CHAPTER 5

Potential for intraregional investment

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Attempts at regional integration under the auspices of the South Asian Association for Regional Cooperation (SAARC) have mainly concentrated on trade integration. The main vehicle for this has been the Agreement on South Asian Free Trade Area (SAFTA). The Agreement, signed in 2004, entered into force on 1 January 2006 and its Trade Liberalization Programme commenced from 1 July 2006.

During the initial years of SAARC's functioning, not much attention was given to facilitating investment flows, whether intraregional or extraregional. It was expected that with the expansion of the regional market through trade liberalization, investments at both the levels would flow in automatically. The nexus between investment and trade was not under consideration.

Promoting intraregional investment among South Asian member states has been a slow process (Box 5.1). The Ninth Meeting of the Sub-Group on Investment and Arbitration was to be scheduled after the circulation by India of a revised Draft SAARC Agreement on Promotion and Protection of Investments. The Standing Committee, at its Forty-first Session (Kathmandu, 23–24 November 2014), urged an early finalization of the text of the Draft Agreement (SAARC Secretariat, 2014). At the time of writing, this was still pending.

The SAARC Limited Multilateral Agreement on Avoidance of Double Taxation and Mutual Administrative Assistance in Tax Matters is another step towards investment cooperation among

Box 5.1

Investment cooperation under SAARC: A timeline

The Seventh SAARC Summit (Dhaka 1993) stressed the need for extraregional foreign direct investment.

The Ninth Summit (Male 1997) stressed the need for initiating specific steps to promote and protect intraregional investment. The Summit Declaration welcomed the offer of India to host a meeting on promotion and protection of investment and that of Pakistan to host a meeting on avoidance of double taxation.

The Tenth Summit (Colombo 1998) stated that an effort to devise a multilateral investment agreement should provide scope to least developed countries to formulate specific investment policies appropriate to their stage of development.

The Eleventh Summit (Kathmandu 2002) called for an early finalization of a regionally agreed investment framework to meet the investment needs of SAARC member states.

The Fourteenth SAARC Summit (New Delhi 2007) directed that the Agreement on Promotion and Protection of Investments be finalized.

The Fifteenth Summit (Colombo 2008) directed that the Agreement on Promotion and Protection of Investments be finalized early and the SAARC Arbitration Council be operationalized.

The Sixteenth SAARC Summit (Thimphu 2010) sought to strengthen the role of the private sector through greater intraregional investment promotion efforts.

The Seventeenth Summit (Addu City 2011) proposed greater flows of financial capital and intraregional long-term investment, focusing particularly on renewable energy.

Note: Drawn from SAARC Summit Declarations and Moazzem (2013).

SAARC member states. It was signed during the Thirteenth SAARC Summit (Dhaka, 12–13 November 2005) and the amendment to its Article 16 (1) (Entry into Force) was approved by the

Thirty-Third Session of the Standing Committee (New Delhi, 31 March–1 April 2007). The Agreement entered into force on 27 December 2006, but, with the amendment, its implementation started from April 2011 as per Article 14. For exchange of information and expertise among the tax authorities of member states, it was decided that seminars/training programmes would be conducted in each SAARC member state on a rotational basis on identified topics (*ibid.*).

The Agreement for Establishment of SAARC Arbitration Council (SARCO), signed during the Thirteenth SAARC Summit (Dhaka, 12–13 November 2005), is another step in the direction of investment cooperation among SAARC member states. Five meetings of the Governing Board of SARCO have been held so far. SARCO is in the process of finalizing the panel of arbitrators. Some of its objectives are: (i) to provide a legal framework within the region for a fair and efficient settlement through conciliation and arbitration of commercial, investment and such other disputes; (ii) to promote the growth and effective functioning of national arbitration institutions within the region; (iii) to provide fair, inexpensive and expeditious arbitration in the region, and act as a coordinating agency in the SAARC dispute resolution system; and (iv) to coordinate the activities of and assist existing institutions concerned with arbitration, particularly those in the region (*ibid.*).

