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What Makes Regional Integration Work? *Lessons for South Asia*

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There has been an explosion of regional trading blocs in the last two decades or so. Nearly every country in the world is either a member of or discussing participation in one or more regional blocs. Regional integration has given rise to a vigorous debate on why countries pursue regional agreements, what makes some like the European Union (EU), North America Free Trade Agreement (NAFTA) and the Association of Southeast Asian Nations (ASEAN) more successful than others like the South Asian Association for Regional Cooperation (SAARC).

This paper attempts to identify and put together the conditions and/or pre-requisites that facilitate the formation and functioning of a regional bloc vis-à-vis conditions or pre-requisites needed for South Asia to become a successful regional bloc. As South Asia aims to be an economic union by 2020, it involves much more than trade and requires cooperation at a much deeper and wider scale. The paper also endeavours to suggest some policy measures to facilitate regional integration in South Asia.

Background

The idea that increasing trade reduces the risk of conflict has a distinguished history, which goes back to Emanuel Kant's Perpetual Peace (1795). Polachek (1992, 1997) used the Conflict and Peace Data Bank to investigate both the association between trade and security, and the direction of causation.¹ He found that a doubling of trade between two countries lowers the risk of conflict by around 17 percent.

The then President of Bangladesh, Zia-ur-Rahman also thought on similar lines and while the basis for the formation of SAARC (in 1985) was to promote peace, harmony and political stability, the countries realised that deeper and stronger economic links were required to overcome the political differences. SAARC was also formed to enable the countries of South Asia to consider and react collectively to international events. The Soviet invasion of Afghanistan in late 1970s and USA's direct military links with Pakistan to counter the Soviet presence in Afghanistan hastened the pace of formation of this regional bloc.

The South Asian Preferential Trade Agreement (SAPTA) came into existence in 1995 to give boost to regional economic integration. However, over the years the level of intra-regional trade has remained low, hovering around five percent of total trade, as compared to more than 60 percent in EU and 38 percent in ASEAN.² Lack of trade complementarity, prevalence of informal trade and political tensions are the culprits.

The South Asian Free Trade Agreement (SAFTA) was signed in 2004 to cut down the trade barriers in the region. On January 1, 2006 SAFTA will partially come into effect and will be fully operational by 2016. SAARC members will bring down average tariffs on goods from 25-30 percent to 0-5 percent over the next decade. Separate deadlines have been set for developing countries like India, Sri Lanka and Pakistan and the Least Developed Countries like Nepal, Maldives, Bhutan and Bangladesh.

Regional Trade Agreement	Intra-regional trade (as a percentage of total trade by the group)
ASEAN	23
NAFTA	46.5
EU-25	65.5
MERCOSUR	15
CARICOM	10
SAARC	4.5

Source: UNCTAD handbook of statistics, www.unctad.org (accessed on 13 Jan. 06)

Obviously, it is expected that free trade will facilitate the establishment of a customs union and, ultimately, result into full-fledged economic union by 2020. A fully integrated South Asia will make the region the second largest market in the world. To tread the path of regional integration and to create an economic union by 2020, South Asia needs to put in place certain initiatives and overcome certain barriers.

Reform & Policy Lock-in

Reform plans can often be thwarted by a mere possibility of being reversed and to escape from this trap, governments often need institutions that enable them to credibly lock-in decisions. Commitment mechanisms are very important in trade as well as in the political arena. Hence, regional integration needs to be used as a commitment mechanism whereby entry into a regional grouping should be based on certain criteria to promote uniformity.

Historically, both NAFTA and the EU have used regional integration for reform and policy lock-in. Although NAFTA was essentially about trade policy, its underlying motivation was the Mexican and US government's interest to lock-in the broad range of economic reforms that the Mexican government had undertaken. Similarly, democracy was an important consideration for EU to grant membership to Portugal, Spain and Greece, whereby countries are required to review their citizenship policies to become a member of the EU.

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South Asian countries till date have not put in place any criteria or commitment for member countries to be a part of SAARC or SAPTA. One reason for this is that the South Asian countries are low-income countries without much trade and economic dependence among themselves. Hence, the penalty for being outside the bloc is not much. Moreover, geopolitical tensions make it difficult to have reforms and policy lock-in: at the domestic as well as regional level. For instance, the domestic crisis in Nepal, the coup and the King assuming power of running the government - are all reflections of the loose hold that the region has on its members.

SAARC needs to put commitment mechanisms, which make it mandatory for a member country to put in place certain measures and fulfill certain criteria to stay as a member.

