

8

BRIEFING PAPER NO.

PILDAT

FEBRUARY 2004

BRIEFING PAPER

FOR PAKISTANI PARLIAMENTARIANS

Strengthening Democracy & Democratic Institutions in Pakistan

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**



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CONTENTS

Foreword

1.	Introduction	05
2.	SAARC: An Overview	05
3.	The Rationale for Regional Trade Agreements	06
4.	Highlights of the SAFTA Agreement	07
5.	An empirical assessment of existing trade between SAARC nations	09
6.	Studies on the impact of SAFTA on South Asia	09
7.	Implications for Pakistan	10
8.	Conclusion	14
Tables:		
	Table 1: Macroeconomic Indicators for SAARC Countries, 2002	09
	Table 2: Share of Intra-Regional Trade in South Asia	10
	Table 3: Pakistan's Trade Balance with SAARC Countries	11
	Table 4: Comparative Growth Rates: India and Pakistan, 1990-2003	11
	Table 5: Comparative Macroeconomic Indicators: India and Pakistan, 2002	12
	Table 6: Pakistan's Trade with India	12

Appendix:

Text of the South Asian Free Trade Area (SAFTA) Agreement

FOREWORD

The South Asian Free Trade Area (SAFTA) agreement marks an important turning-point in the future of South Asian regional trade. The draft framework approved by SAARC Foreign Ministers is perceived as a confidence-building measure that will help in drastically reducing trade barriers to promote intra-regional trade and enable South Asia to emerge as a key player in the forum of world trade. The signing of the framework treaty has significant implications for Pakistan in both an economic and political context.

In this context, Pakistan will play an instrumental role in creating an environment for freer trade in South Asia by working towards the removal of barriers to market access and trade flows. This briefing paper intends to present an overview of the SAFTA agreement for parliamentarians by highlighting opportunities and challenges that Pakistan will face when the treaty is implemented.

There is an urgent need for greater parliamentary involvement in policy issues relating to SAFTA. Our aim is to provide parliamentarians with a comprehensive assessment of SAFTA that will raise awareness about its political and economic ramifications for Pakistan as a South Asian trading partner and help in constructive legislative action taken to promote economic development through protection of regional trade interests. Although this briefing paper gives an overview of SAFTA's potential impact on Pakistan's economy, there is a need to conduct empirical research on the subject, and develop a consensus amongst all concerned stakeholders about how to best promote Pakistan's interests.

PILDAT acknowledges the support of US-AID in producing the briefing paper. We would also like to thank Mr. Akbar Zaidi for his invaluable support in providing his research and input.

PILDAT and its team of researchers have made every effort to ensure the accuracy of the contents of this paper. We however, do not accept responsibility of any omission or error, as it is not deliberate.

Lahore

February 11th, 2004

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**

1. Introduction

The South Asia Free Trade Area (SAFTA) Agreement was signed on January 6, 2004 at the 12th SAARC Summit held in Islamabad. The treaty will come into force on January 1, 2006 and will be fully implemented by December 31, 2015. SAFTA is intended to strengthen intra-SAARC economic co-operation and maximize the region's economic and social potential through various instruments of trade liberalisation. The agreement binds all contracting states to reduce tariffs to 0-5 per cent by December 31, 2015.

The rationale for establishing free trade areas stems from the belief that trade liberalisation leads to improved economic performance. This ideology is based on the theory of comparative advantage, which advocates that free trade eventually results in countries producing and trading only those items for which they have a comparative advantage. The theory states that a reduction in trade barriers fosters an adjustment in the allocation of resources towards comparatively more efficient industries. In the long run, successful trade liberalisation is meant to result in an expansion of exports and a contraction of import-competing industries and an overall transfer of resources from sectors producing nontradables to sectors producing tradables. The World Trade Organisation was established in order to institutionalise this principle of free trade. At the regional level, Free Trade Areas are considered to be engines of growth and progress. Trading blocs are meant to maximise the advantages of common socio-cultural and economic attributes and regional proximity, with the view of increasing long-term regional competitiveness.

One of the consequences of regional trade liberalisation can be improved political relations between member countries. In other words, regional integration can be used to build trust and reduce friction between antagonistic neighbours. In this context, it is envisaged that SAFTA will not only establish greater economic co-operation amongst contracting states but will also lead to better political relations between India and Pakistan. In fact, political consequences of regionalism can have further economic implications in terms of diversion of resources towards more productive uses due to reduced defence expenditure.

However, since each country has a unique set of

institutional factors, resources and endowments, it is important to look beyond the theoretical framework of regional integration. Regional partners may be at different stages of economic development with varying levels of technological sophistication and industrial competitiveness. The impact of trade agreements will consequently depend on these differences.

2. SAARC: An Overview

The South Asian Association for Regional Cooperation (SAARC) was established on December 8, 1985. SAARC consists of the following member countries: Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. SAARC was established with the intention to increase regional co-operation and accelerate the process of economic and social development in member states.

Summits, held annually, are the highest authority in SAARC. The country hosting the Summit holds office as Chairperson of the Association until the next Summit. The Council of Ministers comprising Foreign Ministers, meets at least twice a year. The Council's functions include formulating policy, reviewing progress of regional cooperation, identifying new areas of cooperation, and establishing additional mechanisms that may be necessary. The Standing Committee comprising Foreign Secretaries, meets at least twice a year. The committee monitors and coordinates SAARC programmes, approves projects, and mobilizes resources.

At the core of SAARC's work programme is the Integrated Programme of Action (SIPA). There are currently seven technical committees under SIPA: Agriculture and Rural Development; Social Development; Environment, Meteorology and Forestry; Science and Technology; Human Resource Development; Transport and Communications; and Energy. Other Specialized Committees include, inter-alia, the Committee on Economic Cooperation consisting of Secretaries of Commerce.

SAARC has adopted the following conventions and agreements:

- Agreement on establishing SAARC Food Security Reserve November 4, 1987

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**

- Agreement on SAARC Preferential Trading Agreement (SAPTA) April 9, 1993
- Regional Convention on Suppression of Terrorism November 4, 1987
- Convention on Narcotics Drugs and Psychotropic Substances, November 3, 1990
- Convention on preventing and combating the Trafficking in Women and Children for Prostitution, January 5, 2003
- Convention on Regional Arrangements for the Promotion of Child Welfare in South Asia, January 5, 2002
- Agreement on South Asia Free Trade Area (SAFTA), January 5, 2004

The SAARC Secretariat is based in Kathmandu. It coordinates SAARC activities and monitors their implementation, prepares for SAARC meetings, and serves as a channel of communication between the Association and other regional organizations and inter-governmental institutions. The Secretary-General is appointed from the Member Countries on rotational basis.

3. The Rationale for Regional Trade Agreements¹

As mentioned earlier, Regional Trading Blocs are established on the premise that free trade leads to greater efficiency and higher growth. Regional Trade Agreements vary widely, but the fundamental objective is to reduce or eliminate trade barriers between member countries in order to reap the benefits of increased economic co-operation and strengthen regional solidarity. The growth of regional blocs can be viewed against the backdrop of globalisation: prominence of international institutions and their drive towards market liberalisation has reinforced the need for regional co-ordination as a means to consolidate strength.