The SAARC Agreement on Trade in Services (SATIS) is yet another initiative to promote investment cooperation among member states. At the Sixteenth SAARC Summit, SATIS was signed. Leaders expressed the hope that this will open up new vistas of trade cooperation and further deepen the integration of the regional economies. They called for an early conclusion of negotiations on the schedules of specific commitments under the Agreement. The Agreement has been ratified by all member states, entering into force on 29 November 2012. So far, ten Meetings of the Expert Group on SATIS have been held with the Eleventh Meeting agreeing that all member states would table their final offer lists and would also finalize and adopt the Schedules of Specific Commitments (*ibid.*).

This chapter examines the nature of intraregional investment flows, by countries of origin and destination, and the causes of low intraregional investment in South Asia. It also examines bilateral investment treaties in the region and the proposed draft SAARC Agreement on Promotion and Protection of Investments. It then examines India's Model Bilateral Investment Treaty before going on to the SATIS, not to mention the potential areas for investment cooperation in the region. Finally, it draws conclusions.

Low intraregional investment

As with intraregional trade, intraregional foreign direct investment (FDI) is very low in South Asia. In fact, FDI flows into the region, regardless of source, are low. A World Bank study estimates that the weighted average FDI inflow was merely 1.63 percent of gross domestic product (GDP) during the 2000–2011 period with wide variations in the FDI/GDP intensity among the countries. While

Table 5.1

Average FDI inflows to South Asian countries
(as percent of GDP, 2000–2011)

Recipients	Percent
Afghanistan	1.48
Bangladesh	1.01
Bhutan	1.22
India	1.56
Maldives	9.43
Nepal	0.15
Pakistan	1.69
Sri Lanka	1.21
South Asia (weighted average)	1.63

Source: Gould et al. (2013).

Table 5.2

Sources of FDI in South Asia
(as percent of total FDI inflows, 2003–2011)

Recipient countries	Source countries		
	India	SAR (excl. India)	Rest of world
Afghanistan	2.72	0.97	96.31
Bangladesh	23.88	0.49	75.63
Bhutan	48.75	0	51.25
India	0	1.34	98.66
Maldives	29.35	0.05	70.6
Nepal	53.63	0.61	45.76
Pakistan	0.83	0.3	98.87
Sri Lanka	37.41	0.22	62.37

Source: Gould (2013).
Note: Table abridged by author. SAR—South Asian region.

this was as high as 9.43 percent for the Maldives, it was 0.15 percent for Nepal (Table 5.1).

Table 5.2 shows that during the 2003–2011 period, around half of the FDI received by Bangladesh and Nepal was sourced from India. According to World Bank estimates, India contributed 70 percent to intraregional FDI. However, the total intraregional FDI was just 3.7 percent of all inward FDI in South Asia (Gould, 2013).

Inflows by sectors show that in 2009 services attracted the most, followed by manufacturing. Agriculture, mining, and all other sectors attracted very little, as may be seen in Table 5.3.

Low domestic savings and investment

South Asian countries are characterized by low levels of domestic savings and investment. The gross capital formation of the region declined from 35 percent of GDP in 2005 to 29 percent in 2016.

Table 5.3

Sectoral breakdown of FDI inflows to South Asia (2009)

Sectors	Percentage distribution
Service	72
Manufacturing	22
Agriculture and mining	4
Others	2

Source: Gould (2013).

Similarly, the gross savings of the region declined from 36 percent of GDP in 2005 to 30 percent in 2016. This decline was primarily due to declines in the two largest countries in the region, namely India and Pakistan. This may be expected to adversely impact these countries' outward investment flows to South Asia.[1]

Low outward flows

Table 5.4 shows that none of the countries has substantial outward investment flows, except India. This is a consequence of low levels of capital formation and gross savings and their declining trend in some countries. Even for India, such outward investment flows have fallen sharply since 2016.

Poor facilitation

Table 5.5 shows poor investment facilitation indicators of South Asia indicating that the countries rank poorly in terms of distance-to-frontier indicators among all the regions in the world, except for Sub-Saharan Africa. Such infrastructural deficiencies restrict the flow of investment, intraregional or extraregional.

Out of 180 countries surveyed, all South Asian countries were ranked quite low in terms of ease-of-doing-business indicators.

