, sequencing, strategy and coherence of policies) are of concern. From discussions in earlier sections, it is evident that these two neighbor countries have differed by a great margin regarding speed and sequencing of economic reforms. A detailed discussion regarding the strategy and direction of reforms will be discussed in later sections.

Can furtber liberalization belp?

The answer to this question, whether or not further liberalization can help in promoting bilateral cooperation in trade between India and Bangladesh, it requires reference to the extent, or degree of openness that not only prevails in economic systems of these two neighboring countries but also is conducive to trading with each other. The first issue, which is of the degree of openness, has mostly been explained in earlier sections of this paper. It is obvious from earlier discussions that trade and investment regime of India is comparatively more restrictive as compared to those of Bangladesh. Going back to the literature of sequencing of economic reforms, comparatively a more gradualist approach towards reforms has restricted India from opening up its borders to greater possibilities. Although India is under the process of reducing its quantitative restrictions continuously on trade, the "non-tariff barriers" (NTBs) and several others domestic and state fiscal instruments are being effectively used to restrict Bangladeshi exporters enter Indian markets (Chandra, 1991). Several institutional developments carried out in India in early nineties indicate that the government is encouraging FDI inflows and exchange of goods and services across borders, even though state regulations and taxes are acting as undue obstacles to potential exporters of Bangladesh. In stylized literature of behavioral science, this is often referred to as a "general protectionist attitude" towards expatriates; however, question still remains if this attitude is towards all expatriates or only towards just a particular group of expatriates with a specific identity.

Moreover, analyzing the concept of "further liberalization" as an appropriate step towards trade cooperation between India and Bangladesh may not be appropriate without investigating the compatibility of policy frameworks of these two countries. Both governments have a similar pattern of policy objective in liberalizing merchandise trade. Both EXIM policies attempt to lift up the practice of import substitution, and in case of a commodity or service which has import demand in one country and export potential in the other, the strategy of import substitution may disrupt the prospect of trading that particular commodity or service (given that import of that commodity is substituted by domestic production, and hence protection devices has been put for the infant industry). Among such commodities, chemicals can be regarded as a suitable export item for India having an import demand in Bangladesh.

India's import demands are certainly huge, considering the size and composition of its economy's aggregate demand for commodities and services, and a relatively small economy like Bangladesh will not have the export capability to meet the demand of entire Indian economy. Such capacity constraints are incompatible for developing regional trade arrangements, when a small country may have the export potential, but not the export capacity to meet entire demand of a relatively huge market. However, trading arrangements with particular states of India that are adjacent to borders of Bangladesh may be a feasible solution. In that case, the non-tariff barrier imposed by India of making canalized imports of potential through state trading corporations may result in distortions in trading practices (Chandra, 1991). To boost up sub-regional cooperation in trade between India and Bangladesh, the issue of trading infrastructure needs to be addressed. In fact, the first and foremost thrust has to be given to the development of the entire network of transportation, border storage facilities, telecommunication and banking. There is absence of storage facilities in popular trading borders like Petra pole so that exporters of Bangladesh need to pay extra detention charge till they can hand over the consignment to the importers of India. Such bottlenecks are incompatible for regional cooperation in trade, and (apart from "further liberalization" issue) need to be resolved.

As discussed earlier, the phasing, sequencing and pacing of the reforms of tariff liberalization in Bangladesh have been much radical compared to the reforms carried out by India. The average tariff rates (import weighted) currently stands at 17.3% in Bangladesh compared to about 25% for India. It interesting to note that the level of Bangladesh's import-weighted tariff rates for imports from India, which stood at 12.05% in late 1990s, was much lower that Bangladesh's global import-weighted tariff rates for the matched period. This indicates that rationalization of tariffs on commodities of export interest to India was done at a relatively faster rate. The issue of non-tariff barriers (NTBs) encountered by exporters to the Indian markets needs special attention, as Bangladesh's business community perceives the NTBs in India to be a real cause of concern. These NTBs come in the form of canalization, surcharges, local taxes, ADDs, CVDs, etc. Although it has been agreed that India will withdraw non-tariff barriers from commodities that have been offered concessional treatment during the three rounds of the SAPTA negotiations, from operational point of view such NTBs continue to remain in practice. Bangladeshi exporters often complain that there is a lack of transparency as to the applicability of NTBs for commodities at 8-digits HSS code level and often exporters go through harassment since, under existing Indian regulations, the decisions making is left at the discretion of the customs authorities.