According to trade theory, Regional Trading Blocs can have the following benefits:

- Increased trade between member countries
- Increased competition for producers leading to greater efficiency
- Greater specialisation in production and trade
- Lower consumer prices, and higher disposable incomes
- Greater market access
- Political stability

There has been a significant shift towards regional trade agreements in recent years. As of May 2003, a total of 184 Regional Trade Agreements were functioning under notification to GATT/WTO. Some popular examples of Regional Trade Agreements include the North American Free Trade Area (NAFTA) consisting of the US, Mexico and Canada; Common Market of the South (MERCUSOR) consisting of Argentina, Bolivia, Chile, Paraguay, Brazil, and Uruguay; and the ASEAN Free Trade Area consisting of Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, Cambodia, Laos, Myanmar, and Vietnam. A study of MERCUSOR (established in 1991) shows that intra-regional exports in the area rose threefold to \$12 billion between 1990 and 1994. According to World Bank Statistics, imports in the area rose from 3.0 per cent to 8.1 per cent of GDP between 1990 and 1996.

It is considered to be especially vital for developing countries to form regional trading blocs in order to take advantage of globalisation and to protect their interests. Prior to the signing of SAFTA, South Asia was the only major world region without a regional economic arrangement.

The benefits from regional trade liberalisation however, depend on whether trade is created or diverted as a result of the agreement. The classical reason for gains from trade is that free trade allows consumers and firms to purchase products and inputs from the cheapest source of supply, resulting in greater specialisation of production and trade. If domestic production of a product is replaced by lower cost imports from a partner country, it leads to trade creation. Such trade creation increases efficiency and economic welfare in the importing country. However, it is also possible that the partner country's imports may displace lower-cost imports from a non-member country due to high trade barriers against the rest of the world. Trade diversion shifts production from more efficient producers outside the trade area to less efficient producers inside the trade area, leading to a loss in total welfare. It is easier to understand this concept with the help of an example. Let us assume that a country can import a product from a potential regional trade partner at \$105 per unit and from an outside country at \$100 per unit and that duty on the product is \$10, making the prices paid by the consumers \$115 and \$110, respectively. In this situation, consumers would purchase from an outside country and pay \$110. If the country signs

1. Discussion in this section is drawn from the following sources: Maurice Schiff and L. Alan Winters, *Regional Integration and Development*, World Bank and Oxford University Press, 2003; Zaidi, S. Akbar, *Pakistan's Development Options: Does India Matter At All?*, 2003, paper presented at the *Deterrence Theory and South Asia Workshop*, New Delhi, August 26-27, 2003

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**

an agreement with the potential partner, the partner's imports come in duty free, hence they become cheaper. Consumers shift to the cheaper product and pay \$105 per unit instead of importing it from the non-member country at \$110, saving \$5. However, the government now loses \$10 per unit (the revenue it was collecting on each unit of import from the non-member country). The net effect is a loss of \$5 per unit for the country. The Regional Trade Agreement in this case reduces the level of real income in the importing country.

In most cases, Regional Trade Agreements lead to both trade creation and trade diversion. It is important to identify the circumstances in which trade diversion is more likely as opposed to trade creation. Trade diversion will not occur if tariffs against the rest of the world are low. Trade diversion will also be less likely in cases where more countries are included in the trade agreement, and transportation costs are low.

According to international trade theory, the long-term benefits of Regional Trade Agreements outweigh short-term costs. The most important gains come from increased competition, lower prices and restructuring of production based on efficiency.

SAPTA

Motivated by the need to move towards regional integration, the SAARC Preferential Trading Arrangement (SAPTA) came into force in December 1995. Three rounds of tariff reductions were implemented under SAPTA. Preferential treatment was offered on the basis of two categories of members, LDCs and non-LDCs. Tariff concessions received by LDCs were higher than non-LDC members. Under SAPTA, each country could decide its own line of commodities and tariff rates for preferential treatment to member countries. India offered the largest number of concessions, followed by Bangladesh, Pakistan and Nepal.

According to a report by the South Asia Centre for Policy Studies² SAPTA has had no significant impact on the trade patterns of South Asia. The lack of progress was attributed to limitations of the agreement and the nature of negotiations. Since concessions were made on a product-by-product basis, only a limited number of products were

offered preferential tariff reductions. The report argues that most of the tariff preferences extended were not relevant to the trade interests of member countries.

Given the limited framework and influence of SAPTA, it was agreed that a more comprehensive arrangement was needed in order to ensure long-term economic co-operation. At the Male summit in 1997, member countries agreed to form a South Asian Free Trade Area (SAFTA) by 2001. The agreement was finally signed during the 12th SAARC summit on January 6, 2004 in Islamabad.

4. Highlights of the SAFTA Agreement

According to the agreement, the South Asian Free Trade Area is meant to "act as a stimulus to the strengthening of national and SAARC economic resilience, and the development of the national economies of the Contracting States by expanding investment and production opportunities, trade and foreign exchange earnings as well as the development of economic and technological co-operation". The objective of the agreement is to promote and enhance trade and economic co-operation by eliminating trade barriers, promoting conditions of fair competition, creating an effective mechanism for resolution of disputes, and establishing a framework for further regional economic co-operation. The following instruments are outlined for the implementation of the agreement: (1) Trade Liberalisation Programme; (2) Rules of Origin; (3) Institutional Arrangements; (4) Consultations and Dispute Settlement Procedures; (5) Safeguard Measures; (6) Any other instrument that may be agreed upon.

Trade Liberalisation Programme:

Non-Least Developed Countries (India, Pakistan and Sri Lanka) are to reduce tariffs to 20 per cent from their existing rates within two years from the date the agreement come into force (January 1, 2006). They are required to subsequently reduce their tariffs to 0-5 per cent within 5 years. Least Developed Countries (Bangladesh, Nepal, Maldives and Bhutan) are required to reduce their tariffs to 30 per cent within two years from the date the agreement comes into force, and subsequently to 0-5 per cent within 8 years. The Contracting States, however, can reduce their tariffs immediately or follow an accelerated schedule if they wish. The above tariff reductions do not apply to products

2. Kelagama, Saman, SACEPS Task Force Report on The Implications of Building a South Asian Free Trade Area: Challenges and Constraints to Regionalism in South Asia, South Asia Centre for Policy Studies.

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**

included in the sensitive list, which will be developed by the Contracting States and incorporated into the Agreement. Non-Least Developed countries are also required to reduce their tariffs to 0-5 per cent for the products of Least Developed Countries within three years from the date the agreement comes into force.

Additional Measures:

Contracting States agreed to include the following measures to facilitate trade and economic co-operation: (a) harmonisation of standards, reciprocal recognition of tests, accreditation of testing laboratories, and certification of products; (b) simplification and harmonisation of customs clearance procedures; (c) harmonisation of national customs classification based on HS coding system (Harmonised Commodity Coding System); (d) customs co-operation to resolve disputes at entry points; (e) simplification and harmonisation of import licensing; (f) simplification of banking procedures; (g) transit facilities, especially for landlocked contracting states; (h) removal of barriers to intra-SAARC investment; (i) macroeconomic consultations; (j) rules for fair competition and promotion of venture capital; (k) development of communication systems and transport infrastructure; (l) easing foreign exchange restrictions relating to products under the SAFTA regime, and (m) simplification of business visas.

Institutional Arrangements:

Contracting States agreed to establish the SAFTA Ministerial Council (SMC), which is to be the highest decision making body of SAFTA. The SMC, consisting of Ministers of Commerce of member states, will be responsible for implementing the agreement. The SMC will be supported by a Committee of Experts (COE), consisting of a senior Economic Official from each member state. The COE will be responsible for assisting the SMC in implementation of the agreement and act as a Dispute Settlement Body.