Table 5.4

Outward FDI flow from South Asia

(US$ million, in current prices)

	2005	2007	2009	2011	2013	2015	2016
Afghanistan	2	..	0	1	1	1	-1
Bangladesh	3	21	29	13	34	46	41
Bhutan	..	..	..	..	..	..	..
India	2,985	17,234	16,058	12,456	1,679	7,572	5,120
Maldives	..	..	..	..	..	..	..
Nepal	..	..	..	..	..	..	..
Pakistan	44	98	71	35	212	25	52
Sri Lanka	38	55	20	60	65	54	237
South Asia	3,071	17,408	16,178	12,564	1,990	7,697	5,450

Source: UNCTAD (2018a).

While Nepal and Sri Lanka ranked relatively high, Afghanistan and Bangladesh were the worst performers. What is notable is that while some countries fell in the third quartile, others fell in the last quartile in terms of ranking. Again, most countries lagged behind in distance to frontier. While Afghanistan and Bangladesh were below the half-way mark, the remaining countries barely crossed it. In terms of trading across borders, only Sri Lanka and Nepal were in the second quartile, while all others fell in the fourth quartile. In a remarkable move forward, India's rank in all indicators shows a significant rise in 2018, placing it in the second quartile of ease of doing business.[2]

Further, low logistics performance, as measured by the Logistics Performance Index (LPI), of South Asia, in relation to other regions of the world, is another factor underlying low investment flows in the region, whether from within the region or beyond. The capacity of developing countries to efficiently move goods and connect manufacturers and consumers with international markets

is improving, even if slowly. Much more is needed to close the existing "performance gap" between high and low performers. Supply chains are only as good as their weakest link and sustainable improvements require complex changes in a range of policy dimensions, including infrastructure, trade facilitation and services. In 2016 the LPI score of South Asia (2.62) was the lowest among all regions in the world, except Sub-Saharan Africa.[3]

Restrictive foreign exchange regimes

The ease of converting and transferring currency is a crucial consideration for firms investing in a foreign economy. Converting and Transferring Currency data and indicators measure foreign exchange restrictions that are relevant for FDI across economies. Such measurement helps identify common policies and benchmarks the restrictiveness of foreign exchange regimes. On average,

Table 5.5

Investment facilitation: Distance to frontier (0–00)

Regions	2017	2018
East Asia & Pacific	61.73	62.7
Europe & Central Asia	70.23	71.33
Latin America & Caribbean	58.3	58.66
Middle East & North Africa	55.81	56.72
OECD high income	77.41	77.46
South Asia	52.64	53.64
Sub-Saharan Africa	49.25	50.43

Source: World Bank (2018b).
Note: Distance to frontier (DTF) is the gap between an economy's performance and the best practice and serves as a basis for ease-of-doing-business rankings. An economy's distance to frontier is reflected on a scale from 0 to 100, where 0 represents the lowest performance and 100 represents the frontier.

South Asia and Sub-Saharan Africa are the most restrictive regions (Table 5.6) (Anderson, 2013).

The primary reason for countries to impose exchange restrictions is to protect their weak balance-of-payments positions. If countries have limited foreign exchange reserves, they may try to direct the existing foreign exchange towards economic transactions considered to be vital.

While Islam et al. (2014) characterize India's and Pakistan's capital accounts as largely liberalized, the authors consider Bangladesh and Sri Lanka as partly repressed.

Until recently, India had Sri Lanka, Bangladesh and Pakistan on the negative list for inward investments. However, in 2006 and 2007, India permitted FDI flows from Sri Lanka and Bangladesh, respectively. The announcement by the Indian Government, on 1 August 2012, to allow FDI from Pakistan has given yet another fillip to the total opening of India to allow free flow of capital from all countries in the region (ICRIER, 2012).

Table 5.6

Percentage of countries with moderate or heavy convertibility restrictions

Regions	Percentage
Organisation for Economic Co-operation and Development	0
Eastern Europe and Central Asia	10
Latin America and Central Asia	14
East Asia and Pacific	18
Middle East and North Africa	38
Sub-Saharan Africa	48
South Asia	83

Source: Anderson (2013).