It also needs to build stronger enforcement of rules and penalties like sanctions, which would make it difficult for countries to deflect. For applying these mechanisms, South Asia needs to develop supra-national institutions that would resolve disputes as well as enforce rules and penalties.

Intra-regional Security

The fundamental impetus for regional integration in most regional blocs has been political and economic interdependence, which has been used by countries to ensure enhanced bargaining power and security. Intra-regional security is very important to ensure the success of a regional bloc and economic integration makes conflicts “materially impossible” by inter-locking strategic and important industries and facilitating interdependence among sectors.

For instance, the fundamental reason for promoting a regional bloc in Europe was to prevent conflicts between France and Germany (three wars in 70 years). Security concerns also played an important role in initiating regional integration in the Southern Cone (known as Mercosur with Argentina, Brazil, Paraguay and Uruguay as founding members). One of the main motives behind the formation of ASEAN was to reduce tensions between Malaysia and Indonesia. Sometimes economic integration also leads to full political integration. For instance, the custom union formed between Moldavia and Wallachia in 1847 led to the creation of Romania 34 years later.³

In South Asia, security has always been a cause of concern and tension especially between India and

Pakistan. The territorial dispute over Kashmir has played a major role in hindering any progress towards economic and security cooperation. SAARC has failed to prevent geopolitical issues coming in the way of economic cooperation. Recently, attempts (bus and rail links between the two sides of Punjab, rail link between Rajasthan in India and Sind in Pakistan) are being made to make the border softer to promote movement of people and trade.

The Indus Waters Treaty, signed in 1960, is the only major economic cooperation agreement between India and Pakistan. It has survived the 1965, 1971 and the 1999 wars. However, the treaty has not led to further economic cooperation or security cooperation.

India’s dispute with Bangladesh regarding illegal movement of people from Chittagong Hill Tracts and on water sharing of the Ganges River has worsened the relationship between these countries.⁴

Another impediment to regional cooperation in South Asia is the threat that smaller countries perceive from India (the hegemonic power in South Asia) as far as territorial sovereignty is concerned. Moreover, India and Pakistan are nuclear powers, a reality that does not go down well with each other as well as other countries in South Asia. As a leader of the region, India needs to play the role of an elder brother (not big brother) to build trust among its smaller neighbours.

South Asia also needs to put in place institutions, like Commission for Security and Cooperation in Europe and Organisation for Security Cooperation in Europe, to promote regional security and trade. Agency for Prohibition of Nuclear Weapons in Latin America and the Caribbean, the ASEAN Regional Forum (ARF) are examples of regional institutions to promote and ensure security cooperation. Efforts should be made to promote intelligence sharing at the regional level and a comprehensive model on security involving economic, political, and military security should be emphasised on.

Trade Cooperation

If there is not much trade between countries and they compete rather than complement, then the reason for working towards a regional bloc diminishes. Simplification of customs procedure and other trade facilitation measures are essential for cross-border trade and economic interdependence.

Box 1: A Regional Forum on Security – Lessons from South East Asia

At the 1992 Singapore Summit, the ASEAN leaders declared: “ASEAN shall move towards a higher plane of political and economic cooperation to secure regional peace and prosperity.” This led to the birth of the ASEAN Regional Forum (ARF). South East Asia faced with political and security conflicts and leaders realised that a regional entity would facilitate in alleviating these conflicts.

As a major avenue for carrying out ASEAN’s objectives of regional harmony and stability, ARF adopted two main objectives: first, to foster constructive dialogue and consultation on political and security issues of common interest and concern and, second, to contribute to efforts towards confidence building and preventive diplomacy in the Asia-Pacific region

South Asia has always been plagued with security and geopolitical tensions, which have hindered the process of regional integration. The Indo-Pak tensions, India’s border tensions with Nepal and Bangladesh have come in the way of regional peace and development.

Like the ARF, a regional security and political initiative in South Asia (such as a SAARC Regional Forum or SRF) can promote confidence building among members, develop preventive diplomacy and elaborate approaches to conflict resolution. ARF has put in place these approaches to enable ASEAN countries to deal constructively with political and security issues that bear on regional peace and stability, including new issues that have emerged as a result of globalisation.

Source: www.aseansec.org

Among the South East Asian countries, the share of intra-regional trade in total trade is approximately 38 percent. In South Asia it is approximately five percent. The ASEAN bloc reflects high economic integration in terms of tariffs and trade, foreign direct investment (FDI) and other private capital flows. ASEAN countries had 0-5 percent tariffs for over 95 percent of goods traded regionally, given the favourable infrastructural conditions. It has adopted a harmonised set of tariffs, effective from 2002, to make trade more expedient and efficient.