Special and Differential Treatment for the Least Developed Contracting States:

The agreement binds all member states to give special consideration to Least Developed Countries regarding application of anti-dumping or countervailing measures. Least Developed Countries are allowed greater flexibility in continuation of trade restrictions on imports from member

countries under critical circumstances. Non-Least Developed Countries are required to give special consideration to requests from Least Developed Countries regarding technical assistance and co-operation arrangements designed to enhance trade. Member States also agreed to establish a mechanism to compensate Least Developed Countries for loss in revenue due to tariff reductions.

Balance of Payments Measures:

The agreement allows a contracting state facing balance of payments difficulties to provisionally suspend the concessions extended by the agreement.

Safeguard Measures:

It was agreed that if a product is imported into a member state in such a manner or in such quantities that it causes or threatens to cause serious injury to domestic producers of competitive products, the importing country can temporarily suspend the concessions granted by the contract. The suspension, however, will be subject to an investigation by the competent authorities and can only be applied for a maximum of three years.

Dispute Settlement Mechanism:

In case of a dispute, a member country can request consultations with the other member country through notification to the Committee of Experts (COE). The member country to which the request is made is required to respond within 15 days and enter into consultations within 30 days after the receipt of the request, unless otherwise mutually agreed. If the consultations fail to settle the dispute within 30 days after the receipt of request for consultations, to be extended by another 30 days by mutual agreement, the complainant can request the Committee of Experts to settle the dispute. The COE is then required to make recommendations within 60 days of the referral. Any member state which is party to the dispute can appeal the recommendation of the COE to the SMC, which is required to review the matter within 60 days.

Withdrawal:

Any member state can withdraw from the agreement at any time after it comes into force.

(Please see appendix for the complete agreement)

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**

5. An empirical assessment of existing trade between SAARC nations

The seven SAARC countries account for approximately 20 per cent of the world's total population. Table 1 summarizes basic macroeconomic features for individual countries. As shown in the table, India is the biggest economy in the region in terms of its population, area and Gross Domestic Product (GDP).

allows member countries to secure larger markets and diversify their local economic structures. According to a study conducted by Pigaro et al. (1997), the creation of SAFTA "would be highly desirable" and "economic gains would be significant, especially for the smaller countries". The study also concluded that SAFTA would reduce political tensions and have a positive impact on regional integration. According to Bandara and Yu (2003), India stands to gain the most from regional trade liberalisation. The study

Table1: MACROECONOMIC INDICATORS FOR SAARC COUNTRIES, 2002

Country	Population	Surface Area (sq km)	GDP (Current \$)	GDP growth (annual %) 2001-2002	GDP per capita growth (annual %) 2001-2002
Bangladesh	135,683,700	144,000	47,327,540,000	4	3
Bhutan	850,820	47,000	594,184,704	8	5
India	1,048,278,528	3,287,260	515,012,395,008	*4	3
Maldives	286,680	300	617,734,400	2	0
Nepal	24,122,310	147,180	5,493,179,392	-1	-3
Pakistan	144,902,416	796,100	60,521,492,480	4	2
Sri Lanka	18,968,480	65,610	16,372,709,376	3	2

Source: World Development Indicators Database

* According to the Indian Economic Survey 2002-2003, GDP at factor cost at 1993-94 prices grew at 5.6 per cent in 2001-2002.

Intra-regional trade for SAARC accounts for 4.6 per cent of the region's total trade (although it is extremely difficult to ascertain the actual level due to illegal cross border trade). This is one of the lowest amongst regional groupings compared to 51 per cent for NAFTA, 55.2 per cent for EU, 25.1 per cent for MERCUSOR and 25.4 per cent for ASEAN.

As indicated by table 2 intra-SAARC trade has increased from 3.5 per cent in 1970 to 4.6 per cent in 1999. Intra-SAARC exports accounted for 4.9 per cent of SAARC's total exports to the world whereas intra-SAARC imports were estimated at 4.3 per cent. Another important trend that can be seen in the table is the growth in India's exports to other SAARC countries (except Pakistan) from 3.9 per cent in 1970 to 5.5 per cent in 1999, and the decline in imports from 1.4 per cent to 0.9 per cent.

6. Studies on the impact of SAFTA on South Asia³

It is commonly argued that increased economic integration

indicates that there would be no major changes in industrial output due to the relative similarity in production structures among member countries. Results of the study also suggest that exports from the SAARC region (except Bangladesh) to NAFTA and EU would decrease. This would result in a significant increase in India's exports to the rest of South Asia, especially in manufacturing. Consequently, India would gain more than the other countries. This is argued to be due to India's economic size and its relatively large manufacturing base.

Rajapakse and Aruntilake (1997) also argue that expansion of trade is larger, the larger the economy. On the other hand, Studies by Srinivasan and Canonero (1993) and Srinivasan (1994) indicate that although potential gains from regional trade liberalisation are substantial, they are larger for smaller economies. Srinivasan also argues that South Asia stands to gain more by dealing with other regional arrangements as a group rather than individually. A study conducted by the World Bank (1997) suggests that South

3. The studies mentioned in this section are summarised in Jayatilleke S. Badara and Wusheng Yu, How Desirable in the South Asian Free Trade Area? A Quantitative Economic Assessment, Blackwell Publishing, 2003.

The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**Table 2: SHARE OF INTRA-REGIONAL TRADE IN SOUTH ASIA (PER CENT)**

Country	1970	1975	1980	1985	1990	1995	1999*
Exports							
Bangladesh	n.a	2.4	9.1	7.7	3.6	2.6	2.2
India	3.9	3.7	3.5	2.9	2.7	5.0	5.5
Nepal	61.9	81.1	38.1	38.5	6.9	8.7	27.7
Pakistan	1.5	6.8	6.3	5.3	4.0	3.3	3.3
SriLanka	3.2	9.0	6.8	3.7	3.1	2.7	2.6
SouthAsia	3.7	5.1	4.8	4.0	3.1	4.4	4.9
Imports							
Bangladesh	n.a	7.9	3.7	1.3	7.0	17.7	14.7
India	1.4	0.9	1.0	0.7	0.4	0.6	0.9
Nepal	73.6	62.0	48.0	32.5	11.5	9.9	33.4
Pakistan	0.5	2.8	2.1	1.7	1.6	1.3	1.8
SriLanka	12.4	6.9	6.3	6.3	6.6	10.3	13.8
SouthAsia	3.3	3.2	2.3	1.7	1.8	3.6	4.3
TotalTrade							
Bangladesh	n.a	6.9	4.9	3.0	5.9	10.1	8.5
India	2.7	2.0	1.9	1.5	1.4	2.8	3.2
Nepal	70.3	67.0	45.7	34.4	10.0	9.3	30.6
Pakistan	0.9	4.1	3.5	2.9	2.6	2.3	2.6
SriLanka	8.1	7.8	6.5	5.2	5.1	6.5	8.2
SouthAsia	3.5	3.9	3.2	2.6	2.4	4.0	4.6

Source: Direction of Trade Statistics, IMF; WTO Trade Statistics

* This is the most recent data available

Asia will gain significantly through regional trade liberalisation. The study argues that it would make the region more attractive to foreign investors, as well as lead to better political relations among member countries.