With such extent of incompatibility, it becomes confusing to address the issue of promoting bilateral trade cooperation between India and Bangladesh only by "further liberalization" of trade policies. Rather, along with the extent of liberalization, the direction and strategic factors of liberalization should be of concern and interest to policy makers and researchers of these countries. The next section of this paper will discuss to what further extent and direction liberalization is required for promoting bilateral trade cooperation between India and Bangladesh.

To what further extent and direction liberalization is reqnired?

In India there has been a steady liberalization of imports and exports regulation over the few year last. This includes abolishing all restrictions on exports. Funding for the farm products and a broad reduction in registration, packaging and other bureaucratic trade restrictions. The provision of statutory rates for all imports except capital imports for 100% export oriented industrial units is still in under consideration. The new EXIM policy 2002-07 has also abolished all excise duties on imports, and has replaced the excise duties with the introduction of comprehensive Value Added Tax (VAT) system at every level.

In Bangladesh, in order to augment the meager resource base of domestic industries, low duty rates on import of primary raw materials, moderate rates on intermediate products and high rates on luxury products are being imposed. As a part of the on-going tariff reforms, custom duty rates above 100% have been minimize to 75% or below in most cases. Only a few products have a duty rate of 100% and 4 categories of sumptuous items attract higher rates than that. The import tariff and domestic tax structure has gone through massive rationalization by with the introduction of the new Value Added Tax (VAT). In rationalizing the import tariff and domestic tax structure, excise duties have been abolished on all items except on manually prepared cigarettes, bank accounts and textiles. Certain products are exempt from the VAT system (CPD-CASEC Working Paper).

The non-tariff barriers of India, which is severe form of trade restriction faced by potential exporters, perhaps, need special attention in this concern. India possesses in a non-tariff barrier policy with discretionary power given to customs authorities engaged in different borders and ports. Some specified agricultural commodities are required to be imported in canalized form through state trading corporations (EXIM 2002-07). In Bangladesh, non-tariff barriers in practice are mostly mandatory licensing requirements from concerned authorities. Imports are regulated/restricted/banned through import policy order 1999. All import items in their original and unprocessed form are banned for export. There is a quarantine restriction imposed on import of live animals and plants and certain other certificates are required for import of specified commodities. In view of bilateral trade cooperation, both Bangladesh and India need to find out where trading potentials are high and harvests mutual benefits. New Delhi's amended stance on transshipment through Bangladesh may be seen as a positive trend. But more can be thought of to promote bilateral trade cooperation between India and Bangladesh. Surely Bangladesh will be able to accrue some financial benefits by ferrying Indian goods to the seven sisters. But it could be made more appropriate in context of sub-regional cooperation provided that goods produced in Bangladesh could be exported in the seven sisters of India. These far-flung Indian states would also benefit much from this as this would save time and extra-freight costs. Besides, current export of manufactured cosmetics items of Bangladesh (soaps, beauty and hair care products etc.) to these states in the north-eastern region (seven sisters) and West Bengal has been severely taxed by state surcharges and luxury items taxes. For these local taxes, price competitiveness of these standardized products reduces that acts as a disincentive for potential exporters of Bangladesh. These indirect tariff-barriers in the form of local taxation should be preferentially waived considering the positive externalities of trading with Bangladesh to ensure proper pricing and mutual gains from trading these products.

The popular belief of developing Free trade areas/custom union to promote sub-regional cooperation between India and Bangladesh also deserves attention. Still now, the preferential regime has been dominated by product offer and request lists. It has tended to leave export items of Bangladesh's interest outside preferential treatment or led to operational difficulties as to definition of products at 8-digit HSS code level. Since India has free trade arrangement with Nepal and Bhutan, Bangladesh is in fact the only other remaining important trading partner in the group. The issue of zero-tariff access to Indian markets needs to be put high on the agenda of bilateral economic cooperation. The practice of free trade area in Europe Union through the provision of increased market accessibility has proved to be effective in establishing equitable trading practices between large economies like France and Germany and small economies like Portugal and Spain.