FDI ownership exclusion

Except health care and waste management, all other sectors have some caps on FDI participation in South Asia. In media, insurance, banking, mining, oil and gas, and agriculture and forestry, there are caps of 10 percent or more.

Country-wise data show that, while Afghanistan and Bangladesh have no caps on FDI participation, India, Pakistan and Sri Lanka have them in several sectors. India has substantial caps on insurance, agriculture and forestry, transport, telecom and media. Pakistan has caps in media, insurance and telecom, and Sri Lanka in mining, oil and gas, media and electricity.[4]

Bilateral investment agreements among South Asian countries

The international legal system that governs international investment flows consists of more than 3,000 bilateral investment treaties and other international investment agreements, such as treaties with investment provisions. In the absence of a comprehensive multilateral agreement, cross-border investment flows are governed by bilateral and regional investment treaties, or investment chapters in free trade agreements. Bilateral treaties have emerged as the primary source of international investment law to protect and promote cross-border investment flows (Singh and Ilge, 2016).

Data compiled from UNCTAD Investment Hub (April 2018) show that South Asian countries have 204 bilateral investment treaties with the world—five of them among themselves (excluding double counting). Of these, two—India-Nepal and Pakistan-Bangladesh—were signed but not implemented. The earliest such treaty in operation in the region is that between India and Sri Lanka (since 13 February 1998), followed by that between Pakistan and Sri Lanka (since 5 January 2000) and that between India and Bangladesh (since 7 July 2011). The last one was signed between India and Nepal on 21 October 2011, which remains to be implemented (UNCTAD, 2018b). Table 5.7 provides the details.

Table 5.7

Bilateral investment agreements in South Asia

Country	With world	With SACs	Signed date	In force date
Afghanistan	3	Nil	na	na
Bangladesh	30	1 (India)	09/02/09	07/07/11
Bhutan	Nil	Nil	na	na
India	83	3 (Bangla-desh, Nepal, Sri Lanka)	09/02/09 with Bangladesh; 21/10/11 with Nepal; 21/01/97 with Sri Lanka	Not in force with Nepal; in force with Sri Lanka since 13/02/98; in force with Bangladesh since 07/07/11
Maldives	Nil	Nil	na	na
Nepal	6	1 (India)	21/10/11	Not in force
Pakistan	53	2 (with Ban-gladesh and Sri Lanka)	24/10/95 with Bangladesh; 20/12/97 with Sri Lanka	Not in force with Bangladesh; in force with Sri Lanka since 05/01/2000
Sri Lanka	29	2 (with India, Pakistan)	20/12/97 with Pakistan; 21/01/97 with India	In force with India since 13/02/98; with Pakistan since 05/01/2000
South Asia	204	5		3/5 in force

Source: Compiled from UNCTAD (2018b).
Note: Signed agreements included, whether in force or not. SACs: South Asian countries. na: not available.

An analysis of mapping exercises by UNCTAD (UNCTAD, 2018c) and content analysis of bilateral investment treaties in the region suggest that these treaties are of the vintage of the 1980s and 1990s, and quite out of sync with present times. The India-Sri Lanka, India-Bangladesh and Pakistan-Sri Lanka bilateral investment treaties make no reference to sustainable development, or

to dimensions of social investment (such as human rights, labour, health, corporate social responsibility) and do not have any flexibility to introduce new regulations. The definition of investment is "asset-based", which is very broad-based. There is no denial of benefits, even when the invested enterprise has no substantial business interest in the host country, or when controlled by a third party or by investors from countries with which the other contracting party does not have diplomatic relations.

These treaties provide national treatment and most-favoured-nation (MFN) treatment to enterprises after their establishment. The MFN treatment excludes economic integration agreements, taxation treaties and procedural issues relating to Inter State Dispute Settlement. There is no mention of any earlier or post-entry bilateral investment treaties by any contracting party. Besides, they refer to unqualified, fair and equitable treatment to investors without even reference to international law. The term "expropriation" is defined, but "indirect expropriation" is generally not mentioned, or if mentioned, not defined. No mention is made of regulatory measures or use of compulsory licences. In all regional bilaterals, there is a provision for settlement of disputes, both between investor and contracting state and between contracting states.