In contrast to the studies mentioned above, some experts have a more negative view on SAFTA. They believe SAFTA will lead to trade diversion, and consequently a lower level of efficiency and welfare. According to Panagariya (1997) SAFTA would prevent South Asia from pursuing a more beneficial, non-discriminatory liberalisation policy, consequently leading to higher tariffs in relation to non-member countries. The empirical results, thus, provide mixed results regarding the potential gains of regional trade

liberalisation for SAARC members. However, most studies arrive at the common conclusion that SAFTA will facilitate economic gains for all member countries through trade.

7. Implications for Pakistan

It is argued that SAFTA will expand Pakistan's trade with member countries, decrease cost of production for the local industry due to availability of cheaper raw materials, intermediate and capital goods, increase industrial competitiveness and efficiency, provide greater market access to local producers, and lead to lower consumer prices and higher disposable incomes. According to the

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**

Karachi Chamber of Commerce and Industry (KCCI), the volume of intra-SAARC trade after implementation of SAFTA will move to 20 per cent of total trade of member countries. It is believed that regional economic integration will allow Pakistan to deal more effectively with the challenges of globalisation and improve its bargaining position in international trade negotiations.

Table 3 shows that Pakistan's main trading partners in the region are India and Bangladesh. Pakistan has had a

persistent trade deficit with India over 2000-2003. Considering India is the largest economy in the region, and will have the greatest impact on Pakistan after SAFTA comes into force, it is important to look at the implications of trading with India in detail.

Table 4 provides a macro-economic overview of the two economies. As evident from the table, the GDP growth rate of India has been persistently higher over the period 1992-93 to 2001-02. India's per capita income was lower than

Table 3: PAKISTAN'S TRADE BALANCE WITH SAARC COUNTRIES (VALUE IN 000 US\$)

Country	2000-2001			2001-2002			2002-2003		
	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance
Bangladesh	133,422	33,270	100,152	101,139	27,525	73,614	114,356	32,638	81,718
Bhutan	282	261	21	320	388	(68)	107	716	(609)
India	55,397	238,337	(182,940)	49,227	186,891	(137,664)	70,664	166,571	(95,907)
Nepal	2,269	973	1,296	2,382	832	1,550	3,077	1,363	1,714
Maldives	1,760	164	1,596	1,499	158	1,341	3,307	72	3,235
Sri Lanka	75,321	35,191	40,130	72,113	28,524	43,589	76,100	38,243	37,857

Source: Export Promotion Bureau, Pakistan

Table 4: COMPARATIVE GROWTH RATES: INDIA AND PAKISTAN, 1990-2003

Country	GDP Growth Rate (%)		Per Capita Income (US \$)	
	Pakistan	India	Pakistan	India
1990-91	5.6	5.6	426	313
1991-92	7.7	1.3	439	263
1992-93	2.1	5.1	453	240
1993-94	4.4	5.9	443	270
1994-95	5.1	7.3	508	318
1995-96	6.6	7.3	513	351
1996-97	1.7	7.8	493	382
1997-98	3.5	4.8	473	406
1998-99	4.2	6.5	438	410
1999-2000	3.9	6.1	441	443
2000-01	2.2	4.4	415	457
2001-02	3.4	5.6	419	479
2002-03**	5.1	4.4	492	514

Source: Economic Survey of Pakistan 2002-03, Economic Survey of India 2003-03, World Development Indicators 2003

** Advanced Estimates

The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**Table 5: COMPARATIVE MACROECONOMIC INDICATORS: INDIA AND PAKISTAN, 2002**

Country	Fiscal surplus/ deficit (% of GDP)	Gross domestic saving (% of GDP)	Gross domestic investment (% of GDP)	Debt (% of GDP)
India	-5.3	21.0	22.4	20.2
Pakistan	-6.7	14.4	14.7	59.4

Source: World Development Indicators 2003, World Bank

Pakistan's from 1990 to 1999, however it surpassed that of Pakistan's from 1999 to 2003.

The rates of domestic saving and investment are considerably higher in India. The fiscal deficit in Pakistan is higher as is the debt-to-GDP ratio. Macroeconomic indicators are thus much more robust in India than in Pakistan (table 5).

Formal trade between India and Pakistan has been very limited, although it is believed that third country trade and smuggling increases the total volume by a factor of four or five⁴. This is a significant increase considering India is Pakistan's main trading partner in the SAARC region. Over 1992-2002, Pakistan had a trade deficit with India for eight out of ten years (table 6). Most of Pakistan's exports to India have been in the 'food and related' category. India's exports have been in agricultural and allied products, manufactured goods, and chemicals and chemical related products⁵.

According to a study conducted by the Ministry of Commerce, there are numerous advantages to free trade with India. These include lower prices for consumers, more revenue for the government from legalising the existing illegal trade, lower production costs, increased competitiveness and greater market access. The Karachi Chamber of Commerce agrees with this view and asserts

that cheaper steel and iron ore imports from India will have a positive impact on the engineering sector. Akbar Zaidi (2003) argues that numerous small industries in Pakistan are likely to benefit from cheaper raw materials from India, which will have an employment enhancing effect. He also concurs that the local industry, faced with increased competition, will have to become more efficient in order to compete with Indian products. According to the South Asia Development and Cooperation Report 2001/2002, it would make more sense for Pakistan to import wheat from India instead of buying it from Canada and the US. The report estimates that this would entail a financial saving of \$25 in freight charges alone on every tonne of imported wheat. The report states that India can provide Pakistan with cheap textile machinery, dyes, chemicals, and steel. It is also commonly argued that Pakistan will benefit enormously by importing Tea from India, which it currently buys from Kenya at a much higher cost. Proponents of trade with India feel that although the short-term impact of free trade with India may be negative because of its more developed industrial base, Pakistan will benefit in the long run due to the increase in competition and access to a larger market.

It is argued that the greatest economic benefit from trade relations between India and Pakistan would occur in the sphere of energy co-operation. India is one of the most rapidly growing energy markets in the world, and Pakistan

Table 6: PAKISTAN'S TRADE WITH INDIA 1992-2002 (\$ MILLION)

	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
Export	83	42	42	41	36	89	175	54	55	49
Import	67	70	64	95	197	153	146	127	235	187

Source: Annual Report, State Bank of Pakistan

4. Zaidi, S.Akbar, Pakistan's Development Options:

Does India Matter At All?, 2003, paper presented at the Deterrence Theory and South Asia Workshop, New Delhi, August 26-27, 2003.

5. ibid

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**

can fulfil this need as a potential transit route for energy from Iran and Central Asia. This would require construction of a pipeline from Iran, the Persian Gulf, and Central Asia through Pakistan to India. It is estimated that a joint pipeline, as a shared project between India, Pakistan and the country of origin would get Pakistan around \$600 million in transit fees⁶. It would also make it easier to attract foreign investment by multinational countries and better financing terms from international capital markets.