Average applied tariff rates in agricultural and industrial products in India were 36.9 and 27.7 percent and in Pakistan they were 20.4 and 16.6 percent. Corresponding tariff rates in Malaysia were 2.1 percent and 8.1 percent, while in Indonesia 8.2 and 6.7 percent.

The cost of non-cooperation is very high for south Asian countries. For instance, a study by Research and Information System for the Non Aligned and Other Developing Countries (RIS, India) in 1999 estimated that for Sri Lanka the cost of non-cooperation amounts to US\$266mn because of its imports from outside the region even when such items were available in South Asia.

Trade across borders is cumbersome and complex among South Asian countries. For instance, to export from India one needs to obtain 258 signatures, make 118 copies of the same information, the keypunching of which takes 22 hours.⁵ The lack of essential facilities like weighbridge, x-ray machine and quarantine facility in border customs prevents the smooth functioning of trade. There was lack of adequate institutions and initiatives to promote customs facilities and other trade-related procedures. For instance, in December 2005 the India-Nepal talks of transit facilities ended inconclusively after India proposed a review on the number of existing transit points. According to a World Bank study done in 2004, if South Asian countries build and raise the capacity of ports and transport infrastructure to half of that as in South East Asia then intra-regional trade in South Asia will increase by US\$2.6bn. Intra-regional trade in South Asia is approximately US\$7bn at present, thus about 37 percent increase through trade and transport (including logistics) facilitation.

Nevertheless, South Asian countries have taken a number of initiatives for trade cooperation. First, enforcement of SAFTA from 2006 will require all seven countries to cut tariffs and ease trade among them. Second, a Group on Customs cooperation was set up in 1996, which decided to simplify procedures for intra-regional trade and upgrade infrastructure facilities. Over the years, the Committee on Economic Cooperation (CEC) has emerged as a central group within SAARC, which addresses economic and trade-related issues. It has provided recommendations and guidance in identifying new areas of cooperation as well as considering reports of specially constituted groups.

The SAARC Chamber of Commerce and Industry (SCCI), set up in 1992 as a SAARC-recognised apex body, has played a significant role in bringing together national business associations under one umbrella. A draft SAARC Agreement on Promotion and Protection of Investment is under consideration.

Harnessing the hydro-electricity potential in the Himalayan region can contribute immensely to the

development of countries such as Bangladesh, Bhutan, India and Nepal. Along with ensuring efficient use of available resources, some of the poorest regions of the sub-continent will benefit from such initiatives.

Monetary Integration

Incoherent monetary policies of neighbouring countries often lead to conflict and volatile pricing of each other's currency. Policy coherence in this regard is not only essential for combating volatility of the value of currencies, but also it makes transactions (particularly, cross-border transactions) much easier. Trade is more facilitated when there is a common currency and this integrates a region more with interlocking of macro economic policies.

EU is a prime example where monetary and exchange rate stability provided much success towards intra-regional trade. The European Central Bank (ECB) has complete independence in its functioning and control over its currency.

On the other hand, financial systems across South Asia show considerable diversity and require harmonisation. There is a debate on common currency in South Asia. However, one of the conditions of common currency is high level of intra-regional trade (as in the case of EU), which is not the case in South Asia.

However, there are initiatives to achieve coherence in macro economic policies, in particular on monetary policies. The SAARC Central Bank Governors and Finance Secretaries' Network (SAARCFINANCE) was established in 1998, at the 10th SAARC Summit in Colombo, Sri Lanka. The 24th Session of the SAARC Council of Ministers held in Islamabad, Pakistan in January 2004 recommended SAARCFINANCE to examine the concept of a South Asian Development Bank (SADB), and to study and make recommendations on early and eventual realisation of a South Asian Economic Union (SAEU). Technical Service Agreements (TSAs) among the banks in South Asia are also gaining momentum (for instance between the Laxmi Bank in Nepal and Hutton National Bank in Sri Lanka, the Everest Bank in Nepal and Punjab National Bank in India).

Social Integration

It is important to involve citizens in the process of regional integration. Disgruntled and dissatisfied citizens who believe that they have been ignored or not consulted will hinder the process of integration. For instance, the rejection of the EU constitution by Germany and France, among other reasons, was because citizens were not properly consulted.