The India-Nepal investment treaty, which was signed later than others, but has not been implemented, is more advanced as it factors in denial of benefits under stipulated circumstances. Indirect appropriation is defined and it carves out general regulatory measures. The text admits that non-discriminatory regulatory measures by a contracting party that are designed and applied to protect legitimate public welfare objectives including the protection of health, safety and environment do not constitute expropriation or nationalization, except in rare circumstances. Similar is the case when awards of any judicial body are issued in the public interest. However, this treaty also suffers from other earlier-mentioned limitations (e.g., definition of "investment", free and equitable treatment, etc.).

Globally, the international investment agreement regime is undergoing change and the developments in India are no exception. In 2016, India served termination notices in respect of its

bilateral investment treaties with 58 countries. But it could not terminate such treaties with 25 countries, including Finland, Iceland and Bangladesh, as they had not completed their initial terms—the initial period in which a party cannot terminate the treaty.

On 12 July 2017, the Indian Union Cabinet gave its approval for the Joint Interpretative Notes on the agreement with Bangladesh. The Notes imparts clarity to the interpretation of the agreement. It includes interpretative notes to be jointly adopted for many clauses, including the definitions of investor, investment, exclusion of taxation measures, fair and equitable treatment, national treatment and MFN treatment, expropriation, essential security interests and settlement of disputes between an investor and a contracting party. Joint Interpretive Notes generally plays an important supplementary role in strengthening the investment treaty regime. With increasing disputes over investment agreements, issuing such statements can have a strong persuasive value before tribunals. Such proactive approach by states can foster a more predictable and coherent reading of treaty terms by arbitration tribunals (Weiniger and Cartwright-Finch, 2017).

Proposed SAARC investment agreement

The text of the Draft SAARC Agreement on Promotion and Protection of Investments was finalized by the Seventh Meeting of the SAARC Sub-Group on Investment and Arbitration held at the SAARC Secretariat on 29 November 2007.[5] As in South Asian bilateral investment treaties, neither the preamble to the draft nor even the text makes any reference to any regulatory measures directed at social protection or sustainable development. Again, the definition of investment is very broad: it includes "every kind of asset" (Article 1(b)). Regarding treatment of investment, the draft Agreement provides for both national and MFN treatment combined in one article (Article 4). However, the clause provides for three exceptions stating that the contracting states "shall not be obliged" to extend to investors of any other contracting state benefits (i) in any other existing or future customs union or any inter-

national agreement; (ii) in any agreement pertaining to taxation; or (iii) any bilateral agreement relating to investment to which it is, or becomes, a party. The third exclusion is not available in the texts of any regional bilateral investment agreement.

Regarding the clause on "expropriation", there is no reference to "indirect appropriation", just as in all the regional bilaterals, excluding the India-Nepal one. Thus, the draft SAARC investment agreement remains deficient in content and is far from being a model treaty. It needs to be comprehensively redrafted. The SAARC Sub-Group on Investment and Arbitration must reconsider the text in the light of the changes in jurisprudence and experiences gained by the member states in the years since it was drafted.

Indian model of bilateral investment treaty

Following economic reforms in the 1990s, India signed several bilateral investment treaties and, like most countries, it had not fully understood the consequences. In 2012, India lost an investor-state arbitration dispute to White Industries. White Industries started the proceedings under the India-Australia investment treaty and, through the MFN clause, took advantage of another, more favourable, investor protection provided in the India-Kuwait investment treaty (Mehta, 2016).

To provide greater protection to India's regulatory power, the 2003 treaty model was reviewed and a final text of a new model was released by the Finance Ministry on 28 December 2015. The new model is designed to limit protection afforded to inbound investors to prevent some of the issues that emerged in the earlier cases (V&E International, 2016).