According to a study by Ijaz Nabi and Anjum Nasim, the three principal segments of the economy most likely to be affected from trade with India are agriculture, textiles and the engineering sector⁷. They argue that there will be significant impact on consumers through the availability of a wide range of agricultural, textile and engineering goods at lower prices. Assessing the impact on textile producers, they argue that since Pakistan has competed successfully with India in international markets, there is no reason to believe that they will not be able to do so in the domestic market. The study shows that Pakistani producers are more competitive in cotton, yarn, grey woven fabric, bleached woven cotton, and hand knotted carpets whereas India has an advantage in women's non-knitted dresses, non-knit blouses and men's shirts. In terms of textile costs and productivity, they argue that the industry in the two countries is "more or less equally efficient". Examining the impact on the engineering sector, the paper states that although the Indian engineering sector is comparatively healthier it is unlikely that Pak India trade will result in major market penetration by Indian goods. This is due to the considerable market presence enjoyed by Korean and Taiwanese products. It is stated that in the segment of mechanical equipment and machinery, since domestic production is severely limited, there is no threat from Indian imports. The transport sector, however, poses a serious challenge for Pakistani producers. The prices of scooters, motorcycles and cars under 1000 cc are 50 per cent higher in Pakistan than in India. In a liberalised trade regime, India will easily be able to penetrate the domestic market. Analysing the electrical and electronic equipment segments, the authors argue that Pakistani manufactures have maintained their competitiveness in a climate of low tariffs and high level of smuggling goods. It is thus unlikely that they will be affected by Indian products. In more quality conscious markets, Pakistani consumers are unlikely to

switch demand from superior products imported from better international suppliers. Comparing agricultural production in India and Pakistan, the paper argues that Indian farmers have achieved higher yields per hectare than Pakistani farmers in all major crops, with the exception of cotton. Taking into account relative advantage in production and availability of exportable surplus, it is likely that India will export rice, maize, grams, wheat and sugarcane, as well as vegetables, fruits and other perishables, whereas Pakistan will export Basmati rice, oranges and mangoes. The authors argue that although in the short-run the balance of trade in agricultural products will be in India's favour, Pakistani producers will be able to improve their yields and quality in the long run. The greatest benefit to Pakistani producers will be from access to high yield technologies and research and extension services.

Challenges

Opposition to free trade with India stems from the fear that Pakistan's exports are unlikely to find a market in India. It is feared that India on the other hand will be able to capture the Pakistani market of industrial raw materials, engineering goods, consumer goods and agricultural products, in all of which India has an exportable surplus. Some analysts believe that Pakistan's consumer and light engineering goods are uncompetitive due to under-capitalisation, high costs, poor quality, bad management practices, and unscientific market research. It is also feared that free trade will allow Multinationals to relocate their manufacturing to lower cost areas, resulting in huge employment and revenue losses for Pakistan⁸.

An examination of academic research on sector wise impact of trade with India reveals that transport equipment, cement and pharmaceutical industries in Pakistan would be negatively affected by free trade with India. As mentioned earlier, prices of cars, scooters, motorcycles and cycles are significantly lower in India than in Pakistan. With the implementation of SAFTA, Indian manufacturers will find no difficulty in capturing these markets. The pharmaceutical sector in India consists mainly of producers of generic products compared to Pakistan's pharmaceutical industry which is dominated by high priced products produced by multinationals. Similarly the cement sector in India is more competitive due to economies of scale and lower costs.

6. Sridharan, Economic Cooperation and Security Spill-Overs: the Case of India and Pakistan, The Henry L. Stimson Centre Report No. 36, 2002.

7. Ijaz Nabi and Anjum Nasim, Trading with the enemy: A case for liberalising Pakistan-India Trade, in Regionalism and Globalisation: Theory and Practice, Routledge, 2001

8. Shahid Scheik, SAFTA may have negative impact on local industry, Business Recorder, January 19, 2004

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**

It is argued that India stands to benefit the most from SAFTA. Having established a strong industrial base and a high growth trajectory, it needs to find new markets for its exports. According to the Asian Development Bank, the Indian Economy is expected to grow at 7.3 per cent during 2004. A report by Goldman Sachs predicts that India will be the third biggest economy in the world by 2050. India's export basket consists of a larger percentage of high value added and skill intensive products compared to Pakistan. Pakistan has failed to create a diversified, modern and competitive industrial sector. The study by Ijaz Nabi and Anjum Nasim argues that the engineering sector in Pakistan has faced negative protection due to lower duties on finished products than on raw materials. The paper argues that Indian producers of engineering goods on the other hand receive substantial subsidies to make them internationally competitive. India has always pursued a very aggressive trade policy through targeted incentives to sectors such as agriculture, textiles and garments, engineering, electronics, computer software and gem and jewellery products. As mentioned earlier, even in textiles, Pakistan is more competitive in low value added products such as cotton yarn, grey cloth and bleached woven cotton, whereas India has a comparative advantage in high value added products. If this trend continues, Pakistan will remain confined to low skill, low value added sectors while India moves into more diversified and high-value added segments. This issue needs to be addressed not just in relation to SAFTA but also in the context of global trade.

It is important to note that although India currently has a comparative advantage in these industries, increased competition can serve as a stimulant to either increase Pakistan's competitiveness in these sectors or reorient the structure of the domestic industry in favour of more efficient segments. However, if we assume that increased competition will phase out uncompetitive sectors and lead to more specialised and efficient production, we need to be prepared for the effects of sectoral unemployment (even if it is temporary), especially in the face of rising poverty and lack of social safety nets.

8. Conclusion

In light of the discussion above, it is clear that SAFTA presents both potential benefits and challenges for

Pakistan. The potential benefits of SAFTA can be summarised as follows: expansion of trade with member countries; technology exchange; access to a much larger market, decrease in the cost of production; increase in industrial competitiveness; and increase in disposable incomes due to lower consumer prices. It is envisaged that SAFTA will help in evolving a horizontal specialisation across South Asia to enable the most optimal utilisation of resources in the region.

The motivation for SAFTA also lies in the hope that inter-regional economic co-operation will eventually lead to better relations with India, and consequently a curbing of the defence establishment and expenditure, and reorientation of resources into more productive sectors. However, Pakistan's domestic industry may also face some serious challenges from intra-SAARC imports, especially in the short-run. It is feared that Pakistan may not be able to increase its exports to member countries, especially India, since they produce similar goods that compete for the same price in International markets.

Pakistan needs to concentrate on developing policies to diversify and upgrade its export base, and creating a favourable climate for private investment. Trade liberalisation with SAARC countries may encourage policy makers as well as the private sector to increase their efforts to strengthen Pakistan's international competitiveness. However, this depends on how well Pakistan responds to the pressures of liberalisation. Trade theory, as well as the studies reviewed in this paper, argue that regional trade liberalisation will lead to a restructuring of Pakistan's economy from less to more competitive sectors, and industries that can achieve international competitiveness will grow due to greater access to a larger market. However, the arguments assume that this will occur as a natural consequence to trade liberalisation. They do not take into account other factors such as infrastructural constraints, political instability and the role of the state. These factors can play an instrumental role in defining a country's competitiveness and economic strength. It is thus imperative for the private sector as well as policy makers to understand how SAFTA will impact them and devise a constructive and practical strategy for investments in trade infrastructure.

APPENDIX

**TEXT OF SOUTH ASIAN FREE
TRADE AREA(SAFTA) AGREEMENT**



**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN****Text of South Asian Free Trade Area (Safta) Agreement**

The governments of the Saarc (South Asian Association for Regional Cooperation) member states comprising the People's Republic of Bangladesh, the Kingdom of Bhutan, the Republic of India, the Republic of Maldives, the Kingdom of Nepal, the Islamic Republic of Pakistan and the Democratic Socialist Republic of Sri Lanka hereinafter referred to as "Contracting States".