For a region like South Asia, which is home to 40 percent of the world's poor, effective regional integration can only happen when there is social integration. Besides people-to-people contact, cross-border movement of labour is imperative for promoting social integration. South Asia should learn from EU, whose citizens enjoy the right to labour mobility. Furthermore, as one of the four fundamental freedoms enjoyed in a single market, Article 18 of the EC Treaty gives every EU citizen a fundamental right to move and reside freely within the territory of the EU's member states (subject to some limitations and conditions).⁶ South Asian countries need

Box 2: Halving Poverty by 2010

The prime target of the Independent South Asian Commission on Poverty Alleviation is to reduce the number of people living on less than \$1 a day in South Asia to half the 2002 level, i.e. approximately from 40 percent to 20 percent by the year 2010.

In absolute terms (522 million), the number of poor in south Asia exceeds the sum of poor in the regions of sub-Saharan Africa, Middle East, Latin America and Caribbean. Thus halving poverty in South Asia by 2010 would be an important first step towards achieving Millennium Development Goals. Reducing poverty also means ensuring food security and availability, putting in place a social security system, providing access to primary education and safe drinking water and preventing child labour and trafficking. Key elements of a strategic framework aimed at achieving this target include-

- Creating opportunities for the poor to participate in the growth process by improving market access of labour-intensive products.
- Improving social services and strengthening social protection systems through increased investment in education, health, nutrition and water supply.
- Empowerment of the poor through group mobilisation and strengthen the role of proven support institutions like SEWA (India), SANASA and WDF (Sri Lanka), BRAC and Grameen (Bangladesh).

Source: Our Future Our Responsibility - Road Map Towards a Poverty Free South Asia, Report of the Independent South Asian Commission on Poverty Alleviation, SAARC Secretariat, 2003.

to come up with policies that disintegrate mobility of labour with geopolitical and domestic tensions. Fast track temporary work permits to professionals could be one such policy measure.

The European Economic and Social Committee (EESC), an advisory body representing employers, trade unions, farmers and consumers, aims to act as a bridge between the Union and its citizens. Similarly, SAARC has a social charter, which covers cooperation on fundamental social issues like poverty, education, and health. Civil society movements on social issues like the SAARC Autonomous Women's Advocacy Group are also quite active.

Efforts are also on for continuous appraisal of the regional poverty profile. With the support of UN agencies and other bodies, the SAARC Secretariat prepares periodic reports in this regard. The 2003 report acknowledges the effort of non-governmental organisations (NGOs) and communities in fighting poverty and deprivations faced by the poor.⁷ A SAARC Poverty Alleviation Fund has been set up, in which India announced a contribution of US\$100mn for projects outside India.

Certain measures can be initiated in the region to ensure social integration like the inclusion of workers rights and progress towards achieving millennium development goals in the social charter. Moreover, empirical evidence and documentation is required to keep track of progress and impediments.

Conclusions

South Asian countries trade much more with countries in other regions of the world than among themselves. This is aggravated by high transaction costs for cross-border trade and geopolitical tensions. With the enforcement of SAFTA (South Asian Free Trade Agreement) from January 2006 it is expected that the intra-regional trade will increase.

In the recently concluded 13th SAARC Summit, three agreements pertaining to the avoidance of double taxation, liberalisation of the member countries' visa regimes and the creation of a SAARC Arbitration Council were signed.

We hope that these agreements will promote trade and investment linkages and, in the process, strengthen regional integration. The head of states have also decided to set up a SAARC Poverty Alleviation Fund (SAPF) and recognise that this is crucial to enable SAARC to meet the hopes and aspirations of the common people of South Asia and visibly improve the quality of their lives.

Though increasing intra-regional trade is a necessary factor for better regional integration, but alone it is not sufficient and a host of other factors are to be taken into consideration. Besides improving the functioning of existing institutions for regional integration, new institutional mechanisms are to be developed for economic and social integration in the region. South Asia should learn from Europe and South East Asia to devise appropriate strategies and institutions in this respect.

Endnotes

- 1 Trade Blocs, A World Bank Policy Research Report, Oxford University Press, 2000.
- 2 However, informal trade is rampant in south Asian countries and if we take it into account then the figure is close to 10 percent for intra-regional trade.
- 3 Trade Blocs, A World Bank Policy Research Report, Oxford University Press, 2000.
- 4 Chandra D. Bhatta, Regional Integration and Peace in South Asia: An Analysis, Peace, Conflict and Development Journal, Issue 5, July 2004.
- 5 Pritam Banerjee & Dipankar Sengupta, Economic Growth and the issue of Trade Facilitation: An Indian Perspective in Trade Facilitation: Reducing the Transaction Costs or Burdening the Poor, CUTS International, 2004.
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- 7 Our Future Our Responsibility, Report of the Independent South Asian Commission on Poverty Alleviation, SAARC Secretariat, 2003.