The model adopts an "enterprise-based" definition of investment, instead of an assets-based one, thus excluding many other assets, manly intangibles such as intellectual property rights, brand name, etc. (Article 1) (GoI, 2015). This limits the coverage and scope of the definition of "investment", which was not the case in the 1993 model. Besides, the enterprise must have "real and substantial business operations." The scope of the model text excludes

a number of other measures such as taxation, state subsidies, etc. (*ibid.*, Article 2). Under the Standard of Treatment, the model does not include "fair and equitable treatment" standard, providing, instead, protection only against specified measures (*ibid.*, Article 3). Article 4 has provisions only for national treatment and does not refer to MFN. Regarding "expropriation", Article 5 states that the state cannot nationalize or expropriate an investment, or take measures having an effect equivalent to expropriation, except "for reasons of public purpose" (*ibid.*). One of the most significant departures from the 2003 model is the requirement that an investor must exhaust all local remedies (judicial and administrative), before initiating international arbitration (*ibid.*, Article 14.3(i)).

SAARC Agreement on Trade in Services

There is a linkage between the SAARC Agreement on Trade in Services (SAARC, 2010) and the flow of investment through "commercial presence" (Mode 3) when it becomes necessary to invest in the host country to provide the service. SATIS provides one of the modes of supply of services in terms of "commercial presence" (Article 22.3). Article 2 (4) of the Agreement states that negotiations for specific commitments for progressive liberalization would be based on request and offer following a positive list[6] approach. This enables contracting states to open only those sectors that meet their comfort level, or those sectors which they wish to promote but lack the requisite skills to operate. Besides, as noted earlier, most FDI inflows in South Asia have taken place in the services sector, even in the absence of any Agreement. Hence, implementation of the Agreement may be expected to create substantial payoffs.

So far, initial offer-request lists have been made by all member countries, with the exception of Afghanistan. However, progress has been lacklustre as SATIS offers are "GATS-minus" and more restrictive than unilateral policies (Chanda, 2014). SATIS provides for MFN (Article 4) and national treatment (Article 5). Article 23 on "General Exceptions" provides safeguards like those under India's model bilateral investment agreement on "public purpose".

This includes protecting public order, health and human, animal or plant life. Besides, the MFN principle is applicable only post-establishment (Article 4(2)).

Areas of investment

Sectors attracting FDI

Abdin (2015) has analysed the top ten sectors attracting FDI in South Asian countries. Textile, clothing and readymade garment are the common manufacturing sectors drawing FDI in Bangladesh, India, Sri Lanka and Pakistan. Many member states are keen to attract more FDI in these sectors, both for catering to the domestic market and for exports. Similarly, most member states have attracted FDI in telecommunications and information technology. Tourism is another sector in which Bangladesh, Bhutan, India, the Maldives, Nepal and Sri Lanka have attracted FDI.

Potential investment to address supply constraints

Table 5.8 presents potential areas for India to invest in Bangladesh, Nepal and Sri Lanka to address supply constraints there. These are the author's estimates on possible trade-investment linkages based on the exports of Bangladesh, Nepal and Sri Lanka to India and the world, and India's imports from the world in 2015. The products are at 2-digit level of aggregation under the Harmonized System of classification. Although the products are among the countries' top five in the Indian market, they are insufficient to meet the Indian demand and the world's. A transition to investment-led exports, particularly in joint ventures with Indian companies, could be the next-stage export growth in these sectors.

Potential for intraindustry trade

Intraindustry trade (IIT), linking similar industries horizontally and linking industries vertically along value chains, provides fur-

Table 5.8

Potential sectors for Indian investment to address supply constraints (2015)

Product code (HS-2)	Bangladesh Sectors	Potential sectors
53	Other vegetable textile fibres; paper yarn and woven fabric	Integrated textile industry
62	Articles of apparel and clothing accessories, not knitted or crocheted.	Integrated textile industry
63	Other made-up textile articles; sets; worn clothing	Integrated textile industry
61	Articles of apparel and clothing accessories, knitted or crocheted	Integrated textile industry
08	Edible fruit and nuts; peel of citrus fruit or melons	Food processing industry

HS code	Nepal Sectors	Potential sectors
09	Coffee, tea, mate and spices	Transferring know-how and best practices in plantation sector
72	Iron and steel	Iron and steel processing
55	Man-made staple fibres	Textile industry
20	Preparations of vegetables, fruit, nuts or other parts of plants	Food processing industry
54	Man-made filaments; strip and the like of man-made textile	Textile industry