Motivated by the commitment to strengthen intra-Saarc economic cooperation to maximize the realization of the region's potential for trade and development for the benefit of their people, in a spirit of mutual accommodation, with full respect for the principles of sovereign equality, independence and territorial integrity of all states;

Noting that the Agreement on Saarc Preferential Trading Arrangement (Sapta) signed in Dhaka on the 11th of April, 1993 provides for the adoption of various instruments of trade liberalization on a preferential basis;

Convinced that preferential trading arrangements among the Saarc member states will act as a stimulus to the strengthening of national and Saarc economic resilience, and the development of the national economies of the Contracting States by expanding investment and production opportunities, trade, and foreign exchange earnings as well as the development of economic and technological cooperation;

Aware that a number of regions are entering into such arrangements to enhance trade through the free movement of goods, Recognizing that Least Developed Countries in the region need to be accorded special and differential treatment commensurate with their development needs; and Recognizing that it is necessary to progress beyond a Preferential Trading Arrangement to move towards higher levels of trade and economic cooperation in the region by removing barriers to cross-border flow of goods;

Have agreed as follows:

Article - 1**Definitions:**

For the purposes of this Agreement:

1. Concessions mean tariff, para-tariff and non-tariff concessions agreed under the Trade Liberalization Programme;
2. Direct Trade Measures mean measures conducive to promoting mutual trade of Contracting States such as long and medium-term contracts containing import and supply commitments in respect of specific products, buy-back arrangements, state trading operations, and government and public procurement;
3. Least Developed Contracting State refers to a Contracting State which is designated as a "Least Developed Country" by the United Nations;
4. Margin of Preference means percentage of tariff by which tariffs are reduced on products imported from one Contracting State to another as a result of preferential treatment.
5. Non-Tariff Measures include any measure, regulation, or practice, other than "tariffs" and "paratariffs".

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**

6. Para-Tariffs mean border charges and fees, other than "tariffs", on foreign trade transactions of a tariff-like effect which are levied solely on imports, but not those indirect taxes and charges, which are levied in the same manner on like domestic products. Import charges corresponding to specific services rendered are not considered as para-tariff measures;
7. Products mean all products including manufactures and commodities in their raw, semi-processed and processed forms;
8. Sapta means Agreement on Saarc Preferential Trading Arrangement signed in Dhaka on the 11th of April, 1993;
9. Serious injury means a significant impairment of the domestic industry of like or directly competitive products due to a surge in preferential imports causing substantial losses in terms of earnings, production or employment unsustainable in the short term;
10. Tariffs mean customs duties included in the national tariff schedules of the Contracting States;
11. Threat of serious injury means a situation in which a substantial increase of preferential imports is of a nature to cause "serious injury" to domestic producers, and that such injury, although not yet existing, is clearly imminent. A determination of threat of serious injury shall be based on facts and not on mere allegation, conjecture, or remote or hypothetical possibility.

Article - 2**Establishment:**

The Contracting States hereby establish the South Asian Free Trade Area (Safta) to promote and enhance mutual trade and economic cooperation among the Contracting States, through exchanging concessions in accordance with this Agreement.

Article - 3**Objectives and Principles:**

1. The Objectives of this Agreement are to promote and enhance mutual trade and economic cooperation among Contracting States by, inter-alia:
 - a) Eliminating barriers to trade in, and facilitating the cross-border movement of goods between the territories of the Contracting States;
 - b) promoting conditions of fair competition in the free trade area, and ensuring equitable benefits to all Contracting States, taking into account their respective levels and pattern of economic development;
 - c) creating effective mechanism for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and
 - d) establishing a framework for further regional cooperation to expand and enhance the mutual benefits of this Agreement.

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**

2. Safta shall be governed in accordance with the following principles:

- a) Safta will be governed by the provisions of this Agreement and also by the rules, regulations, decisions, understandings and protocols to be agreed upon within its framework by the Contracting States;
- b) The Contracting States affirm their existing rights and obligations with respect to each other under Marrakesh Agreement Establishing the World Trade Organization and other Treaties/Agreements to which such Contracting States are signatories;
- c) Safta shall be based and applied on the principles of overall reciprocity and mutuality of advantages in such a way as to benefit equitably all Contracting States, taking into account their respective levels of economic and industrial development, the pattern of their external trade and tariff policies and systems;
- d) Safta shall involve the free movement of goods, between countries through, inter-alia, the elimination of tariffs, para-tariffs and non-tariff restrictions on the movement of goods, and any other equivalent measures;
- e) Safta shall entail adoption of trade facilitation and other measures, and the progressive harmonization of legislations by the Contracting States in the relevant areas; and
- f) The special needs of the Least Developed Contracting States shall be clearly recognized by adopting concrete preferential measures in their favour on a non-reciprocal basis.

**Article - 4
Instruments:**

The Safta Agreement will be implemented through the following instruments:

1. Trade Liberalisation Programme
2. Rules of Origin
3. Institutional Arrangements
4. Consultations and Dispute Settlement Procedures
5. Safeguard Measures
6. Any other instrument that may be agreed upon.

**Article - 5
National Treatment:**

Each Contracting State shall accord national treatment to the products of other Contracting States in accordance with the provisions of Article III of GATT, 1994.

Article - 6**Components:**

Safta may, inter-alia, consist of arrangements relating to:

- a) tariffs;
- b) para-tariffs;
- c) non-tariff measures;
- d) direct trade measures.

Article - 7**Trade Liberalisation Programme:**

1. Contracting States agree to the following schedule of tariff reductions:

a) The tariff reduction by the Non-Least Developed Contracting States from existing tariff rates to 20% shall be done within a time frame of 2 years, from the date of coming into force of the Agreement. Contracting States are encouraged to adopt reductions in equal annual instalments. If actual tariff rates after the coming into force of the Agreement are below 20 per cent, there shall be an annual reduction on a Margin of Preference basis of 10 per cent on actual tariff rates for each of the two years.

b) The tariff reduction by the Least Developed Contracting States from existing tariff rates will be to 30 per cent within the time frame of 2 years from the date of coming into force of the Agreement. If actual tariff rates on the date of coming into force of the Agreement are below 30 per cent, there will be an annual reduction on a Margin of Preference basis of 5 per cent on actual tariff rates for each of the two years.

c) The subsequent tariff reduction by Non-Least Developed Contracting States from 20 per cent or below to 0-5 per cent shall be done within a second time frame of 5 years, beginning from the third year from the date of coming into force of the Agreement. However, the period of subsequent tariff reduction by Sri Lanka shall be six years. Contracting States are encouraged to adopt reductions in equal annual instalments, but not less than 15 per cent annually.

d) The subsequent tariff reduction by the Least Developed Contracting States from 30 per cent or below to 0-5 per cent shall be done within a second time frame of 8 years beginning from the third year from the date of coming into force of the Agreement. The Least Developed Contracting States are encouraged to adopt reductions in equal annual instalments, not less than 10 per cent annually.

2. The above schedules of tariff reductions will not prevent Contracting States from immediately reducing their tariffs to 0-5 per cent or from following an accelerated schedule of tariff reduction.

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

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**

States to seek derogation in respect of the products of their export interest.

b) The Sensitive List shall be reviewed after every four years or earlier as may be decided by Safta Ministerial Council (SMC), established under Article 10, with a view to reducing the number of items in the Sensitive List.

4. The Contracting States shall notify the Saarc secretariat all non-tariff and para-tariff measures to their trade on an annual basis. The notified measures shall be reviewed by the committee of experts, established under Article 10, in its regular meetings to examine their compatibility with relevant WTO provisions. The committee of experts shall recommend the elimination or implementation of the measure in the least trade restrictive manner in order to facilitate intra-Saarc trade.

