



### HIGHLIGHTS from Box 3.1

#### SEQUENCING TRADE AND LABOR REFORMS

##### Key Points

- *An ambitious trade reform that cuts South Asia's import cost by half relative to other EMDEs could generate double-digit growth in exports and imports, and raise real per capita incomes by 1.2 percent.*
- *These income gains from trade liberalization would be significantly larger if combined with reforms that lower workers' moving costs to new jobs by just 5 percent.*
- *South Asian governments can support labor mobility by reducing barriers to worker reallocation, for example through streamlined laws and regulations to spur firm growth or investments in connectivity, such as transport and housing infrastructure.*

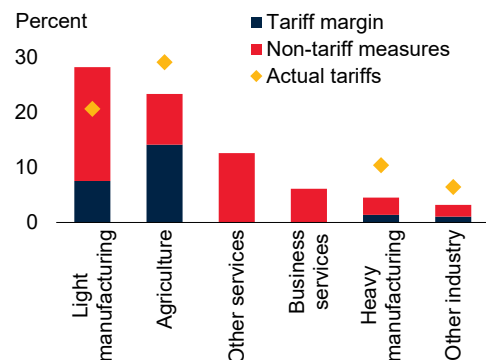
**Potential trade reform.** Import costs to South Asia are 14 percent above those in the median EMDE and, for imports of light manufacturing and agricultural goods, more than 20 percent higher (figure 1). For all sectors other than South Asian agriculture, non-tariff barriers are a larger source of trade cost than tariffs. An ambitious trade reform scenario that halves the gap in trade cost between South Asia and other EMDEs would reduce total import costs by 6–15 percent across all South Asian countries.

**Impact of trade reform.** Cutting South Asia's import barriers by half relative to other EMDEs would markedly increase trade in South Asian countries. On average, exports would rise by 22 percent and imports by 19 percent. Lower import barriers would broaden access to cheaper intermediate inputs which, indirectly, would also lower export cost and improve competitiveness. Lower import barriers in one South Asian country would generate spillovers to others, by expanding export markets. Real per capita income would rise in all South Asian countries—on average by 1.2 percent, in part as a result of workers reallocating toward more productive firms, sectors, and locations. For comparison, these per capita income gains are on par with similarly derived estimates for the effect of the North American Free Trade Agreement (NAFTA) on Mexico.

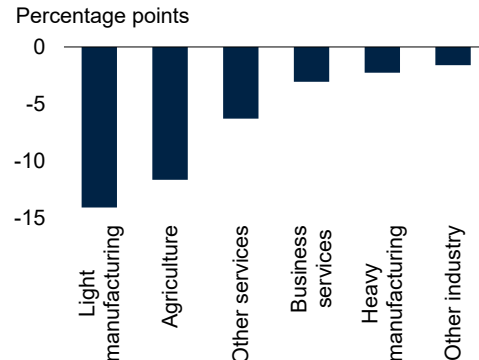
**Sequencing trade and labor reforms.** When barriers to trade fall but workers cannot easily move to expanding sectors, potential income gains may not be fully realized. Even a modest reduction in worker mobility costs—such as job search costs, retraining barriers, or regulatory constraints—by 5 percent can therefore substantially amplify the effect of trade liberalization. If such a labor reform were to *coincide* with, or *precede*, trade reform, the per capita income gains would be 1.3 percentage points larger because workers would be more likely to reallocate to expanding sectors and higher-paying jobs.

**FIGURE 1. Trade and labor reforms in South Asia**

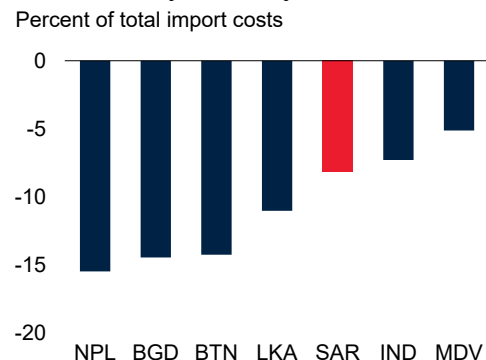
**A. Import costs to South Asia relative to other EMDEs by sector in 2023**