Both Bangladesh and India must remove certain non-tariff barriers (NTBs), which distort trading practices between these two countries. Both India and Bangladesh impose NTBs in the form of a licensing requirement for standardization of import materials. First thing in reducing the potential for NTBs would be to standardize technical product specifications across borders of India and Bangladesh. Harmonizing technical standards or adhering to a given international standard will remove the ambiguities associated with product classification, and reduce the potential for uncertainties in valuation. The role of the joint standard testing authority (if established) should therefore, be the prime focus in ensuring consistent standards amongst both countries. This institutional arrangement would treat traders preferentially and would issue them a standardization certificate (or non-transferable and renewable license). In course of time, companies may choose to produce items for each segmented market in the region according to the specifications set by the authorities. Undoubtedly, there cannot be cooperation if it is tracked one way. The pros and cons of the opportunities and problems of both parties should be taken in full cognizance. Suppose India's desire to import of natural gas from Bangladesh, it would perhaps be worthwhile if India imports fertilizer and other products produced by using the gas. Again, import of fertilizer in India is severely prohibited by NTB in form of canalization through state corporations. Due to such canalization, the import price offers for fertilizer is often regulated by the state trading corporations. Indian government in 1991 decanalized import of another 24 items including natural gas (as a raw material for fertilizer). At present import of 8 items including fertilizer falls under canalization (EXIM, 2002-07). While import of gas has been decanalized, India must change the NTB of canalized import of fertilizers. That Bangladesh enjoys a comparative advantage over India in producing and exporting fertilizers should be recognized and explored by India in view of regional cooperation.

Concluding remarks

The above arguments and facts implicitly may well indicate the interdependence between the Indian and Bangladesh economy, but recommendations for the mechanisms for policy cooperation between these two neighbor countries poses a set of difficult questions. To what extent should India and Bangladesh design their policies based on South Asian Sub regional accords or a negotiated consensus may well be one of the burning issues to be addressed. Moreover, if cooperation beats independent policy making by each country, how should cooperation be implemented and by which means is compliance with the agreements going to be verified and enforced is yet another query. In order to analyze the cooperated interaction between India and Bangladesh, we must explicitly examine the way by which these two countries take into account the actions of others in deciding on policies.

Proponents of bilateral policy cooperation typically identify two broad rationales. First of these is that cooperation of macroeconomic policies can take into account and potentially minimize policy externalities. The second justification for cooperation is that if national policy-makers work together, they may be able to achieve larger number of goals with their available policy instruments than they would achieve by acting alone. However, in question of equitable cooperation, how much a nation should sacrifice is another query to address. Nations entering into regional and/or bilateral cooperation must give up at least some measure of national sovereignty to implement such agreements. Besides, bilateral policy cooperation between India and Bangladesh can, if policymakers' credibility levels are low within their own countries, lead to higher average inflation rates and distort the stability of macro economy. Whatever so far has been seen and said, the perception of sub-regional economic cooperation should absolutely be on the basis of equality. The conception of sub-regional economic cooperation still looks possible with some opportunities of benefit. It is working well in several parts of the globe where industrially developed countries of G-7 are cooperating with small developing countries like Spain and Portugal. The greatest output of such a cooperation would not only be the development of the concerned economies alone but it could contribute substantially to the proper balance of global trade as a whole.

As far as trade cooperation between India and Bangladesh is concerned, many major recommendations can be made. Among the recommendations, priority should be placed on rationalization of tariff regimes and across the board reduction of tariff rates, rationalization of local taxes distorting trading practices, unification of customs and other trading procedures among different local government frameworks (for India), development of trading infrastructure, removal of certain Non-tariff barriers inhibiting or discouraging trade between the two countries, and withdrawal and preferential waiver of QRs on imports. There may be some advocates of an optimal currency area, or maintaining a so-called "common currency" for trading between India and Bangladesh. To address this question, there is a need to examine the existing labor movement regulations and labor mobility conditions across borders of India and Bangladesh. The question of direct policy cooperation may also be of concern. Such questions cannot be answered without theoretical underpinning, and hence requires distinct research attempts.

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