5. Contracting Parties shall eliminate all quantitative restrictions, except otherwise permitted under GATT, 1994, in respect of products included in the Trade Liberalization Programme.

6. Notwithstanding the provisions contained in paragraph 1 of this Article, the Non-Least Developed Contracting States shall reduce their tariff to 0-5 per cent for the products of Least Developed Contracting States within a timeframe of three years beginning from the date of coming into force of the Agreement.

Article - 8

Additional Measures:

Contracting States agree to consider, in addition to the measures set out in Article 7, the adoption of trade facilitation and other measures to support and complement Safta for mutual benefit. These may include, among others:

- a) harmonization of standards, reciprocal recognition of tests and accreditation of testing laboratories of Contracting States and certification of products;
- b) simplification and harmonization of customs clearance procedure;
- c) harmonization of national customs classification based on HS coding system;
- d) Customs cooperation to resolve dispute at customs entry points;
- e) simplification and harmonization of import licensing and registration procedures;
- f) simplification of banking procedures for import financing;
- g) transit facilities for efficient intra-Saarc trade, especially for the land-locked Contracting States;
- h) removal of barriers to intra-Saarc investments;
- i) macroeconomic consultations;
- j) rules for fair competition and the promotion of venture capital;
- k) development of communication systems and transport infrastructure;

l) making exceptions to their foreign exchange restrictions, if any, relating to payments for products under the Safta scheme, as well as repatriation of such payments without prejudice to their rights under Article XVIII of the General Agreement on Tariffs and Trade (GATT) and the relevant provisions of Articles of Treaty of the International Monetary Fund (IMF); and

m) simplification of procedures for business visas.

Article - 9

Extension of Negotiated Concessions:

Concessions agreed to, other than those made exclusively to the Least Developed Contracting States, shall be extended unconditionally to all Contracting States.

The initial notification shall be made within three months from the date of coming into force of the Agreement and the COE shall review the notification in its first meeting and take appropriate decisions.

Article - 10

Institutional Arrangements:

1. The Contracting States hereby establish the Safta Ministerial Council (hereinafter referred to as SMC).
2. The SMC shall be the highest decision-making body of Safta and shall be responsible for the administration and implementation of this Agreement and all decisions and arrangements made within its legal framework.
3. The SMC shall consist of the ministers of commerce and trade of the Contracting States.
4. The SMC shall meet at least once every year or more often as and when considered necessary by the Contracting States. Each Contracting State shall chair the SMC for a period of one year on rotational basis in alphabetical order.
5. The SMC shall be supported by a committee of experts (hereinafter referred to as COE), with one nominee from each Contracting State at the level of a senior economic official, with expertise in trade matters.
6. The COE shall monitor, review and facilitate implementation of the provisions of this Agreement and undertake any task assigned to it by the SMC. The COE shall submit its report to SMC every six months.
7. The COE will also act as Dispute Settlement Body under this Agreement.
8. The COE shall meet at least once every six months or more often as and when considered necessary by the Contracting States. Each Contracting State shall chair the COE for a period of one year on rotational basis in alphabetical order.
9. The Saarc secretariat shall provide secretarial support to the SMC and COE in the discharge of their functions.
10. The SMC and COE will adopt their own rules of procedure.

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN****Article - 11****Special and Differential Treatment for the Least Developed Contracting States:**

In addition to other provisions of this Agreement, all Contracting States shall provide special and more favourable treatment exclusively to the Least Developed Contracting States as set out in the following sub-paragraphs:

a) The Contracting States shall give special regard to the situation of the Least Developed Contracting States when considering the application of anti-dumping and/or countervailing measures. In this regard, the Contracting States shall provide an opportunity to Least Developed Contracting States for consultations. The Contracting States shall, to the extent practical, favourably consider accepting price undertakings offered by exporters from Least Developed Contracting States. These constructive remedies shall be available until the trade liberalization programme has been completed by all Contracting States.

b) Greater flexibility in continuation of quantitative or other restrictions provisionally and without discrimination in critical circumstances by the Least Developed Contracting States on imports from other Contracting States.

c) Contracting States shall also consider, where practical, taking direct trade measures with a view to enhancing sustainable exports from the Least Developed Contracting States, such as long and medium-term contracts containing import and supply commitments in respect of specific products, buy-back arrangements, state trading operations, and government and public procurement.

d) Special consideration shall be given by Contracting States to requests from Least Developed Contracting States for technical assistance and cooperation arrangements designed to assist them in expanding their trade with other Contracting States and in taking advantage of the potential benefits of Safta. A list of possible areas for such technical assistance shall be negotiated by the Contracting States and incorporated in this Agreement as an integral part.

e) The Contracting States recognize that the Least Developed Contracting States may face loss of customs revenue due to the implementation of the Trade Liberalization Programme under this Agreement. Until alternative domestic arrangements are formulated to address this situation, the Contracting States agree to establish an appropriate mechanism to compensate the Least Developed Contracting States for their loss of customs revenue. This mechanism and its rules and regulations shall be established prior to the commencement of the Trade Liberalization Programme (TLP).

Article - 12**Special Provision for Maldives:**

Notwithstanding the potential or actual graduation of Maldives from the status of a Least Developed Country, it shall be accorded in this Agreement and in any subsequent contractual undertakings thereof treatment no less favourable than that provided for the Least Developed Contracting States.

Article - 13**Non-application:**

Notwithstanding the measures as set out in this Agreement its provisions shall not apply in relation to preferences already granted or to be granted by any Contracting State to other Contracting States outside the framework of this Agreement, and to third countries through bilateral, plurilateral and multilateral trade agreements and similar

arrangements.

Article - 14

General Exceptions:

a) Nothing in this Agreement shall be construed to prevent any Contracting State from taking action and adopting measures which it considers necessary for the protection of its national security.

b) Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the similar conditions prevail, or a disguised restriction on intra-regional trade, nothing in this Agreement shall be construed to prevent any Contracting State from taking action and adopting measures which it considers necessary for the protection of:

(i) public morals;

(ii) human, animal or plant life and health; and

(iii) articles of artistic, historic and archaeological value.

Article - 15

Balance of Payments Measures:

1. Notwithstanding the provisions of this Agreement, any Contracting State facing serious balance of payments difficulties may suspend provisionally the concessions extended under this Agreement.

2. Any such measure taken pursuant to paragraph 1 of this Article shall be immediately notified to the committee of experts.

3. The committee of experts shall periodically review the measures taken pursuant to paragraph 1 of this Article.

4. Any Contracting State which takes action pursuant to paragraph 1 of this Article shall afford, upon request from any other Contracting State, adequate opportunities for consultations with a view to preserving the stability of concessions under Safta.

5. If no satisfactory adjustment is effected between the Contracting States concerned within 30 days of the beginning of such consultations, to be extended by another 30 days through mutual consent, the matter may be referred to the committee of experts 6. Any such measures taken pursuant to paragraph 1 of this Article shall be phased out soon after the committee of experts comes to the conclusion that the balance of payments situation of the Contracting State concerned has improved.