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HS code	Sri Lanka	Potential sectors
	Sectors	
09	Coffee, tea, mate and spices	Transferring know-how and best practices in plantation sector
08	Edible fruit and nuts; peel of citrus fruit or melons	Food processing industry
23	Residues and waste from the food industries; prepared animal fodder	Transferring waste management practices
89	Ships, boats and floating structures	Ship building industry
85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television ...	Electrical machinery and music system

Source: Estimated from Trade Map Database, International Trade Centre.
Note: The descriptions of sectors under HS classification are in brief. For full citation, see Cybex Solutions Pvt. Ltd.

ther opportunities for FDI in South Asia. Such trade shows the opportunity to increase the scale of production through joint ventures to meet demand in each other's markets. Linking up with value chains means a possibility of linking up with suppliers at different stages of the production cycle. This improves efficiency and the competitiveness of end products.

Table 5.9 shows India carried out intraindustry trade in 1,201 products in 2015. Of these, 342 had an IIT index value exceeding 25 percent. Thus, considerable opportunities exist for India to have joint ventures in its neighbouring countries in the region.

Based on intraindustry trade, Table 5.10 provides an illustrative list of sectors for potential investment by India in its South Asian neighbours.

Table 5.9

India's intraindustry trade with South Asian countries (2015)

Countries	Number of matched products (IIT)	Number of products having IIT value of 25% and above
Afghanistan	22	4
Bangladesh	286	84
Bhutan	46	16
Maldives	48	10
Nepal	200	54
Pakistan	182	59
Sri Lanka	417	115
South Asia	1201	342

Source: Author's estimates from UN Comtrade database, August 2016.
Note: calculation based on 4-digit Standard Industrial Trade Classification (SITC).

Vertical integration

Trade in intermediate goods plays an important role in linking with value chains. This enables countries to participate in value chains instead of competing with each other in similar products. Instead, they can compete in each link of the value chain depending on their competitiveness.

Table 5.11 shows India's trade with South Asian countries, by basic economic categories. It shows that by far the largest component consists of intermediate goods. This clearly demonstrates the possibility of investors from both India and neighbouring countries to take part in value chains and produce more value-added products for each other's markets.

South Asian countries could jointly promote this region for better coordination in attracting FDI. Not all of them are equally competitive in each sector. For instance, in garments Sri Lanka

may attract more FDI at the high end of the market, while Bangladesh is more competitive at the lower and middle ends. In tourism also, joint packages between India and Sri Lanka would be more effective in catering to the requirements of Buddhist pilgrims. South Asia provides a variety of topography and climatic conditions. During winter, tourists may be inclined to visit coastlines, while in the summer, hills would be more alluring.

Several studies have demonstrated the possibility of increasing intraregional trade through supply chain links in two major sectors in the region: (i) textiles and clothing and (ii) food processing. In textiles and clothing, Banga and Razaaque (2014) have found significant scope for developing supply chains using production networks across the borders of South Asian countries. Many products identified as inputs in the potential supply chains can be sourced from the region, without undermining competitiveness as these inputs are globally competitive.

Table 5.10

Illustrative sectors for potential Indian investment based on intraindustry trade (2015)

Potential investment in host countries	Industries
Bangladesh	Fish processing, portland cement, integrated textile mills
Bhutan	Non-alcoholic beverages, fruit juice, floor coverings, flat rolled products of iron, animal feeds, plastics, edible nuts
Nepal	Floor coverings, flat rolled products of iron, animal feeds, plastics, edible nuts
Sri Lanka	Parts n.e.s., of machines, plastic storage containers

Source: Author's compilation.

Table 5.11

Composition of India's trade with South Asian countries (%)

Basic economic categories	Exports (US$17,198 million)	Imports (US$2,908 million)
Consumer goods	20	41
Intermediate goods	54	48
Capital goods	13	6
Others	13	5

Source: UN (2018).
Note: Based on UNSTAT classification.