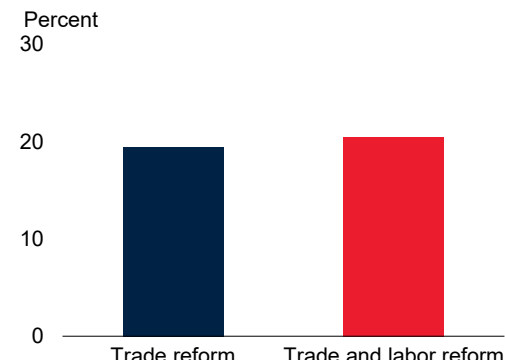
**B. Reform: South Asia's import cost reduction by sector**



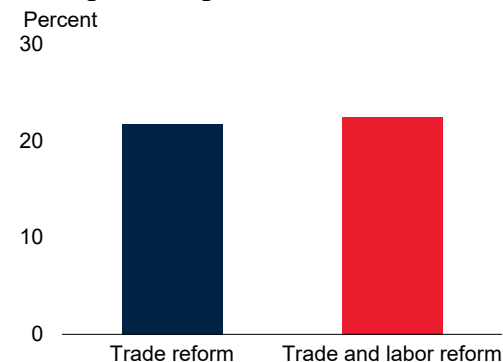
**C. Reform: Average import cost reduction by country**



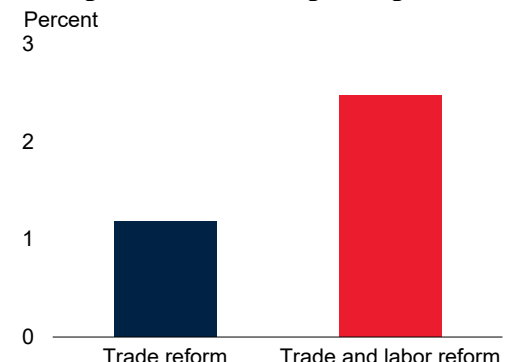
**D. Impact: Imports**



**E. Impact: Exports**



**F. Impact: Real GDP per capita**



Sources: ADB Multiregional Input-Output Tables (database); WTO Analytical Database; World Bank.

Note: BGD = Bangladesh; BTN = Bhutan; EMDEs = emerging market and developing economies; IND = India; LKA = Sri Lanka; MDV = Maldives; NPL = Nepal; SAR = South Asia. Broad sectors are disaggregated following the International Standard Industrial Classification of All Economic Activities, revision 4, with “Agriculture” comprising section A; “Other industry” comprising sections B, D, and E (that is, mining; electricity, gas, and water supply; and construction); “Light manufacturing” comprising divisions 10 to 18 and 31 to 33 (for example, manufacture of food products, textiles, or furniture); “Heavy manufacturing” comprises divisions 19 to 30 (for example, manufacture of refined petroleum, electronics, or transport equipment); “Business services” comprising divisions 58 to 83 (for example, technical and administrative support, including IT services); and “Other services” comprises all other divisions (for example, wholesale and retail, accommodations and restaurants, and government services). Aggregation across countries uses GDP in current U.S. dollars as weights.



# South Asia Development Update

## Jobs, AI, and Trade

A. Total bilateral trade costs  $\kappa$  across 18 sectors and 73 economies in 2023 are calibrated following Lewis et al. (2022). Subsequently, we decompose  $\kappa = (1 + \tau + \eta) \times d$ , where  $d$  refers to all trade cost that are outside the immediate scope of trade policy (such as geography, language differences, historical ties),  $\tau$  refers to the tariff rate, and  $\eta$  to non-tariff barriers within the scope of trade policy (such as regulations, custom procedures, infrastructure). We approximate  $(\tau + \eta)$  as the trade cost difference toward a regional EMDE benchmark. Finally,  $\eta$  is backed out as residual after accounting for observed tariff data.

B.C. The reform scenario represents a 50 percent reduction in trade policy barriers relative to the regional EMDE benchmark, that is,  $0.5 \times (\tau + \eta)$ . Figures summarize average reform magnitudes across broad sectors and countries.

D.-F. Each panel shows the effects on exports, imports, and GDP per capita (all three outcomes in real terms—that is, deflated by aggregate price effects) as a result of the trade policy reform (a halving of the gap with the EMDE average for trade policy costs in each country and sector) and labor reform (a 5-percent reduction in the cost of transitioning between jobs) in South Asian countries. All three general equilibrium effects are estimated using a dynamic quantitative multi-sector open-economy model following Caliendo, Dvorkin, and Parro (2019). The model is calibrated in changes relative to 2023 data for 73 economies, including a rest-of-world aggregate.