Article - 16

Safeguard Measures:

1. If any product, which is the subject of a concession under this Agreement, is imported into the territory of a Contracting State in such a manner or in such quantities as to cause, or threaten to cause, serious injury to producers of like or directly competitive products in the importing Contracting State, the importing Contracting State may,

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**

pursuant to an investigation by the competent authorities of that Contracting State conducted in accordance with the provisions set out in this Article, suspend temporarily the concessions granted under the provisions of this Agreement. The examination of the impact on the domestic industry concerned shall include an evaluation of all other relevant economic factors and indices having a bearing on the state of the domestic industry of the product and a causal relationship must be clearly established between "serious injury" and imports from within the Saarc region, to the exclusion of all such other factors.

2. Such suspension shall only be for such time and to the extent as may be necessary to prevent or remedy such injury and in no case, will such suspension be for duration of more than 3 years.

3. No safeguard measure shall be applied again by a Contracting State to the import of a product which has been subject to such a measure during the period of implementation of Trade Liberalization Programme by the Contracting States, for a period of time equal to that during which such measure had been previously applied, provided that the period of non-application is at least two years.

4. All investigation procedures for resorting to safeguard measures under this Article shall be consistent with Article XIX of GAIT, 1994, and WTO Agreement on Safeguards.

5. Safeguard action under this Article shall be non-discriminatory and applicable to the product imported from all other Contracting States subject to the provisions of paragraph 8 of this Article.

6. When safeguard provisions are used in accordance with this Article, the Contracting State invoking such measures shall immediately notify the exporting Contracting State(s) and the committee of experts.

7. In critical circumstances where delay would cause damage which it would be difficult to repair, a Contracting State may take a provisional safeguard measure pursuant to a preliminary determination that there is clear evidence that increased imports have caused or are threatening to cause serious injury. The duration of the provisional measure shall not exceed 200 days, during this period the pertinent requirements of this Article shall be met.

8. Notwithstanding any of the provisions of this Article, safeguard measures under this article shall not be applied against a product originating in a Least Developed Contracting State as long as its share of imports of the product concerned in the importing Contracting State does not exceed 5 per cent, provided Least Developed Contracting States with less than 5 per cent import share collectively account for not more than 15 per cent of total imports of the product concerned.

Article - 17**Maintenance of the Value of Concessions:**

Any of the concessions agreed upon under this Agreement shall not be diminished or nullified, by the application of any measures restricting trade by the Contracting States, except under the provisions of other articles of this Agreement.

Article - 18**Rules of Origin:**

Rules of Origin shall be negotiated by the Contracting States and incorporated in this Agreement as an integral part.

Article - 19**Consultations:**

1. Each Contracting State shall accord sympathetic consideration to and will afford adequate opportunity for consultations regarding representations made by another Contracting State with respect to any matter affecting the operation of this Agreement.
2. The committee of experts may, at the request of a Contracting State, consult with any Contracting State in respect of any matter for which it has not been possible to find a satisfactory solution through consultations under paragraph 1.

Article - 20**Dispute Settlement Mechanism:**

1. Any dispute that may arise among the Contracting States regarding the interpretation and application of the provisions of this Agreement or any instrument adopted within its framework concerning the rights and obligations of the Contracting States will be amicably settled among the parties concerned through a process initiated by a request for bilateral consultations.
2. Any Contracting State may request consultations in accordance with paragraph 1 of this Article with other Contracting State in writing stating the reasons for the request including identification of the measures at issue. All such requests should be notified to the committee of experts, through the Saarc secretariat with an indication of the legal basis for the complaint.
3. If a request for consultations is made pursuant to this Article, the Contracting State to which the request is made shall, unless otherwise mutually agreed, reply to the request within 15 days after the date of its receipt and shall enter into consultations in good faith within a period of no more than 30 days after the date of receipt of the request, with a view to reaching a mutually satisfactory solution.
4. If the Contracting State does not respond within 15 days after the date of receipt of the request, or does not enter into consultations within a period of no more than 30 days, or a period otherwise mutually agreed, after the date of receipt of the request, then the Contracting State that requested the holding of consultations may proceed to request the committee of experts to settle the dispute in accordance with working procedures to be drawn up by the committee.
5. Consultations shall be confidential, and without prejudice to the rights of any Contracting State in any further proceedings.
6. If the consultations fail to settle a dispute within 30 days after the date of receipt of the request for consultations, to be extended by a further period of 30 days through mutual consent, the complaining Contracting State may request the committee of experts to settle the dispute. The complaining Contracting State may request the committee of experts to settle the dispute during the 60-day period if the consulting Contracting States jointly consider that consultations have failed to settle the dispute.
7. The committee of experts shall promptly investigate the matter referred to it and make recommendations on the matter within a period of 60 days from the date of referral.
8. The committee of experts may request a specialist from a Contracting State not party to the dispute selected from a

**The South Asian Free Trade Area (SAFTA):
ADVANTAGES AND CHALLENGES FOR PAKISTAN**

panel of specialists to be established by the committee within one year from the date of entry into force of the Agreement for peer review of the matter referred to it. Such review shall be submitted to the committee within a period of 30 days from the date of referral of the matter to the specialist.

9. Any Contracting State, which is a party to the dispute, may appeal the recommendations of the committee of experts to the SMC. The SMC shall review the matter within the period of 60 days from date of submission of request for appeal. The SMC may uphold, modify or reverse the recommendations of the committee of experts.

10. Where the committee of experts or SMC concludes that the measure subject to dispute is inconsistent with any of the provisions of this Agreement, it shall recommend that the Contracting State concerned bring the measure into conformity with this Agreement. In addition to its recommendations, the Committee of experts or the SMC may suggest ways in which the Contracting State concerned could implement the recommendations.

11. The Contracting State to which committee's or SMC's recommendations are addressed shall within 30 days from the date of adoption of the recommendations by the committee or the SMC, inform the committee of experts of its intentions regarding implementation of the recommendations. Should the said Contracting State fail to implement the recommendations within 90 days from the date of adoption of the recommendations by the committee, the committee of experts may authorize other interested Contracting States to withdraw concessions having trade effects equivalent to those of the measure in dispute.

Article - 21**Withdrawal:**

1. Any Contracting State may withdraw from this Agreement at any time after its entry into force. Such withdrawal shall be effective on expiry of six months from the date on which a written notice thereof is received by the secretary-general of the Saarc, the depositary of this Agreement. That Contracting State shall simultaneously inform the committee of experts of the action it has taken.

2. The rights and obligations of a Contracting State which has withdrawn from this Agreement shall cease to apply as of that effective date.

3. Following the withdrawal by any Contracting State, the committee shall meet within 30 days to consider action subsequent to withdrawal.

Article - 22**Entry into Force:**

1. This Agreement shall enter into force on 1st January 2006 upon completion of formalities, including ratification by all Contracting States and issuance of a notification thereof by the Saarc secretariat. This Agreement shall supersede the Agreement on Saarc Preferential Trading Arrangement (Sapta).

2. Notwithstanding the supercession of Sapta by this Agreement, the concessions granted under the Sapta Framework shall remain available to the Contracting States until the completion of the Trade Liberalization Programme.

Article-23

Reservations:

This Agreement shall not be signed with reservations, nor will reservations be admitted at the time of notification to the Saarc secretariat of the completion of formalities.

Article-24

Amendments:

This Agreement may be amended by consensus in the Safta Ministerial Council. Any such amendment will become effective upon the deposit of instruments of acceptance with the Secretary General of Saarc by all Contracting States.

Article - 25

Depository:

This Agreement will be deposited with the secretary-general of the Saarc, who will promptly furnish a certified copy thereof to each Contracting State.

SAFETA



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