A UN-ADB (2005) study identified processed food and beverages as a sector where the region's global exports and imports grew rapidly during the 2000s. Intraregional exports in this sector increased from two percent in 1990 to 23 percent in 2011. This reflects the region's growing competitiveness in agricultural products. The sector is a fertile ground for exploring potential intraregional supply chains.

Table 5.12 highlights India's trade in intermediate goods with its neighbouring countries. The figures indicate India's dominance in exports. Data reveals that possibilities for developing value chains exist in apparel, footwear, parts of vehicles and electronics. The possibilities are greater where some two-way trade exists, such as India's trade with Afghanistan, Bangladesh and Pakistan in apparel and footwear, and with Sri Lanka in vehicle parts.

Major reviews called for

Initial attempts in regional integration among South Asian countries have mainly concentrated on trade. As with trade, intraregional investment flows remain low. Low levels of domestic capi-

tal formation and outbound capital flows from the region, poor investment facilitation, restrictive foreign exchange regimes and exclusion of FDI in some sectors explain South Asia's low level of

Table 5.12

India's intermediate goods trade with South Asian countries (US$ million)

Partner countries	Intermediate goods	Export value	Import value
Afghanistan	Apparel & footwear	89.09	0.21
	Vehicles	3.46	0.04
	Electronics	1.53	0.02
Bangladesh	Apparel & footwear	1277.12	16.74
	Vehicles	139.22	2.71
	Electronics	22.86	0.50
Bhutan	Apparel & footwear	4.04	0.56
	Vehicles	0.01	0.02
	Electronics	10.51	0.00
Maldives	Apparel & footwear	0.00	0.00
	Vehicles	4.04	0.01
	Electronics	10.51	0.00
Nepal	Apparel & footwear	34.46	43.72
	Vehicles	120.50	0.00
	Electronics	8.21	0.01
Sri Lanka	Apparel & footwear	440.34	0.02
	Vehicles	4.04	22.39
	Electronics	10.33	0.00
Pakistan	Apparel & footwear	234.58	21.59
	Vehicles	0.07	0.02
	Electronics	0.22	0.49

Source: Extracted from World Bank, World Integrated Trade Solution (WITS).

intraregional investment. More favourable investment facilitation beyond the region—say, in the members of the Organisation for Economic Co-operation and Development, in Eastern Europe and in Central Asia—explain why most of the global investment flows are concentrated in those regions. This also explains why so few bilateral investment treaties are operating in the region, as compared to those elsewhere.

The draft of the SAARC Agreement on Promotion and Protection of Investments remains in limbo. In today's globalized world, trade-led investment needs to be underwritten by investment-led trade. Both need to work in tandem, which begs a favourable investment environment.

India's bilateral investment agreements with South Asian countries, based on its 2003 model, are out of sync with those that are being currently negotiated. In other words, India needs to revisit its treaty with Sri Lanka, which has been in operation for more than ten years. It should renegotiate with Nepal, which, though signed, has not been implemented. Similarly, Pakistan needs to renegotiate its treaty with Bangladesh that has not been implemented. Its agreement with Sri Lanka has been in operation for more than a decade and needs a review. Regionally, an early conclusion of SATIS is also called for, since services have a high potential for FDI. Besides, as with Bangladesh, India could initiate dialogue with its neighbours (including Pakistan) on Joint Interpretive Notes on Agreements—whether in force, or yet to be implemented.

India's investment treaty model may not serve as a SAARC template. Still, India is the major investor in this region. Some of its positive elements that bring a better balance of interests between the investor and the states may be included to improve the comfort levels of host states of the region.

Furthermore, enormous opportunities exist for investors to integrate both horizontally (via intraindustry trade) and vertically (through value chains). However, for this potential to be realized, constraints that impede the smooth flow of investments within the region must be addressed.

Notes

[1] Data obtained from World Bank (2018a).
[2] Based on analysis of data in World Bank (2018b).
[3] Based on analysis of data in World Bank (2018c).
[4] Based on analysis of data in World Bank (2018d).
[5] The Draft Agreement has been obtained, on request, from the SAARC Secretariat.
[6] Under a positive-list approach, only negotiated sectors are opened.

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